

# **Capital Strategy**

## **2020/21 to 2024/25**

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# Foreword

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Shropshire Council's Capital Strategy considers the local authority's long-term aspirations taking into account corporate objectives, affordability criteria and available resources to guide capital investment decisions over the next five to ten years.

Capital expenditure relates to long term investment in assets and differs completely from the Council's revenue budget as set out in the Council's Financial Strategy. We receive capital grants, apply for capital funding and have the ability to raise capital finance ourselves, either by selling property and other assets that we no longer need, or by borrowing funds to support long-term investment in assets.

The Council has a limited amount of capital receipts to fund the capital programme. Furthermore, any borrowing undertaken needs to be repaid, with interest, and this creates a revenue burden. Together these shift the Council's capital strategy towards commercial considerations i.e. investments that generate a return, rather than investments that create a net revenue cost.

We have a robust process in place to test and consider all capital investment proposals with the underlying requirement that all decisions taken are affordable. A recent example of this was the acquisition of Shrewsbury Shopping Centres - a decision that committed significant amounts of capital expenditure but, nevertheless, generates an income stream to help support service delivery across the Council. The Council's Asset Management Strategy, Economic Growth Strategy and Commercial Strategy are important documents that link together with the Capital Strategy and Treasury Strategy to enable the Council to take long term and large-scale investment decisions in a balanced and well-considered manner.

James Walton

Director of Finance, Governance & Assurance (Section 151 Officer)

# 1. Introduction

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- 1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) published a revised Prudential Code for Capital Finance in Local Authorities (The Code) in 2017. The objectives of the Code are to ensure 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 and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation.
- 1.2 In order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability authorities should have in place a capital strategy that sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.
- 1.3 Over the last five years there has been a growing trend for authorities to acquire land and buildings with the effect of supplementing their revenue budgets with rental income. Often these acquisitions have been supported by borrowing cheaply from the Public Works Loan Board (PWLB).
- 1.4 Questions have been asked about how these transactions fit with the guidance that has been traditionally given that borrowing to make an investment return is not permissible. The Ministry of Housing, Communities and Local Government's (MHCLG) Statutory Guidance on Local Government Investments and CIPFA's Prudential and Treasury Management codes have all been updated recently to address the implications of investment in property.
- 1.5 Alongside these updates, in November 2019 CIPFA issued additional guidance ("Prudential Property Investment") to explain the provisions in the updated Prudential Code and Framework that relate to the acquisition of properties intended to make investment returns and confirm their implications in the light of the growing activity and the changes to statutory guidance.
- 1.6 The capital strategy has been revised to accommodate these updates and additional guidance.
- 1.7 The capital strategy is intended to give a high-level 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 and the implications for future financial sustainability.
- 1.8 Capital investment is technically described as "Expenditure on the acquisition, creation, or enhancement of 'long term assets'". This is items of land, property and plant which have a useful life of more than 1 year.

- 1.9 The Capital Strategy will continue to develop over the coming years as greater certainty over Council resources and responsibilities is ascertained following the roll out of Fair Funding and Business Rates Retention by April 2021. It is anticipated that, in the fulness of time, the arrangements and ambitions set out in this document will be refined to appropriately reflect the nature of Shropshire Council's Capital Strategy over a 5 to 20-year planning horizon.

## 2. Objectives

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2.1 The key aims of the capital strategy are to:

- Provide a clear set of objectives and a framework, within the CIPFA codes and statutory legislation, by which new projects are evaluated to ensure that all new funding is targeted at meeting the priorities of the Councils Corporate Plan;
- Prioritise projects that not only achieve ongoing statutory requirements but also deliver the key underlying objective of all the Council's strategies; to become more financially sustainable.
- Set out how the Council identifies, programmes and prioritises funding requirements and proposals arising from business cases submitted through a Capital Investment Board following a stringent gateway appraisal mechanism comprising of Expression of Interest Case (EOI), Outline Business Case (OBC) and Full Business Case (FBC) before necessary Cabinet and/or Council approval;
- Consider options available for funding expenditure and how resources can be maximised to generate investment. To determine a prudent, affordable and self-sustaining funding policy framework, whilst minimising or mitigating the ongoing revenue implications of any such investment;
- Identify the resources available for investment;
- Ensure the strategy has an overall balance of risk, on a range of projects;
- Establish effective arrangements for the management of expenditure including the assessment of project outcomes, budget profiling, deliverability, value for money, liquidity and yield of investments.

## 3. Asset Management Planning

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*Section still to be updated to align with Asset Management Strategy*

- 3.1 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 latest Asset Management Strategy 2020 – 2025 sets out a portfolio approach and defines five key areas. The five portfolios set out the definition of how and why the property and land is held and for what purposes:
- **Operational** - Efficient, suitable and fit for purpose accommodation for the future delivery of public services.
  - **Heritage** - Community infrastructure for the future, the Council as custodian, manages and invests in these assets for future generations.
  - **Development and regeneration** - Appropriate intervention and enablement to deliver economic growth.
  - **Investment** - In support of the Council's Commercial Strategy, maximising income generating opportunities through appropriate and effective property investment.
  - **Disposal** - To divest, reduce revenue burden and fuel the Council's capital programme.
- 3.2 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.
- 3.3 The Council's Asset Management Strategy sets out the requirements for the continued capital investment in its estate to ensure that its maintained appropriately to manage and mitigate against financial risk from health and safety breaches and / or failure of its landlord responsibilities incurring significant financial burden.
- 3.4 The Council's Asset Management Strategy sets out the requirement for the continued capital investment in its estate to ensure that the revenue income emanating from its property is protected and durable for future years.
- 3.5 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.

