

Capital Programme Strategy

Introduction

- 1.1 The Capital Programme has invested on average £200m per annum over the last three years. The most significant areas of capital investment have been, and continue to be, in schools and highways. In order to provide more stability to services in light of the one-year spending plans from Government, the capital programme now looks at a ten-year planning window, with greater detail in years 1-3.

Capital Strategy Principles

- 1.2 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 and incorporates requirements from the prudential system. Prudential Indicators which are required under the 2017 Prudential Code are included within the Capital Strategy (see Appendix 1).

- 1.3 The core principles of the Council's Capital Strategy are as follows:

The Capital Strategy will:

- Be based on delivering the Council's strategic priorities,
- Set out and deliver its statutory responsibilities on a risk-based approach,
- Ensure the capital programme is long term (10 years), deliverable, realistic and affordable,
- Exclude property investments where loans are provided to third parties, such as No Use Empty – these will be considered as part of the Treasury Management Strategy,
- View borrowing as a last resort – affordability across the medium to long term will be key.

- 1.4 The development of the capital strategy is underpinned by a number of actions that will be undertaken during the year:

- An evaluation matrix based on the priorities agreed by Members will be developed,
- The evaluation matrix will be used to evaluate bids and make recommendations to the Corporate Management Team and Corporate Board,
- A rolling 10-year capital programme will be developed and updated annually,
- The planning and delivery timescales of all capital projects will be reviewed and revised to minimise slippage,

- The monitoring and reporting requirements will be reviewed and revised to provide a council wide position,
- Set up an earmarked fund for feasibilities to ensure more robust estimates and achieve more realistic planning and delivery,
- Set up an earmarked fund for ICT linked to the Technology Strategy and Technology Strategy Board.

The Council's Strategic Outcomes

- 1.5 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.
- 1.6 As work on the new five-year strategic statement develops for 2020-2025, the capital strategy will be refreshed annually to incorporate this, and the capital programme will continue to be aligned with the 3-year rolling Strategic Delivery Plan.
- 1.7 Capital investment should also evidence how it will support the priorities and principles set out in significant strategies. The following are examples of the Council's key strategies:
- Kent and Medway Growth and Infrastructure Framework – this sets out the future strategic infrastructure requirements for the county
 - Local Transport Plan 4 – this plan sets out strategic transport priorities
 - Commissioning Plan for Education Provision – this sets out changes to existing schools and commissioning of new schools
 - Kent Environment Strategy – this sets out priorities to support economic growth whilst protecting and enhancing Kent's environment
 - ICT Strategy – this sets out how innovation in technology will support the delivery of the Council's strategic priorities outcomes
 - Asset Management Strategy – this sets the framework for managing the Council's property portfolio effectively

Affordability

- 1.8 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" – 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 service provision, and this is considered alongside revenue pressures.

- 1.9 In assessing affordability, indicators set by the Prudential Code and the Council's own internal set of fiscal indicators need to be considered. The fiscal indicator "net debt costs should not exceed 15% of net revenue spending" is key to capital investment decisions, and should be seen as a ceiling. This indicator was calculated in times of austerity to allow capital investment to continue to avoid significant increases to backlogs in terms of maintenance of highways and structures and of the office estate. As the period of fiscal restraint lengthened the aim was to stay well within this limit. In recent years this indicator has been reducing as a positive result of prudent spending.
- 1.10 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, with project plans to support this. If a project slips, funding assigned to that project could have been attributed to other worthy projects that were ready to proceed. 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.

Statutory Requirements

- 1.11 The Council will ensure that appropriate capital funding is allocated on a risk based approach, to meet 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, whilst there may be 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. Funding for capital projects will be applied in the most logical and efficient way, for example, to use specific grants for their intended purpose or time limited funding first, and where grant is not sufficient other sources of external funding will be explored, before using the Council's resources.

Invest/Spend to save bids

- 1.12 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 and strategic priorities. 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 realistically achievable within a reasonable period.

Enhancement of Existing Estate and Roads

- 1.13 Maintenance of the estate and highway roads and structures network is coming under increasing pressure following years of reactive works. The development of a longer-term capital planning period will help provide the service with future funding stability and the ability to highlight forthcoming pressures for early consideration by Members. The level of investment in this area will ensure our statutory responsibilities are met, again using a risk-based approach.

Funding

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

Borrowing

- 1.15 The Council currently has external borrowing of just under £900m and a further circa £163m of internal debt (including Private Finance Initiative and leases). This results in a Capital Financing Requirement (CFR) of £1.3bn in 2019-20. The Council's fiscal rule is that net debt costs must not exceed 15% of the net revenue budget. 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 for 25 years, when considering borrowing the Prudential Code must be taken into account. In line with the Code, borrowing is not undertaken in advance of need. The longer term capital programme planning period will assist in more effective management of borrowing levels over the longer term.

