Appendix 11a

Teignbridge District Council Capital Strategy 2018-19 to 2020-21

Background

Local authorities are required by regulation to have regard for CIPFA's Prudential Code. The updated 2017 version requires that local authorities have in place a capital strategy. This is in order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and overall organisational strategy and resources. The aim is to ensure decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority.

Purpose

The Teignbridge Medium Term Financial Plan shows how the council can prepare for the grant reductions and anticipated central government funding regime by continuing to make savings and generate income. The proposals within it allow increased capital investment over the next 3 years. The capital strategy sits alongside the Medium Term Financial Plan and Capital Programme. It is intended to give an overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services, along with an overview of how associated risk is managed.

1. Capital Expenditure

1.1 Strategic factors

The capital programme is included at Appendix 7 of the budget papers. The capital strategy which underpins it is driven by a number of factors:

> **The Teignbridge District Council ten year strategy**, or "Teignbridge Ten". These overarching projects aim to focus our resources to shape services to withstand future technological, economic and social changes, championing the district, our people, environment, business and heritage. Projects within the capital programme which reflect this include provisions for significant investment in town centres and employment land, flood alleviation, housing grants and affordable housing.
>
> **The Local Plan**, which guides development in the district, setting out policies, proposals and actions to meet the environmental, social and economic challenges facing the area. This includes supporting infrastructure for proposed developments. The capital programme shows contributions to a new railway station at Marsh Barton and provisions for improvements to the A382, education in South West Exeter and the wider Teignbridge area, green spaces, sports and leisure facilities and cycle routes.
>
> **The council's asset management plan**, which sets out the council's approach to the strategic management of its land and building assets. It aims to ensure the council maximises use and efficiency of its property portfolio, making a long term positive contribution to service delivery. The capital programme includes items which invest in council buildings, such as the provision for heating improvement at Forde House. The capital programme is supported by any capital receipts arising from the disposal of assets.

Teignbridge District Council Capital Strategy 2018-19 to 2020-21

The council's investment strategy. The council is in the early stages of formulating and developing an investment strategy. The aim would be to increase revenue streams through the acquisition of a balanced range of commercial property assets in order to support service delivery and allow future revenue contributions to its capital programme.

The council's Medium Term Financial Plan – the programme must be affordable within the council's overall budget plans. This means that business cases for projects funded by borrowing must demonstrate that they will cover the revenue costs associated with borrowing over the life of the asset.

CIPFA and Government guidance – the council must have regard to both CIPFA's Prudential Code (capital expenditure and financing) and its Treasury Management Code (the management of borrowing, investments and cash flow). Both of these Codes were recently updated at the end of 2017. In addition the Ministry of Housing, Communities and Local Government (MHCLG) issued updated statutory guidance on investments and minimum revenue provision in February 2018.

1.2 Governance

Responsibility for decision-making and ongoing monitoring in respect of capital expenditure, investment and borrowing, including prudential indicators remains with Full Council. Each year, the budget process reports to Full Council across a range of strategies and information which is relevant to capital expenditure, investment plans and financing implications, to ensure that decisions are taken in accordance with good professional practice and in full understanding of the risks involved.

The capital programme is considered annually by Full Council. Updates are reported to CLT and Executive throughout the year, with any budgetary changes approved by reference to the virement rules in the financial instructions. Separate reports are brought back to Full Council for approval for any larger projects (over £250k).

The Treasury Management strategy, which sets out policies relating to the management of investments, balancing security, liquidity and yield. This is approved annually by Full Council and includes the approved lending list and the council's approach to borrowing. Updates are brought to Executive throughout the year as necessary.

The Minimum Revenue Provision Statement sets out the council's method of making prudent provision from revenue in respect of capital expenditure financed by borrowing or credit arrangements. Any changes are required to be approved by Full Council.

The Prudential Indicators aim to demonstrate whether the Council has fulfilled the objectives of an affordable, prudent and sustainable approach to capital expenditure, investment and debt. Any revisions are required to be approved by Full Council.

