Report of the Director of
Governance & Partnerships

Agenda Item No: **3(b)**
Meeting: 26th February 2020

NORTH LINCOLNSHIRE COUNCIL

COUNCIL

CAPITAL INVESTMENT STRATEGY AND REVISED CAPITAL PROGRAMME 2019/23

1. OBJECT AND KEY POINTS IN THIS REPORT

1.1. To seek approval of the Council's capital investment strategy 2020/23.

1.2. To approve the revised £131.4m capital investment programme for 2019/23.

2. BACKGROUND INFORMATION

2.1. Capital expenditure is a key enabler for the Council to fulfil its duties and delivery of its ambitions and Council Plan priorities. Investment in the right things can underpin and support the achievement of improved outcomes for people and place of North Lincolnshire. Capital investment also contributes to efficiencies in the operation of the council and income generation to support long-term financial sustainability.

2.2. From 2019/20, it became a requirement for Local Authorities to publish a Capital Investment Strategy as per the Chartered Institute of Public Finance and Accountancy (CIPFA): Prudential Code for Capital Finance in Local Authorities (2017). The code was updated to introduce more contextual reporting through the requirement to produce a capital strategy, which is intended to allow individual local authorities to give greater weight to local circumstances and explain their approach to borrowing and investment.

2.3. The strategy contained within this report, and for which approval is sought, updates the 2019/20 strategy approved by Council last year. As with the 2019/20 strategy, there are three key elements:

- Capital investment principles
  - Invest in outcomes
  - Invest for a return
  - Invest to save

- Prudential indicators
  - Indicators required by the Prudential Code

- Local indicators
  - Indicators of sustainability, value for money and risk management

The Strategy also sets out the legal and regulatory framework around capital investment. The Local Government Act 2003 is the main relevant legislation and CIPFAs Prudential Code is the core of the regulatory framework

2.4. In approving the capital investment strategy for 2019/20, the Council approved a new investment approach which moved away from an annual capital investment allocation process. This enabled capital initiatives to be developed and tested throughout the year, ensuring sufficient time for due-diligence and making sure that proposed investment supported delivery of the Council Plan. During the course of 2019/20, the additional capital investment allocation has been allocated in full to emergent priority schemes.

2.5. The Council has utilised its capital investment tools to good effect over a long-term period. At the end of 2009/10, the Council's capital financing requirement and long-term need to borrow for capital investment purposes was £125m and is expected to exceed £262m at the end of 2022/23. The rate of increase cannot be sustained forever. In balancing the need for more investment with long-term affordability, it is proposed that the Council invests £10m p.a. every year from 2022/23 onwards, after the current programme has been delivered. This provides re-prioritisation phasing options to the Council for the period and enables long-term affordable investment decisions to be taken.

2.6. The proposed plan provides an affordable and agile approach to investment prioritisation to enable the investment required to grow the local economy, enable communities to flourish, keep people safe and well whilst ensuring efficient operation of the council and long-term financial sustainability.

3. OPTIONS FOR CONSIDERATION

3.1. To consider approval of the Capital Investment Strategy 2020/23 set out in appendix 1.

3.2. To consider approval of a revised capital investment programme 2019/23 contained in appendix 2.

4. ANALYSIS OF OPTIONS

Affordability and Prudence

4.1. Appendix 2 identifies funding of £131.4m to finance the capital programme over the three year period 2019/23. The funding is broken down as follows.

- <u>Grant and External Funding (£65.5m)</u>
  The Council seeks to maximise external funding for its capital schemes. This funding includes Government grants, funding from external organisations such as LEP funding. Some external funding requires match funding from the Council.

- <u>Capital receipts (£14.7m)</u>

The Council has an ambitious programme of asset rationalisation and disposal. This generates capital receipts which reduce the council's need to borrow.

- Borrowing (£51.1m)
  Further borrowing is required to support the proposed programme. The revenue cost of this borrowing, in the form of interest payments and Minimum Revenue Provision (MRP) payments are incorporated into the Medium Term Financial Plan presented alongside this report. Similarly the effect on Prudential Indicators are incorporated into the Treasury Strategy report also presented alongside this report.

- Revenue Funding (£0.2m)
  On an exceptional basis, revenue funds are used to contribute towards the cost of capital schemes, primarily within schools where it is affordable to do so.

4.2. The appropriate level of borrowing for the council is locally determined, taking into account the advice of its Chief Financial Officer. The Chief Financial Officer has determined that the prudent limit for capital financing costs as a proportion of the net revenue stream should remain between 10% and 12%.

4.3. Capital resources are limited and therefore robust prioritisation is a fundamental element of the Council's stewardship of public funds. A finite programme needs to work for the Council, make a difference to the area and people and generate returns on the investment. In extending the capacity of the programme it is important to avoid erosion of capital funding capacity through investment in schemes which may stand up on an individual basis, but collectively do not deliver the impact they could or exposes the council to too much collective risk. Schemes need to be evaluated relative to each other as well as independently necessitating a programmed approach.

4.4. The Capital Investment Strategy sets out the framework for all capital investment decisions. To enable long-term financial sustainability, the Capital Investment Strategy puts in place a more business-like approach to asset management and use of capital to support delivery of the Council Plan. This report proposes an affordable level of internally funded capital resource to be made available to future projects, after taking account of the existing commitments.

4.5. In addition to the committed capital programme the council also recognises that additional capital investment will be needed to support its transformation plans, to meet new and existing legislation; to maintain the infrastructure required to carry out its day to day business effectively and efficiently and to support the regeneration of the area. New investment needs are identified through the council's capital planning process and in line with our Capital Investment Strategy. Decisions are informed though a prioritisation process which takes account of such issues as local need, financial & social return, external funding availability and overall affordability.

4.6. Ongoing investment is required in some areas of the council's responsibilities, investment in highways improvements, replacement of

machinery and vehicles, replacing outdated technology and improving flood defences being good examples of where this is the case. Other areas of potential new investment may be more focussed on enhancing our current offer or making the most of commercial opportunities, potential new facilities for children or the purchase of commercial property for local business.

4.7. The Council will also look for more efficient ways of working and capital investment is often essential in facilitating these changes. This might take the form of physical changes to council buildings or new customer focussed digital software and hardware amongst other things.

4.8. The medium term financial plan considered in the revenue report requires some capital investment to support the achievement of ongoing reductions to the cost base, pending completion and approval of business cases.

4.9. For planning purposes the current capital programme is prudent in terms of the internal resources currently available for the period of the plan. Grant and external funding can provide additional resource, but the potential for increased operating costs associated with assets funded in this way must be factored into our budget planning to determine affordability. The MTFP provides for the appropriate level of borrowing after taking account of grants and other external funding, and an ambitious target of capital receipts to be generated through the sale of surplus assets.

5. FINANCIAL AND OTHER RESOURCE IMPLICATIONS (e.g. LEGAL, HR, PROPERTY, IT, COMMUNICATIONS etc.)

5.1. The capital programme has to be contained within available resources, including the impact of borrowing on revenue budgets.

5.2. Part 1, section 3 of the Local Government Act 2003 places a duty on the council to determine an affordable borrowing limit and to keep this under review. The proposed basis for measuring what is affordable is discussed in section 4.

5.3. Future revenue resources are not yet certain pending the Fair Funding Review and further proposed changes to the local government finance system including the reset of the Business Rates Retention Scheme. It is important, therefore, that the council does not overcommit resources to capital investment, which has an unsustainable impact on its revenue budget.

