APPENDIX B

DRAFT CAPITAL STRATEGY
2019-20 – 2028-29

1. INTRODUCTION AND BACKGROUND

This Capital Strategy is an overarching document which sets the policy framework for the development, management and monitoring of capital investment. The strategy focuses on core principles that underpin the council's capital programme; its short, medium and long-term objectives; the key issues and risks that will impact on the delivery of the programme; and the governance framework required to ensure the capital programme is delivered and provides value for money for residents of Southwark.

The capital strategy aligns with the priorities set out in the Council Plan and other key council strategies. The strategy is integrated with the medium term financial strategy and treasury management strategy.

Council Assembly will agree the capital strategy and programme at least once every four years and as necessary in the event of a significant change in circumstances.

2. CORE PRINCIPLES THAT UNDERPIN THE CAPITAL PROGRAMME

The key principles for the capital programme are summarised below and shown in more detail as Annex A.

- Capital investment decisions reflect the aspirations and priorities included within the Council Plan and supporting strategies
- Schemes to be added to the capital programme will be subject to a gateway process, prioritised according to availability of resources and scheme specific funding, fairer future for all commitments and factors such as legal obligations, health and safety considerations and the longer-term impact on the council's financial position.
- The cost of financing capital schemes, net of revenue benefits, are profiled over the lifetime of each scheme and incorporated into the annual policy and resources strategy and budget.
- Commissioning and procuring for capital schemes will comply with the requirements set out in the council's constitution, financial regulations and contract standing orders.

3. GOVERNANCE FRAMEWORK

The council's constitution requires the Council Assembly to agree the capital strategy and programme at least once every four years and in the event of a significant change in circumstances. The reports from the chief finance officer will consider the compliance of proposed schemes in the programme with the medium term financial strategy, the capital resources available to the council, the revenue implications of the proposed capital expenditure, and any other relevant information.

Democratic decision-making and scrutiny processes provide overall political direction and ensure accountability for investment in the capital programme. These processes include:

- Council Assembly approves the Council Plan which sets out the strategic priorities for the council
- Council Assembly is ultimately responsible for approving the Capital Strategy, Treasury Management Strategy and capital programme
- The Cabinet receives regular capital monitoring reports, approves variations to the programme and considers new bids for inclusion in the capital programme
- Portfolio holders are assigned projects in line with their responsibilities
- Scrutiny committees can call in Cabinet reports, receive and scrutinise reports
- All projects progressing to the capital programme follow the constitution, and financial regulations
- The capital programme is subject to internal and external audit.

Any new capital expenditure is set out as part of a thorough evaluation. The evaluation will outline the key benefits that are expected to arise from this programme in relation to council priorities. The evaluation will include the financial considerations such as the expected cost and funding sources identified. Any risks to either the delivery or cost forecasts are to be considered as part of an evaluation. Approval to spend on individual capital schemes will only be given once procedural guidelines have been complied with and assessed to the satisfaction of the strategic director of finance and governance.

Senior officer teams exist within directorates to monitor the delivery of the directorate capital programme. Directorate management teams must consider and recommend all additions, variations to their directorate capital programme before being agreed by the strategic director of finance and governance and then by cabinet.

4. SHORT, MEDIUM AND LONG-TERM CAPITAL PLANNING OBJECTIVES

The council maintains an approved capital programme that covers a ten year period subject to a minimum four yearly refresh at Council Assembly and annual update by Cabinet.

The capital programme for the council is a long term ambition, with the lifetime of new and existing assets stretching far into the future. The obligation for maintaining and improving council dwellings and operational buildings is very long term and as such should be considered accordingly in financial and asset management planning.

The application and planning for the capital expenditure obligations and objectives for the council can be considered over short, medium and long term time horizons.

<u>Short to medium term (1-3 Years)</u>

Within a shorter timeframe the focus of the capital strategy is towards the delivery and implementation of any capital scheme. At this stage, the management of potential risks in the acquisition or delivery of particular capital schemes is of significant importance for the council.

Within the short term timeframe the capital programme may be amended with the introduction of urgent, high priority capital schemes. The programme will need to be flexible to ensure that the capital programme can incorporate schemes to meet the requirements or opportunities that arise. As part of capital programme and resource management, schemes may be phased over multiple years due to factors such as complexity, resourcing, legal and planning requirements.

Medium to long-term (4-10 Years)

There is typically a long lead time from identifying investment need or opportunity and to implementation. The medium term programme allows the council to develop plans for the delivery and funding across capital projects as well as the contribution of this capital expenditure toward council objectives and individual service priorities.

Early evaluation can be developed to allow the council to assess the expected benefits and costs of capital expenditure. The identification of sources of funding, specific grants, external contributions or revenue budget may be identified to fund capital projects.

