

THE MORAY COUNCIL CAPITAL STRATEGY

1. INTRODUCTION

- 1.1 The Council owns a range of assets which are used to deliver – directly or indirectly – services to the people of Moray. The investment needed to ensure that these assets meet the Council approved standard for the asset type is ascertained through the asset management planning process. The Capital Strategy links that process to the Council's Capital Plan.
- 1.2 The Council also requires to invest to provide the infrastructure needed for economic growth, in accordance with the Local Development Plan, and to ensure that the Council operates efficiently and can meet the needs of transformation to a sustainable operating model.
- 1.3 All investment in capital is made under the Prudential Code. A revised version of the Code was published in 2017 and this contains new requirements for a Capital Strategy. This Strategy complies with these requirements. The Code states that:

“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.

2. CAPITAL EXPENDITURE

- 2.1 Capital expenditure is expenditure to acquire, improve, upgrade or extend the life of an asset, such as land and buildings, roads infrastructure, vehicles and equipment. The council sets *de minimis* levels below which expenditure will not be accounted for as capital. The current levels are:
- Land and buildings, council houses, surplus assets (valued at current value) - £20,000
 - Infrastructure, vehicles, equipment, community assets (valued at historic cost) - £6,000
- 2.2 Much capital expenditure requires a lead-in time to ensure that relevant legal conditions are met, eg planning permission is in place; for project design, and for procurement. Capital expenditure therefore requires a longer planning time-frame than revenue expenditure. The Council therefore prepares and annually updates a ten year capital programme.

- 2.3 Due to the short-term nature of council funding settlements from Scottish Government, only the early years of the plan are submitted to the Council for approval. However, the full ten year plan is approved as indicative of the Council's intentions.
- 2.4 Currently all of the Council's planned capital expenditure is operational; none is for commercial or purely income generating purposes.

3. CAPITAL INVESTMENT OBJECTIVES

- 3.1 The Council's objectives in investing in capital are to ensure an adequate suite of assets to deliver the Council's services, in accordance with the Council's policies, strategies and plans, and priorities; legislative duties and other requirements.
- 3.2 A key consideration in developing the capital plan is the requirement to provide new infrastructure and facilities to accommodate planned local developments.
- 3.3 The Capital Plan reflects the requirements identified in the Local Development Plan for Moray for infrastructure projects required to support growth including transport, schools, health services and where necessary sports and community facilities. These requirements are established through the strategic planning of relevant departments such as Transport and Education but also include Community Planning Partners and the evidence base on housing and employment land demand and forecasted delivery. This evidence base allows for the long term planning of Capital expenditure to support economic growth and also for the Developer Obligations requirements to ensure that the development pays for the infrastructure burden it creates.
- 3.4 The process relies upon robust strategic planning of major infrastructure provision relating to School Estate, Transport, Health and Sports and Community facilities. Where this evidence base does not exist or is not robust it will be difficult to obtain developer obligations. The Council also needs to demonstrate its commitment to deliver the Infrastructure required to support the economic growth within the Local Development Plan through its Capital Planning process.
- 3.5 The Community Planning Partnership has 5 priorities, which are encompassed in the Moray 2027 Local Improvement Plan (LOIP) and from this the Council has developed the priorities for its Corporate Plan 2018 – 2023:

- Ensure caring and healthy communities
- Promote economic development and growth and maintain and promote Moray's landscape and biodiversity
- Provide a sustainable education services aiming for excellence
- Work towards a financially sustainable council that provides valued services towards our communities

3.6 The General Services Capital Plan includes direct and indirect investment to promote economic development and investment in the school estate. There are two strands to working towards a financially sustainable Council which are encompassed in the capital plan: investment in transformation (for example in digital services) and provision for spend to save projects.

3.7 A key outcome of the Local Housing Strategy is to ensure there is an adequate supply of affordable housing and the Council agreed to a new build programme of 70 units per annum from 2017/18 to 2019/20. This is reflected in the Housing Revenue Account (HRA) Capital Plan.

3.8 The balance of the Council's Capital Plan arises from the need to invest in the Council's current asset base, either to bring it to the approved standard or to maintain it at the Council's approved standard for the asset type.

4. ASSET MANAGEMENT

4.1 The Council's Asset Objectives were approved by the Policy and Resources Committee on 11 October 2011:

- To ensure that our assets are fit for purpose in terms of condition, sufficiency, suitability, and accessibility.
- To ensure that our asset use demonstrates Best Value in terms of running costs and environmental impacts.
- To ensure that our Asset Management processes reflect good practice.
- To ensure that our assets reflect the policies and priorities of the Council.