Appendix 11a

Teignbridge District Council Capital Strategy 2018-19 to 2020-21

Role of the Capital Review Group

Teignbridge District Council operates a Capital Review Group (CRG), with members including senior officers across a range of services. Its role is to consider and prioritise capital proposals, ensuring that proper option appraisals are carried out and that they have considered in sufficient detail those matters which are required to be taken into account by the Prudential Code:

- Strategic service objectives
- Stewardship of assets
- Value for money (option appraisals)
- Prudence and sustainability (including external debt implications and impact on revenue budgets)
- Affordability
- Practicality (including staff resource requirements)

Proposals must follow the Capital project reporting flow chart as per the Financial Instructions. An initial Outline Proposal Form is followed up by a financial appraisal and Project Initiation Document (PID) as required. The CRG ensures early wide consideration, including the Corporate Leadership Team (CLT). Stage 2 of the flow chart ensures the correct level of approval as per the Council's constitution.

The CRG also monitors the existing capital programme to ensure its continued relevance, consider the progress of schemes including variations and re-phasing and to identify or reallocate unused resources.

The role of the CRG is crucial to ensuring that the risks associated with capital investments are mitigated. It ensures that projects demonstrate affordability, that there is wide consultation to ensure proper procedures are followed, for example tender processes, legal and financial matters. It also considers whether there are sufficient resources for effective project management and delivery.

1.3 Policies on Capitalisation

The Council's accounts are required to be prepared in accordance with proper accounting practices. For capital, these practices are governed by the Local Authorities (Capital Finance and Accounting)(England) Regulations 2003 (SI 2003 No 3146, as amended) supported by International Financial Reporting Standards (IFRS). Local authorities must also have regard to CIPFA's Prudential Code.

The Council's Statement of Accounts includes detailed policies on the treatment of different asset classes. Capital documentation such as the outline proposal form is considered by the Capital Review Group to ensure that projects meet the requirements for capital expenditure. There are three routes by which expenditure might qualify as capital:

The expenditure results in the acquisition of, or the addition of subsequent costs to non-current assets in accordance with proper practices.

Teignbridge District Council Capital Strategy 2018-19 to 2020-21

REFCUS expenditure (Revenue Expenditure Funded from Capital Under Statute): These are arrangements which recognise that some expenditure incurred by local authorities has a wider, lasting public benefit than is reflected in the accounting rules for non-current assets, for example grants and loans and expenditure on non-Council assets.

The Secretary of State makes a direction that the expenditure can be treated as capital expenditure.

The Council's de minimus for capital is £10,000.

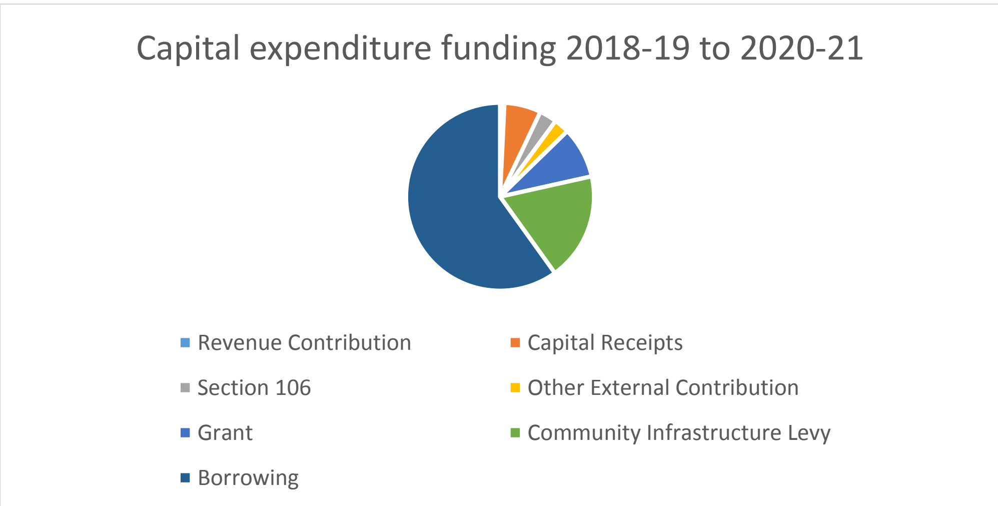
1.4 Capital Expenditure Plans and Financing Strategies