- 3.6 When a capital asset is deemed as surplus, it may be sold so that the proceeds, known as capital receipts, can be spent on planned capital expenditure. Repayments of capital grants, loans and investments also generate capital receipts. The Council already has budget commitments within the current capital programme of projects expected to be funded from capital receipts. The current position of expected capital receipts against budget commitments is as follows:

| Detail  | 2019/20<br>£      | 2020/21<br>£      | 2021/22<br>£       | 2022/23<br>£       |
|---|-------------------|-------------------|--------------------|--------------------|
| Corporate Resources Allocated in Capital Programme                              | 8,876,475         | 12,422,575        | 5,400,824          | -                  |
| Capital Receipts used to finance redundancy costs                               | -                 | -                 | -                  | -                  |
| To be allocated from Ring Fenced Receipts                                       | 2,914,688         | 9,027,441         | -                  | -                  |
| <b>Total Commitments</b>  | <b>11,791,163</b> | <b>21,450,016</b> | <b>5,400,824</b>   | -                  |
| <b>Capital Receipts in hand/projected:</b>                                      |                   |                   |                    |                    |
| Brought Forward in hand   | 20,478,421        | 12,649,884        | (4,093,445)        | (9,494,269)        |
| Generated 2019/20YTD  | 3,811,382         | -                 | -                  | -                  |
| Projected - 'Green'   | 151,244           | 4,706,687         | -                  | -                  |
| <b>Total in hand/projected</b>  | <b>24,441,047</b> | <b>17,356,572</b> | <b>(4,093,445)</b> | <b>(9,494,269)</b> |
| Shortfall to be financed from Prudential Borrowing / (Surplus) to carry forward | (12,649,884)      | 4,093,445         | 9,494,269          | 9,494,269          |
| Further Assets Being Considered for Disposal                                    | 2,659,025         | 18,785,460        | 10,453,404         | -                  |

- 3.7 The previous table demonstrates that by 2022/23 the Council will require £9.5m of generated capital receipts to meet its current liabilities within the approved capital programme. Of this budget requirement £32.0m of assets have been identified as surplus to requirements with the potential to dispose, therefore potentially resolving the funding shortfall. However, considerable work will be required to realise these receipts and so minimise the funding shortfall.
- 3.8 Asset Management Planning needs full consideration as part of the Capital Strategy to fund future projects that are deemed unsuitable to be funded from Prudential Borrowing as they neither generate new income nor create revenue savings that will fund the resulting MRP requirement. At the point of considering such projects for inclusion in the Capital Programme, asset disposals to fund these projects will form part of the full appraisal process.



## 4. Commercial Activity & Investment Property

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- 4.1 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.
- 4.2 The reasons for buying and owning property investments are primarily:
- Financial returns to fund services to residents.
  - Economic development and regeneration in the council area.
  - Market and economic opportunity.
- 4.3 The principal reasons for Shropshire Council to buy and own property investments are to secure a continuing service objective, to directly deliver service benefits and to promote economic development and regeneration activity in the Council's area: not primarily to take advantage of market and economic opportunities. Generation of financial returns from a property investment will normally be secondary to these principal reasons and the monies generated utilised to fund services to residents. However, there may be occasions where the Council decides to acquire a commercial investment to purely generate a financial gain.
- 4.4 Local authorities have a range of powers available to them permitting the acquisition of property, powers to undertake income generating and commercial activity and to invest for purposes relevant to their functions, or for the purposes of the prudent management of their financial affairs (Section 12 of the Local Government Act 2011).
- 4.5 Before undertaking any commercial or investment activity, the Council will need to make sure that its proposals are legally compliant: consider any increased risk to the Council; take account of the requirement of its published strategies relevant to the project; and are compliant with other relevant statutory requirements, such as "state aid" rules, i.e. to ensure public funding is not used to subsidise commercial entities operating in a market economy.
- 4.6 Legal advice will be an early aspect of any development of commercial activities or investment projects to ensure the Council will be acting within the legislative framework in undertaking the activity and to inform good decision making. Specialist external advice will be sought as appropriate.
- 4.7 Identification of the relevant statutory powers to be relied upon may impact upon the funding available for a project, including whether the Council is permitted to borrow to fund the investment. The Council will consider the requirements of the statutory codes that comprise the CIPFA prudential framework, including the Prudential Code for Capital Finance in Local Authorities, in addition to the CIPFA guidance on Prudential Property Investment.

- 4.8 In summary, the ability to borrow for an investment will depend on the powers utilised for the acquisition. Where the Council acquires an investment property utilising a power permitting the acquisition of land and building, borrowing will be considered to fund the acquisition, however, where a power permitting the acquisition of investments has been utilised, borrowing will not be considered as a funding option where this constitutes borrowing in advance of need.
- 4.9 Although local authorities are able to acquire land and property both inside and outside their own administrative areas, the Council will limit investments to within its own administrative area.
- 4.10 Historically, property has provided strong investment returns in terms of capital growth and 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.
- 4.11 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.

## 5. Capital & Investment Priorities

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- 5.1 Underlying the Capital and Investment Strategy is the recognition that the financial resources available to meet capital expenditure priorities are constrained by a significant reduction in financial resources. The Council must therefore rely on internal capital resources including borrowing or external funds and seek ways in which all investment decisions can be no less than self-sustaining financially whilst generating significant positive returns in terms of meeting priorities.
- 5.2 The Council will assess its overall approach to investment. This will reflect those investments made into the delivery of services and those designed for a wider economic basis. A balanced portfolio approach to investment will ensure an overall net average return reflecting some investments will yield higher returns than others and limit exposure to volatility in any one area.
- 5.3 The Council envisages that investments can be classified into three main categories being:
- Commercial
  - Transformation
  - Economic Growth

### 5.4 **Commercial**

Commercial investments can be sub-divided into several investment types:

#### *Private Commercial (C1)*

Build, re-develop, manage, sell property for commercial purposes, for which the Council is predominantly seeking a commercial return rather than another factor, such as economic regeneration.