4.2 The Council adopted the following standards for the asset classes within the Capital Plan on 11 February 2014:

Asset Type	Recommended Standard
Schools	B condition B suitability
Offices, Depots etc	Of a standard that supports the efficient delivery of services
Leisure Centres and Community Centres	B condition B suitability

Asset Type	Recommended Standard
Children's Play Areas	To meet safety standards
Town Halls	B condition B suitability
Day Centres and Resource Centres	B condition B suitability
ICT	Schools 5 Year Replacement Offices etc 7 Year Replacement
Plant and Vehicles	Replacement based on cost effectiveness – assessment of replace or repair
Industrial Estates	B condition B suitability
Waste Management	Of a standard that supports the efficient delivery of services
Roads	At end of 10 year period aim to be at the midpoint of the table for road conditions in Scotland.
Bridges	
Street Lighting	
Harbours	B condition B suitability

4.3 At the same meeting the Council adopted the following policy in relation to the preparation of the Capital Plan:

“The Council recognises the importance of the principles underpinning the CIPFA Prudential Code in relation to capital expenditure, in particular, affordability and sustainability of its investment plans. The Council's policy in relation to Capital Planning is:

- a) To maintain all buildings at a satisfactory level of condition and suitability for the provision of council services;
- b) To maintain the road infrastructure with regard to the safety of all road users and by the end of the 5 year period aim to be at the mid-point of the table for carriageway conditions in Scotland;
- c) To maintain all short-life assets (less than 10 years) required for the provision of council services at the optimum level to minimise the annual cost to the council;
- d) To provide investment funding to support economic development plans; and
- e) To identify assets for disposal.

In relation to the council's housing stock the same principles are applied in the Housing Business Plan. The council is also required to meet the Scottish Housing Quality Standard.”

- 4.4 A 30 year Business Plan for the HRA is regularly updated to ensure that housing stock can be brought up to and maintained at the Scottish Housing Quality Standard (SHQS) and can achieve Energy Efficiency Standard for Social Housing (EESH) by 2020.
- 4.5 To ensure that the General Services Capital Plan is affordable and sustainable, the draft Capital Plan is reviewed in the context of the Council's financial planning processes for the General Fund. It is recognised that the Council's current asset base is not sustainable in the current financial climate, and this was affirmed by Council on 30 March 2016 (paragraph 7 of the Minute refers). As a consequence of this, Council on 25 May 2016 (paragraph 11 of the minute refers) approved an interim approach to capital expenditure, focussed on avoiding potentially abortive spend, which is known as Make Do and Mend. Under this policy expenditure on buildings is to be limited to that necessary to keep them open and functioning whilst minimising health and safety risks to service users and staff.
- 4.6 A Property Asset Management Appraisal has been carried out with a view to identifying the Council's optimal property asset base and an action plan arising from this is reported to Council (12 December 2018).

5. CAPITAL FINANCING

- 5.1 A number of sources of funding are available to the Council to finance its capital expenditure:
- General and specific capital grants from Scottish Government and other bodies
 - Contributions from the Council's revenue budgets
 - Capital receipts from the disposal of surplus Council assets
 - Developer contributions
 - Borrowing
- 5.2 The Council is awarded General Capital Grant from the Scottish Government and this is used to fund capital expenditure before the use of any other capital receipts. The HRA makes extensive use of contributions from its revenue budget, but the General Services Capital Plan does not budget for contributions from revenue. The amount of capital expenditure which cannot be met from grant or other receipts will be funded by borrowing.
- 5.3 When setting the amount which it is willing to borrow, the Council must comply with the Prudential Code. The two main criteria for compliance with the code are affordability and sustainability, and the Council approves Prudential Indicators, prescribed by the Code, when the budget is set.
- 5.4 The capital plan impacts on the revenue budget in two ways: the impact of increased loan charges required by additional borrowing required to finance capital expenditure and the revenue (running) costs of new facilities, or revenue savings achieved through spend-to-save projects.