The council incorporates the capital programme expenditure and funding projections into medium term cashflow forecasting which in turn feeds into the debt management strategy for the council. Decisions on debt financing will be influenced by capital projections as well as forecast capital receipts.

The ten year capital programme and the implications of the programme for MRP and debt financing costs are incorporated into the medium term financial strategy.

Long Term: 10 Years Plus

The council is currently preparing its New Southwark Plan, a new borough-wide planning and regeneration strategy up to 2033. Once finalised and adopted, it will replace the current local plan.

The council is able to review and develop strategies for meeting investment need in the much longer term where there is considerable uncertainty and complexity, for example understanding economic, social and technological factors that drive regeneration and redevelopment initiatives, long-term planning issues to deliver objectives e.g. the council's ambition to deliver new homes; the rolling HRA business plan which looks to identify over a very long term time horizon the likely financial and housing need provision for the HRA; the joint strategic needs assessment for social care; pupil planning data for the future provision of school places; asset management planning for long-term property need and investment.

There is a clear link between long term planning for capital and for treasury management purposes. The council's debt portfolio contains loans that mature up to 2057-58. The debt repayment profile needs to be managed alongside the longer term expectations for capital expenditure and funding forecasts.

Long-term forecasts are not easily predicted and the accuracy of all financial estimates will be limited. However, long-term forecasting is valuable in informing strategic plans taking account of the cumulative sustainability and affordability of existing and planned investment, which will need to be repaid over future periods. For major projects and investment the funding and financial implications need to be planned well in advance.

5. COUNCIL PLAN CAPITAL INVESTMENT PRIORITIES

Capital investment plans are driven by the Council Plan, the council's key strategic document that sets out the council's vision, ambitions, values and priorities. A refreshed Council Plan is currently being consulted on and will be presented to Council Assembly for approval in the autumn. Key capital commitments in the draft Council Plan include:

- to build more council houses and secure new homes at London Living Rent
- to build a new library and GP health centre on the Aylesbury estate
- to open a new, modern leisure centre at Canada Water
- to open a new secondary school at Borough
- to build a new library on the Walworth Road
- to open a new library at Grove Vale in East Dulwich
- to work with the Mayor of London to build a new pedestrian and cycling bridge from Canada Water to Canary Wharf
- to deliver new affordable business spaces
- to open two nursing homes
- to build extra care housing

6. ASSET MANAGEMENT PLANNING

The overriding objective of asset management within the council is to achieve a corporate portfolio of property assets that is appropriate, fit for purpose and affordable. The council's property portfolio consists of operational property, investment property and property held for specific community or regeneration purposes. The council has specific reasons for owning and retaining property:

- Operational purposes e.g. assets that support core business and service delivery e.g. schools, office buildings.
- Investment properties held to provide a financial return to the council that supports service provision.
- Parks, playgrounds and open spaces.
- Regeneration, enabling strategic place shaping and economic growth.

Asset management is an important part of the council's business management arrangements and is crucial to the delivery of efficient and effective services, the ongoing management and maintenance of capital assets will be considered as part of the strategy. The asset management planning includes an objective to optimise the council's land and property portfolio through proactive estate management and effective corporate arrangements for the acquisition and disposal of land and property assets.

The council will continue to realise the value of any properties that have been declared surplus to requirements in a timely manner, having regard to the prevailing market conditions.

7. COMMERCIAL ACTIVITY AND INVESTMENT PROPERTY

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines investment property as property held solely to earn rentals or for capital appreciation or both. Returns from property ownership can be both income driven (through the receipt of rent) and by way of appreciation of the underlying asset value (capital growth). The combination of these is a consideration in assessing the attractiveness of a property for acquisition.

In the context of the Capital Strategy, the council is using capital to invest in property to provide a positive surplus/financial return. The council may fund the purchase of the property by borrowing money, normally from the Debt Management Office as part of HM Treasury. The rental income paid by the tenant should exceed the cost of repaying the borrowed money each year. The annual surplus then supports the council's budget position, and enables the council to continue to provide services for local people.

The reasons for buying and owning property investments are primarily

- Financial returns to fund services to residents
- Market and economic opportunity.
- Economic development and regeneration activity in the Borough (all investment property is currently located within Southwark)

Historically, property has provided strong investment returns in terms of capital growth generation of stable income. Property investment is not without risk as property values can fall as well as rise and changing economic conditions could cause tenants to leave with properties remaining vacant.

The strategy makes it clear that the council will continue to invest prudently on a commercial basis and to take advantage of opportunities as they present themselves, supported by our robust governance process.