#### *Public Commercial (C2)*

Build, re-develop and manage property specifically designed to deliver services from public sector partners.

#### *Hybrid (C3)*

Develop new and innovative solutions that provide a mix between Council Services, Public Sector, Commercial Return and Place Shaping.

#### *Private Housing (C4)*

Build, re-develop, manage or sell-on residential housing solutions encompassing all development types including high end to affordable, new build to redevelopment of iconic sites.

## 5.5 Transformation

Transformation investments can be sub-divided into several investment types:

### *Non-Property Service Investment (T1)*

Invest in and re-develop direct service delivery, but not necessarily physical assets or property.

### *Assets to Manage Growth (T2)*

Build, re-develop, manage and deliver services from property specifically designed to deliver core Council services with the key objective being arresting growth in service costs.

### *Assets to Manage Rationalisation (T3)*

Build, re-develop, manage and deliver services from property specifically designed to deliver core Council services with the key objective being rationalisation, reduction and efficiency.

## 5.6 Economic Growth

Economic growth investments can be sub-divided into a few investment types:

### *Infrastructure (EG1)*

Build or commission strategic infrastructure within Shropshire, potentially for commercial return, potentially to reduce costs, potentially to create wider strategic opportunity for development.

### *Economic Growth (EG2)*

Build, re-develop, manage, sell property with a focus on place shaping and regeneration that is financially viable in that, as a minimum, it remains affordable and delivers value for money to the Council.

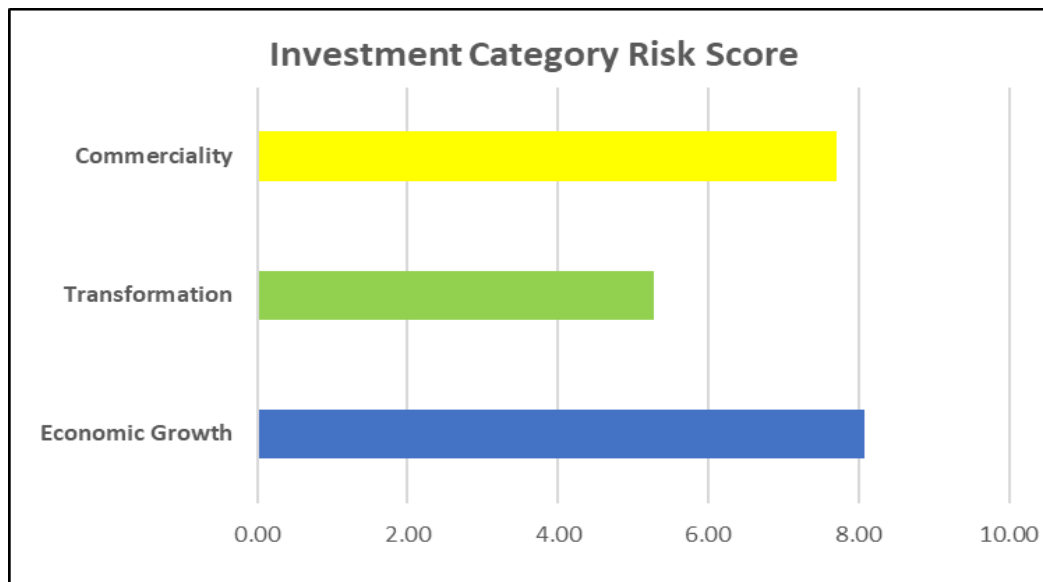
## 5.7 Each investment category and investment type are exposed to the following investment risks:

- Technological - impact of the Fourth Industrial Revolution<sup>1</sup>.
- Demographic - Ageing population.
- Economic - Economic slowdown/slow recovery, death of the high street, Brexit - business investment in the UK and supply chain disruption.
- Employment - Brexit - large scale involuntary reverse migration.
- Governmental - Regulatory/legislative changes and fiscal impacts.

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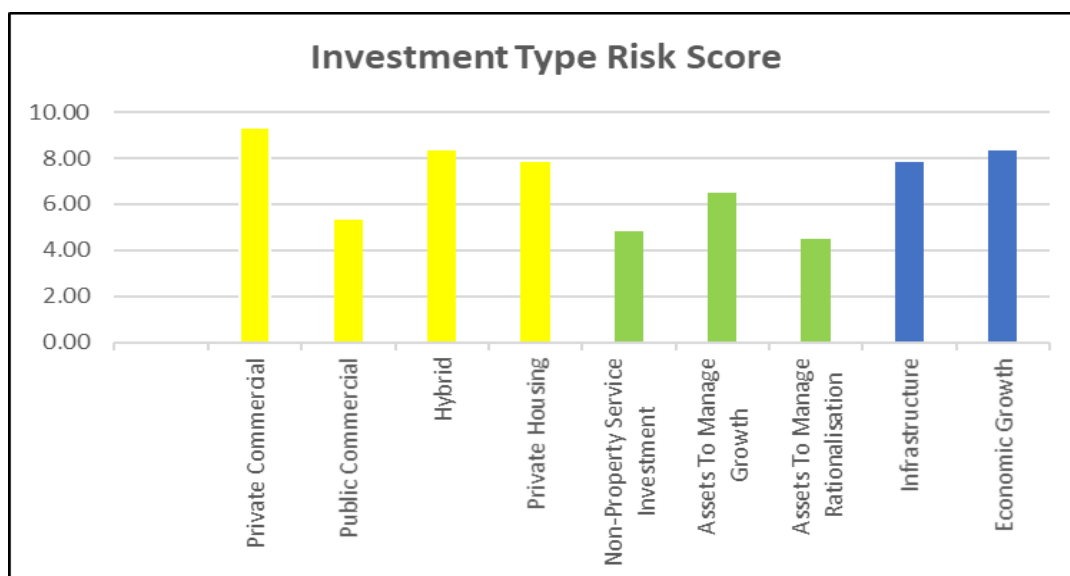
<sup>1</sup> The Fourth Industrial Revolution is the current and developing environment in which disruptive technologies and trends such as the Internet of Things (IoT), robotics, virtual reality (VR) and artificial intelligence (AI) are changing the way we live and work.