Grants

- 1.16 The challenging financial environment means that national government grants are reducing or changing in nature and becoming more heavily prescribed. These prescriptions reduce the freedom to decide where and how to spend grants— 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 Local Enterprise Partnerships (LEPs). This funding is specific to individual projects and has to be closely monitored. The Council's aim is to use other, less specific grants for their intended purpose in a way that meets 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 using the Council's resources such as capital receipts and borrowing.

Developer Contributions: Community Infrastructure Levy (CIL)/S106

- 1.17 Developer contributions continue to be a challenging issue and need careful consideration when they are put forward to fund major projects. The nature of s106 agreements means 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 completed. Depending on size, a development can take several years to be fully completed. Developer contributions will be built into the programme at the point 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.
- 1.18 Any forward funding arrangements of developer contributions must be approved 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.
- 1.19 The Government intends to largely replace the use of s106 agreements with 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 the Council 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.
- 1.20 The latest regulations on developer contributions have removed the “pooling restriction” which prevented local authorities using more than five section 106 obligations to fund a single infrastructure project. This is a positive move as it will help to unlock funds. However, the monitoring requirements have increased significantly, and revised arrangements will need to be put in place to ensure compliance with the new regulations.

Capital Receipts

- 1.21 The Council 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 surplus assets have already been sold. Increasingly capital receipts will need to be generated 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. The Council’s Infrastructure division will continue to work with 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 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)

The Council is an active partner in the One Public Estate “Kent Estates Partnership”; other partners include District Councils, and the NHS. The One Public Estate Programme aims to improve the 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 the viability of marginal projects, masterplan and extend scope to include other partners etc. Within its Asset Utilisation and Disposal work streams, the Council 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 them within the One Public estate work stream.

- Transformational Reviews

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

- Property Investment Fund

The Property Investment Fund (comprising PIF I and PIF II), which is part of our current capital programme, aims to achieve a net revenue income and/or to maximise the capital return from various investment opportunities. These may include (but are not limited to) commercial investments, properties/sites where there is potential to add value (e.g. through gaining planning permission prior to disposal) and surplus properties available from public sector partners.

The Property Investment Fund is currently capped, and any surplus capital generated on the sale of each investment (i.e. after initial acquisition and development costs) is released back to the Council. If the Fund were to reinvest all of its returns, 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, although the risks are also increased.

- Strategic Acquisitions

This strategy also makes provision for the acquisition of strategic assets, where business cases will be subject to approval by external review to ensure that these generate an income stream and will not create a financial burden on the County Council. That is, income streams must cover the total debt costs, including the minimum revenue provision over the medium term, and the short term consequences will have to be reflected in the medium term revenue budget. The external advisors will be appointed by the S151 Officer.

The approval process and tests that need to be satisfied for the business case to proceed are as follows:

- a) That the rate of return meets the set criteria
- b) That all revenue costs are identified including debt costs and are covered by the income stream
- c) Signed approval of business case by external company review
- d) Sign off by S151 Officer
- e) Sign off by Head of Paid Service
- f) Sign off by Monitoring Officer
- g) Approval through the appropriate formal governance route

As and when these business cases are agreed, they will be added to the capital programme.

With financial return being the main objective, the Council accepts higher risk on commercial investment. The principal risk exposures include void periods when properties are empty and falls in capital values. These risks are managed by a rigorous appraisal process prior to any acquisition decision.

- Disposal Strategy

As part of its disposal strategy the Council has identified that there may be opportunities to further maximise the capital return from its assets through participating in development activity, either directly or through partnering arrangements with third parties. This may include the establishment of joint venture(s) and other company structures.

Other potential funding sources to be further explored:

Business Rates Growth Pool

- 1.22 The business rate growth pool which was developed with districts continues to be a success. In 2019-20 the pool enabled an estimated additional £10m 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.

Public Partnerships

- 1.23 The Council has been developing various strategic relationships with other public sector bodies (primarily the NHS through the Sustainability and Transformation Partnership) which have the potential to generate an enhanced capital receipt for the Council, to reduce the Council'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 Council's superior covenant strength (with the Council retaining the additional capital receipt).
- Utilising the Council'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 in order to generating greater gains.
- Funding partners' invest to save projects (and taking a share of the gains).
- Developing joint service initiatives that generate savings (including a reduced requirement for space).
- Removing duplication in services and/or solving joint problems again to generate savings (including a reduced requirement for space).

Privately Funded Initiatives

- 1.24 There are a number of ways in which the Council can work with the private sector to leverage private sector capital funding. The majority of opportunities will involve the Council (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 Council is restricted.

1.25 Other opportunities include:

- Using Council 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 the Council may make the rest of the investment attractive to the private sector. The Council 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. The Council's contribution to the partnership would be low cost borrowing (in return for guaranteed repayments). The Council 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 Social Impact bonds, that are available to Councils.

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

Other Sources

1.27 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

1.28 The governance arrangements for the capital programme are as set out in the Council's constitution.