5.4. Calls for additional internally resourced capital schemes or contributions to match funded schemes should be carefully considered against other priorities for the revenue budget and where possible financing costs should aim for the lower end of the affordability benchmark.

6. OTHER RELEVANT IMPLICATIONS (e.g. CRIME AND DISORDER, EQUALITIES, COUNCIL PLAN, ENVIRONMENTAL, RISK etc.)

6.1. Not applicable.

7. OUTCOMES OF INTEGRATED IMPACT ASSESSMENT (IF APPLICABLE)

7.1. Individual capital schemes are subject to impact assessment as appropriate.

7.2. The Local Government Act 2003 provides the legal framework for local authorities in determining the use of capital resources and use of borrowing. The strategy has been written in line with the statutory guidance published by CIPFA: Code of Prudential for Capital Finance in Local Government.

8. OUTCOMES OF CONSULTATION AND CONFLICTS OF INTERESTS DECLARED

8.1. The capital strategy is part of the council's strategic and service planning. Consultation takes place on a number of these plans including the Local Transport Plan and an Asset Management Plan for schools

8.2. These plans help the council to identify its priorities for capital investment. Plans are made with reference to professional and technical requirements and in consultation with relevant stakeholders.

9. RECOMMENDATIONS

9.1. To approve the capital investment strategy outlined in Appendix 1.

9.2. To approve a revised capital investment programme for 2019/23 at Appendix 2.

9.3. To confirm that, subject to the scheme of delegations, further capital projects, fully funded by external sources, which are self-financing or which will not cause the council’s capital financing costs to exceed 12% of its net revenue stream, may be added to the capital programme when known and assessed by a proper business case.

9.4. To the Chief Financial Officer be delegated authority to:

- Borrow within authorised limits and the operational boundaries for external debt

- Effect movements between agreed borrowing figures and long term liabilities, in accordance with option appraisal and the achievement of value for money for the council. Movements are to be reported to cabinet or council as appropriate at the next meeting following the change

9.5. To approve the Prudential Indicators contained in Capital Investment Strategy Annex F, as modified by changes made to the capital programme, in accordance with Part 1, sections 3 and 5 of the Local Government Act, 2003.

9.6. To report any amendments required to Prudential Indicators during 2020/21, to Audit Committee, Cabinet or Council as appropriate.

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Date: 12th February 2020

Background Papers used in the preparation of this report

- Local Government Act 2003
- CIPFA Code of Practice 2018-19
- CIPFA The Prudential Code for Capital Finance in Local Authorities (2017 Edition)

2020/23 Medium Term Financial Plan:

Capital Investment Strategy

Appendix 1

Contents

Capital Investment Strategy

Executive Summary

The North Lincolnshire Council's Capital Investment Strategy provides the framework for all capital investment decisions. It is a requirement of the Prudential Code for Capital Finance in Local Authorities (2017). The purpose of the Strategy is to make sure borrowing decisions are prudent and that sufficient focus is given to its:

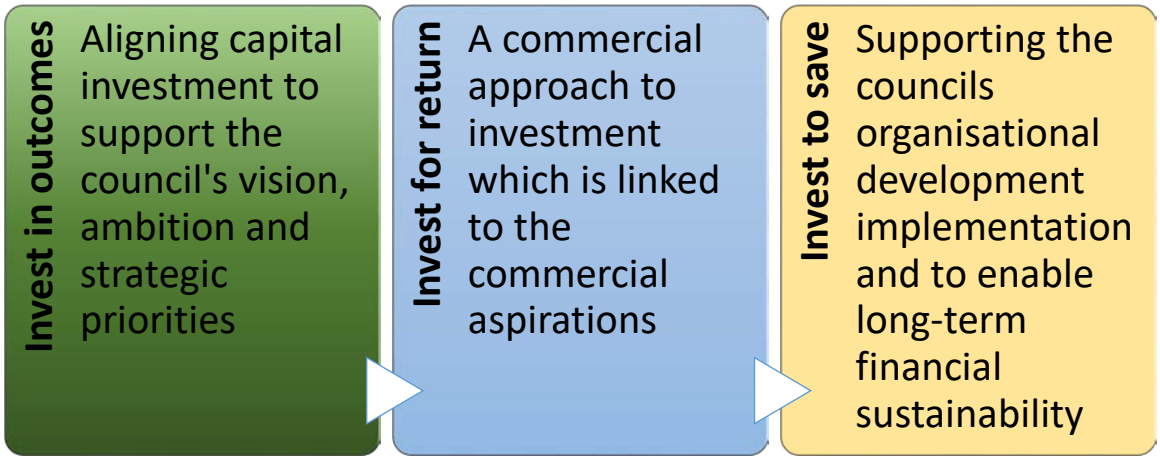
- Longer term sustainability
- Managing the risk attached to capital plans
- Avoiding exposure of public funds to unnecessary or unquantified risk

The Capital Investment Strategy frames the programme of capital schemes which will enable the Council to meet its duties, strategic ambition and priorities for North Lincolnshire set out in the Council Plan and will facilitate the Council's ambitious transformation programme. As the Council redesigns its offer to residents and communities and the way in which it operates,

capital investment is required to support delivery, ensuring optimisation of assets in the right places to meet community needs and to enable agile ways of working.

There are three key features of the Strategy:

The Capital Investment Principles at page 8, which translate into the three core strands of the capital investment programme.



The Prudential indicators at page 10 which ensure total council investment is sustainable

- The capital financing requirement
- The operational boundary and authorised limit
- Net financing costs set in the range 10-12% of the net revenue budget

The local indicators to manage the Council's exposure to risk (page 11)

- Total debt as a percentage of all long-term assets, maximum 40%
- Investment income as a proportion of net cost of services, maximum 5%
- Value of investment properties as a % of total property, plant and equipment 15% indicative
- Percentage of annual capital programme delivered in year 75% minimum
- A net real rate of return on commercial investments of 2-6% over the cost of borrowing

Legal and Prudential Framework

The Council undertakes capital investment within a legal and regulatory framework. This framework is particular to the Local Government Sector. It includes definitions of what constitutes capital expenditure, how this can be financed, and a prudential regime that sets limits on the scale of investment based on measures of prudence and affordability. Further detail is provided at Annex A.

Definition of Capital Investment

Capital expenditure is spending on assets and infrastructure required to deliver the best outcomes for the place and people of North Lincolnshire. That includes spending on:

- Operational property, plant, or equipment;
- School buildings and facilities;
- The area's infrastructure, primarily the road network and investment to stimulate the local economy;
- Investments in property designed to achieve a commercial return; and
- Grants or loans (see Annex C for more details) to other bodies or individuals for purposes which would be capital for the council;
- The establishment or purchase of shares in organisations designed to deliver public services

Funding Capital Investment

The Local Government Act, 2003 requires capital spending to be accounted for separately. The council also has to fund capital expenditure in certain ways. These include:

- Grants and other external funding;
- Borrowing;
- Capital receipts from the sale of council assets;
- Direct contributions from the council's revenue budget
- Funding through partnership arrangements.

There are restrictions to each type of funding;

Grants and external funding

These are usually from government, non-governmental public bodies and from private sector partners. These are generally allocated for specific schemes or areas of spending, such as investment in schools, with some limited scope to apply to other Council priorities.

Access to other forms of funding to promote regional growth and infrastructure development in the region are available through the Local Enterprise Partnerships.