- 5.5 Loan charges represent the cost of interest on loans and also of principal repayments of loans used to fund capital expenditure. The Council will develop a local prudential indicator based on General Services loan charges as a percentage of the total General Services revenue budget. This indicator is to be used, not as a definitive cap, but to act as a guideline to assist with the Council budget setting process and to highlight the overall impact of capital expenditure to the Council's annual budgeted revenue costs. Currently the budget for loan charges stands at 7.2% of the new General Services revenue budget.
- 5.6 The period of time over which loans repayments are made into the loans pool is matched to the expected life of the asset. These can vary from three to sixty years.
- 5.7 Proposals for expenditure from the General Fund on asset maintenance are scrutinised to ensure that all costs which could potentially be capitalised are funded through the capital programme as in the short term this is the most economically advantageous way for the Council to fund replacement of failed elements or life-expired assets.
- 5.8 If appropriate specific grant funding is available it may be applied for to reduce the amount of borrowing required or to increase the level of expenditure possible within the Council's agreed borrowing limit.
- 5.9 The Council has entered into several Public Private Partnership (PPP)/ Private Finance Initiatives (PFI) contracts over the past few years. Under such an arrangement, the Council enters into a long term contract with a private sector organisation to construct new assets. Annual payments are then made over the life of the contract for the assets provided. The Council has used such arrangements to facilitate the building of new schools in Keith and Elgin, with another new school under construction in Lossiemouth. Such arrangements can mean capital investment where, due to financial constraints, it might not have been possible otherwise. All the Council's PPP/PFI arrangements have been supported by funding from Scottish Government.

6. TREASURY MANAGEMENT

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

- 6.2 The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans and long-term fixed rate loans where the future cost is known but higher. Statutory guidance from the Prudential Code is that debt should remain below the capital financing requirement, except in the short-term.
- 6.3 Under the Prudential Code, the Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year, and a lower "operational boundary" is also set as a warning level should debt approach the limit.
- 6.4 Treasury investments arise from receiving cash before it is paid out again. Any investment made for service reasons or for pure financial gain would not generally be considered to be part of treasury management. The Council's policy on treasury investments is to prioritise security and liquidity over yield, focussing on minimising risk rather than maximising returns.

7. GOVERNANCE

- 7.1 The Asset Management Working Group is tasked with corporate responsibility for asset management. It has the responsibility of ensuring systems are in place to develop and update asset management plans (AMPs) to identify the maintenance and replacement requirements to deliver the Council's policy for assets and agreed position in relation to standards of condition and suitability.
- 7.2 The Asset Management Working Group aims to ensure that AMPs are robust and that tools such as options appraisal are used as appropriate. The assumptions behind AMPs are challenged periodically by the Group.
- 7.3 The group is also responsible for developing the council's draft capital plan each year. A ten year plan is prepared in draft and updated annually. The group uses a process of peer review to ensure that appropriate rigour can be demonstrated in preparing the draft ten year Capital Plan and that revenue consequences of capital expenditure are recognised in the financial planning process, including whole life costing in relation to maintenance requirements. All new proposals for capital expenditure are taken through the Council's corporate Gateway process, from mandate to post-project review.
- 7.4 Spend-to-save is a feature of the Council's financial strategy. There is a presumption that a spend-to-save proposal with a suitable business case will be approved. However, such proposals will always be reviewed to ensure that they fit within the Council's priorities and do not divert staff from other core duties. As an indicative guide the payback period of a spend-to-save project should be three years or less. The factors to be taken into account when assessing a spend-to-save proposal are:

- Size of investment required;
- Payback period;
- Risk assessment of achieving payback;
- Impact on service.

- 7.5 The Council's Planning and Development service provide the Group with information on the infrastructure required to support new housing development – schools, roads, leisure and health facilities – and expenditure and developer contributions are factored into the Capital Plan.
- 7.6 To ensure that no capital project is considered on its own merits alone, but that all proposals for capital expenditure are considered in the context of the Council's overall plans for capital expenditure, no individual requests for capital projects is considered outwith the agreed cycle of approval when the revenue budget is set (February) and review when capital carry forwards from the previous year are considered (generally June) and when estimated actuals for the year are first reported (November), with the exception of spend-to-save projects, and only then if a good case can be made for why these should be considered outwith the normal planning cycle.
- 7.7 The full 10 year General Service Capital Plan reflecting all projected expenditure requirements for the council's current asset base and approved standards for condition, along with growth requirements, was deemed to be unaffordable in the current financial climate and expenditure contained by adopting a short term Make Do and Mend policy. This policy was adopted in May 2016 as a short-term measure.
- 7.8 Various work streams to reduce the Council's asset base – including a review of the school estate and development of the Property Asset Strategy - are taking place. In parallel to this, the Asset Management Working Group is looking to develop a robust basis on which to prioritise proposals for capital expenditure, and to develop a local affordability PI for capital spend.
- 7.9 Governance arrangements for the council's HRA capital plan are separate and recognise the ring-fenced nature of any HRA spend. The HRA Business Plan, last reviewed in October 2016, models scenarios for additional investment in further new build development which has been set against a range of risk factors, rent affordability and debt affordability levels to ensure borrowing levels are prudent, affordable and sustainable.