- 5.8 The Council has assessed each investment type in terms of the likelihood and impact of each investment risk and so compiled an investment risk score for each investment type and an overall investment risk score for each investment category.
- 5.9 The graph below shows the average investment risk score for each of the three investment categories.



- 5.10 Economic Growth is assessed as the riskiest investment category because of high-risk perception in relation to the impact of the Fourth Industrial Revolution, economic slowdown / slow recovery, death of the high street and Brexit - large scale involuntary reverse migration.
- 5.11 Economic Growth is closely followed by the Commercial investment category as the result of high-risk perception in relation the impact of the Fourth Industrial Revolution, death of the high street, economic slowdown / slow recovery and regulatory / legislative changes.
- 5.12 Unsurprisingly, the investment category with the lowest risk perception is Transformation. Essentially this is the Council investing in existing areas of expertise, i.e. investing in and developing direct service delivery either through non-property or assets to transform services and manage service growth and rationalisation.
- 5.13 Risk is one side of a Risk and Reward assessment that should be made for any proposed investment. It follows that higher risk areas would be expected to deliver a higher financial return. The scope and nature of potential investments that a local authority can make do not necessarily follow this pattern, however, and as such the management of risk at a macro level provides an appropriate level of assurance at early stages of development.
- 5.14 Diversification across all risks is the key to delivering a balanced portfolio of investment across the Council. It follows, however, that low risk, high return proposals, which may centre around investment in local authority and other public sector bodies' assets, could be an acceptable exception to this general rule.

5.15 The following graph shows the average investment risk score for each of the nine investment types.



5.16 The risk scores for the various investment categories and investment types have been utilised to determine proposed, estimated Investment Fund exposure ranges for each investment type as follows:

| Investment Category & Type         | Investment Fund Exposure Range (%) |              | Investment Fund Exposure Range (£150m Investment Fund) |             |
|------------------------------------|------------------------------------|--------------|--|-------------|
|                                    | Minimum %                          | Maximum %    | Minimum £m   | Maximum £m  |
| <b>Commercial</b>                  | <b>34.0%</b>                       | <b>44.0%</b> | <b>51.0</b>  | <b>66.0</b> |
| - Private Commercial               | 6.3%                               | 9.3%         | 9.5  | 14.0        |
| - Public Commercial                | 12.2%                              | 15.2%        | 18.2   | 22.7        |
| - Hybrid                           | 7.2%                               | 10.2%        | 10.9   | 15.4        |
| - Private Housing                  | 7.8%                               | 10.8%        | 11.7   | 16.2        |
| <b>Transformation</b>              | <b>38.0%</b>                       | <b>48.0%</b> | <b>57.0</b>  | <b>72.0</b> |
| - Non-Property Service Investment  | 13.1%                              | 17.1%        | 19.6   | 25.6        |
| - Assets To Manage Growth          | 9.2%                               | 13.2%        | 13.8   | 19.8        |
| - Assets To Manage Rationalisation | 14.2%                              | 18.2%        | 21.3   | 27.3        |
| <b>Economic Growth</b>             | <b>13.0%</b>                       | <b>23.0%</b> | <b>19.5</b>  | <b>34.5</b> |
| - Infrastructure                   | 6.3%                               | 12.3%        | 9.4  | 18.4        |
| - Economic Growth                  | 5.7%                               | 11.7%        | 8.6  | 17.6        |

## 6. Governance of the Programme

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- 6.1 To ensure that available resources are allocated optimally and deliver value for money, investment programme planning is, whilst having its own approval process, determined in parallel with the service and revenue budget planning process within the framework of the Financial Strategy.
- 6.2 New programmes of expenditure will be appraised along with other investments and grant allocation programmes following a clearly defined gateway process. The authority will make use of internal officer experience supported by external professional advisors where necessary to ensure robust investment decisions are made. This advice will cover financial, legal, property and economic outcomes through appropriate appointments.
- 6.3 The authority has an appraisal mechanism in place which will seek to ensure that there is an integrated approach to addressing cross-cutting issues, both internal and external to the authority, developing and improving service delivery through transformation and its investment in pursuance of the authority's over-arching aims. These include Officer Groups which bring together a range of service interests and professional expertise, including:
- Democratic decision-making and scrutiny processes which provide overall political direction and ensure accountability for the investment in the Capital Programme.
  - A Capital Investment Board (CIB) which will oversee the investment portfolio. It will be supported by a matrix group of officers of all specialities that will continue to appraise all business plans using independent external advisors if necessary. This will assist the making of investment decisions based on full site investigations, due diligence, funding package, undertaking full risk and reward assessments, lifetime costings, asset replacement and monitoring the outcome and reviewing those projects already in progress;
  - The Senior Programme Officer Group (SPOG) overseeing and approving business cases for investments prior to sign off and for submission to Capital Investment Board and Cabinet/Council approval;
  - Specific Project boards of management groups with wide ranging membership to oversee significant development projects as required.
- 6.4 For projects and programmes an Expression of Interest (EOI) will be submitted that needs to include the investment levels required, source of funding, outcomes to be delivered, risk assessments, appropriate due diligence, repayment mechanisms, revenue impacts and full lifetime costings. These will be scored against an agreed weighting and appropriate recommendations made to the investment board.