Borrowing

For funds raised through borrowing Part 1, section 3 of the Local Government Act 2003 sets some specific requirements. It places a duty on the council to set an affordable limit to its borrowing and to keep this under review. The cost of all future borrowing for capital purposes falls wholly on the council and it must ensure that its revenue budget is sufficient to carry the cost of financing its debt.

Borrowing is primarily arranged through the Public Works Loans Board, an arm of the Treasury, because of the generally favourable rates available. But Councils can also borrow from banks, public and private pension funds, and any other lending institutions approved to operate in the UK; they can also issue Bonds on the capital markets, but only on a large-scale.

There is an expectation that the term of borrowing will broadly match the useful life of the assets it will fund.

Capital receipts
These are generated by the sale of surplus assets – for example buildings or land no longer required for council purposes. Normally councils must use these receipts for new capital investment- they cannot be used to cover the day-to-day costs of running council services. However for the plan period government has waived these rules so that councils can apply receipts to short-term expenditure on service transformation in the same year.

Direct contributions from revenue
These are also permitted. In addition, in some circumstances if the council chooses to lease an asset rather than purchase it the lease costs are paid for from the revenue budget. For reasons of value for money, the council has purchased new vehicles and equipment rather than entering into lease arrangements for a number of years now, but the option remains.

Funding through partnership arrangements
These can be with other public sector or private sector bodies, and may take a number of forms including delivery through a commercial vehicle established for a specified purpose.

The Prudential Code
It is for Councils to determine their own programmes for capital investment in the delivery of public services. But in undertaking capital investment, the Council is required by regulation (under part 1 of the Local Government Act 2003) to have regard to the Prudential Code for Capital Finance in Councils developed by the Chartered Institute of Public Finance and Accountancy (CIPFA). The Prudential Code is a professional code of practice which is intended to support Councils' decision making in the areas of capital investment and financing.

The Code was last updated in December 2017, and now requires all Councils to produce a Capital Investment Strategy. In acknowledgement of the requirements of the updated Code,

Council approved a capital investment strategy in February 2019 ensuring that it complies with the revised code and adopts best practice in managing its investment resources.

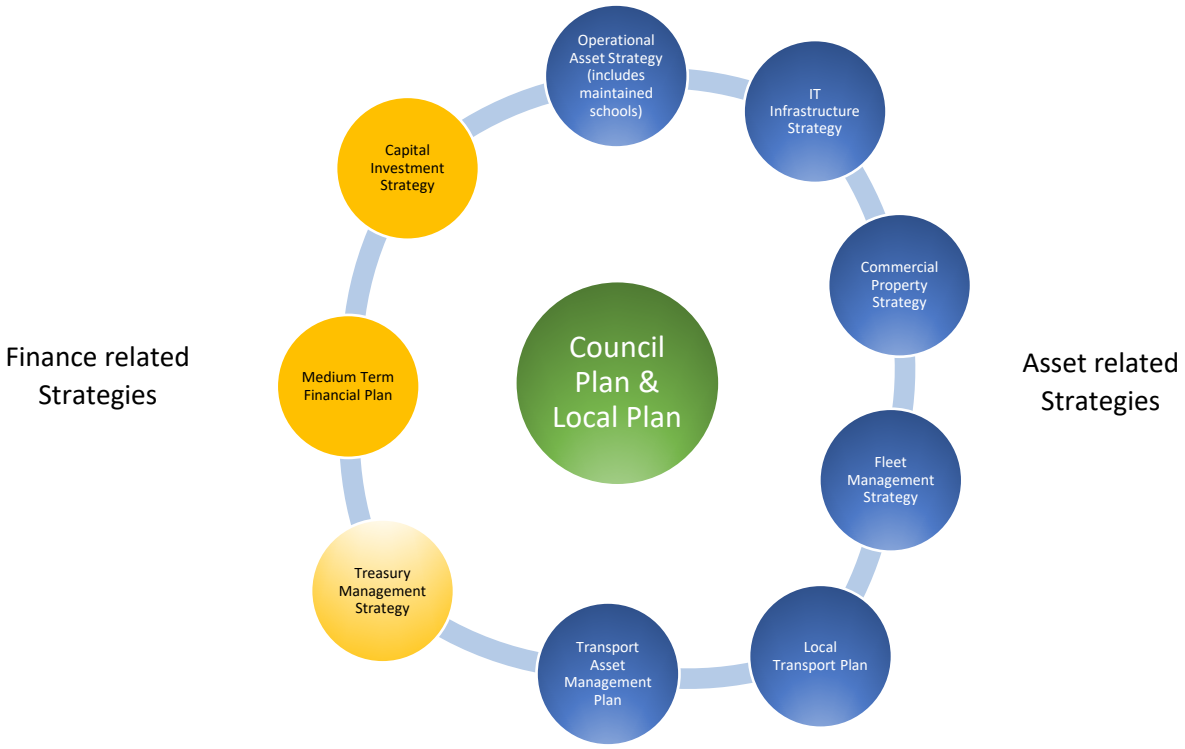
The revised Prudential Code (2017) requires Councils to take a longer planning horizon than the required three years specified for setting of the prudential indicators. As part of this longer planning horizon Councils should consider the whole life costs of major capital investment decisions to establish their affordability over the whole life of the asset.

The Council's Strategic Planning Framework

The Capital Investment Strategy does not stand in isolation. It is a part of the overall Governance framework of the Council, and it links to other key strategies and plans.

Its first point of reference is the **Council Plan** which sets the direction and priorities for all that the Council does. This sets out the Council's ambition for North Lincolnshire to be the best place to live, work, visit and invest. The Council is committed to deliver better outcomes for the people and place of North Lincolnshire by growing the economy, keeping people safe and well, and enabling communities to flourish.

This is translated into action through a range of other inter-related plans and strategies as shown in the diagram below:



There are Finance related plans and strategies:

The Medium Term Financial Plan which translates the ambitions and priorities of the Council Plan into specific decisions on the deployment of resources, both revenue and capital, typically over a four year period. It does this through a set of resource assumptions, and a cross-cutting financial process driven by the Council's priority outcomes, which feeds into business plans.

The Capital Investment Strategy which is integral to the delivery of the Investment Plans, and prioritises the use of capital to deliver the desired outcomes. It also ensures that Council investment is sustainable in the long-term and that financial risk is effectively managed.

The Treasury Management Strategy key purpose is to manage the risks surrounding cashflow, investment and debt management activity. It seeks to ensure the Council understands its Treasury Management risks and makes a conscious decision around how much risk it is prepared to accept. Professional and Government Guidance requires the Council to give priority to the security and liquidity of an investment over the return on that investment.

There are also a number of asset related plans and strategies:

The Operational Assets Strategy which sets out the strategic approach to managing the Council's property assets in a way which most effectively delivers the Council's strategic and local service priorities and outcomes. It also seeks to achieve value for money from its property assets. This includes Maintained Schools Asset Management Plan.

The Commercial Property Strategy which aims to secure additional commercial income to supplement the Council's core funding base and to facilitate economic growth in the area.

The IT Infrastructure Strategy which sets out the priority investment necessary to enable the council to operate its business securely and to maximise technology to change the way we work and the way we connect with the public.

