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Date: 21 November 2012

Dear Member

POLICY AND RESOURCES CABINET COMMITTEE - THURSDAY, 22 NOVEMBER 2012

Please find enclosed the Draft Capital Strategy for item D2 which should have been included with the papers for Thursday, 22 November 2012 meeting of the Policy and Resources Cabinet Committee.

Agenda No	**Item**
D2	<u>**Capital Strategy**</u> **(Pages 1 - 10)**

Apologies for any inconvenience caused.

Yours sincerely

Peter Sass
Head of Democratic Services

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Kent County Council

Capital Strategy (Draft)

1. Overview

1.1 **Introduction**

Capital expenditure is defined as the purchase or enhancement of assets where the benefits last longer than the year of expenditure. A de minimis level is applied – for KCC this is £10k i.e. anything below this value individually is classed and treated as revenue. The capital budget should support the overall objectives of the organisation, and act as an enabler for transformation to support Kent County Council's (KCC's) strategic priorities in 'Bold Steps for Kent', our Medium Term Plan.

In recent years KCC has spent an average of £290m per year on capital projects. We plan to invest £693m over the next five years and to finance 25% of this expenditure from borrowing which will impact our revenue budget.

1.2 Capital investment shapes the future, ensures the organisation is fit for purpose, and can transform services and ways of working. It can act as a catalyst and enabler for change. Our spending on capital remains a significant proportion of overall spend and provides an important driver for economic growth - stimulating regeneration and construction, and providing local jobs for local people.

1.3 With a challenging financial environment for the foreseeable future that is influenced by a variety of external factors, there will only ever be a limited amount of capital resources available. Therefore, it is vital that we target limited resources to maximum effect with a sharper focus on our strategic priorities and 'invest to save' opportunities.

1.4 We will use capital investment proactively as an enabler and facilitator for driving transformation in service delivery in our communities. We will become agile and flexible enough to be able to both plan ahead and to respond innovatively to emerging opportunities and challenges. We will target and maximise investments, manage risk, anticipate trends and radically re-think how best to focus our capital programme to keep pace with changes in national policy, legislative requirements and business needs.

1.5 **What role does the Capital Strategy play?**

The capital strategy sets out the strategic direction for KCC's capital management and investment plans, and is an integral part of our financial and service medium-long term planning and budget setting process. It sets the principles for prioritising our capital investment under the prudential system.

1.6 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 £1m per annum in financing costs (revenue) for 25 years. This is in addition to any ongoing maintenance and running costs associated with the investment Our fiscal indicator limits spend on debt charges to 15% of the Council's net revenue budget – as revenue budgets are reducing this heightens the need to ensure we get the best benefit from capital investment.

1.7 KCC's budget planning processes integrate both capital and revenue so that coherent decisions are made on a level of borrowing that is prudent, affordable and sustainable for the Authority. The difficult financial environment means we have to spend limited money wisely and there is a delicate balancing act in managing these types of potential pressures effectively.

1.8 **Ambition**

The Authority is taking a transformational stance in relation to its capital strategy. This involves setting aside some capital projects in favour of others that are more in-line with current strategic priorities. This stance will enable maximum flexibility but could also result in increased capital spend. This may be funded through the introduction of rigorous capital receipts targets, better targeted invest to save projects and other innovative funding streams but not through increased borrowing, which would have a negative impact on our fiscal indicator and revenue budget.

2. Drivers for Change

2.1 This is a time of unprecedented change in the public sector and the following drivers for change have informed and impacted our capital strategy.

2.2 **A challenging financial environment**
The Coalition Government has put in place stringent reductions in revenue and capital grant funding for public services, with a strong drive towards austerity and value for money. Local authorities are facing rising demand (particularly in social care and waste management) and customer expectations for public services. To respond to this KCC is seeking creative new ways of providing services which may require capital investment to deliver best value for Kent's communities and taxpayers. Our future capital programme must deliver tangible benefits that support sustainable, long term delivery of the three ambitions in **Bold Steps for Kent** and our core budget themes of productivity, prevention, procurement and partnership.