The Council's capital expenditure plans for the 3 years of the Medium Term Financial Plan and capital programme amount to £72.6 million, summarised in the table below:

Capital Expenditure and Financing (Estimate)	2018-19	2019-20	2020-21	2018-21 Total
	£'000	£'000	£'000	£'000
Total Expenditure	**35,142**	**28,391**	**9,076**	**72,609**
Revenue Contribution	(550)	-	-	**(550)**
Capital Receipts	(2,916)	(1,184)	(484)	**(4,584)**
Section 106	(1,780)	(392)	(15)	**(2,187)**
Other External Contribution	(1,400)	(510)	-	**(1,910)**
Grant	(1,987)	(2,679)	(1,724)	**(6,390)**
Community Infrastructure Levy	(2,909)	(3,724)	(6,853)	**(13,486)**
Borrowing	(23,600)	(19,902)	-	**(43,502)**
Total Funding	**(35,142)**	**(28,391)**	**(9,076)**	**(72,609)**

Sources of funding

The programme is funded from a combination of capital receipts, revenue contributions, grants and external contributions, Community Infrastructure Levy (CIL) and borrowing. These are explained in further detail below.



Teignbridge District Council Capital Strategy 2018-19 to 2020-21

Community Infrastructure Levy (CIL) is a charge on new development which aims to ensure that it contributes to the provision of essential local facilities. It must be spent on infrastructure. Under the current system, local authorities are not permitted to borrow against the receipt of future CIL. The council is aware that the government is committed to responding to the recent CIL review, which may address this issue. Teignbridge's priorities for CIL expenditure are available on the Council's website and reflect the needs identified in the Infrastructure Delivery Plan which supports the Teignbridge Local Plan. Projects include provision of Suitable Alternative Natural Green Spaces, habitat mitigation, leisure provision such as playing pitches and parks, education infrastructure and improvements to local roads and rail, infrastructure for cycling, walking and public transport. CIL projects often involve working together with other organisations, such as the Habitat Mitigation Executive and Devon County Council to achieve improvements across a wide range of infrastructure.

Section 106 contributions are received from developers in relation to specific needs such as leisure and open space improvements, affordable housing, air quality and drainage improvements.

Grants and external contributions are received from a range of government and agency sources towards expenditure such as Disabled Facilities Grants, flood alleviation and prevention and open space and leisure improvements.

Capital schemes funded by CIL, Section 106 contributions, grants or external contributions are required to follow the capital approval process to ensure that the matters which the Prudential Code requires to be taken into account are considered. For example, strategic service objectives, revenue budget implications and the practicalities of delivery.

Teignbridge Capital Funding. There are two ways in which the council can directly contribute to capital projects. **Capital Receipts** are funds which result from events such as the disposal of assets or the repayment of loans which were made for a capital purpose. The Council also receives Right to Buy receipts, allocated to Housing. The council had £3.8 million capital receipts at the start of 2017-18. It is currently forecast that General Fund capital receipts will largely be used by the end of the current Medium Term Financial Plan. In order for Teignbridge to continue to benefit from capital investment, the council is budgeting £2 million **Revenue Contribution** to capital over the same period, towards both projects on the forward programme and earlier expenditure which has not yet been funded by the methods above. Projects funded by capital receipts and revenue contributions include contributions to superfast Broadband provision, car park improvements, improvements to Council buildings and equipment including IT projects, discretionary Housing grants, affordable housing contributions, contributions to grant schemes as "match" funding.