The Fleet Management Strategy which sets out the optimum investment in the council-run fleet of vehicles, to ensure operational efficiency and value for money

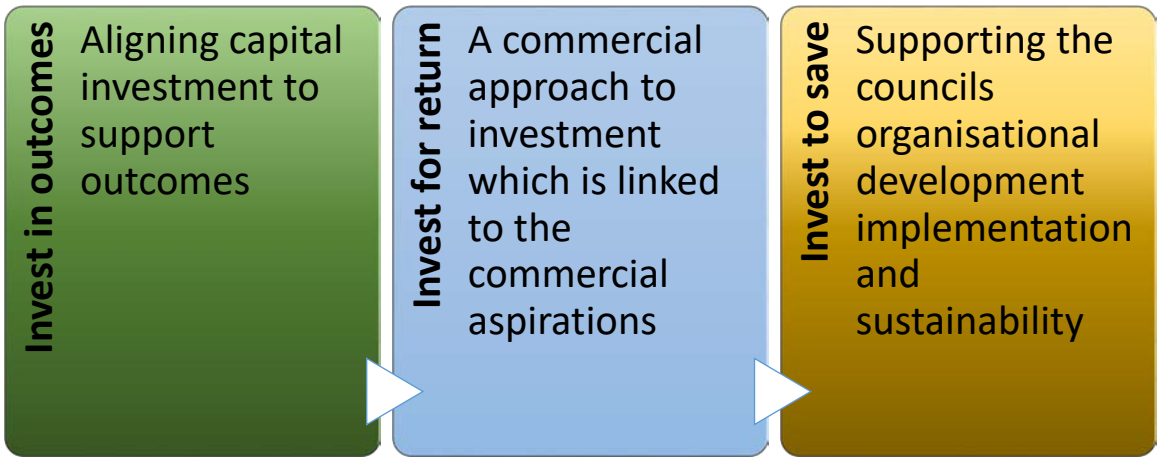
The Local Transport Plan (LTP) is a statutory document setting out how the local authority will deliver strategic transport improvements over a given period of time.

Transport Asset Management Plan (TAMP) helps prioritise investment in our transport network to ensure it is well maintained.

The Asset related plans and strategies provide an informed view of current and future needs over a medium and longer planning horizon. These plans focus on the maintenance, improvement and acquisition of assets required to deliver the Council's strategic priorities and outcomes. They also provide an assessment of the long-run operating costs of the Council's assets and how they can secure value for money. The Commercial Property Strategy aims for sustainable long term income to support the Council's budget; and the Operational Assets Strategy also plans for the disposal of surplus land and assets to generate capital receipts for reinvestment.

Framework for Investment Decisions

The Investment Strategy focusses on three key strands of investment



Capital Investment Principles

Capital investment is informed by the following principles:

Theme	Investment Decisions
Making Informed Decisions	• Investment decisions are aligned to agreed ambitions, goals, outcomes and priorities • Investment decisions enable achievement of the overall levels of income from commercial sources set in the budget • Investment decisions and commercial operations demonstrate an ongoing tangible benefit and do not generate legacy revenue cost
Manage Risk	• Investment decisions are congruent with Council values • Investment decisions meet the relevant regulatory requirements set nationally • Investment decisions avoid exposure of public funds to unnecessary or unquantified risk

Invest in Success	• Investment decisions and commercial operations demonstrate benefits to local people, priority given to projects that provide social value and support vulnerable people.

Prioritising investment

Capital investment is one means the Council has to achieve the outcomes for the people and place of North Lincolnshire. Capital investment generally creates an asset which makes a contribution to delivery of Council priorities for periods of more than one year, and it is on this basis that the Council can choose to spread the cost of creating the asset over its useful life through borrowing. This ties up a proportion of the Council's revenue for long periods until the debt is discharged, and there needs to be a careful judgement of the trade-off between utilising limited revenue resource into capital investment for the long-term with the flexibility of investment into the direct running costs of services. At scheme level this should take the form of an appraisal of the different options available.

The council's own resource, primarily the statutory power to borrow for capital purposes, is limited by what it can afford to repay over the lifetime of its assets, and so must focus on the right things. The council has already committed significant funds of its own to finance its current asset base, and still carries a debt burden from that earlier investment; and there is further planned investment of own resources of £65.9m in the current programme, primarily from borrowing.

For some areas of investment there is national funding available from Government: grants for maintained educational and other provision for children, where the council has a statutory duty to ensure sufficient places for the children of the area; grants for the local highway infrastructure and traffic management; and further funding via the Local Enterprise Partnership for infrastructure which supports economic growth.

A finite programme needs to work for the Council, make a difference to the people and place of North Lincolnshire and generate returns on the investment. The following considerations should apply:

- The need for **prioritisation** of resource due to finite resources, where schemes are not only considered on their own merit but also in relation to one another to avoid erosion of capital funding capacity
- The reality that the existing programme is close to the **limit** of what is **prudent** in terms of internal resources currently available in the plan period. This is based on the proximity of the current programme to the 10 - 12% range of borrowing costs limits set by Council
- If further borrowing is required outside this limit, it must be robustly **self-financing**

- A **risk based approach** to capital investment, with an understanding of how new investments affect the mix of risk and reward
- The requirement for a **full Business Case** to be produced for higher risk schemes
- High-level **evaluation** criteria

The council is transforming the way it does business. This will mean it delivers its duties and functions in different ways. It also means it will be focussing on optimising operational assets and releasing of surplus assets. This has the potential to generate capital receipts and revenue savings that can be reinvested to support the council's strategy. Schemes that deliver a positive return should be vigorously tested, monitored and evaluated. Schemes that require Council intervention to stimulate private sector investment should be tested against full return generated even if it is indirect (NNDR/Council Tax Growth).

Prudential Indicators

The Council also has a set of prudential indicators to help it decide what is prudent and affordable.

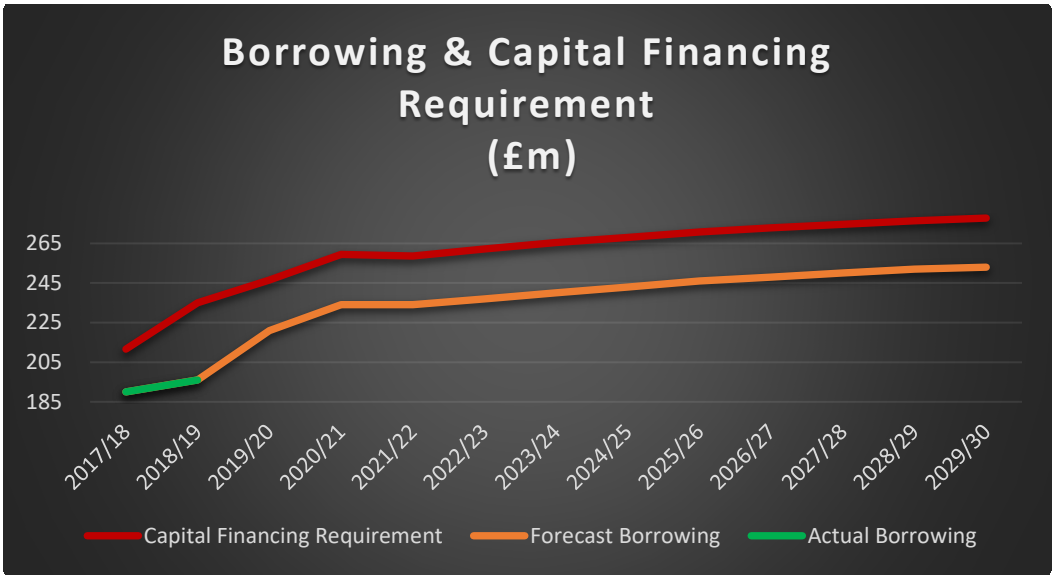
Prudential indicators were introduced as required proper practice when the Prudential regime was introduced by the Local Government Act 2003. This gave Councils the freedom to determine their own level of borrowing for long-term investment in place of the annual borrowing limits previously exercised by Government. The indicators were designed to provide councils with a reference point to test and ensure compliance with the central requirements of affordability, prudence and sustainability. **They provide a measure of how much capital investment the Council can afford to undertake and sustain over a longer term period. This is important since borrowing decisions taken now commit the council to payments over periods of up to fifty years depending on the nature of the asset.**