2.3 The challenge of an ambitious capital programme is that due to the nature of capital projects (e.g. building projects delayed by funding, planning or construction issues) they do not always deliver to anticipated timescales or budgets, which can increase costs and create additional revenue pressures. In a challenging financial environment, effective procurement, robust contract management and strong management grip are essential to manage costs and ensure every penny counts.

2.4 **Stimulating growth**
Capital investment needs to focus on delivering the essential strategic priorities of our long term regeneration framework - **Unlocking Kent's Potential**. It can be a catalyst for transformational regeneration and infrastructure projects, providing jobs, enhancing skills and creating an efficient highways network that supports the vision in **Growth without Gridlock.** This will benefit both the Kent economy and our residents.

2.5 Collaboration with our public, private and voluntary & community sector partners will enable us to seize appropriate external capital funding opportunities, joining-up bids that attract and stimulate growth. We will develop a partnership response to national funding challenges such as reductions in Homes & Communities Agency grants. The 'Community Right to Buy' is an area where KCC are working with District Councils (as the local planning authority responsible for holding the register of 'assets of community value') to recognise opportunities that may be suitable for 'right to buy' to maximise community benefit and drive local regeneration.

2.6 **Community Infrastructure Levy**
The Community Infrastructure Levy (CIL) is being introduced to help ensure that new development pays its way in terms of the infrastructure required to support new dwellings (schools, roads, leisure facilities etc). However, for the first time economic viability is now a material consideration in setting tariff levels. While the concept of a strategic tariff is welcome (and may be very helpful over the next ten years should the economy improve) the recession means that there is a widening gap between the viability of new development and the ability of local public agencies to gather resources to offset infrastructure pressures. The Government's proposed objective for a "meaningful" amount of CIL being passed to Parishes could further compromise viability.

2.7 Districts & Boroughs are legally responsible for CIL collection and there is no obligation to collect on behalf of KCC. However, KCC is working closely with boroughs and districts in the preparation of their infrastructure funding schedules. Furthermore, the Kent Forum has agreed that KCC and the districts will jointly lobby the government about the implications of CIL for growth.

2.8 This is an important strategic challenge for Kent as a place – the Government's aim is to stimulate growth through CIL and a number of other 'growth levers' (e.g. retained business rates, New Homes Bonus) but in the short term at least these levers will not produce the funding required to cover infrastructure costs, particularly in east and north Kent. It is vital that KCC work with the Districts to ensure an adequate level of CIL is passed across to KCC to deliver the infrastructure required. KCC cannot afford to put the infrastructure in place without CIL funding, but the infrastructure is needed to ensure these areas are desirable to live in. The implications for KCC's budgets of CIL (and any renegotiations of existing S106s) are reported to the Development Contributions Sub Group and/or the Budget Programme Board as appropriate.

.2.9 **A rapidly changing education landscape**
The 2010 'Education Act' has prompted fundamental change in the education landscape and the role of the Local Education Authority. With an increasing number of academies, free schools and federations between schools, the education property estate is moving away from direct local authority control towards independent academies taking responsibility for the ownership, management and maintenance of schools. By 2013/14 the Education estate will look radically different in Kent.

2.10 We need to ensure that any capital investment in education reflects these changes and takes a flexible, pragmatic asset management approach, ensuring KCC invests money in assets we are likely to retain. The **education commissioning plan** sets out our capital investment in education. The Priority Schools Build provides a focus to ensure we meet our requirements on basic need (e.g. increasing school primary places in growth areas, or keeping schools open, safe and warm). We will work closely with our local schools to ensure that capital investment is targeted where limited resources can be used to best effect.

2.11 **Enhancing community facilities**
The transformation of frontline services means we must ensure our assets continue to be fit for purpose to respond to rising customer demands, expectations and changing needs. Capital investment can be a key enabler for high quality design that helps to deliver more vibrant community facilities. The 'Social Care White Paper' (2012), advocates that local authorities maximise the potential for innovative use of community assets to reduce social isolation and increase connections for social care service users, their families and carers. The increasing integration of frontline services will require different types of facilities and enabling technology to work smarter and better together. It will increase demand for asset collaboration solutions which may require disposals to generate capital receipts, to reinvest in modernising and enhancing community facilities to make them more sustainable.

