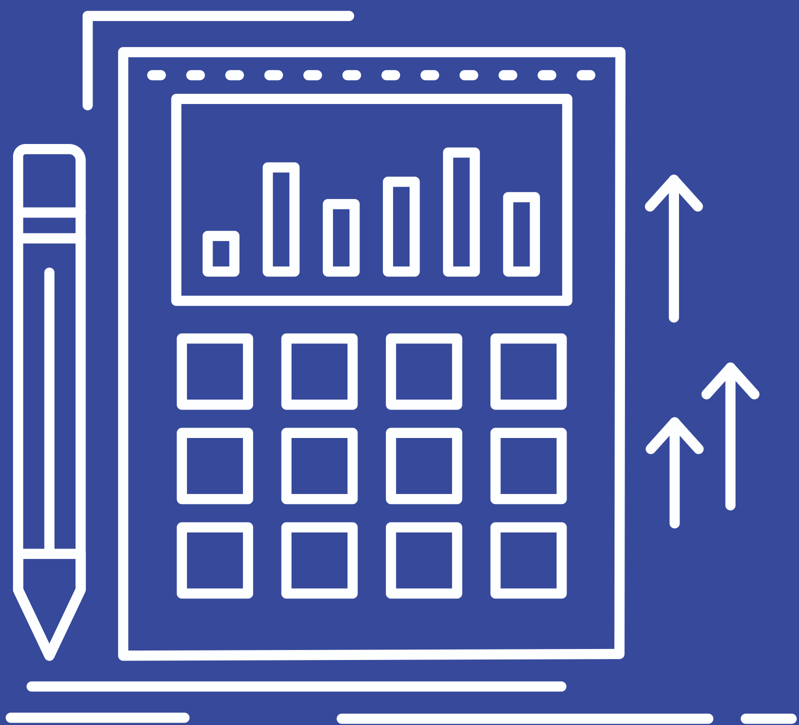
Capital Strategy

2022/23 to 2026/27



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INTRODUCTION

Overview

CIPFA’s Prudential Code requires councils to have a capital strategy. The Code states that “In order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability, authorities should have in place a capital strategy that sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

Objectives

The purpose of the strategy as per the Code is that it is “intended to give a high-level overview of how capital expenditure, capital financing and treasury management activity contributes to the provision of services, along with an overview of how associated risk is managed and what the implications might be for future financial sustainability.”

The council must demonstrate that it takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability giving due consideration to both risk and reward and the impact on outcomes.

The strategy aims to balance capital expenditure needs and expectations (e.g. replacement of business critical IT systems) with the scarcity of available resources to enable the identification and optimisation of all sources of capital funding and also be flexible enough in order to respond to emergencies and changes in priorities.

It is a collective document involving various departments within the organisation. It is not purely a finance function, all the relevant officers should review this document from time to time and it be updated accordingly.

Capital Strategy framework

How do existing strategies feed into the Capital Strategy

The strategy maintains a strong and current link to the council's priorities and to other key strategy documents as shown below:

Benefits of adherence

Strategic direction of the council

A key driver of the Capital Strategy is the council's "vision for a better future" (2022-2026). This programme provides strategic direction to help the council become more effective and sustainable and to enable it to meet the demands of the future.

The strands of the Vision programme are:

- offering a better customer experience
- strengthening external relationships
- providing more digital online services
- becoming smaller and more effective

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Capital Strategy

Scope

Capital expenditure is strictly defined and is principally expenditure incurred in buying, constructing or improving assets such as land, buildings, vehicles, plant, machinery and intangibles (e.g. computer software). It also includes grant and advances to be used for capital purposes, such as Disabled Facility Grants.

The council's policy on capitalisation in accordance with the council's approved accounting policies and procedures, is that expenditure on land, buildings, vehicles, plant, machinery and intangibles over £25,000 will be capitalised, expenditure under these limits is deemed to be a revenue cost.

Working with partners

Given the financial challenges faced by the council it is particularly important that it works closely with regional and local authority partners to deliver investment across the district which otherwise would not be deliverable or affordable. Whether this is through central government grants and town council contributions or through delivering schemes in partnership with West Sussex County Council.