In setting or revising its prudential indicators, the Council is required to have regard to the following:

- **Council Priorities** (Council Plan)
- **Stewardship of Assets** (e.g. asset management planning)
- **Value for Money** (e.g. option appraisal)
- **Prudence and Sustainability** (e.g. risk, implications for external debt and whole life cost)
- **Affordability** (e.g. implications for the council's revenue income stream)
- **Practicality** (e.g. achievability of the forward plan)

The Key indicators prescribed in the Code are:

- **Capital Financing Requirement** – the Council's underlying need to borrow for capital investment purposes. This represents the actual need to borrow if the Council's current and future capital plans are delivered in full, on top of the investment it has already undertaken.



- **Operational Boundary** – an estimation of all of the borrowing that the organisation may need to undertake (revenue and capital) to run the business.

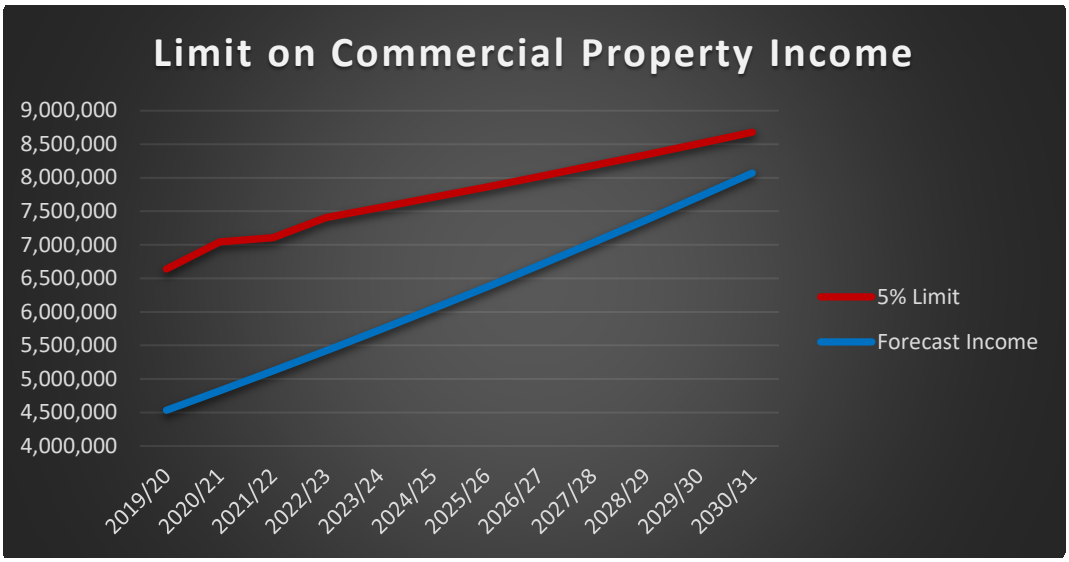
- **Authorised Limit** – the level of borrowing that could be afforded but may not be sustainable, and if breached requires immediate corrective action to be taken.

- **Net Financing Costs** – the percentage of revenue budget set aside each year to service debt financing costs. **The Council has set its limit at 10-12%.** This is a key indicator of affordability. Although Council circumstances differ it is informative to note that the estimated Unitary Council average in 2018-19 was 6.56%.

These indicators can be supplemented by other **local indicators** to help the Council to determine what an appropriate limit to capital investment is, and the degree of risk for the organisation associated with its investment programme. It is proposed that the following are added as local indicators. The most pertinent criteria are those which have the greatest bearing on the Council's exposure to risk drawn from the Balance Sheet and its ability to deliver a balanced budget in-year.

- Total debt as a % of long term assets - total debt can pose both short term liquidity risk and long term cash pressures, therefore the lower the relative debt the lower the risk to the council. T**he proposed limit is 40%**
- The Council has set targets to earn additional income from property investment, through a combination of active management of the existing portfolio and through the acquisition of new property investments. The aim is to generate a financial return to support the Council's revenue budget. **It is proposed that commercial income generate a maximum income equivalent 5% of the net**

revenue budget.



- Value of Investment properties as a % of total Property, Plant and Equipment - A higher total value of investment property indicates more opportunity to raise income. However, return on investment can vary depending on the type of investment and on the investment strategy. **The indicative limit is 15%**
- Percentage of initial capital programme delivered by financial year-end. The higher the percentage the more robust the capital investment plans. A low percentage could be an indicator of a failure to deliver service outcomes in a timely way with an impact on the quality of service, or of poor value for money. **The proposed minimum is that at least 75% by value of the initial programme should be achieved**
- The return on commercial investment to be set at between **2% and 6% return** net of the Councils' cost of borrowing.

CURRENT POSITION ON INDICATORS	2018/19	Trend	2017/18	Trend	2016/17
Total Debt as %age of long term assets	35.8%	↑	34.2%	↑	31.4%
Investment Property Income as %age of net revenue expenditure	3.4%	↑	3.3%	↑	3.0%
Investment Properties as %age of Total PPE	10.0%	↑	9.1%	↓	10.3%
%age of capital programme achieved	87.3%	↑	59.1%	↑	52.2%

Risk and Return

The Council takes a risk-based approach to capital investment so that the council's appetite for risk informs the size of investment available to higher risk projects.

In considering the initial financial risk of a business case the Net Present Value (NPV) on the whole life cost of the scheme, and Internal Rate of Return (IRR) financial appraisal techniques should be utilised where appropriate. NPV will be the key financial assessment tool. NPV

calculations will be carried out using the Government's Green Book discount rate, currently 3.5% (up to 30 years). These techniques are standard in business decision-making.

These techniques are most suited to schemes which are intended to deliver a financial return, whether in the form of cost savings which accrue by adopting a more cost effective model of service delivery, or schemes with a specific purpose of generating income through rental income or capital appreciation. This would include 'spend to save' initiatives.

However, not all Council capital projects can be evaluated in this way as there may not be a direct financial return. Some schemes will generate social value; or may be a legal requirement, such as health and safety; or discharge a public duty, such as the requirement to ensure a sufficiency of school places in the local area. For these a different set of measures is required, which will include a value for money assessment.

Any capital bid is based on a series of assumptions, and inevitably requires a degree of estimation. To help ensure cost assessment is robust the Council makes use of the professional judgement of qualified surveyors and engineers for its building and infrastructure projects. It is important that estimations do not show an optimism bias.

It is also important that the phasing and scale of the programme reflects the **capacity** of the Council to deliver it. The consequences of not doing so will include:

- Projects not delivered to required timescales and/or budget which affects the quality of service provided
- The cost of delivering the programme is materially different to initial estimate

The Council is able to re-profile and reallocate capital resource, providing that no prudential indicator is breached. This may include the acceleration or deferral of schemes to a later year. It is also prudent to re-assess the programme from time to time to ensure it continues to align with Council priorities.