2.12 **Strategic asset management**
Capital and assets are two sides of the same coin and it is vital that our capital programme complements our emerging **Strategic Asset Management Plan.** The challenge is to turn the inefficient properties into efficient ones, or if this is not possible, sell and to realise a capital receipt to re-invest in a property from which an improved service can be offered. Our asset rationalisation and disposals policy will be more rigorous, creating headroom in the capital programme. We will focus on meeting basic need to secure an acceptable market value and target capital investment on facilities that enable service transformation. We will focus on investing in priority property locations where modernising assets may help to promote opportunities for co-location, asset collaboration and service integration.

2.13 **Smarter ways of working**
We need to ensure that capital investment can be seen not only as a way to respond to and help implement service changes, but also as a catalyst to initiate broader cultural change. Through modernising an office work space or introducing enabling technology through our **New Work Spaces** programme, we will enable frontline staff to carry out their roles closer to service users, and ensure office-based workers can work more effectively.

2.14 This needs to be complemented by investment in ICT infrastructure that supports our **ICT Digital Strategy**, to transform the way we work and provide new ways for customers to communicate access and interact with our services. We want to create more efficient, streamlined systems and promote economic growth (e.g. investment in broadband infrastructure will support learning, employment, skills and business growth, particularly in our rural communities). Over time this will reduce the need for costly face-to-face locations. Unified Communications will also be a key enabler to support this. This is consistent with our priorities around ‘channel shift’ to enhance the customer experience – a key part of our **Customer Services Strategy**. We will target capital funding on projects that redesign our services from the customer’s point of view and transform initial access points for services..

2.15 **Smarter and greener investment**
We need to ensure that every penny counts on our capital programme. Our category management approach will ensure a more intelligent, cost-effective approach to procurement and ensure we are doing all that we can within legal frameworks to allow the best opportunity to direct spend to local suppliers and make it easy for Kent businesses to trade with us. Robust contract management will ensure we hold providers to account and ensure they deliver to time and quality and meet priority outcomes. Our **Environment Strategy** will ensure we deliver a sustainable capital programme by ensuring all works help to reduce our carbon footprint, through efficient energy and water consumption. This will not only have a positive environment benefit; it will also be more cost effective.

3. Funding

3.1 **Sources of capital funding**

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

3.2 **Borrowing**

KCC currently has borrowing of just over £1 billion and our policy is that net debt costs must not exceed 15% of the net revenue budget. However, this indicator is at risk of being exceeded, particularly as over the coming years our revenue budget is forecast to reduce, so 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 5 year 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 revenue borrowing costs are around £1m and we must also consider the Prudential Code.

3.3 **Grants**

The challenging financial environment means that national government grants (currently 55% of our financing for capital projects) are reducing, or changing in nature. A large proportion of this funding is currently un-ringfenced which means it is not tied to particular projects but it is often tied to a particular area such as education or highways so we do not have complete freedom on where to spend our grants. Our aim is to use only up to the level of grant provided and we will not use prudential borrowing to 'top up'. However, we must also meet our statutory obligations and where the grant is not sufficient, other sources of funding such as New Homes Bonus, CIL and capital receipts will be sought to fund the gap.

There will be an ‘approval to bid’ process which will create a centralised mechanism for flagging when external funding/grants are being bid for, and identifying the implications including the impact on the Authority’s budget. This will ensure that funding is bid for within an agreed framework, that information is being shared with appropriate colleagues in a timely manner, and that opportunities for joined up working are identified at the beginning of projects.

3.4 **Community Infrastructure Levy**

CIL is a challenging issue and needs careful handling and consideration when put forward to fund major projects. CIL will be built into the programme at the point that planning permission is granted, but recognising that there are still risks around housing development and the realisation of CIL. Careful monitoring of expenditure against this funding is critical to ensure that we don’t have to forward fund significant levels using borrowing. Careful negotiation is required to ensure we cover any potential borrowing costs resulting from late or reduced levels of CIL funding.

