Resources Scrutiny Commission

25 April 2017

Report of: Service Director Finance

Title: Capital Programme

Ward: City Wide

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Recommendation

That the Resources Scrutiny Committee consider the capital programme 2017-22, its financing and the implications for the revenue budget and medium term financial plan

Summary

This report for provides information on the Council's agreed capital programme and its financing. The Council agreed its 2017/18 budget in February 2017 and as part of that the capital programme for the year. Council also agreed the outline capital programme for the 4 years 2018 to 2022 as part of that report.

Decisions on capital and revenue cannot be considered isolation from each other. A larger and more ambitious capital programme on the one hand can facilitate more cost effective asset management, improving efficiency and the need to incur cost of maintenance, and can help deliver economic growth, but it means the Council will incur a higher level of fixed costs for the foreseeable future and impacts upon revenue resources available to fund day-to-day services.

Capital Programme 2017-22, its Financing and Prioritisation of Future Capital Pressures

1. Introduction

1.1. This report sets out for consideration by the Resources Scrutiny Commission the capital programme, as agreed by Full Council at its meeting of 21st February. It puts that decision in the context of capital financing arrangements and explains the rationale for a departure from the previous three tier approach to capital programming.

1.2. Capital expenditure involves investing in new assets or improving existing assets. The distinction is important because whilst capital expenditure can be financed from revenue resources, revenue expenditure cannot generally be financed from revenue resources. Any expenditure developing capital schemes, including enabling works that do not culminate in adding or improving the asset base will fall as a charge to revenue.

1.3. Capital expenditure has revenue budget consequences – through whole life running costs associated with servicing the asset, additional costs of services utilising the asset, cost of borrowing, and depreciation or minimum revenue provision (MRP). It is vital therefore that the capital programme is agreed as part of the Council's budget making and medium term financial planning processes so that the revenue implications of planned capital expenditure consequences are reflected in the budget process and treasury management strategy.

1.4. Bristol has a large and ambitious capital programme. On the one hand that can facilitate more cost effective asset management, improving efficiency and the need to incur cost of maintenance, and can help deliver economic growth, but it means the Council will incur a higher level of fixed costs for the foreseeable future and impacts upon revenue resources available to fund day-to-day services. It also exposes the Council to significant financial risks. This report also therefore sets out the need to develop a capital strategy and a structured approach to scheme prioritisation.

2. Report

2.1. The Council plays a key role in investing in its community; providing facilities for local people to use as well as business premises that provide jobs and opportunities. Longer term capital programme aspirations are significant, however the Council recognises that these investments are essential to deliver revenue savings and transform capacity to meet future needs.

2.2. In recent years the Council has adopted a three tier approach when presenting the capital programme for approval by Council;

- Tier 1 – Actual proposed programme for approval and funded within the medium term financial plan
- Tier 2 – Projects under development – published but not formally approved and not funded within the medium term financial plan
- Tier 3 – Projects in early stages of development – again published but not approved nor funded.

2.3. Whilst both Tier 2 and 3 elements of the programme comprised schemes that contained some external funding, they primarily assumed they would be wholly funded through the Councils own resources.

2.4. Whilst this approach facilitated a degree of transparency for Council decision-making – in that the process could facilitate Council agreeing alternative priorities to the Executive's recommended programme – such determinations would not be based on any agreed criteria, and could lend itself to criticism of prioritisation not being evidence based.

3. 2016/17 Capital Monitoring

3.1. Each month Cabinet has been receiving an update on capital expenditure and projected outturn to the end of the financial year. Projections are provided by directorate programme and project managers. The following table shows the position as at the end February;

Table 1 - Capital Programme Forecast Expenditure & Financing

	Period 10 2016/17 Budget £m	Capital Budget Adjustments £m	Period 11 2016/17 Combined Budget £m	2016/17 Forecast Outturn £m	2016/17 Forecast Outturn Variance £m	2016/17 Actual Spend to Date £m
People	40.7	(0.6)	40.1	36.8	(3.3)	24.1
Place	83.6	(4.7)	78.9	85.4	6.5	53.8
Neighbourhoods	9.7	(0.5)	9.2	8.9	(0.3)	7.0
Resources	12.2	0.0	12.2	12.2	0.0	9.5
City Director	0.8	0.0	0.8	0.7	(0.1)	0.6
Housing Revenue Account	56.0	0.0	56.0	51.6	(4.4)	41.7
Corporate	11.6	0.1	11.7	14.7	3.0	14.5
Totals	**214.6**	**(5.7)**	**208.9**	**210.3**	**1.4**	**151.2**
Finance By:						
Prudential Borrowing			80.8	86.6	5.8	
Capital Grants			58.7	58.7	0.0	
Capital Receipts			0.4	0.4	0.0	
Revenue Contributions			13.0	13.0	0.0	
Housing Revenue Account (Self-Financing)			56.0	51.6	(4.4)	
TOTAL CAPITAL FINANCING			**208.9**	**210.3**	**1.4**	

