CAPITAL PROGRAMME STRATEGY

INTRODUCTION

4.1 The Capital Programme has invested on average £230m per annum over the last three years. The most significant areas of capital investment have been in schools and highways. The preceding capital strategy was implemented from the financial year 2013-14. This strategy was based on a transformational approach to look at alternative ways of delivering outcomes, together with using less of the Council's own resources at a time of fiscal restraint and the change in emphasis towards capital investment by the government part way through the 2011-15 spending period. The aim is to build on this approach as part of developing a new strategy now that the period of fiscal restraint looks likely to continue for the foreseeable future.

4.2 The capital strategy has been refreshed to take account of the current financial climate following the 2015 Spending Review (SR2015) and the impending pressures on the capital programme, as well as the Statutory Guidance on Local Government Investments (3rd Edition) which was published in January 2018. This will be relevant for the 2019-22 medium term plan subject to changes following the 2019 Spending Review (SR2019). New bids that came forward for 2019-20 and beyond will be assessed against this revised strategy.

Capital Strategy Drivers

4.3 The Capital Strategy sets out the strategic direction for KCC's capital management and investment plans, and is an integral part of our medium to long term financial and service planning and budget setting process. It sets out the principles for prioritising our capital investment under the prudential system. Prudential Indicators which are required under the 2017 Prudential Code are included within the Capital Strategy (Annex A in the 2019-20 Approved Budget Book).

4.4 KCC's drivers for the Capital Strategy are (in no specific order):

- To align with the Council's strategic outcomes,
- To meet statutory requirements,
- To be affordable,
- Invest/spend to save schemes.

The Council's Strategic Outcomes

4.5 The Council's strategic outcomes are set out in the *"Increasing Opportunities, Improving Outcomes"* Strategic Statement (2015-2020) and comprise:

a. Children and young people in Kent get the best start in life.
b. Kent communities feel the benefits of economic growth by being in-work, healthy and enjoying a good quality of life.
c. Older and vulnerable residents are safe and supported with choices to live independently.

4.6 Capital investment should also evidence how it will support the priorities and principles set out in significant strategies, including (but not limited to):

- Kent and Medway Growth and Infrastructure Framework – sets out the future strategic infrastructure requirements for the county
- Local Transport Plan 4 – sets out strategic transport priorities
- Commissioning Plan for Education Provision – sets out changes to existing schools and commissioning new schools
- Kent Environment Strategy – sets out priorities to support economic growth whilst protecting and enhancing Kent's environment
- ICT Strategy – sets out how innovation in technology will support the delivery of KCC's outcomes
- Asset Management Strategy – sets the framework for managing our property portfolio effectively

New bids to the Capital Programme will be assessed against the Council's Strategic and Supporting Outcomes and the other Capital Strategy Drivers outlined above as part of the Capital budget setting process. Should the strategic objectives be reviewed as part of an update to Increasing Opportunities Improving Outcomes then uncommitted capital projects will be reassessed against the new criteria. Projects which are necessary to meet the Council's statutory requirements will inevitably be given a higher priority under the strategy than non-statutory projects even where these would deliver a higher contribution to the Strategic Objectives.

Affordability

4.7 Capital plays an important role in delivering long term priorities as it can be targeted in creative and innovative ways. However, capital is not unlimited or "free money" – our capital funding decisions can have significant revenue implications. Every £10m of prudential borrowing costs approximately £0.7m per annum in revenue financing costs (including repayment of the principal) for 25 years, assuming an asset life of 25 years. For Information Technology projects the revenue costs are much higher per annum as the life is shorter. This is in addition to any ongoing maintenance and running costs associated with the investment. The more revenue that is tied up to repay borrowing, the less is available for front line services, and this should be considered alongside revenue pressures.

