

**CAPITAL STRATEGY
2020-21 – 2029-30****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.

2. CORE PRINCIPLES THAT UNDERPIN THE CAPITAL PROGRAMME

The key principles for the capital programme are summarised below:

- 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.

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.

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 and capital expenditure is subject to internal and external audit.

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. CAPITAL INVESTMENT PRIORITIES AND PLANS

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 will be considered accordingly in financial and asset management planning.

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. The 2018-2022 Council Plan includes the following key capital commitments:

- 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

The application and planning for the capital expenditure obligations and objectives can be considered over short, medium and long term time horizons. 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. The council maintains an approved capital programme that covers a ten year period. Prudential indicators for capital expenditure and financing are set out in Appendix E.

5. TREASURY MANAGEMENT

Treasury Management is concerned with keeping sufficient but not excessive cash available to meet the council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of resources will be met by prudential borrowing. The council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

Each year the council assembly agrees an annual treasury management strategy covering the management of council debt and cash investments Appendix B.

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

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.

Historically, property has provided strong investment returns in terms of capital growth and generation of stable income. However, 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 investment appraisal, including taking external professional advice, ensuring all investments are in Southwark (local strategic knowledge) and risk assessment ensure that commercial investments remain proportionate to the size of the council and that the revenue impact can be managed should expected yields not arise.

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 AND OTHER LIABILITIES

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.

In addition to debt liabilities set out in the treasury management strategy, the council is committed to making future payments to cover any pension deficit. The pension fund is subject to a triennial valuation and the revenue implications are built into the Medium Term Financial strategy.

9. REVENUE BUDGET IMPLICATIONS

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and Minimum Revenue Provision (or debt repayment in HRA) are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream, i.e. the amount funded from council tax, business rates and general government grants (see Prudential Indicators).

Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend up to 50 years into the future. 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 approving the inclusion of schemes and projects within the capital programme, the strategic director of finance and governance must be satisfied that the proposed capital programme is prudent, affordable and sustainable.

10. 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.