All capital projects should have a risk log that is regularly reviewed and updated. All risks that may affect a project must be considered. These can include political, economic, legal, technological environmental and reputational as well as financial. Projects should be managed using the **project management toolkit**, which provides guidance and templates which can be found at KI 3456 Project Management Templates on Topdesk

Additional consideration needs to be given to schemes that the council invests in solely for a return, in accordance with the Localism Act.

The council's investment in commercial property will align to its outcomes or Council Plan priorities and evidence that the return is 'incidental' to broader social and economic aims. If this is not possible or the link is not clear e.g. in the case of an out of area investment, legal advice and other relevant professional advice will be required and consideration needs to be given to ensure the investment is not deemed to be ultra vires.

CIPFA are advising Councils to have regard to the Statutory Investment Guidance the informal commentary to which cautions Councils against:

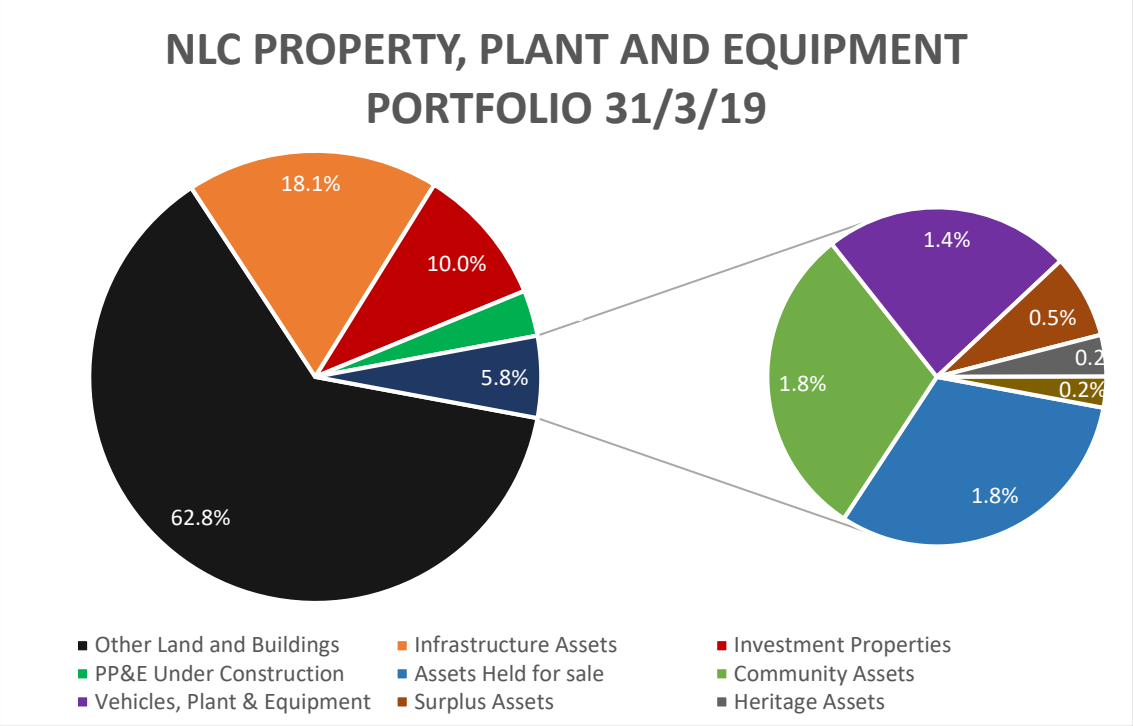
- becoming dependent on commercial income;
- taking out too much debt relative to net service expenditure; and
- taking on debt to finance commercial investments.

It had been thought that the Government would issue statutory guidance to limit council investments. This now seems less likely as the Government has increased PWLB rates which makes borrowing to invest less attractive and makes yields lower.

Current Commercial Portfolio

The Council has an extensive property portfolio valued at £55m as at 31/3/19, which earned £4.2m of income or 3.4% of net council spending in 2018/19. Property is held to deliver both the outcomes the Council desires and to earn income to support general council activity. The Commercial Property Portfolio has always had a dual purpose to develop the local economy and to generate a cash return for the Council.

The majority of the Council's Property Plant and Equipment portfolio is relatively low or very low risk. Investment properties are about 10.0% of the total portfolio by value. These properties are higher risk. The risks associated with these properties include exposure to fluctuations in the value of commercial property, difficulty in obtaining payment for rentals and breaks in tenancy leading to reduced income and increased costs. Most of the council's current Investment Portfolio was inherited from its predecessor councils and almost all of any associated borrowing has been repaid. There are therefore no associated costs of borrowing for these assets. Meaning that almost all of the investment income they yield can go to support the Council's Priorities.



The Council has set targets to earn additional income from property investment, through a combination of active management of the existing portfolio and through the acquisition of new property investments. The aim is to generate a financial return to support the Council's

revenue budget. **It is proposed that commercial income generate income equivalent to a maximum 5% of the net revenue budget.**

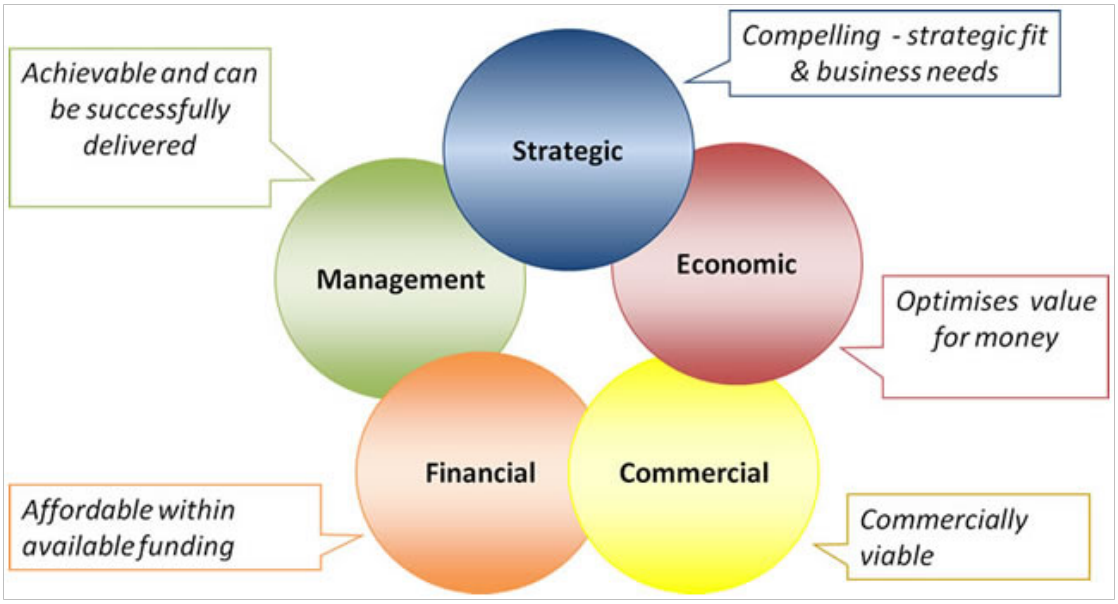
To assist in the consideration of risk various techniques may be used. However it is proposed four techniques are utilised wherever possible:-

- Real rate of return on investment this technique provides the net gain from the investment as a percentage. It uses the net present value of the cashflows which are generated by the scheme so that the time value of money is taken into account.
- Rate of return must be at least the Council's cost of borrowing, which fluctuates. To provide an adequate return above the cost of borrowing while not incurring excessive risk a target gross rate of return of between 8% and 12% has been proposed for evaluating each investment proposal. **This would generate a net return over the cost of borrowing of between 2% and 6%.**
- Internal Rate of Return (IRR) is a technique which calculates the discount rate that would need to be applied to a cashflow to make it zero. This technique allows a comparison to be drawn between different investments and types of investment and is a useful supplementary measure.