4.8 In assessing affordability, indicators set by the Prudential Code and KCC's own internal set of fiscal indicators need to be considered. The most significant of these being "Net debt costs should not exceed 15% of net revenue spending". This fiscal indicator was first established in 2011 at the outset of the current period of austerity. This was a time when government revenue grants were reducing and there were limits on the Council's ability to raise council tax. The indicator was set as a ceiling, and the 15% was calculated so that it was not so draconian that capital investment was ceased leading to a backlog. At the time it was anticipated that the period of austerity would only last four years. However, as the period of fiscal restraint has lengthened we have sought to undershoot this limit. Over the past three years this indicator has been reducing as a positive result of prudent spending, and at the end of 2017-18 this was around 13%.

4.9 Any additional borrowing will result in this indicator moving back towards the 15% limit, and will need to be carefully monitored and managed. We will also have to keep performance against this indicator under review in light of any changes arising from SR2019 or changes to legacy capital financing within the revenue funding settlement following the Fair Funding Review.

4.10 Projects must come forward with alternative options for delivering outcomes, and with a variety of funding options. All projects must be supported by a business case, using the agreed template which captures this information. The business case must also show realistic phasing of the proposed project, as rephasing is a common occurrence. If a project slips, funding assigned to that project could have been attributed to other worthy projects that were ready to go. As stated above, a critical element of the business case is to identify revenue costs and revenue savings as these will be integral to the budget setting process.

4.11 As part of the 2018-21 capital budget process, scope for an additional £100m borrowing was allocated, plus a further maximum of £50m for basic need school places pending a resolution to meet the demand for school places with Government and the Education and Schools Funding Agency (ESFA). Our ambition going forward is to keep below the 15% indicator, but to ensure enough is spent to keep buildings and roads safe, and to safeguard the Council from potential negligence claims. Options are also being explored to maximise the returns from our assets and investments whilst retaining an acceptable level of risk.

4.12 All of the £100m was taken up in the 2018-21 programme. However, an urgent need to consider further additional capital spending arose during 2018-19 and as part of refreshing the programme for 2019-22. This included a re-evaluation of schemes in the current programme where spending could be reduced or fully externally funded. The revised 2019-22 programme includes a net £156m of prudential borrowing. The timing of this borrowing and the scope to refinance other schemes means the full revenue costs of £11.5m will impact later than 2021-22 but would be an additional revenue cost for another 20/30 years thereafter. As part of managing this it is proposed that the Council will not incur any additional future borrowing to secure sufficient school places.

Statutory Requirements

4.13 KCC will ensure that appropriate capital budget is allocated on a risk assessed approach, to meet our immediate statutory requirements, such as basic need, health and safety, disability discrimination act (DDA) and other legal requirements. Increasingly, it is anticipated that satisfying statutory requirements and avoidance of legal challenges will need to play a more prominent role in capital investment decisions. Nonetheless, just because there is a statutory requirement, capital bids will still need to explore alternative options to satisfy the affordability requirement. Capital spend may not always be necessary to achieve the minimum or required outcomes. For example, additional school places required on a temporary basis may have: option 1 as an extension, option 2 for mobile accommodation, and option 3 use of existing school buildings but staggering times. Funding options for capital projects will be to use specific grants for their intended purpose first, and where grant is not sufficient other sources of external funding will be explored, before tapping into KCC resources as a last resort.

Invest/Spend to save bids

4.14 Invest/spend to save bids are encouraged as these will be integral to achieving additional savings/income which is increasingly important to ease the pressure on the revenue budget, although not at the expense of meeting the Council's statutory obligations. Any bids under this category will be rigorously reviewed and challenged to ensure all relevant costs including any costs of borrowing or other revenue impacts have been adequately accounted for and the identified savings are realistic within a reasonable period.

Enhancement of Existing Estate and Roads

4.15 Maintenance in our estate and highway roads and structures network is coming under increasing pressure after years of reactive works only. Bids for maintenance backlog will be assessed on a case by case basis, taking a risk based approach to asset management, but in the current financial climate it is unlikely that affordable investment levels will make significant inroads into the backlog. Maintenance priorities will increasingly need to be directed to areas where the Council is at risk of failing to meet statutory requirements or potential prosecution.