3.2. The actual capital spend to the end of Period 11 was £151.2m (72% of adjusted budget). Whilst historic trends indicate that capital spending increases towards the end of the financial year, the level of forecast spend appears high compared to spend to date. Initial indications of outturn would suggest actual spend will be below £200m. A review of slippage and carry forward assumptions will be undertaken as part of the 2016/17 accounts finalisation, and along with the resourcing implications of that review will be brought back to Cabinet for consideration as part of the regular budget monitoring cycle for Cabinet early in the new financial year.

3.3. Details of 2016/17 programme are set out as Appendix A. More detailed monitoring will be provided as part of the normal P11 reporting, and provisional outturn will be available at the beginning of May.

4. 2017/18 and Onwards

4.1. The approach to capital programming has been amended for 2017/18 onwards to improve transparency and certainty. A review of the former three tiers was undertaken as part of the budget process to take account of key corporate priorities, statutory responsibilities, new and emerging pressures, and affordability. The decision to have one published programme is supported by greater clarity of the estimated revenue implications of that programme.

4.2. That has meant that a number of proposed former tier 2 and 3 schemes have been removed from the programme – but it has also facilitated the introduction of provisions to ensure more cost effective asset management and investment to support the delivery of key aspects of the revenue efficiencies programme. A corporate contingency of £10m per annum is also incorporated into the programme. This is to help mitigate inherent financial risks across the portfolio.

4.3. All schemes over £500k require Cabinet approval to formally adopt a capital estimate and approval to progress as part of the Council's budget and policy framework. Governance arrangements are currently under review to ensure effective officer assessment and evaluation at project initiation, inception and delivery stages.

4.4. Capital and revenue expenditure cannot be considered in isolation of each other. A larger and more ambitious capital programme on the one hand can facilitate more cost effective asset management, improving efficiency and the need to incur cost of maintenance, and can help deliver economic growth, but it means the Council will incur a higher level of fixed costs for the foreseeable future and impacts upon revenue resources available to fund day-to-day services. The programme set out will increase capital financing charges by an estimated £27m in 2021/22. If interest rates rise during that period then that will add further revenue budget pressures.

4.5. The Council’s agreed capital budget (including the HRA) for the year 2017/18 totals £213.5m. The capital programme for the years 2018/19 to 2021/22 is a further £689.9m. Table below summarises our current capital spending plans for the next five years that total £900.4m;

Capital Programme	2017/18 £000's	2018/19 £000's	2019/20 £000's	2020/21 £000's	2021/22 £000's	Total £000's
People Directorate	30,826	35,472	25,310	32,500	15,300	139,408
Place Directorate	107,202	72,109	106,631	73,875	60,857	420,674
Neighbourhoods Directorate (GF)	8,794	10,450	3,600	2,400	2,400	27,644
Resources Directorate	8,135	7,600	2,700	2,700	2,700	23,835
City Director & Corporate	17,558	14,075	17,213	10,000	10,000	68,846
Housing Revenue Account	41,000	47,000	44,000	44,000	44,000	220,000
Total	***213,515***	***186,706***	***199,454***	***165,475***	***135,257***	***900,407***

4.6. The detailed draft programme and its financing is set as Appendix 2 to the budget report. Further information can be provided on each of the agreed schemes.

4.7. Appendix 3 sets out those former tiers 2 and 3 schemes which have now been withdrawn from the programme. The table also sets out the revenue cost of those schemes, representing a net increase to the Council’s base budget of some £3.2m over the period of the medium term financial plan.

5. Capital Financing

5.1. Financing of the programme is from a number of different sources, including specific capital grants (e.g. for some transport schemes or increasing school places), utilisation of capital receipts, S106/ CIL receipts, direct revenue funding and prudential borrowing. Funding sources for the capital programme are summarised in Appendix 2. Further details can be provided on a scheme by scheme basis.