The strategy for commercial investment is considered more fully in the **Capital Investment Strategy.**

Making the Business Case

The council has developed a **toolkit to be used to create robust business cases**. It comes in two parts, a Mini Business Case that sets out the essence of the scheme at a high level and a Full Business Case which sets out the scheme in more detail. Both of these can be found on Topdesk section KI 2060 Business Case Toolkit. This is based on the five case model for Capital Appraisal and Evaluation from the Treasury's Green Book:



As a public body which operates within the constraints of public policy and finite resources there is a need to choose among alternative capital investment opportunities. What makes this kind of decision demanding is not the problem of projecting return on investment under any given set of assumptions, but making the right assumptions and a robust estimation of their impact. Taken together, these can generate significant uncertainty. For that reason a degree of sensitivity analysis should be undertaken on those projects with greatest risk.

The scope of an evaluation should depend upon the complexity, scale of the impact of a programme or scheme, and also be informed by the level of benefit to the people of North Lincolnshire. Learning should be taken from previous schemes to inform future decisions.

The risk and impact of the current programme should add context to the decisions being taken and how investment proposals affect the mix of risk being taken. Higher risk investments should be judged in the context of impact.

In making an assessment of each scheme the full cost impact should be taken into account, both financing and running costs.

Governance of the Capital Programme

It is Full Council which sets the Capital Investment Strategy and approves the resource envelope for a multi-year programme of capital investment. The Constitution sets out the role of Cabinet which provides executive oversight and determines the powers and responsibilities delegated to cabinet members and officers.

An internal board of senior officers has been established to act as the Council's advisory body on the Council's major projects and capital investment within the authority and all asset management.

To support delivery of the Capital Investment Strategy, the following process will be applied in determining resource allocation and prioritisation of schemes. This process is based on the production of robust business cases. Initially only an outline business case is required but if the scheme passes the first stage of approval a detailed business case will be required. The process requires each proposed scheme cover the following:-

(a) Strategic fit with Council Plan.

(b) Relative importance and affordability and fit with Councils Strategic Asset Management Plan where a new or existing asset is to be developed.

(c) Financial viability needs to be examined in 2 stages:-

- Initial stage with 'order of costs' and indicative outputs
- If approval is made on all the above, feasibility resources will be invested in developing the scheme to outline stage so it can be costed, while refining financial output data in order to produce the business case.

Annex A-The Statutory and Regulatory Framework

The Council has to work within a statutory framework. In practice this means that its spending must be in line with statutory powers and powers of competence and is not 'ultra vires'.

The relevant legislation and regulations include:-

- Local Government Finance Act 1992 which sets out the requirement to set a balanced budget.

- Local Government Act 2003 provides councils with the power to borrow within certain limits. The act also gives councils the power to make an investment.

- The Chief Financial Officer has a duty to ensure the limits referred to in the 2003 Act are not exceeded and can call on specific legal powers, if in their professional opinion, there is a danger this will happen

- Section 16 of the 2003 Act defines Capital Expenditure as:-

  1. Expenditure that results in the acquisition of, or the construction of, or the addition of subsequent costs to noncurrent assets in accordance with 'proper practices'
  2. Expenditure that meets one of the definitions specified in regulations made under the Act.
  3. The Secretary of State makes a direction that the expenditure can be treated as capital expenditure e.g. the capital receipts flexibility.

- Government have issued guidance on the calculation of the annual Minimum Revenue Provision which councils that have borrowed to finance their capital programme must make. This ensure that a prudent revenue provision is made to repay borrowing undertaken for capital purposes.

- Localism Act 2011 This Act includes a General Power of Competence which allows Councils some additional freedoms and sets out in Section 4 the need to operate through a Limited Company any activities it undertakes for purely Commercial purposes.

- A requirement to produce independently audited Council accounts each year. Each year every council must have its accounts and arrangements for obtaining value for money audited by 31st July. External Auditors also have the power to issue a Public Interest Report if they believe the council is failing in its duty to provide value for money services.

- Tax Legislation. The council generally is able to recover VAT on goods and services, but can only recover the VAT it incurs on VAT exempt activities e.g. education & training; and selling, leasing and letting of commercial land and buildings (this exemption can be waived) up to the value of 5% of all the VAT it incurs. This is known as the de minimis threshold or limit. If this limit is exceeded none of this VAT may be recovered and will be a significant cost to the council. The VAT implications of every capital scheme therefore need to be considered.

Annex B-Technical Accounting Matters

Accounting

The accounting for capital has some special rules that do not apply to revenue expenditure. For Local Authorities capital expenditure is defined under UK law as expenditure that can be capitalised under proper practice or the Secretary of State deems it to be capital. In this case proper practice is the CIPFA Code of Accounting Practice. The code defines capital as spending to purchase, enhance or construct a long term asset with the benefit gained from the spending lasting more than one year. Loans to organisations or individuals for them to spend on things that would be capital if the council had bought them can also be capital

Capitalisation policy

The Council has a capitalisation policy, which complies with the code and which sets out what types of costs can be capitalised. Under UK law anything that cannot be capitalised is a revenue cost.

Leasing

As a Lessee a lease can be a way of obtaining the use of a capital asset for a period of time. Conversely as a Lessor a lease can be used to generate an ongoing income from a capital asset. There are two different types of lease. These are Finance and Operating leases. Operating leases are purely rental agreements with the Lessor retaining the majority of the risks and rewards of ownership. Finance leases are agreements where the majority of the risks and rewards transfer to the Lessee.

There are important differences between the two types of lease. Finance leases require lessors to remove the asset from their balance sheets and lessees to include the asset on their balance sheet. Finance lease income to a lessor is received in a form that limits how this income can be used.

As the lessor there are five indicators of a finance lease they are:-

- the lease transfers ownership of the asset to the lessee by the end of the lease term
- the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value so as to make it reasonably certain the option will be exercised
- the lease term is for the major part of the economic life of the asset
- the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset
- the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

Each lease has to be assessed on its own merits

Annex C-Principles for making of Council loans:

The following principles are a framework for making loan decisions. Loans should:

- Support the Council Strategy/help deliver council outcomes
- Be authorised under statutory powers
- Be planned not reactive
- Be part of the Capital Strategy and Capital Programme for consideration and prioritisation (revenue loans are to be discouraged)
- Be on a Commercial basis i.e. on commercial terms, or with clear justification if charging less than the commercial rate (e.g. passing on the PWLB rate which is generally below the market rate); and only after undertaking a robust due diligence process
- Minimise the risk to the public purse e.g. by being facilitated through a third party
- Be able to demonstrate clearly why the Council should act as lender