CAPITAL PROJECTS KEY PRINCIPLES

4.16 Consideration should be given to the following key principles before submitting a capital bid:

4.17 Spend included in business cases must conform to the definition of capital expenditure i.e. "the purchase or enhancement of assets where the benefits last longer than the year of expenditure". KCC applies a de-minimis level of £10k meaning that anything below this value individually is classed and treated as revenue.

4.18 Projects coming forward for KCC funding should comprise the bare minimum. Gold plating is no longer acceptable.

4.19 Feasibility/planning costs must be met from a revenue budget until approval to spend has been agreed through the relevant route, these should therefore be built into the revenue MTFP and be considered as part of the budget build process.

4.20 Ongoing revenue implications must be included within business cases and identified as pressures in the revenue budget.

4.21 Realistic phasing must be provided from the outset. Without this, the limited funding available could be assigned to a project which is delayed, preventing an alternative viable project from proceeding. In many cases grants and external funding are time limited and delays in the project could lead to losing precious external funds.

4.22 Match funding must be given appropriate consideration. Is the project significant enough in meeting our strategic outcomes to warrant the match funding? Consideration must also be given to grant or external funding conditions and officer time and cost it will take to comply.

4.23 Maximise use of existing assets where cost effective to do so. Look for full occupancy of the asset in terms of space and length of time the asset is in use. This could mean looking for synergies with other organisations (for example, the One Public Estate programme with key partners).

4.24 Longevity/flexibility of asset – consider how the asset will conform with longer term service delivery plans? Has flexibility of the use of the asset been considered?

4.25 Who will own the asset? Will value be added to KCC's balance sheet?

4.26 Officers and Members must not commit funds until projects have been through the correct procedure.

4.27 Minimise the requirement for capital outlay (having regard to any impact on the revenue budget). Can strategic outcomes be achieved in alternative ways? What are the implications of proceeding/not proceeding with the project?

4.28 A robust equalities impact assessment is needed for the Council's investment decision, as well as individual projects where appropriate.

FUNDING

4.29 There are a variety of different sources of capital funding, each having different implications and risks attached.

Borrowing

4.30 KCC currently has external borrowing of just under £1 billion and a further circa £200m of internal debt (including Private Finance Initiative and leases). This results in a Capital Financing Requirement (CFR) of £1.3bn in 2018-19. Our fiscal rule is that net debt costs must not exceed 15% of the net revenue budget. We must continue to effectively manage our borrowing and look at alternative sources of funding to ensure that we stay within the 15% target over the Medium Term Financial Plan. The level of borrowing to fund the capital programme must take into account the revenue implications, i.e. for every £10m of borrowing our annual revenue borrowing costs are around £0.7m and we must also consider the Prudential Code. We are considering a longer term capital strategy which takes into account affordability levels.

Grants

4.31 The challenging financial environment means that national government grants (currently over 50% of our financing for capital projects) are reducing, or changing in nature and becoming more heavily prescribed. We will have to abide by these prescriptions and consequently freedom to decide where and how to spend grants will be diminished – they are largely tied to particular areas such as education or highways. An increasing number of funding schemes directly relate to housing and economic growth such as Local Growth Funding (LGF) from the Local Enterprise Partnerships (LEPs). This funding is specific to individual projects and has to be closely monitored. Our aim is to use other, less specific grants for their intended purpose yet also in a way that meets our statutory obligations. Therefore where the grant is not sufficient, other sources of external funding such as Central Government grants and s106/Community Infrastructure Levy (CIL) will be explored first, before tapping into KCC resources of capital receipts and borrowing.

Developer Contributions: Community Infrastructure Levy (CIL)/S106

4.32 Developer contributions continue to be a challenging issue and need careful handling and consideration when they are put forward to fund major projects. The nature of s106 agreements mean that once the total funding figure has been secured with a s106 contract, the funding is received by the County Council in staged payments as the development is built out, with the full funding potentially not received until the development has been fully occupied. Depending on size, a development can take several years to be fully completed. Developer contributions will be built into the programme at the point that they are secured within s106 agreements, but it must also be recognised that at this point there are still risks around housing development and realisation of the funding. Careful monitoring of expenditure against this funding is critical.