- 6.5 Subject to the EOI proposal being approved a detailed Outline Business Case (OBC) will be submitted and appraised prior to a Full Business Case being completed and appended to a Council report. A suite of template documents is appended to the OBC to ensure a consistent approach to project delivery. These include;
- Risk Register;
  - Lifetime Costing Plan;
  - Gantt Chart for project timeline;
  - Project Board Terms of Reference and Agenda;
  - Procurement considerations;
  - Project closure report.
- 6.6 Officers negotiating commercial deals are aware of the core principles of the Prudential Framework and the regulatory regime through the provision of appropriate training and advice.
- 6.7 Officers and Members involved in the decision making process in relation to proposed projects and programmes will have the appropriate capacity, skills and information to enable them to take informed decisions to acquire specific investments, to assess investments in the context of the Council's strategic objectives and risk profile and to understand how decisions have changed the overall risk exposure of the Council.
- 6.8 This assurance will be secured through the provision of relevant training and advice, detailed scheme business cases and financial appraisals and regular monitoring and review of the Council's overall investment position.
- 6.9 A summary of the programme governance is detailed in Appendix A.
- 6.10 Future monitoring of the programmes will include more rigorous expenditure profiling, outcome achievements, delivery against timetable, returns, risk assessments and completion reviews for each project.
- 6.11 Quarterly Capital Programme reports will continue to be submitted to Cabinet that identify changes to the approved programme to reflect;
- New resource allocations
  - Rescheduling in programme delivery
  - Programmes reduced or removed
  - Virements between schemes and programmes to maximise delivery.
  - Revisions to spend profile and funding to ensure ongoing revenue costs are minimised.
  - Monitor the funding of the programme
  - Capital receipts generated



## 7. Capital Programme 2018/19 Actual - 2022/23 Estimate

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- 7.1 The current projected capital programme is shown below in summary with the full detailed programme included as Appendix B. It includes all projects that have proceeded to approval stage, either via delegated powers or full Cabinet and Council recommendation approvals. It also includes estimates for capital grants for 2020/21 and beyond where there is an expectation that grant funding will continue, such as Highways Maintenance and School Maintenance Grants.

| <b>Capital expenditure</b>                      | <b>2018/19 Actual</b> | <b>2019/20 Estimate</b> | <b>2020/21 Estimate</b> | <b>2021/22 Estimate</b> | <b>2022/23 Estimate</b> |
|---|-----------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|   | <b>£ m</b>            | <b>£ m</b>              | <b>£ m</b>              | <b>£ m</b>              | <b>£ m</b>              |
| Non HRA Capital expenditure                     | 41.9                  | 51.9                    | 68.4                    | 51.1                    | 64.4                    |
| HRA Capital expenditure                         | 5.50                  | 5.5                     | 22.26                   | 18.7                    | 18.7                    |
| Commercial activities/non-financial investments | 3.7                   | 3.9                     | 32.4                    | 20.0                    | 20.0                    |
| <b>Total Capital expenditure</b>                | <b>51.0</b>           | <b>61.3</b>             | <b>123.0</b>            | <b>89.8</b>             | <b>103.1</b>            |

- 7.2 The above table shows the expected capital programme budget as at Quarter 3 2019/20. It will be revised following completion of the 2019/20 capital closedown procedure when final figures are established, which may result in slippage of budgets from 2019/20 into 2021/22.
- 7.3 The Council may also receive additional grant notifications throughout the financial year or if bids are submitted for additional grant funding as the year progresses. These changes will be reported as part of the quarterly finance strategy reporting.
- 7.4 There are several projects being considered that are being processed via the appraisal mechanism that is in place. As these projects have not completed the full cycle of appraisal they are not included in the capital programme budget above but are informed as part of Section 10 "Future Capital & Investments Schemes", where the impact of having additional budget requirements, and the resulting effect on the Capital Financing Requirement against prudential indicators is fully assessed. As these projects progress through both the appraisal process and the Councils governance requirements they will added into the capital programme.

## 8. Funding the Current Capital Programme 2018/19 Actual - 2022/23 Estimate

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8.1 There are several sources of funding the Council can use to finance its Capital Programme. The Current Programme is funded from the following sources;

- Capital Receipts
- Prudential Borrowing
- Developers Contribution (S106, CIL)
- Revenue Contributions
- Capital Grants
- Cash Balances / Internal Borrowing

### 8.2 Capital Receipts

Capital Receipts come from the sale of the Council's assets. If the disposal is Housing Revenue Account land or property, then the whole receipt is not available to support the capital programme as a percentage must be paid over to the MHCLG. Where the sale of an asset leads to the requirement to repay grant, the capital receipt will be utilised for this purpose. Once this liability has been established and provided for, capital receipts will be available to support the capital programme as a corporate resource. Where the asset has been funded from prudential borrowing a review will be undertaken to determine whether the most cost-effective option is to utilise the receipt to repay debt, considering the balance sheet position of the authority.

### 8.3 Flexible use of Capital Receipts

The 2015 Comprehensive Spend Review (CSR) announced that local authorities will be allowed to spend up to 100% of capital receipts (excluding Right to Buy receipts) on the revenue costs of reform projects. Instead of holding assets that could be made surplus, councils will be able to sell them to reinvest in their services. Guidance relating to specific conditions, number of years that this will be offered and the qualifying criteria for a 'reform' project was issued as part of the Final Local Government Settlement on 11th March 2016. The key points included:

- The direction only relates to new receipts received in the period 1st April 2016 to 31st March 2019 that could be applied to meet the revenue costs of reform incurred in the same timeframe;
- The key criteria to use when deciding whether expenditure can be funded by the capital receipts flexibility is that it is forecast to generate ongoing savings to the authority's net service expenditure and is expenditure on a project where incurring upfront costs will generate ongoing savings; and

- Individual authorities demonstrate the highest standards of accountability and transparency.
- Examples of qualifying expenditure include the sharing of back office and administrative services; investment in service reform feasibility work; collaboration between central and local government to free up land for economic use; funding the cost of service reconfiguration or restructuring leading to ongoing efficiencies; sharing Chief Executives; driving a digital approach; aggregating procurement on common goods; improving systems and processes to tackle fraud; setting up commercial or alternative delivery models to deliver services more efficiently or increase revenue income; and integrating public facing services across two or more public sector bodies

#### **8.4 HRA Right to Buy Receipts**

In most cases there will be no ring fencing of capital receipts to specific projects. One exception to this is the retained Right to Buy (RTB) receipts held by the Council under the agreement signed in June 2012 and amended in June 2013. Under this agreement any retained RTB receipts, which are not used for the specific purpose of providing replacement affordable housing, must be returned to MHCLG.