The Capital Strategy sets out the council's approach to:

- working with partners
- asset management planning
- risk appetite
- governance and decision making
- capital financing & affordability
- managing borrowing
- monitoring & project evaluation
- capital investment in 2022/23 to 2026/27

Bandstand Bognor Regis seafront, council received £50k Coastal Revival Fund grant towards its renovation

Capital Strategy (continued)

Asset management planning

The council has responsibility for a range of assets. The Asset Management Strategy establishes the priorities for asset management planning. It is essential to understand the need, utilisation, condition, income generating potential and the investment and operating cost requirements of assets, whether owned or leased.

The core asset management programme which deals with General Fund assets is now supplemented with additional budget as a result of a review in 2019 of the condition of the council's General Fund assets. This revealed that after years of under investment that significant funding would be required to ensure that they are maintained at an acceptable standard to allow the Council to continue to deliver its services.

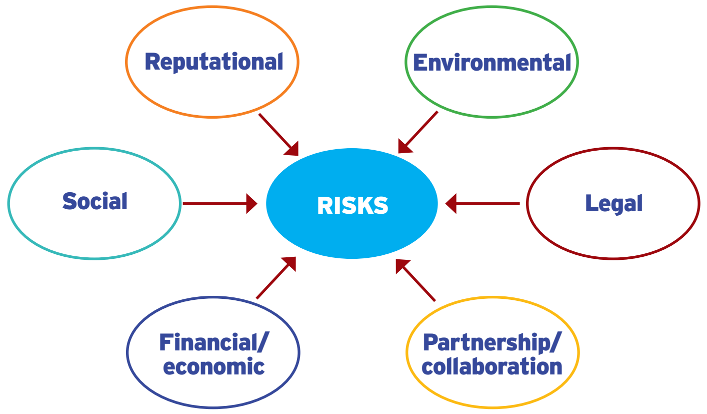
The Housing Revenue Account (HRA) business plan looks at the expenditure requirements over the next 30 years.

Property Investment Strategy

This strategy sets out the policies relating to the Property Investment Fund which aims to generate a return for the council through property acquisitions. These are funded by earmarking a proportion of the council's capital receipts from land and property disposals. Acquisitions can only be made once a full business case has been completed and the risks fully understood and evaluated. Further details are set out in the Arun District Council Property Investment Strategy 2017–2022 as amended by Cabinet 13 January 2020.

Risk appetite

Any new proposed capital scheme should be supported by a sound business case/options appraisal and should include a full evaluation of risk:



This should have regard to the whole life costing methodology, "the systematic consideration of all relevant costs and revenues associated with the acquisition and ownership of an asset." In practical terms this means that any appraisal will need to consider not just the initial outlay but all costs/income associated with the project that are likely to occur in future years, including possible replacement. This is vital to ensure that the council is not committing itself to future liabilities that are unsustainable.

Capital Strategy (continued)

Governance & decision making

It is important that those charged with governance understand the long-term context in which investment decisions are made and the financial risks to which the council is exposed. The strategy should therefore contain sufficient detail to allow members to understand how stewardship, value for money, prudence, sustainability and affordability will be achieved.

In common with other local authorities Arun is facing a challenging financial climate and it is therefore essential that systems are in place to ensure that scarce resources are allocated in the most effective possible way and therefore expenditure needs to be prioritised.

Capital financing & affordability

The council will need to assess the overall affordability of any new scheme, having regard to the availability of resources, existing financial commitments and the projected level of balances forecast in the medium-term financial strategy.

The Prudential Code requires "the local authority shall ensure that all of its capital and investment plans and borrowing are prudent and sustainable."

Capital expenditure can be funded in a variety of ways:

Capital financing

- Grants & contributions
- Developer contributions
- Capital receipts
- Revenue contributions
- Borrowing