4.33 Any forward funding arrangements of developer contributions must be approved through finance to ensure appropriate debt costs of forward funding are built into the repayments. The repayment schedule must be formalised by being built into the s106 agreement.

4.34 The Government intends to largely replace the use of s106 agreements The Community Infrastructure Levy (CIL), a flat rate tariff charge. CIL rates are set by districts as the Charging Authorities, they are also responsible for collection and spend of the levy. To date only four districts in the county have adopted CIL, others are at varying stages of introducing CIL although some may choose not to. The share of CIL funding which Kent will receive in the future is unknown and cannot currently be forecast as unlike s106 agreements the money raised through CIL is administered by the district council and KCC does not automatically receive a share.

Through the 2018 Budget the Government announced an intention to introduce a simpler system of developer contributions that provides more certainty for developers and local authorities, while enabling local areas to capture a greater share of uplift in land values for infrastructure and affordable housing. Detail on the Government's proposals are yet to be announced. The Capital Strategy will need to take account of any national changes, to find the best solution for Kent.

Capital Receipts

4.35 KCC has had a rigorous disposal programme over the past few years which has helped to minimise the level of borrowing. Going forward the same level of receipts will not be achievable as the majority of our surplus assets have already been sold. Increasingly we will have to look to generate capital receipts from underutilised assets rather than surplus assets. In some cases this may require additional capital investment to develop these assets which would need to be included and approved on an individual scheme basis as part of refreshing future capital programmes. KCC's Infrastructure division will continue to work with the service directorates and public sector partners to explore options to release property and maximise capital receipts, with a view to creating a sustainable pipeline of funds in the future, through the following initiatives:

- Asset Utilisation Strategy

  In a similar way to New Ways of Working, the Asset Utilisation strategy is aimed at increased utilisation of the operational assets in order to generate surplus assets/capital receipts. This is being achieved through a number of initiatives including more efficient and effective ways of working, exploring alternative, more flexible uses of assets and increasing overall utilisation. This programme is dependent on decisions about future local service delivery.

- Kent Estates Partnership (One Public Estate)

  Kent County Council is an active partner in the One Public Estate "Kent Estates Partnership"; other partners include District Councils, Health and Blue Light Services. The One Public Estate Programme aims to improve occupational efficiency of buildings and identify surplus assets for disposal which result in economic or regenerative benefits. Funding is available from Central Government through a bidding process which can be used to improve viability of marginal projects, masterplan and extend scope to include other partners etc. Within its Asset Utilisation and Disposal work streams, KCC now considers opportunities to collaborate within the Kent Estate Partnership as part of its initial appraisal of options and in the event that it identifies financial or operational synergy, explores further the merits of including within the One Public estate work stream.

- Transformational Reviews

  As the Authority transforms to become a commissioning authority, the requirement for publicly owned assets reduces, generating more surplus assets.

- Property Investment Fund

  The Property Investment Fund, which is part of our current capital programme aims to achieve a revenue income and/or to maximise the capital return from various investment opportunities. These include properties/sites where there is potential to add value (e.g. through gaining planning permission prior to disposal) or surplus properties available from our public sector partners (which offer a reasonable return on investment).
  The Property Investment Fund is currently capped, and any surplus capital receipts over and above the initial purchase costs are released back to the Authority. If the Fund were to reinvest all of its returns in the short term, there would be potential to generate more capital and revenue receipts over the longer term. This would also create the opportunity to invest in development opportunities where the returns are higher, but the risks are inevitably increased.

- Disposal Strategy

  As part of its disposal strategy the Council has identified that there may be a potential opportunity to further maximise the capital return from its assets through participating in development activity through partnering arrangements with third parties. This may include the establishment of joint venture(s) and other company structures which are currently being explored and tested. It is envisaged that subject to business case approval that implementation will commence in the new financial year.

