Agenda Item No. CR5

SHADOW EXECUTIVE
16 DECEMBER 2008

SUBJECT	CAPITAL INVESTMENT STRATEGY (To consider a draft Capital Investment Strategy and formulation of the Capital Programme for Central Bedfordshire.)
REPORT OF	Director of Corporate Resources
Contact Officer: Brian Mew (Tel: 01462 611070)	

IMPLICATIONS

SUSTAINABILITY	The Council's Capital Investment Strategy and Capital Programme is directed towards achieving the Council's key priorities, including managing growth effectively. Under Government guidelines, local authorities are expected to review this Strategy annually to seek continuous improvement and take on board any necessary amendments.
FINANCIAL	The Capital Investment Strategy is one of the fundamental resource management strategies of the Council, influencing capital investment of potentially up to £160 million over the next four years. The revenue effects of that part of the Council's Capital Programme that is not funded by external finance forms a significant element of the Council's revenue budget.
LEGAL	The provisions in the Capital Investment Strategy and the detailed documents produced in respect of it will ensure that the Council fully complies with all legislation and regulations in relation to Capital Finance
PERSONNEL/EQUAL OPPORTUNITIES	None
COMMUNITY DEVELOPMENT/SAFETY	None
TRADES UNIONS	None
HUMAN RIGHTS	None
KEY ISSUE	Yes
BUDGET/POLICY FRAMEWORK	Yes

OTHER DOCUMENTS RELEVANT TO REPORT
None

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RECOMMENDATIONS:

That the Shadow Executive: -

1. Approve the draft Capital Investment Strategy for Central Bedfordshire attached as Appendix A for submission to Full Council as part of the budget process.

2. Approve the process for consideration and approval of the Capital Programme and financing outlined in this report.

Reason for Recommendation: *To progress the process of approving the Capital Programme and provide a framework for the consideration of capital investment and financing requirements during 2009/10.*

1. **Purpose of Report**

(a) Shadow Executive and Shadow Council will, as an integral part of the budget process, be required to approve a Capital Investment Strategy and Capital Programme for the period 2009/10 – 2012/13. The Capital Investment Strategy is one of the key resource management strategies of the Council, and is intended to support and deliver the Council's corporate objectives and priorities. The Council's Capital Programme, which will propose a programme of works aimed at meeting the Council's strategic objectives, is a major component of the Council's Medium Term Financial Strategy with significant financial implications - the programmes established by the predecessor authorities entailed estimated gross expenditure of around nearly £160 million over the period 2009/10 to 2012/13.

(b) The commencement of the new authority and the current transition period inevitably places the authority in a different position to that of established authorities when formulating and considering its Capital Investment Strategy and Capital Programme. Indeed, since the new Council will not meet until June 2009, members will have had little opportunity to debate and shape their priorities to meet the new unitary's objectives. Against this background, the purpose of this report is to:

- Present a draft Capital Investment Strategy for approval, which is intended to provide a framework for more detailed consideration of the capital investment and financing requirements of the Council during 2009/10;

- Report on the current position regarding the Capital Programmes of the three predecessor authorities and work undertaken to date;

- Outline the current position regarding financing the Capital Programmes of both the predecessor authorities and Central Bedfordshire;

- Outline a proposed process and key principles for the remaining stages of formulating and approving the Council's Capital Programme for 2009/10.

2. **Draft Capital Investment Strategy**

(a) As a Shadow Authority, Central Bedfordshire has agreed its vision, values, and priorities, which form the basis for work on business planning and budget preparation for 2009/10. The Council's agreed Vision is:

"To improve the quality of life of all in Central Bedfordshire and enhance the unique character of our communities and our environment."

(b) Within this overall vision, the five agreed council priorities for 2009-11(the first two full years of the new Council) are:

(i) Supporting and caring for an ageing population
(ii) Educating, protecting and providing opportunities for children and young people
(iii) Managing growth effectively
(iv) Creating safer communities
(v) Promoting healthier lifestyles

(c) At its meeting in September 2008, the Shadow Executive approved the first Strategic Plan for the Council, which has been developed from the Council's Visions, Values, and Priorities.