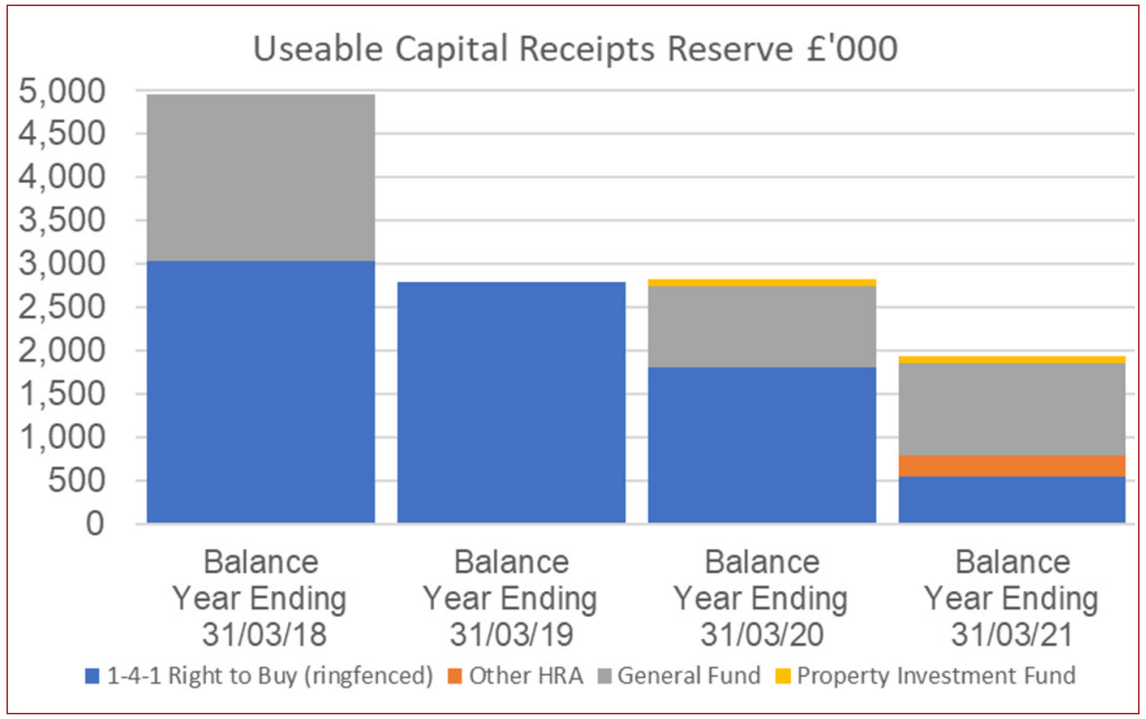
Grants and developer contributions are generally used to fund specific capital schemes linked to the conditions imposed by the relevant grant or contribution. There is little, if any, latitude in the way grant funding can be applied.

Capital receipts are derived from the sale of the council's assets, including council houses sold under the Right to Buy. It is the council's policy to use these receipts (with the exception of "1 for 1" Right to Buy receipts which can only be used for the provision of new social housing) to support the General Fund capital programme. A specified proportion of General Fund receipts are earmarked for the Property Investment Fund.

Capital Strategy (continued)

It should be noted that other than right to buy receipts there are very little opportunities for capital receipts, asset disposals are infrequent and although there are a few assets which have been identified as possible disposals this can take years.

The graph below shows how the levels of useable capital receipts have reduced over the last few years as a result of being applied to fund capital expenditure.



Revenue contributions are a flexible source of funding, but they put an immediate strain on the General Fund balance and can therefore only be used to a limited extent.

Borrowing spreads the cost over a number of years but loan servicing costs and the overall level of debt exposure both need to be considered and clearly flagged in a business case.

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Capital Strategy (continued)

Invest to save
Invest to save is the investment now to transform and reshape services to reduce running costs/generate efficiency savings or earn income to pay back the initial outlay. Priority should be given to these projects providing that they are supported by a sound business case and financial appraisal.

A good example would be investment in new beach huts, as there is a demand for beach huts (supported by a waiting list), the initial outlay to build new huts would be recovered over a period of years through the rental these would generate.

Managing borrowing
With the exception of the PWLB loan taken out on the inception of self-financing of the HRA at the end of the previous subsidy system, the council currently has no external debt. The expenditure on HRA stock development not funded from 1-4-1 receipts will require external borrowing. It should be noted that due to the cost of borrowing the council will only consider it as a last resort after all other sources of financing have been exhausted.


Felpham Beach Huts

Leasing
Leasing obligations are similar to borrowing as they have an ongoing revenue budget commitment. Leasing will be considered following due diligence over the life of the asset, comparing the financial and non-financial benefits and risks compared to the council owning such asset itself.

From 1 April 2022 the accounting standard which sets out the guidelines for recognising and disclosure requirements for accounting for leases changes from IAS 17 (International Accounting Standard) to IFRS 16 (International Financial Reporting Standard). This means from this date the way the council accounts for assets it leases will change.