5.2. A number of major projects have complex financing assumptions. With that comes significant financial risk which is underwritten by increased borrowing. For example schemes supported via LEP monies will normally require the Council to finance development costs initially with grants being received post completion and as an offset of annual borrowing costs over say 25 years. The availability of such funding is subject to business rate growth in enterprise zones and areas providing sufficient resources across the LEP region. If business rate growth falls short of assumptions there could be insufficient resources in the pool. Also assumed Community Infrastructure Levy funding could be adversely impacted by any sudden downturn in the development market should prevailing economic conditions change. These and other financial risks have implications for the revenue budget. Officers are currently re-assessing the financial risk associated with key projects.

5.3. HRA expenditure is ring-fenced, which means all landlord services cannot be subsidised from council tax or business rates, and vice versa. All borrowing within the HRA is funded from rents and services charges (via major works recoveries). There can be cross over between some capital receipts, but current council policy is to utilise housing receipts to support capital investment in existing council housing stock and delivery of new supply. Over 40% of the annual costs attributable to the HRA relate to capital expenditure and its financing.

5.4. The agreed HRA business plan assumes some 200 right-to-buys for 2017/18. This will generate some £10.6m of useable capital receipts. However £6.3m form part of the 1-4-1 agreement with DCLG, which must be earmarked for expenditure on new affordable housing – either by the Council itself, or via a registered provider. The receipt can only fund a maximum of 30% of new development, and funding for the remaining 70% precludes HCA grant. Failure to spend receipts within 3 years, under the agreement, means they must be paid over to the Treasury with a punitive interest rate.

5.5. Local authorities are subject to a statutory HRA debt cap, which limits the amount of borrowing that can be applied either for new supply housing or investment in existing stock. This cap on total borrowing is £257m, and outstanding HRA debt is £245m. This means Council currently has “headroom” of £12m – which is the maximum the HRA can currently borrow over the period of the 30 year business plan, unless existing debt is redeemed. The primary source of funding for investment over the medium term will be depreciation (formerly known as major repairs allowance). This is, in effect, a quasi-sinking fund levied on tenants rents. Any revenue surpluses can also be invested in the HRA programme. All capital expenditure must be contained within an affordable 30 year HRA business plan.

5.6. Financing of the general fund capital programme must be seen in the context of the Council’s very challenging revenue position. It is estimated that the Council will now have a net borrowing requirement of £470m over the MTFS period. This will generate additional general fund capital financing charges of £27m by 2022, and which will contribute towards the estimated revenue funding gap of £42m outlined in the table below. Within this context, and taking into account the financial risks inherent in the programme, it is important that clear criteria are established for prioritisation of competing demands for limited capital resources. In terms of gearing, as a proportion of net general fund, costs of borrowing will represent some 12% by 2022, compared to less than 8% at present.

Summary of Funding Gap						
	Original 2016/17 £'000	2017/18 £'000	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000
Base Revenue Budget	**345,437**	**345,433**	**364,741**	**375,851**	**389,115**	**419,293**
Inflation & Central Adjustments		8,135	15,731	16,735	25,535	12,260
Investment in Services	**0**	44,242	11,913	6,634	6,647	2,028
Savings / Efficiencies	0	(33,068)	(16,534)	(10,105)	(2,003)	(488)
Annual Budget Requirement	345,437	**364,741**	**375,851**	**389,115**	**419,293**	**433,093**
Financed by:						
Total Funding	345,437	364,741	361,552	366,625	378,363	391,028
Residual (Surplus) / Deficit	0	(0)	14,298	22,490	40,930	42,065

5.7. The Council must ensure sufficient funding is available to meet the requirements of the agreed projects within its Treasury Management Strategy which is regularly reviewed and updated to reflect projects as they are refined or become ready for delivery.

6. Capital Strategy

6.1. Given the issues outlined above prioritisation of the programme is essential to ensure it remains within an affordable envelope and has involved broadly ranking new pressures and prior tier 2 and 3 schemes as essential, high priority, priority and desirable. Going forward a renewed capital strategy will be developed, in parallel with the asset management strategy that will outline the approach to capital investment, ensuring that it is affordable, sustainable and prudent, and aligned to the Council's corporate priorities.

6.2. Both asset management and capital strategies need to sit within the context of wider infrastructure delivery planning, which is integral to core planning policies.

6.3. An idealistic model for public sector capital investment portfolio is one that provides an appropriate blend of investment to do the following:

- undertake mandatory duties keeping the public safe and maintain its investment,
- invest to grow the economy; and
- invest to save by reducing costs that would be borne by the revenue account or generating external income.

6.4. Further consideration will be given to the appropriate blend of future schemes in the Medium Term Financial Plan.