Borrowing

Projects which are not funded by one of the sources above are initially funded by borrowing and must first demonstrate a sound business case during the capital approval process. This is because there are revenue budget implications associated with borrowing. Both the principal borrowed and interest costs will have to be repaid and it is essential that the capital programme remains affordable, prudent and sustainable with regard to:

- Capital financing costs, eg. interest
- Loss of investment income
- Other income and costs eg. rent, fees & charges, salaries, rates, energy and maintenance arising from the investment
- MRP – this is the statutory requirement to charge the revenue account with the principal cost of capital expenditure which has not been met from grants, contributions or capital receipts. It is explained in the Council's Minimum Revenue Provision statement.

Business cases must demonstrate a scheme's ability to cover all the relevant costs above for the whole life of the asset.

Projects funded from borrowing are driven by the Teignbridge 10 "Investing in Prosperity" goal and the council's developing Investment Strategy. They aim to bring a broad range of economic benefits such as continued growth in local jobs, business expansion and wealth creation as well as improving the Council's income resilience against the challenge of lower government funding. Projects include town centre improvements and commercial and industrial estates.

The council's approach to borrowing is laid out in Appendix 11 of the budget papers – the Treasury Management Strategy. See also Section 2 below for a projection of the Council's borrowing requirements.

1.5 Asset Management Planning

The Council's approach to its strategic management of its land and building assets is set out in the Asset Management Plan. This plan is currently being updated. It seeks to make sure the Council and its communities get the best use out of property assets. It also aspires to ensure property assets are used in the most effective and efficient way to support service strategies and policies and our community and strategic public sector partners.

Property represents the Council's largest physical resource in financial terms. It supports and underpins all of our service activities. Strategic Asset Management must therefore be an integral element of high quality service planning aligning the disposition, quality and effectiveness of property assets with ongoing service strategies.

Property assets are expensive, in terms of both their capital value and revenue costs; they need to be carefully managed over their lives to ensure best value through their use, maintenance and generation of income. Any disposal of assets will result in capital receipts, which can then be reinvested in the capital programme. There need to be realistic assumptions about the achievable capital receipts which council assets can deliver. These values should be constantly updated to inform the capital programme.

Teignbridge District Council Capital Strategy 2018-19 to 2020-21

1.6 Investment Strategy

As stated above the council is in the early stages of developing an investment strategy, the aim of which would be to increase revenue streams to contribute to the financial sustainability of the Council, enabling it to continue to deliver and/or improve frontline services in line with ten-year "Teignbridge 10" strategy. Any investment portfolio would need to ensure a balanced range of commercial property assets, mitigating the risks of investment through diversity of both sector and geographic area. As the portfolio would be held for investment purposes, properties would be managed on a fully commercial and tenant-repairing basis. The assets sought would predominantly be funded through borrowing, therefore business cases would need to demonstrate an agreed minimum investment yield to make satisfactory contributions to the council's budget. This would be rigorously investigated during the due diligence phase and monitored to ensure that both yield and market value perform as anticipated.

2. Debt, Borrowing and Treasury Management

2.1 Projection of borrowing requirements

Previous capital projects such as the purchase of Market Walk mean that Teignbridge District Council has an underlying need to borrow. In addition, the capital programme contains projects which would not be immediately funded by grants, contributions, capital receipts or revenue contributions. When taken together, the current underlying need to borrow and projected borrowing from the capital programme give an estimate of the council's future borrowing requirements. The table below divides this between the amount it is estimated we could fund internally from our other cash balances and the amount we would seek to borrow externally.

	2018-19	2019-20	2020-21
	£'000	£'000	£'000
Capital Financing Requirement (total cumulative underlying need to borrow).	43,254	61,948	66,831
Estimated internal borrowing and prudential adjustments	16,922	14,922	12,922
Estimated external borrowing	26,332	47,026	53,909

Acceptable sources of loans are the Public Works Loans Board, the emerging UK Municipal Bonds Agency, local authorities, public bodies and UK banks and building societies.