(d) Central Bedfordshire, as well as having its own priorities, will work within a framework of national priorities determined by Government. Emerging legislation and guidance constantly impacts upon the duties and responsibilities of the Council and the way in which services are delivered.

(e) As a new unitary authority, the Council is focused on the twin tasks of a smooth and effective transition to the new arrangements, and the subsequent transformation of services. As a result, there are inevitably limits to the extent to which a new Capital Investment Strategy and Capital Programme can initially be developed to truly reflect the vision and Strategic Plan. As well as there being limited time and resources to undertake such an exercise, there are also issues concerning establishing the starting point for the new authority in terms of inherited capital schemes and programmes, available finance, and affordability.

(f) Consequently in these circumstances, this report recommends that the Shadow Executive approve a draft Capital Investment Strategy, attached as Appendix A. This draft strategy is essentially a consolidation of current strategies, which outlines the key principles and suggested processes to be adopted for formulation, management, and monitoring, of the authority's Capital Programme. The Strategy will need to be developed and amended during the course of 2009/10 to ensure that it truly reflects the new Council's objectives, and it is proposed that the Capital Programme be the subject of a detailed review in the light of this further development earlier in 2009/10 than would normally be the case in the budget and planning cycle.

3. Current Position

(a) As a starting point for formulating the Capital Programme for Central Bedfordshire, a number of actions have been undertaken, or are in progress:

- Updating the current Capital Programme monitoring position, reflecting the 2007/08 outturn position and current forecasts, for Bedfordshire County Council, SBDC, and MBDC;

- Updating and reviewing the current position regarding both earmarked and general capital funding;

- Disaggregating the Bedfordshire County Council Capital Programme to Bedford BC and Central Bedfordshire including disaggregation of funding, in order to provide an initial starting point;

- Categorising current and proposed capital schemes attributable to Central Bedfordshire over Directorate headings, and undertaking some review of schemes;

- Identifying revisions to current schemes and new, urgent, capital requirements in the context of the new unitary authority.

(b) An important area of work has been disaggregation of the current approved Bedfordshire County Council programme. Current Bedfordshire County Council schemes that are location specific have been allocated relatively easily to the two unitary authorities, together with the relevant earmarked funding if applicable. In some areas, disaggregation and allocation has been less straightforward.

(c) Bedfordshire County Council 2008/09 Schemes

A significant number of Bedfordshire County Council schemes have been budgeted for 2008/09 only. There is likely to be some slippage of these schemes into 2009/10 requiring either Central Bedfordshire or Bedford to pick this slippage up in their programmes. The position regarding capital financing and financing of the 2008/09 Bedfordshire County Council programme is referred to later in this report.

(d) Latest budget monitoring information from MBDC, SBDC, and Bedfordshire County Council indicates that the capital programmes of all three predecessor authorities are showing significant slippage / deferral from 2008/09. In the majority of cases, these relate to areas where the current economic climate is a significant factor, such as the realisation of Section 106 Agreements, and where schemes are to be progressed in partnership with private sector development.

The MBDC programme focuses on the provision of affordable housing, and the Flitwick and Stotfold Leisure Centre schemes, and also shows large slippages into future years. Delays are also apparent in some significant SBDC schemes, and there may be areas where some pump priming is required from the Council's own resources to secure external funding and progression of the schemes. In respect of Bedfordshire County Council, there are undoubtedly areas where Section 106 related projects will slip into future years. The level of potential slippage indicated by the latest Bedfordshire County Council monitoring information is probably understated in comparison with the likely outturn position, as County monitoring tends to focus on budget revisions and approvals rather than forecasting the actual expenditure in year.

4. Capital Financing, Financial Implications, and Affordability

(a) Capital financing is a complex area for the new authority. In very general terms, the current position is that for Bedfordshire County Council the balance of funding required for the Capital Programme after earmarked funding is raised through borrowing, whilst the balance of funding required by MBDC and SBDC is financed by usable capital receipts. One of the features of the Capital Programme for county level services is that earmarked funding, particularly from Government Capital Grants, is a more significant factor than in district level services. The Revenue Support Grant settlement for Bedfordshire County Council includes an element for Capital Financing and it has been agreed that this will be split between Central Bedfordshire and Bedford BC on the basis of tax base.