The definition of a lease has been adapted for the public sector as being 'a contract, or part of a contract, that conveys the right to use an asset for a period of time.'

The council currently leases such things as land, buildings, vehicles and photocopiers.

Under these changes these right of use assets will be shown on the balance sheet except for leases of 12 months or less or if the asset is of low value. The accounting standard does not include intangible assets (e.g. computer software licences) or where a contract contains use of an asset but the supplier has the ability to substitute alternative assets throughout the period (e.g. hygiene bins).

When the asset is recognised in the balance sheet a corresponding liability is then created, representing the obligation to make lease payments. When the council makes a lease payment rather than it showing as an expense against the relevant cost centre, it is split between paying off this liability and interest

Capital Strategy (continued)

payments. The asset is depreciated in the same way as similar assets of that class, usually over the life of the lease unless the asset useful life is lower.

Separate provision for leases at peppercorn, nominal or nil consideration is based on donated asset accounting.

In preparation a data gathering exercise has already been undertaken to record all the leases the council has, including those at peppercorn/nil consideration (where the council pays little or no rental payments at any point during the duration of the lease). The council has had to evidence to its external auditors that it is prepared for these changes. The 2022/23 accounting policies will be amended to reflect the move to IFRS 16 and the threshold for low value will be determined.

Accountancy should be consulted on all new leases and contracts which includes the use of an asset (whether this is directly by the council or by the contractor to deliver obligations under the contract so that it can be assessed to see if the contract contains an embedded lease.

Treasury management
Treasury management is the management of the council's borrowing, investments and cashflows and is essential in particular when accessing the affordability of a capital project, the Treasury Management Strategy includes:

- the incremental impact of capital investment on council tax and housing rent levels
- the borrowing strategy
- the authorised limit for external debt

Where capital expenditure has been incurred without a resource to pay for it, this will increase the Council's Capital Financing Requirement (CFR) which is the council's underlying need to borrow. The council is required to make a prudent provision for the repayment of historic capital expenditure from its revenue budget, this known as minimum revenue provision (MRP). CFR is calculated below:

Opening CFR
+
Capital expenditure for the year
-
Grants, contributions, reserves, capital records
-
Minimum revenue provision and voluntary provison
=
Closing CFR

Capital Strategy (continued)

Monitoring & project evaluation

It is the responsibility of the relevant budget holder and their team to manage costs and to provide explanations for any variations from the approved budget. Budget monitoring statements are presented to Corporate Management Team on a monthly basis and to Policy and Finance Committee quarterly.

Major capital projects will have a designated project board who will have regular meetings throughout the project. The board will have representation from across the council including Finance. These are to discuss project progress, including cost projections.

A post project evaluation is required to be undertaken to measure delivery against required project outcomes, not just time and cost. It is again the responsibility of the budget holder to undertake this review. This will help council for the future as lessons learned can be transferred to new projects and help with such things as benchmarking.

Artist impression of
Place St. Maur, Bognor Regis

Capital investment 2022/23 to 2026/27

HRA and General Fund Capital Programmes

The Housing Revenue Account (HRA) is a statutorily ring-fenced account covering income and expenditure relating to the council's rented stock and the General Fund covers all other council services. This ring-fence means that the HRA and the General Fund are completely separate entities, each having their own budget and financial model. For these reasons the HRA and General Fund capital programmes are considered separately, in the following sections.

The capital expenditure & financing forecast for both General Fund & HRA for the period 2022/23 to 2026/27 can be found in Appendix 1.

Top: Play area, Bognor Regis seafront
Bottom: Mill Road Play area, Arundel

Housing revenue account (HRA) programme

Stock development

The HRA capital programme for 2022/23 to 2026/27 which is driven by the updated HRA Business Plan (presented to Housing and Wellbeing Committee on 2 December 2021), will be approved in February 2022. One of the key priorities of this plan is the provision of 250 new dwellings over a 10 year period, the acquisition/building of these dwellings funded from a mix of “1 for 1” right to buy receipts and borrowing. Right to buy receipts are retained by agreement with the Government subject to them being used for the provision of new social housing within five years of receipt. These can be used to fund up to 40% of the cost of acquisition/ new build schemes, whilst the council has to fund the remaining 60%.