CAPITAL INVESTMENT PROGRAMME 2019/23 Appendix 2

Table 1 – Programme Summary 2019/23

PROPOSED PROGRAMME	2019/20 £000's	2020/21 £000's	2021/22 £000's	2022/23 £000's	Total £000's
Investment In Priority					
Keeping People Safe And Well	450	2,521	156	156	3,283
Enabling Communities To Flourish	7,444	6,899	1,929	1,729	18,001
Growing The Economy	25,853	28,921	14,407	7,391	76,572
Running the Business	5,661	11,201	2,738	20	19,620
Total	39,408	49,542	19,230	9,296	117,476
Additional Capital Investment Allocation	-	1,959	1,959	10,000	13,918
Capital Investment Limit	**39,408**	**51,501**	**21,189**	**19,296**	**131,394**
Funding Analysis					
External & Grant Funding	19,437	26,930	9,796	9,296	65,459
Revenue Funding	145	16	16	-	177
Borrowing	16,775	18,805	5,524	10,000	51,104
Capital Receipts	3,051	5,750	5,853	-	14,654
Total	**39,408**	**51,501**	**21,189**	**19,296**	**131,394**

Table 2 – Programme Detail 2019/23

Capital Investment Programme	2019/20			2020/21			2021/22			2022/23
	Total £000's	External Funding £000's	Internal Funding £000's	Total £000's	External Funding £000's	Internal Funding £000's	Total £000's	External Funding £000's	Internal Funding £000's	Total £000's
Keeping People Safe & Well										
Safe & Sound Grant	10	10	0	0	0	0	0	0	0	0
Safer Roads Fund	300	248	52	2,051	2,051	0	0	0	0	0
School Safety Zones	8	0	8	7	0	7	0	0	0	0
Telecare Investment	132	132	0	463	463	0	156	156	0	156
Total Keeping People Safe & Well	**450**	**390**	**60**	**2,521**	**2,514**	**7**	**156**	**156**	**0**	**156**
Enabling Communities to Flourish										
Ancholme River Path / Isle Cycleways	265	0	265	0	0	0	0	0	0	0
Barton Leisure & Wellbeing Investment	1,189	0	1,189	0	0	0	0	0	0	0
Baysgarth Park Footpath	138	138	0	0	0	0	0	0	0	0
Burton Sports Centre	3	0	3	83	0	83	0	0	0	0
Community Capital Grants	250	0	250	550	0	550	200	0	200	0
Community Equipment	172	172	0	129	129	0	129	129	0	129
Community Services Infrastructure & HRC Sites	90	0	90	0	0	0	0	0	0	0
Cremator	16	0	16	0	0	0	0	0	0	0
Disabled Facilities Grants	1,800	1,800	0	3,016	3,016	0	1,500	1,500	0	1,500
Education Health Care Plan System	36	0	36	0	0	0	0	0	0	0
Enhanced & Prosperous Communities Fund	603	31	572	606	0	606	0	0	0	0
Healey Rd Community Play Area	109	109	0	0	0	0	0	0	0	0
Home Assistance/RHHA Loan	469	371	98	190	111	79	100	100	0	100
Humberhead Levels Landscape Pt	8	5	3	223	86	137	0	0	0	0
Kirton Allotments	0	0	0	25	0	25	0	0	0	0
Learning Disability & Tech	459	459	0	0	0	0	0	0	0	0
Leisure Equipment Replacement	218	17	201	0	0	0	0	0	0	0
Normanby Hall Country Park Investment	282	0	282	0	0	0	0	0	0	0
Scunthorpe Library Hub Investment	51	0	51	0	0	0	0	0	0	0

Capital Investment Programme	2019/20			2020/21			2021/22			2022/23
	Total £000's	External Funding £000's	Internal Funding £000's	Total £000's	External Funding £000's	Internal Funding £000's	Total £000's	External Funding £000's	Internal Funding £000's	Total £000's
Skate Parks & Multi Use Games Areas	26	0	26	0	0	0	0	0	0	0
Street Lighting & LED	1,258	0	1,258	2,077	0	2,077	0	0	0	0
Winterton Gym & Skate Park	2	0	2	0	0	0	0	0	0	0
Total Enabling Communities to Flourish	**7,444**	**3,102**	**4,342**	**6,899**	**3,342**	**3,557**	**1,929**	**1,729**	**200**	**1,729**
Growing the Economy										
A18 Melton Ross Railway Bridge	60	0	60	96	0	96	0	0	0	0
BDUK North Lincs Broadband	18	0	18	1,069	1,000	69	526	500	26	0
Early Years Capital Fund	372	280	92	0	0	0	0	0	0	0
Formula Capital Devolved To Schools	1,032	1,017	15	1,299	1,299	0	377	377	0	377
Gauge Enhancements	1,000	1,000	0	0	0	0	0	0	0	0
Goxhill Flood Alleviation	0	0	0	676	451	225	0	0	0	0
Lincolnshire Lakes Blue Offer	0	0	0	4,835	4,835	0	0	0	0	0
Lincolnshire Lakes Flooding Prevention	2,961	2,961	0	0	0	0	0	0	0	0
Infrastructure Schemes	6,842	6,055	787	13,803	9,550	4,253	11,622	5,632	5,990	5,632
Mainstream Inclusion SEND	121	37	84	45	0	45	0	0	0	0
Market Investments	1,090	0	1,090	0	0	0	0	0	0	0
Normanby Enterprise Phase 7	1,967	689	1,278	0	0	0	0	0	0	0
Property Trading Account Developments	4,308	0	4,308	427	0	427	0	0	0	0
Schools Investment Programme	3,652	2,547	1,105	5,173	3,123	2,050	1,882	1,382	500	1,382
South Humber Bank Gateway Resurfacing	1,198	1,198	0	0	0	0	0	0	0	0
Town Centre Regeneration	189	135	54	1,016	796	220	0	0	0	0
Town Centre Regeneration - Car Parking	24	0	24	169	0	169	0	0	0	0
Trent & Humber Flood Works	450	0	450	313	0	313	0	0	0	0
Council Offices - Town Centre Regeneration	569	0	569	0	0	0	0	0	0	0
Total Growing the Economy	**25,853**	**15,919**	**9,934**	**28,921**	**21,054**	**7,867**	**14,407**	**7,891**	**6,516**	**7,391**

Capital Investment Programme	2019/20			2020/21			2021/22			2022/23
	Total £000's	External Funding £000's	Internal Funding £000's	Total £000's	External Funding £000's	Internal Funding £000's	Total £000's	External Funding £000's	Internal Funding £000's	Total £000's
Running the Business										
Capital Receipts Flexibility	1,268	0	1,268	732	0	732	0	0	0	0
Community Buildings (Community Hubs)	815	0	815	4,210	0	4,210	0	0	0	0
Community Buildings (Operational Infrastructure)	782	0	782	1,071	0	1,071	200	0	200	0
Digital & IT Infrastructure	436	0	436	270	0	270	270	0	270	0
Dragonby Energy Efficiency	48	26	22	20	20	0	20	20	0	20
Modern Gov - Meeting & Decision Management	44	0	44	6	0	6	0	0	0	0
Fleet Asset Management Programme	868	0	868	4,492	0	4,492	2,248	0	2,248	0
Shared Horizons	1,400	0	1,400	400	0	400	0	0	0	0
Total Running the Business	**5,661**	**26**	**5,635**	**11,201**	**20**	**11,181**	**2,738**	**20**	**2,718**	**20**
Capital Investment Allocation										
Additional Capital Investment Allocation	0	0	0	1,959	0	1,959	1,959	0	1,959	10,000
Capital Investment Allocation	**0**	**0**	**0**	**1,959**	**0**	**1,959**	**1,959**	**0**	**1,959**	**10,000**
Total Capital Programme	**39,408**	**19,437**	**19,971**	**51,501**	**26,930**	**24,571**	**21,189**	**9,796**	**11,393**	**19,296**