Other potential funding sources to be further explored:

Business Rates Growth Pool/Pilot

4.36 The business rate pool which was developed with districts continues to be a success. In 2017-18 the pool enabled an estimated additional £7m of the 50% local share of business rate income to be retained by pool members to support local services and the financial sustainability of individual authorities. 30% of the pool resources were identified to be spent on jointly agreed projects between districts and the County Council to promote future business growth. There is potential for this element of the pool, in agreement with the relevant district, to fund capital projects that support the agreed objectives.

KCC was confirmed to pilot retention of 100% of business rate growth in 2018-19. This significantly increased the amount of business rate growth retained within the Kent & Medway area. The pilot included a revised approach to approving growth projects on a consortia basis (rather than with individual districts. A further pilot for 2019-20 was not approved and thus we revert to the original pool (albeit with enhanced arrangements to approve growth bids).

Public Partnerships

4.37 The Authority has been developing various strategic relationships with other public sector bodies (primarily Health but also districts) which have the potential to generate a capital receipt for the Authority, to reduce the Authority's requirement for capital and/or to generate income to fund prudential borrowing. The opportunities are varied, but could include the following:

- Enhancing capital gains by utilising the Authority's superior covenant strength (with the Authority retaining the additional capital receipt).
- Utilising the Authority's property experience to enhance the value of surplus land prior to disposal/letting or to dispose of 'less desirable' sites at a profit.
- Linking adjacent land holdings to improve the overall value of the sites.
- Accessing cheaper borrowing (than would otherwise be available) to fund partner's capital projects.
- Entering into joint development projects with the benefit of spreading the risks/costs with the aim of generating greater gains.
- Funding partner's invest to save projects (and taking a share of the gains).
- Developing joint service initiatives that generate savings (including a reduced requirement for office space).
- Removing duplication in services and/or solving joint problems again to generate savings (including a reduced requirement for office space).

Privately Funded Initiatives

4.38 There are a number of ways in which the Authority can work with the private sector to leverage private sector capital funding. The majority of opportunities will involve the Authority (or its partners) committing to long term revenue payments in return for the provision of capital assets. This is likely to be more expensive than funding the provision of the asset through prudential borrowing, however this is an important funding source where capital available to the Authority is scarce.

Other opportunities include:

- Using KCC funding to subsidise private sector investment. For example, it might be possible to subsidise a project that would otherwise be unattractive to the private sector because the returns are too low. A capital injection from KCC may make the rest of the investment attractive to the private sector. KCC may be able to recover its capital injection over the longer term.

- Partner with the private sector to fund capital projects, potentially on behalf of other public sector bodies, e.g. a hospital. KCC's contribution to the partnership would be low cost borrowing and a vast array of intellectual property. The Authority would expect to share in any returns (commensurate with their contribution).
- PFIs and similar variants. Whilst traditional PFIs (subsidised by PFI credits i.e. revenue funding) are no longer available, there are a number of other similar initiatives, such as the phoenix project within Health (PFI) and social impact bonds, that are available to Authorities.

Any such initiatives will need to be considered on their own merits, and the relative value to the Authority. This will need to include an assessment of risk to the Authority, particularly where the opportunity is over the long term, and of any other impacts on the Authority, such as on the partial exemption calculation for VAT.

Other Sources

4.39 Where relevant, consideration should be given to other forms of funding that are not traditionally used by Local Authorities, such as variants on crowd funding, levies (such as tolls on roads), bond issues.

GOVERNANCE ARRANGEMENTS

4.40 KCC operate a stringent internal process alongside the formal decision making process, when considering capital projects. The Infrastructure Commissioning Board (ICB), chaired by the Leader and attended by lead officers and Members, reviews business cases for capital projects at varying stages throughout the project life.

4.41 ICB is not a decision making group and the formal approval and decision making routes must be followed alongside this prior to project spend.

4.42 ICB is aligned with Service Commissioning Board (SCB), Commissioning Advisory Board (CAB), Corporate Board (CB) and Budget Delivery Group (BDG) to ensure papers are directed to the most relevant board, which streamlines the process for services.