3.5 **Capital Receipts**

KCC has a rigorous disposal programme, aimed at maximising the return on our assets. These receipts are critical to delivering our capital programme and reducing the level of borrowing that we require. We will also aim to create headroom by setting a capital disposal target. This supports the transformation agenda. KCC's Property managers will work with the service directorates to explore options to release property as part of the transformation reviews to continue to create a sustainable pipeline in the future.

3.6 Partnership Working

We will continue to explore opportunities for more partnership working.

4. Targeting investment

4.1

The strategy requires a mechanism for determining the way forward in line with the transformational ambition of the Authority, the drivers for change and the constraints that we are under. This means that tough decisions will have to be made as to which projects go ahead and which ones don't (we can't meet all the 'wants'). This section explains the criteria that have been developed to assess capital projects, to ensure that our capital budget is targeted to our priority areas.

4.2 Meeting our statutory requirements

KCC will always ensure that appropriate capital budget is allocated to meet our statutory requirements, such as basic need, health and safety, DDA and other legal requirements. As such it is appropriate to assess the Approval to Plan business cases for the statutory spend against a different set of criteria than for all other spend. This is mainly because the statutory spend is unlikely to score well against the 3 key drivers in the Bold Steps for Kent.

4.3 Statutory bids will be assessed against the following two criteria.

Criteria	Description	Yes/No?
1. Statutory	Evidence must be provided that the bid is for statutory capital expenditure	Y/N
2. Basic minimum	Evidence must be provided that the bid is for doing the basic minimum and no optional extras.	Y/N

4.4 If a bid is submitted via the 'statutory spend' route and the answer is 'No' to Criteria 1 then the bid will be assessed against the 'other spend' matrix. If the answer is 'Yes' to Criteria 1, but 'No' to Criteria 2 then the bid will be split in two – the element that is requesting capital spend above the basic minimum will be assessed against the 'other spend' matrix and if it is not approved then only the basic minimum amount of capital spend will be allowed.

4.5 **Making the available headroom count**

Having separated the capital budget into 'statutory spend' and 'other spend', the big question is how we prioritise all the 'wants' within the 'other spend' category. 'Other spend' covers invest to save projects and all other non-statutory projects. These projects should clearly link in with KCC's strategic priorities.

4.6 The scoring matrix below will be used to assess all bids against the ‘Other Spend’ category:

Criteria	Description	Weighting
1. Benefits	How does bid achieve 3 key drivers of Bold Steps for Kent and any relevant underlying strategies? What are the social/economic outputs? How does it improve service delivery and/or contribute towards long term service provision and integration of services? Does the bid consider the wider organisation and other similar projects and strategies to ensure a joined up approach?	50%
2. Invest to Save	Do the savings generated from the project fund the prudential borrowing/debt costs, and generate ongoing savings in addition to that?	15%
3. Delivery	Has an achievable delivery mechanism been identified? Have all the delivery options been considered?	20%
4. Value for Money	Not only about initial capital cost, but also whole-life cost (and payback period if relevant) and ongoing revenue implications. Is there any match funding?	15%

4.7 **Encouraging innovative ideas**

Another dimension to how we put the available headroom to best use is being more creative with the use of banding and specific pots of money within the capital programme.

A pot of £5m has been set aside in the 2013-16 capital programme for people to bid against at intervals throughout 2013/14. With the organisation changing so fast, it is possible that opportunities will be missed on our static business cycle. Creating this process in addition to the annual cycle enables the organisation to be more flexible and agile, and encourages creativity. This also creates more regular opportunities for bids to be re-worked if not quite right the first time or if opportunities for collaboration are identified, and to come back in a relatively short time period for bid to be reassessed. This pot will not be funded from borrowing.

5.0 Governance and process

In order to deliver the strategy, there will be a strong “one route” governance framework. This will ensure that decisions taken are agreed by the right people at the right point, to ensure that the agreed strategy for the capital programme is delivered.