#### **8.5 Prudential Borrowing**

The Council will investigate opportunities to resource capital projects using prudential borrowing where plans are sustainable, affordable and prudent. Full appraisal will take place to ensure that, where appropriate, sufficient revenue returns are generated to cover the cost of borrowing.

Where it is considered that prudential borrowing is the appropriate method of funding, but it requires additional revenue financing, the cost will be built into the revenue budget planning process. There are various debt instruments available for financing prudential borrowing and these are explored in detail in the Treasury Management Strategy.

The PWLB remains the Council's preferred source of long-term borrowing given the transparency and control that its facilities continue to provide. The Council qualified for borrowing at the 'Certainty Rate' (20 basis points, i.e. 0.20%, below the PWLB standard rate) for a twelve-month period from 01/11/2019, through its application to MHCLG) in September 2019.

#### **8.6 S106 Developer Contributions**

S106 agreements are made with developers / landowners as part of the planning approval process to ensure that new development mitigates its own impact and provides the necessary infrastructure to support it.

These contributions are site specific or can be 'pooled' for a maximum of 5 site specific projects. Any contributions received are 'ring-fenced' for the purpose as set out in the relevant S106 agreement and are applied to fund schemes within the relevant capital programme once an eligible scheme has been identified.

S106 contribution agreements have covered all types of infrastructure including transport, affordable housing, play areas, open spaces, playing fields, public realm and public art. However, since the Council adopted CIL the planning obligations sought within S106 agreements have been scaled back to deal with only site-specific requirements, as required by the CIL Regulations. Pooled contributions previously sought for strategic transport, public realm and public open space related obligations are now dealt with by CIL.

The S106 contributions are time limited in that if they are not spent within an agreed timescale, typically 5 - 10 years, dependent on what has been agreed in the S106 agreement and any funds not spent in line with the agreement would have to be repaid to the developer, which, may include interest.

Consideration of available S106 funding should be taken into consideration when agreeing, for example, the roads programme for future years to maximise the use of the available funding and reduce the reliance on other sources of funding, predominantly borrowing. With the exception of funding for affordable housing the other pooled S106 obligations, such as Strategic Transport, Public Realm and Public Open Space will become zero over time as the CIL continues to be applied.

#### **8.7 Community Infrastructure Levy (CIL)**

CIL contributions are determined by set rates as detailed within the Council's CIL Charging Schedule and based on the amount of floor space being created by the development. CIL can be used to fund a wide range of infrastructure that is needed as a result of new development but is not site specific, giving more flexibility in where the funding can be used in geographical terms.

The CIL does not replace the requirement of S106 contributions. S106 contributions will still be relevant and will be sought alongside CIL.

The Planning Act and subsequent Community Infrastructure Levy Regulations 2010 (as amended) says that authorities can only spend CIL on providing infrastructure to support the development of their areas. This includes flood defence, open space, recreation and sport, roads and transport facilities, education and health facilities. However, it does not include affordable housing, which will continue to be funded by S106 obligations.

#### **8.8 Revenue Contributions**

An element of the revenue budget can be set aside to fund the capital programme (Direct Revenue Financing). However, with increasing General Fund revenue pressures these amounts available are reducing. A service or school may wish to offer some of its revenue budget to support the financing of a capital project. This is acceptable if it can be demonstrated that this funding is unfettered.

## 8.9 Government Grants

Capital resources from Central Government can be split into two categories:

- *Non-ring fenced* - resources which are delivered through grant that can be utilised on any project (albeit that there may be an expectation of use for a specific purpose). This now encompasses the vast majority of Government funding and the Council will initially allocate these resources to a general pool from which prioritised schemes can be financed.
- *Ring-fenced* - resources which are ring fenced to particular areas and therefore have restricted uses, specified by the funder.

## 8.10 Non-Government Contributions

Where there is a requirement to make an application to an external agency to receive external funding, and when appropriate to commit Council resources as matched funding to any bid for external resources, a business case should first be presented for consideration to the CIB. The business case must demonstrate how the project aligns to Council's priorities and how matched funding and any revenue consequences can be managed within the context of the capital and revenue budget.

## 8.11 Funding Summary of the Capital Programme 2019/20 - 2022/23

The current projected capital programme is financed as follows:

| <b>Financing of capital expenditure</b> | <b>2018/19<br/>Actual</b> | <b>2019/20<br/>Estimate</b> | <b>2020/21<br/>Estimate</b> | <b>2021/22<br/>Estimate</b> | <b>2022/23<br/>Estimate</b> |
|---|---------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|   | <b>£ m</b>                | <b>£ m</b>                  | <b>£ m</b>                  | <b>£ m</b>                  | <b>£ m</b>                  |
| Capital receipts                        | 0.3                       | 9.3                         | 12.4                        | 5.4                         | 0.0                         |
| Capital grants                          | 38.5                      | 35.4                        | 43.7                        | 34.2                        | 61.5                        |
| Other Contributions                     | 2.6                       | 3.6                         | 14.0                        | 13.6                        | 5.0                         |
| Major Repairs Allowance                 | 4.3                       | 4.6                         | 5.0                         | 3.7                         | 3.7                         |
| Revenue                                 | 0.6                       | 3.0                         | 4.2                         | 2.0                         | 2.0                         |
| Prudential Borrowing                    | 4.6                       | 5.4                         | 43.6                        | 30.9                        | 30.9                        |
| <b>Total Financing</b>                  | <b>51.0</b>               | <b>61.3</b>                 | <b>123.0</b>                | <b>89.8</b>                 | <b>103.1</b>                |

The term Prudential Borrowing above does not automatically lead to external borrowing as the Council may be able to use cash it holds in reserves and as working capital which is usually termed internal borrowing. Over time all debt whether it be internal or external borrowing must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). The Council is required to make annual MRP statement which is included within the annual Treasury Management Strategy report. The project appraisal process ensures that all projects that are not fully funded from secured grants or capital receipts are assumed to be funded from Prudential Borrowing and must demonstrate that any future borrowing requirement is affordable and sustainable within the requirements of the project.