8. LOANS

The council has discretion to make loans for a number of reasons, primarily for economic development. These loans are treated as capital expenditure.

In making loans the council is exposing itself to the risk that the borrower defaults on repayments. The council, in making these loans, must therefore ensure they are prudent and has fully considered the risk implications, with regard to both the individual loan and that the cumulative exposure of the council is proportionate and prudent.

The council will ensure that a full due diligence exercise is undertaken and adequate security is in place. The business case will balance the benefits and risks. All loans are agreed by Cabinet. All loans will be subject to close, regular monitoring.

9. REVENUE BUDGET IMPLICATIONS FROM CAPITAL INVESTMENT DECISIONS

Capital expenditure for the council is financed through a variety of sources, typically

- Receipts from the sale of capital assets
- Capital grants
- External contributions such as S106 or Community Infrastructure Levy
- The use of reserves or from revenue budget contributions

Any capital expenditure not financed by the above will need to be funded by borrowing. Existing council debt is therefore the consequence of historical capital expenditure. The council can temporarily utilise other resources in lieu of external borrowing to fund capital expenditure. This is referred to as internal borrowing.

In approving the inclusion of schemes and projects within the capital programme, the council ensures all of the capital and investment plans are affordable, prudent and sustainable. In doing so the council will take into account the arrangements for the repayment of debt, through a prudent MRP policy in line with MRP guidance produced by the Ministry of Housing, Communities and Local Government.

The capital financing charges and any additional running costs arising from capital investment decisions are incorporated within the annual budget and medium term financial plans. This enables members to consider the consequences of capital investment alongside other competing priorities for revenue funding.

As part of the appraisal process, and at the discretion of the Strategic Director of Finance and Governance, the financing costs of prudential borrowing, may be charged to directorate budgets.

Long Term revenue implications of capital investment decisions

Capital investment decision making is not only about ensuring the initial allocation of capital funds meets the corporate and service priorities but ensuring the asset is fully utilised, sustainable and affordable throughout its whole life. This overarching commitment to long term affordability is a key principle in any capital investment appraisal decision. In making its capital investment decisions the council must have explicit regard to consider all reasonable options available.

10. RISK APPETITE

This section considers the council's risk appetite with regard to its capital investments and commercial activities, i.e. the amount of risk that the council is prepared to accept, tolerate, or be exposed to at any point in time. It is important to note that risk will always exist in some measure and cannot be removed in its entirety.

A risk review is an important aspect of the consideration of any proposed capital or investment proposal. The risks will be considered in line with the risk management strategies we have in place and commensurate with the council's low risk appetite.

Subject to careful due diligence, the council may consider a moderately higher level of risk for strategic initiatives, where there is a direct gain to the council's revenues or the ability to deliver its statutory duties more effectively and efficiently.

11. KNOWLEDGE AND SKILLS

The council has professionally qualified staff across a range of disciplines including finance, legal and property that follow continuous professional development (CPD) and attend courses on an ongoing basis to keep abreast of new developments and skills.

The council establishes project teams from all the professional disciplines from across the council as and when required. External professional advice is taken where required and will always be sought in consideration of any major commercial property investment decision.

Internal and external training is offered to members to ensure they have up to date knowledge and expertise to understand and challenge capital and treasury decisions taken by the strategic director of finance and governance.

Annex A

CORE PRINCIPLES UNDERPINNING THE CAPITAL PROGRAMME

In considering schemes for inclusion in the capital programme, regard will be had to the following principles:

- schemes to be included in the Capital Programme should follow an appropriate level of due diligence and assurance regarding deliverability/practicable
- prior to mobilisation, all projects should be supported by an affordable and sustainable plan, including carefully consideration of value for money and options appraisal
- capital appraisal should promote schemes which provide a direct gain to the council's revenues within agreed risk appetite, e.g. council tax and business rate growth, commercial investment return, "invest to save" outcomes
- environmental and social sustainability issues should be built into project appraisal
- the financial implications of capital investment decisions will be properly appraised as part of the determination process
- available resources will be identified for investment over the capital planning period
- available capital funding will be optimised e.g. through surplus asset disposal strategy, maximising use of planning gain, by corporately pooling capital receipts and by exploring external financing sources
- that capital funding decisions minimise or mitigate the ongoing revenue implications of capital investment decisions
- the financial implications of capital investment decisions should be fully integrated into revenue budget and longer term financial plans
- robust governance arrangements are in place for all programmes and projects, clearly defining responsibility for the delivery of individual schemes within the capital programme
- all capital schemes follow appropriate project management arrangements
- there are effective working relationships with partners
- that projects are reviewed on completion to ensure key learning opportunities are maximised