(b) An exercise is currently being undertaken to disaggregate the actual Bedfordshire County Council capital financing position, i.e. debt and investments, as at 31 March 2009. This disaggregation will also be based primarily on tax base, although there are some complications regarding some Bedfordshire County Council market loans, which, unlike PWLB debt cannot be physically split between the two unitary authorities.

(c) In addition to this exercise, specialist external advisors, Sector Treasury Management Services, are also advising Bedfordshire County Council, Bedford Borough Council and Central Bedfordshire on two key issues regarding capital financing. Their work in both of these areas has the objective of producing options that put the two successor unitary authorities in the most advantageous financial position possible, given current circumstances.

(d) Firstly, Sector are working with officers to consider options for financing the unfinanced balance of the Bedfordshire County Council capital programme in 2008/09. At the start of the year, Bedfordshire County Council estimated that their new borrowing requirement for 2008/09 would be around £22.4 million. The latest Bedfordshire County Council monitoring would appear to indicate a larger requirement than this, but as referred to earlier, the actual outturn position is likely to be less than currently reported. Consequently, this estimated requirement is still considered to be valid by BCC, and Sector are working on options for the timing and nature of this required funding. It should be noted that this work is taking place against the background of a rapidly changing and uncertain financial climate, which is significantly affecting the interest rates relating to both local authority borrowing and investment. This financial climate also has a major impact on the overall affordability and deliverability of the Central Bedfordshire Capital Programme as referred to below.

(e) Sector are also looking at whether there are options in 2008/09 for all of the local authorities in Bedfordshire to take decisions that place the new unitary authorities in a more advantageous financial position in 2009/10 and subsequent years. Sector's proposals in this respect have focussed on a possible balance sheet adjustment by Mid Bedfordshire in 2008/09 that could reduce the revenue impact of the Bedfordshire County Council debt and the funding requirements of the Capital Programme in 2009/10 and subsequent years.

(f) For an authority with debt, (Central Bedfordshire is likely to have in excess of £175 million debt on Vesting day), the revenue impact of borrowing is the interest cost of that borrowing, plus a Minimum Revenue Provision (MRP) of 4% to cover the principal element of borrowing. The MRP is based on the authority's Capital Financing Requirement (CFR). Sector have been looking at options whereby the 2009/10 opening CFR position for Central Bedfordshire, and consequently the MRP, can be reduced by setting aside some or all of the unapplied capital receipts of Mid Bedfordshire (estimated to be over £55 million as at 31 March 2009). This reduction would be achieved by setting aside these receipts in the Capital Adjustment Account in the Mid Bedfordshire balance sheet as at 31 March 2009. This proposal has the effect in terms of MRP of netting off these capital receipts against the debt inherited from Bedfordshire County Council, without the receipts having to be physically used. The receipts would still be available to fund capital expenditure in the future, the effect of their use being to reduce the MRP advantage. A recommendation on these proposals will be presented to the Shadow Executive meeting in January that considers the draft Capital Programme for 2009/10. This report will also recommend specific proposals for funding of the programme. Given the current outlook for interest rates, this funding strategy may be primarily focussed on the use of available capital receipts rather than higher levels of prudential borrowing.

(g) In theory, the capital programmes of the three authorities should have been capable of being consolidated and disaggregated, then funded and delivered based on their existing levels. This is because as well as identifying the relevant capital funding for the programmes, the financial strategies of each authority should have accounted for the medium term revenue budget implications. However, there are now two very significant questions in the light of both the local government reorganisation and the economic climate. Firstly, is the question of the affordability of the existing Capital Programme approved by the predecessor authorities, in the light of the projected revenue position for Central Bedfordshire, and secondly, is there sufficient funding availability for the programme in the light of current economic conditions? In the first case, if there is a need for additional revenue savings to be identified, then reductions or deferrals in the capital programme, with a resultant reduction in the revenue impact, are a potential option. The second case is slightly more complicated. Those schemes dependent on private sector investment to some degree may slip significantly in any event, potentially reducing the call on the Council's contribution to these schemes. On the other hand, this may create the scenario whereby the Council is under a variety of pressures to "unlock" or "pump-prime" schemes prior to the availability of external funding.