Appendix 11a

Teignbridge District Council Capital Strategy 2018-19 to 2020-21

2.2 Implications of borrowing

2.2.1 Minimum Revenue Provision (MRP)

All capital expenditure has to be financed from capital receipts, grants and contributions (such as S106 and CIL) or eventually from revenue income. Where local authorities borrow to fund capital expenditure, there is a requirement to ensure that they put aside enough revenue money over time to cover those debts. This is MRP and the broad aim is to ensure that the period over which it is charged is commensurate with the period over which the capital expenditure provides benefits.

The Local Government Act 2003 requires the council to have regard to the Ministry of Housing, Communities and Local Government's (MHCLG) Guidance on MRP. This guidance requires the council to approve an annual MRP statement and recommends a number of options for calculating the required prudent provision, while also not ruling out other methods should they be deemed more appropriate. This is discussed in more depth in the council's Minimum Revenue Provision Statement.

The majority of the council's current and projected underlying need to borrow arises from investment in assets which could be sold to repay any outstanding debt liabilities. Where this is the case, Teignbridge proposes that payments made in respect of providing a fund against differentials in value (such as improvements which do not add value or market fluctuations or the purchasing costs of new investment assets), will be paid into an earmarked reserve. This protects the council's revenue budgets, demonstrating prudence. The value of the reserve will be dependent upon the calculation of appropriate payments, taking into account the valuation and useful economic life of each relevant unfunded asset. It will vary according to the accumulation and use of these sums.

The council has taken into account the recently updated MHCLG Statutory Guidance on Local Government Investments and Minimum Revenue Provision.

2.2.2 Interest payable

Based on the projected borrowing discussed above and a maturity structure which is spread to mitigate against interest rate risk, it is calculated that interest payable would be £560k in 2018-19, rising to £1,000k in 2019-20 and £1,146k in 2020-21.

It should be borne in mind that the business cases for each project would need to demonstrate that they would achieve sufficient return to cover interest costs and any MRP.

2.2.3 Proportionality

In its new investment guidance, MHCLG introduces the concept of proportionality. This is to allow assessment of the contribution of yield-bearing investments to the achievement of a balanced budget.

Net income (excluding finance costs) resulting from the Council's purchase of Market Walk provides a minimum of a 5% contribution to the Council's net service cost over the Medium Term financial plan. The Council has chosen to forego treasury management interest in order to fund the underlying need to borrow from other balances in the medium term. Based on the average treasury management interest rate received during the first half of 2017-18, interest foregone would be in the region of £34,000 per annum. However, it should be noted that base rate has risen and is likely to rise again, which would increase this figure.

The purchase of Market Walk contributes to the Teignbridge Ten strategic priorities, so is not viewed as a wholly non-core investment.

2.2.4 Prudential Indicators

The Local Government Act 2003 requires the council to have regard to CIPFA's Prudential Code. Its objectives are to ensure, within a clear framework, that the capital expenditure plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice, with an understanding of the risks involved. Local authorities must look at capital expenditure and investment plans in the light of overall organisational strategy and resources, ensuring decisions are made with sufficient regard to the long run financing implications and potential risks to the authority.

To that end, the Prudential Code sets out indicators which must be approved by Full Council and factors which must be taken into account. The factors which must be taken into account underpin the work of the Capital Review Group (see above).

In setting its Prudential Indicators, the council sets borrowing limits which are affordable and sustainable. The authorised (absolute) limit and operational (day-to-day) boundary are consistent with the council's capital programme and treasury management strategy.

Estimates of capital expenditure and the capital financing requirement bring together past and future capital commitments for consideration of affordability.

The treasury management prudential indicators are designed to deliver accountability in taking capital financing, borrowing and treasury management decisions. They also highlight possible risks such as interest rate exposure and demonstrate the policies in place to mitigate the risks, for example, limiting the length of investments and the maturity structure of borrowing.