The current MRP budget requirements based on the estimated capital programme above are as follows:

| <b>MRP Budget Requirement</b>        | <b>2018/19<br/>Actual</b> | <b>2019/20<br/>Estimate</b> | <b>2020/21<br/>Estimate</b> | <b>2021/22<br/>Estimate</b> | <b>2022/23<br/>Estimate</b> |
|--------------------------------------|---------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|                                      | <b>£ m</b>                | <b>£ m</b>                  | <b>£ m</b>                  | <b>£ m</b>                  | <b>£ m</b>                  |
| MRP (Excluding PFI / Finance Leases) | 4.2                       | 4.4                         | 4.8                         | 5.7                         | 6.4                         |

## 9. Approved Capital & Investment Schemes

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- 9.1 To date several Expressions of Interest (EoIs) have been submitted to the Senior Project Officer Group (SPOG), considered and scored against an agreed weighting by the SPOG Appraisal Group and appropriate recommendations made to SPOG and subsequently Capital Investment Board.
- 9.2 These schemes and programmes are currently at various stages of approval and are either detailed below as approved capital schemes and so included in the Council's Capital Programme or in Section 10 "Future Capital & Investment Schemes".
- 9.3 Several projects and programmes were approved by the Capital Investment Board to proceed to Outline Business Case (OBC) and / or Full Business Case (FBC) and subsequently approved as investment schemes or programmes by Cabinet and / or Council. A summary of these projects and programmes is detailed below:
- Shrewsbury Shopping Centres.
  - The Tannery Development (Blocks B & C).
  - Whitchurch Medical Practice.
  - Shrewsbury - Commercial Site Acquisition.
  - Oswestry Central - Commercial Site Acquisition.
- 9.4 In future the actual performance (forecast and actual net yield against target) of approved schemes and programmes in delivery will be tracked against both the Council's target yield and the forecast yield of the schemes and programmes.
- 9.5 Shrewsbury Shopping Centres and The Tannery Development are the schemes currently in delivery. Whitchurch Medical Practice, Shrewsbury - Commercial Site Acquisition and Oswestry Central - Commercial Site Acquisition have all been approved by Council but have yet to commence.
- 9.6 Each scheme and programme will be categorised to one of the nine investment types discussed in Section 5 "Capital & Investment Priorities" and so enable the level of investment in each type to be tracked in relation to the investment fund exposure ranges determined in the same section.
- 9.7 The Council has allocated an Investment Fund to facilitate the acquisition of commercial investments and provide for the impact on revenue in terms of the cost of investment. A commercial investments income target of £2m per year from 2019/20 to 2022/23 is included in the Council's Financial Strategy equating to investment of £80m and cost of investment of £4.4m.

9.8 The following table summarises the commercial investments made to date and the remaining balance on the Investment Fund.

|  | 2019/20    | 2020/21     | 2021/22    | 2022/23    | Total       |
|--|------------|-------------|------------|------------|-------------|
| Approved budget allocation                     | 20,000,000 | 20,000,000  | 20,000,000 | 20,000,000 | 80,000,000  |
| Unutilised Fund Carry Forward:                 | 0          | 12,420,000  | 23,627,000 | 43,527,000 |             |
| Drawn down into capital programme:             |            |             |            |            |             |
| Tannery Block C & B                            | -7,580,000 | -440,000    |            |            | -8,020,000  |
| Whitchurch Medical Practice                    |            | -3,678,000  | -100,000   |            | -3,778,000  |
| Shrewsbury - Commercial Site Acquisition       |            | -1,200,000  |            |            | -1,200,000  |
| Oswestry Central - Commercial Site Acquisition |            | -3,475,000  |            |            | -3,475,000  |
| Balance of unutilised fund                     | 12,420,000 | 23,627,000  | 43,527,000 | 63,527,000 |             |
| Schemes not yet in the capital programme:      | 0          | -11,400,000 | -6,500,000 | 0          | -17,900,000 |
| Balance of unutilised fund - futures           | 12,420,000 | 12,227,000  | 25,627,000 | 45,627,000 |             |



## 10. Future Capital & Investment Schemes

- 10.1 The main objective for the introduction of the Capital Strategy requirement was in response to the major expansion of local authority investment activity into the purchase of non-financial investments, particularly property. The capital strategy therefore requires local authorities to assess investments over the long-term as opposed to the usual three years that planning has been conducted over.
- 10.2 Section 7 of this strategy details the current approved capital programme for the three years to 2022/23. The projects included within this programme have progressed through the governance process and are deemed to have been assessed fully to ascertain the outcomes of the project against criterion of risk and reward.
- 10.3 In order to comply with the requirement to consider capital expenditure over a medium to long-term period and to determine the financial sustainability of the authority, focusing on the affordability of the capital programme, Shropshire Council has compiled a planned programme of both Capital and Investment Scheme expenditure that is proposed but is yet to complete the full due diligence process.
- 10.4 All projects being considered have been evaluated to establish an estimated cost, delivery timeline and categorisation against investment type to produce a proposed capital programme 2020/21 to 2024/25 which totals £433.7m and is summarised as follows:

| <b>Investment Category &amp; Type</b> | <b>2020/21</b> | <b>2021/22</b> | <b>2022/23</b> | <b>2023/24</b> | <b>2024/25</b> | <b>Total</b>   |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
|                                       | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      |
| <b>Commercial</b>                     |                |                |                |                |                |                |
| Private Commercial                    | -              | 5.000          | 5.400          | -              | -              | <b>10.400</b>  |
| Public Commercial                     | -              | 3.500          | -              | -              | -              | <b>3.500</b>   |
| Hybrid                                | -              | 1.000          | -              | -              | -              | <b>1.000</b>   |
| Private Housing                       | 1.500          | 14.000         | 32.500         | -              | -              | <b>48.000</b>  |
| <b>Transformation</b>                 |                |                |                |                |                |                |
| Non-Property Service Investment       | -              | 3.000          | 3.000          | 4.000          | -              | <b>10.000</b>  |
| Assets To Manage Growth               | -              | 7.350          | 5.600          | 4.000          | -              | <b>16.950</b>  |
| Assets To Manage Rationalisation      | 4.000          | 18.167         | 25.667         | 5.666          | 4.000          | <b>57.500</b>  |
| <b>Economic Development</b>           |                |                |                |                |                |                |
| Infrastructure                        | 4.980          | 34.974         | 33.899         | 23.414         | 22.279         | <b>119.546</b> |
| Economic Growth                       | 4.166          | 43.402         | 64.716         | 41.521         | 13.000         | <b>166.805</b> |
| <b>Total</b>                          | <b>14.646</b>  | <b>130.393</b> | <b>170.782</b> | <b>78.601</b>  | <b>39.279</b>  | <b>433.701</b> |

- 10.5 All capital expenditure must be financed. Some of the proposed projects above have been identified as securing Government and External Grants to the sum of £69.121m as part of their deliverability and also the utilisation of Developer Contributions to those deemed infrastructure requirements as a result of growth and a SALIX loan facility to the sum of £3.250m. There is a remaining requirement for financing by Shropshire Council of £361.330m from either Capital Receipts or Prudential Borrowing. The planned financing of the proposed expenditure is as follows:

Financing the future capital programme:

| <b>Proposed Financing Source</b> | <b>2020/21 to 2024/25<br/>£m</b> |
|----------------------------------|----------------------------------|
| Government Grants                | 48.000                           |
| External Grants                  | 21.121                           |
| Developer Contributions          | 0.750                            |
| SALIX Loan                       | 2.500                            |
| Revenue Contributions            | 0.200                            |
| Capital Receipts                 | 125.046                          |
| Internal Borrowing               | 68.000                           |
| Prudential Borrowing             | 168.084                          |
| <b>Total</b>                     | <b>433.701</b>                   |

- 10.6 In the above table, financing of the proposed capital programme required several proposed projects to be categorised as funded from either Capital Receipts or from Prudential Borrowing. Those projects considered not to be of an investment nature, and therefore not expected to generate a new income stream or operational savings to finance future debt repayment have been shown as funded from Capital Receipts as the preferred route. This includes infrastructure development or asset management schemes that cannot be funded from other sources. The total of the schemes identified as non-investment activity, and thus requiring Capital Receipt financing, total £125.046m.
- 10.7 The current known Capital Receipt position detailed in section 3.7 above highlights a shortfall in funding the current three-year approved capital programme of £9.494m. Adding in a further Capital Receipt funding requirement for the proposed future programme will add to this shortfall that would require the Council to fund through Prudential Borrowing if the gap cannot be addressed over the five-year period.
- 10.8 A further £31.898m of assets have been identified as surplus to requirements with the potential to dispose, therefore potentially resolving the funding shortfall and providing additional capital receipts of £22.404m potentially available to fund a proportion of the proposed capital programme of £433.701m.

10.9 The Council has already secured external funding in relation to some schemes within the proposed capital programme of £433.7m as follows:

| <b>Proposed Capital Scheme</b> | <b>Estimated Scheme Cost<br/>£m</b> | <b>External Funding<br/>£m</b> | <b>Funding Balance<br/>£m</b> |
|--------------------------------|-------------------------------------|--------------------------------|-------------------------------|
| North West Relief Road (NWRR)  | 74.253                              | 54.407                         | 19.846                        |
| Oswestry Innovation Park (OIP) | 12.000                              | 7.200                          | 4.800                         |
| Bishops Castle Business Park   | 4.384                               | 2.120                          | 2.264                         |
| Ellesmere Business Park        | 9.490                               | 1.750                          | 7.740                         |
| Ludlow Business Park           | 8.917                               | 3.150                          | 5.767                         |
| Oswestry Mile End Roundabout   | 12.800                              | 9.300                          | 3.500                         |
|                                | <b>121.844</b>                      | <b>77.927</b>                  | <b>43.917</b>                 |

10.10 Taking into account external funding (Government Grant, LEP, ERDF and HIF) secured for these schemes of £77.927m, there remains a funding requirement of £43.917m. In the absence of the identification of alternative sources of funding such as S106, CIL, etc., the funding balance would fall on capital receipts which are insufficient at the current £31.898m to resolve the total requirement. Between Cabinet (12<sup>th</sup> February) and Council (27<sup>th</sup> February) further work will be undertaken to identify alternative funding sources and so reduce the reliance on capital receipts.

10.11 The remainder of the financing requirement to deliver the proposed capital programme has been identified as funded from Prudential Borrowing. This currently totals £168.084m over the next five years and is linked to projects identified as investment type proposals. This assumption will be given fuller consideration during the due diligence process, with proposed projects having to demonstrate full affordability of any debt financing requirements as part of the Business Case completion.

10.12 As Business Cases progress through the governance process put in place, the financing requirement will be reflected both in the capital financing requirement (CFR) calculation and in the future Treasury Management Strategy.