(h) In any event, in both these cases the economic climate has created significant problems for the Council in formulating and delivering an affordable capital programme. Firstly, the interest rate outlook, which is inextricably linked to capital financing decisions, will have a serious impact on the Central Bedfordshire revenue position. Investment interest income is likely to be at least half, or possibly even a third, of the levels projected in the budgets of the three authorities. In contrast, debt is essentially fixed, with the average debt interest rate for Bedfordshire County Council being around 4.4%. With regard to financing ability, there has been a significant fall in capital receipts arising from the sale of land and property assets in all three authorities, particularly the County Council.

(i) Overall, as a result of these financial pressures, the situation is that Central Bedfordshire is extremely unlikely at this stage to be able to simply deliver a Capital Programme in the short term based on consolidating and disaggregating the existing programmes, and much less deliver on significant new schemes in addition to this. The next section of this report outlines an approach to formulating the Capital Programme in the light of this situation.

5. Capital Programme - Recommended Process

(a) The financial position, and the current transitional situation, outlined above indicates that further work needs to be undertaken over the next few weeks to develop an affordable Capital Programme that can be delivered in the first year of Central Bedfordshire. It is inevitable that Central Bedfordshire will need to initially focus on supporting ongoing capital programme commitments already entered into and base load programmes for core service areas as a minimum, subject to affordability. Whilst it is important for them to be identified and allocated a priority in the draft programme, enhanced programmes, new spend proposals, and existing plans which are not committed will have to be regarded as discretionary until affordability is finally established as a result of the ongoing revenue budget process, In addition as outlined in this report, Central Bedfordshire needs to develop the processes referred to in the draft Capital Investment Strategy. At this stage of the authority's development, mechanisms have yet to be put in place to ensure that priorities are accurately determined across the entire range of the new council's functions, and that scarce capital resources are allocated in accordance with those priorities.

(b) Considerable work has already been undertaken on producing a Capital Programme for Central Bedfordshire. Over the next few weeks it is recommended that officers, in consultation with Portfolio Holders where appropriate, undertaken an exercise to establish the status and prioritisation of current and projected schemes. It is proposed that a useful starting point for categorisation and prioritisation could be as follows:

First Tier Schemes:

(i) In progress

(ii) Fully Funded

(iii) Significant External Funding Available (esp. where external funding could be lost)

(iv) Mandatory / Health and Safety Critical

(v) Strategic / Policy Commitment (esp. to third parties)

Second Tier Schemes:

(i) Second Tier Priority 1

(ii) Second Tier Priority 2

(c) Some further work may also be necessary to apply a prioritisation mechanism within capital rolling programmes, e.g. corporate property maintenance, as these tend to have elements of all of the suggested categorisations referred to above. However, it is also suggested that officers will need to be mindful of materiality and timescale when undertaking this review. It should be noted that the capital requirements directly associated with transition and implementation are not included in this exercise, nor is it intended that they will form part of the draft Capital Programme to be considered as outlined below.

(d) It is appreciated that any prioritisation mechanism at this stage will not be as refined as that previously used in the three authorities, or that envisaged for Central Bedfordshire. However, some form of prioritisation is required given the current position. Officers will continue to work on reviewing the capital financing position and determining the overall level for an affordable 2009/10 programme. This will in turn determine which programmes it is recommended to the Shadow Executive to progress. Regarding the member consideration and approval process, it is recommended that the Shadow Scrutiny Committee on 15 January 2009 considers the first draft of the Capital Programme in the light of this prioritisation exercise. Subsequently, it is recommended that the Shadow Executive on 20 January 2009 recommends the Capital Programme to Shadow Council in the light of any comments from the Shadow Scrutiny Committee.

Background Papers:

Location of Papers: Accountancy Section, Council Offices, Priory House

File Reference: N/A