2.3 Treasury Management

Management of the Council's cash balances and borrowing is governed by the Treasury Management strategy. The council's investment priorities relating to this area are security of the principal sums and liquidity, keeping money readily available for expenditure when needed. Yield becomes a consideration after the priorities have been satisfied. Investments are "specified" as defined in the MHCLG 2018 investment guidance; in sterling, with a maturity of no more than one year, placed with the UK government, other local authorities or bodies and investment schemes of high credit quality, determined by the lending list, which is reviewed quarterly and updated as necessary.

Teignbridge District Council Capital Strategy 2018-19 to 2020-21

The council's Treasury Management schedules require that institutions meet the following minimum ratings from the ratings agencies:

Ratings Agency	Long Term	Short Term	Baseline Credit Assessme Bank viability
Fitch	BBB	F2	bbb
Moody's	Baa2	P2	baa2

In addition to considering ratings from agencies, use is made of market indicators (share prices and credit default swap pricing) where available. Financial news is monitored in sector journals and the quality press. Daily relevant financial news updates are received by email from brokers and the Council's bank. Teignbridge District Council does not use external treasury management advisors.

The Treasury Management strategy also sets out the Council's approach to borrowing and is underpinned by the Prudential Code and MHCLG investment guidance. Any decision to borrow in advance for capital projects or debt maturities would only occur if there was a clear business case to do so. Borrowing may occur to cover temporary shortfalls in cash balances.

The Council will adopt a flexible approach to borrowing, making use of internal resources and keeping shorter term borrowing under review in comparison to longer term borrowing costs. This approach is to minimise financing costs and to spread re-financing risk. Acceptable sources of loans as stated in the Treasury Management schedules are the PWLB, the UK Municipal Bonds Agency, local authorities, public bodies and UK banks and building societies. Officers will also review alternative sources of borrowing and select those offering the best value for money to the Council at the time the funding is required.

The latest Treasury Management Code includes investments which fall outside normal treasury management activity. Commercial investments for financial benefit rather than for service outcomes are sometimes entered into outside of normal treasury management activity. These need careful financial risk assessment. Where such investments do not give priority for security and liquidity over yield, CIPFA recommends that such a decision should be explicit, setting out the risks and the impact on financial sustainability. This is a critical purpose of due diligence procedures.

3. Knowledge and Skills

The Prudential Code requires that the capital strategy gives details of the knowledge and skills available to the authority and confirmation that they are commensurate with its risk appetite.

As a district council, Teignbridge strikes a balance between the retention of suitably qualified staff and the use of external expertise where this offers best value and flexible use of resources.

Treasury management staff receive internal training from experienced staff and managers. Staffing is arranged so that a bank signatory (all experienced managers), is always available for consultation on decisions. Procedure and system notes, together with official guidance from CIPFA and the MHCLG are maintained for consultation within the section. These are updated for any changes, which are also communicated to the relevant staff. Bank signatories are professionally qualified accountants, with the officers carrying out daily procedures either studying with or AAT-qualified.

In terms of capital expenditure, the Council has the benefit of the experience of three fully qualified chartered accountants and six AAT-qualified members of staff. It also has access to specialist advice through subscription to consultants who specialise in local authority accounting and capital finance. In addition, knowledge and skills are shared throughout the region via the Devon Accounting Development Group.

In relation to the investment strategy, as well as the experience of RICS-qualified staff, the Council has working relationships with a range of specialist consultants whose areas of expertise include property management, development and infrastructure, investment and valuation.

Council officers across a range of disciplines, including Property and Assets, Planning, Housing and Finance as well as other service areas, make up the Capital Review Group to ensure project appraisal is subject to wide early scrutiny and practical considerations.

The Council's constitution ensures an effective governance process. The chief finance officer is responsible for ensuring that all matters required to be taken into account are reported to the decision-making body (normally Full Council).