A number of acquisition/new build schemes have already been delivered with new schemes currently progressing.

The initial £15m budget in 2018/19 was supplemented in 2020/21 with an additional £9m, funded from a combination of 1-4-1 receipts and borrowing. £100k per annum is set aside to cover any revenue expenditure such as feasibilities.

Units at Windroos, Littlehampton

Housing repairs & improvements

The updated HRA Business Plan reflects a substantial increase in the levels of investment required in the existing housing stock including statutory compliance which is heavily regulated.

This expenditure is a combination of revenue and capital. The capital includes boiler, kitchen and bathroom replacement programmes as well as reroofing and rewiring.

Other expenditure

There are plans to redevelop the sheltered housing stock and therefore additional capital expenditure has been included in the budget from 2022/23 for three years. This is subject to a full feasibility having been undertaken.

Affordability, borrowing and the abolition of the HRA debt cap

The HRA capital programme will need to be constantly reviewed to assess affordability. In particular, consideration will need to be given to the loan servicing costs of any new borrowing to ensure that these costs, together with the costs associated with existing (self-financing) debt can be sustained. This is particularly important in light of reducing the number of right to buy disposals. The “1 for 1” right to buy receipts being used to part-fund current acquisition/new build schemes are not being replaced by new receipts and there will therefore be insufficient receipts to support future schemes.

General fund programme

Core & enhanced programme

The Council has a core annual programme comprising:

- Asset management – the repairs and maintenance of all non HRA land and property assets, where such repairs are major and can be capitalised. Where repairs and maintenance or minor they are recorded as generally revenue and funded by use of revenue balances.
- Disabled Facilities Grants (DFGs) – these grants pay for essential adaptations to help people with disabilities stay in their own homes. The DFG programme is entirely funded by a Better Care Fund Government Grant.

Public Conveniences St. Martins car park, Littlehampton

In addition, the council also has an enhanced programme of expenditure which is based on the additional requirements for the year, expenditure will likely be more of a capital nature. The expenditure includes:

- asset management – a programme of larger one-off projects, which will be capital expenditure; for instance a schedule of public convenience refurbishments over the next 5 years.
- play areas – a programme of play area replacements for the next five years, most expenditure is capital and is funded from a combination of external funding, capital receipts, developers’ contributions and revenue.
- ICT – the replacement of business-critical systems over a period of 5 years which is normally the useful life of software.
- other one offs – for instance replacement of life expired vehicles, plant and equipment, regeneration projects.

The key issue with the enhanced programme is the uncertainty with regard to future funding levels. The Council’s Medium-Term Financial Strategy (MTFS) recognises that capital investment needs to be carefully prioritised due to limited amount of council resources.

Appendix 1

Capital expenditure & financing 2022/23 to 2026/27

			2022/23 forecast	2023/24 forecast	2024/25 forecast	2025/26 forecast	2026/27 forecast
			£'000	£'000	£'000	£'000	£'000
Expenditure							
	General fund	Asset management	2,114	717	642	1,310	450
		Disabled facilities	1,400	1,400	1,400	1,400	1,400
		Play areas	225	190	100	100	100
		ICT	200	0	0	50	435
		Chipper	0	0	0	0	26
			3,939	**2,307**	**2,142**	**2,860**	**2,411**
	HRA	Improvements	5,366	4,460	5,274	5,194	5,207
		Stock development	100	100	100	100	100
		Housing IT (Civica)	285	0	0	0	0
		Sheltered accommodation	2,600	2,000	1,400	0	0
			8,351	**6,560**	**6,774**	**5,294**	**5,307**
Total expenditure			**12,290**	**8,867**	**8,916**	**8,154**	**7,718**
Financing							
	General fund	Revenue	52	907	742	1,460	1,011
		Borrowing	987				
		Capital receipts	1,500	0	0	0	0
		Improvement grants	1,400	1,400	1,400	1,400	1,400
			3,939	**2,307**	**2,142**	**2,860**	**2,411**
	HRA	Major repairs reserve	5,336	4,430	5,244	5,164	5,177
		Revenue	515	230	230	130	130
		Borrowing	2,500	1,900	1,300	0	0
			8,351	6,560	6,774	5,294	5,307
Total financing			**12,290**	**8,867**	**8,916**	**8,154**	**7,718**