8. RISK AND RISK MANAGEMENT

- 8.1 The Council is exposed to risk in various ways through its programmes of capital expenditure. There are risks associated with various funding streams; different types of procurement, and predictability and controllability of spend. These are managed by individual project managers and corporately by the monitoring regimes for both General Services and HRA capital. The asset management led components of the programmes themselves are risk-mitigators against the risk of failure of the Council's assets.

- 8.2 There are different types of risk associated with different methods of financing capital projects. Public-private partnerships seek to transfer risk to the private sector. Investors will typically expect higher returns for higher risk projects, so there is usually a financial trade-off when risk is transferred. General Capital Grant funding comes at no risk to the Council. The terms and conditions of the grant are well understood and the risk of having to repay grant because it had been misapplied are minimal. However, specific grants vary greatly in their terms and conditions. There is a much higher risk that some specific grants – particularly some European grant funding – may have to be repaid. The terms and conditions are typically much more stringent and the very tight requirements for the records to be retained and the retention period of ten years following closure of the funding programme make European grants quite high risk.
- 8.3 The Council generates capital receipts from the sale of surplus assets. Capital receipts can only be applied to capital expenditure. Whilst no risk attaches to the use of capital receipts, there would be a risk in budgeting for significant funding from capital receipts that they would not meet the target either in terms of amount or timing.
- 8.4 The Council also receives developer contributions towards the cost of development of infrastructure or other requirements arising from developments. They are time-limited and the main risk from these is that they are used timeously. The amounts received might also be insufficient to fund the expenditure required. Developer contributions from major developments will typically be received over a long time scale, whereas the Council may have to invest up front to provide infrastructure. The Council bears the cost associated with the time-lag in funding; the risk that future contributions may not materialise, and the risk that relevant Council policy might change over time.
- 8.5 The Council manages the risks of borrowing through its Treasury Management strategy. The residual risk to the Council is that borrowing can carry very long term commitments and so capital expenditure in any one year can have revenue implications thirty or forty years into the future.
- 8.6 The Council can develop its asset base in conjunction with other public sector partners. The risks involved in that relate largely to the governance of the project, and to the possibilities of one partner rescinding on their agreement. These risks must be addressed at the inception of the project.
- 8.7 There are risks involved in developing assets through innovative funding models. This is exemplified by the stalling of the replacement for Elgin High School whilst technicalities of whether the finance for this project could be treated as the Scottish Government had planned, were resolved. Such risks are likely to be largely outwith the Council's control.

- 8.8 Inflation poses a risk to the Council. Construction Industry inflation can be highly volatile and current construction cost increase predictions are varying widely with the impact of Brexit being unknown. Projects are included in the Capital Plan at current prices. Depending on how far in advance these have been scheduled, costs may be significantly above the original estimate simply because of inflation in the intervening period. This is a risk to the affordability of the Capital Plan.
- 8.9 A significant risk arises from the Council's revenue budget for repairs and maintenance. If the budget for revenue maintenance is insufficient and results in deterioration of assets there may be a resulting requirement for capital expenditure to replace or renew the asset. If revenue budgets are reduced without a corresponding reduction in the asset base then the Capital plan will come under pressure. A related risk is the risk that a health and safety issue might arise, contravening the Council's legislative responsibility to the public and to Council employees.
- 8.10 The other main risks concerning the Capital Plan relate to project management and the many factors which impinge upon the delivery of the Capital Plan. These factors may be internal – such as staff shortages or competing priorities – but are frequently external, ranging across supplier delivery time, landowner disputes / compensation requests, unforeseen site conditions, contractor delays, weather conditions and many others. Project specific risks are identified in the capital monitoring reports to committee and, where appropriate, project Transformation Boards.

9. KNOWLEDGE AND SKILLS

- 9.1 The Council employs professionally qualified and experienced staff in senior position with responsibility for making recommendations on capital expenditure and borrowing and investment decisions. The Council also makes use of external advisors and consultants which are specialists in their field. Specialist advisors are generally specific to major capital projects, eg Lossiemouth High School replacement, NESS energy from waste project, Elgin Traffic Strategy, and employed as required. This approach is more cost effective than employing specialist staff directly. In addition, the Council also employs treasury management advisors, currently Arlingclose Ltd.

10. LINKS WITH OTHER PLANS AND PROCESSES

