

APPENDIX G: Capital Strategy 2023-2027

Introduction

This strategy sets out the County Council's approach to compiling the capital programme, its priorities, availability of funding and financial management.

The County Council's capital programme is derived primarily from the Strategic Plan. It aligns with departmental commissioning and service plans to ensure a prioritised, joined up use of resources to maximise outcomes for all Leicestershire service users, citizens and other stakeholders.

This strategy links to the Medium Term Financial Strategy, the Investing in Leicestershire Fund (IILP) Strategy and the Treasury Management Strategy. The IILP Strategy sets out the Council's approach to non-Treasury Management investments made to support the Council's objectives through property and infrastructure assets that will have an element of financial return, for example supporting economic development. The level of funding available for the IILP is determined by the Capital Strategy.

The overall approach to developing the capital programme is based upon the following key principles:

- To invest in priority areas of growth, including roads, infrastructure, economic growth;
- To invest in projects that generate a positive revenue return (spend to save);
- To invest in ways which support delivery of essential services;
- Passport Government capital grants received for key priorities for highways and education to those departments.
- Maximise the achievement of capital receipts.
- Maximise other sources of income such bids to the LLEP, section 106 housing developer contributions and other external funding agencies.
- No investment in capital schemes primarily for financial return, where borrowing is required anywhere within the capital programme (in line with the prudential code).
- In exceptional circumstances limited prudential borrowing will be considered where needed to fund essential investment in service delivery.

The 4 year capital programme 2023-27 totals £509m. External funding from capital grants, section 106 agreements and third party contributions totals £270m. Without this funding being available schemes of any significant size would not be affordable by the Council.

The balance of funding required is £239m and is from one off revenue reserves, capital receipts and a funding gap of £124m to be financed by prudential borrowing at a cost to the Council's revenue budget of around £8m p.a. over the next 40 years. This is a significant commitment to the Council given its wider financial pressures.

Funding Sources

The approach to funding is:

External Funding

- Central Government Grants – passport grants to the relevant departments, even when not ring fenced.
- External Grants - maximise bids for funding from external sources including providing matched funding where appropriate to do so, subject to approval of fulfilment conditions and any contingent liabilities.
- External Contributions – maximise section 106 developer claims/ contributions to cover the full capital costs.

Discretionary Programme

- Capital Receipts – maximise individual receipts and use to fund the discretionary capital programme.
- Earmarked Capital Receipts – only to be used in situations where this is an unavoidable requirement of an external party, for example, there is a requirement to gain DfE approval for the disposal of education assets, with the related receipts to be earmarked to education assets. These will be reviewed on a case by case basis to ensure the requirement is met and to consider options for substitution of discretionary funding where appropriate.
- Revenue underspends and surplus earmarked funds – review opportunities as they arise to contribute to the discretionary capital programme.
- Prudential borrowing (internal or external borrowing) – only to be used after all other available funding. Before prudential borrowing will be considered all opportunities to maximise bids for external funding, and agreement from other partners, particularly Central Government, for additional funding, will be taken. Internal borrowing (from County Council cash balances) will be prioritised over external borrowing.
- Leasing – due to the County Council's ability to access relatively inexpensive funding rental/ lease proposals need to be appraised to ensure additional benefits justify the financing cost over outright purchase.

Other

- Renewal reserves – held to make an annual contribution reflecting the life and replacement cost of the asset and to avoid annual variations in replacement cost. Use when the service is externally funded (commercial, partnerships, specific grants) or small scale asset owned by an individual service. Larger more significant assets will be funded through the discretionary capital programme.
- Building Maintenance – funded through the Central Maintenance (revenue) Fund (CMF). Significant lifecycle replacements to be funded through the discretionary capital programme.
- Tax Incremental Financing (TIF) – investment repaid from additional income generated, for example additional Business Rates.

Capital Requirements

Children's and Family Services

Demand	£	Funding
Meet demand for new school places. Meet increasing demand for SEN places Children's Accommodation Strategy	High High High	Central Government grants Developer contributions (section 106) Discretionary programme and grants
Maintenance and renewal for: Maintained school estate Children's Centres	High Low	Central Government grants Discretionary Programme
Children's social care (minimal demand as commissioned service)	Low	Spend to save

Adults and Communities

Demand	£	Funding
Adult Accommodation Strategy	High	Discretionary programme
Heritage and Learning Collections Hub	Mid	Discretionary programme
Disabled Facilities Grant	Mid	Central Government grants
Maintenance and renewal for: Libraries & Heritage Community Libraries	Low Low	Discretionary programme Support external funding bids
Adult Social Care (minimal demand from commissioned service)	Low	Spend to save

Public Health

Demand	£	Funding
Public Health (minimal demand from commissioned service)	Low	Spend to save

Environment and Transport

Demand	£	Funding
Maintenance of the highway infrastructure (using asset management principles)	High High	Central Government grants/ Discretionary programme
New Waste Transfer Station		Discretionary programme
Highways Depot Improvements	High	Discretionary programme
New Recycling and Household Waste Site	Mid	Discretionary programme
Improvement to the highway infrastructure Major schemes Minor Schemes	High Mid	External Funding Central Gov't grants (inc. LLEP, TIF) Central Government grants
Advanced Design	Mid	Discretionary programme
County Council vehicle replacement programme	Mid	Discretionary programme
Maintenance and renewal of waste management infrastructure	Mid	Discretionary programme

Chief Executives

Demand	£	Funding
Case Management Systems	Low	Spend to save, Discretionary programme
Economic Development, e.g. Broadband	Low	Spend to save, Discretionary programme

Corporate Resources

Demand	£	Funding
ICT Infrastructure Renew and expand the current corporate estate Major ICT upgrades and replacements	Mid	Discretionary programme Discretionary programme + Spend to save
Transformation – Ways of Working Office Infrastructure End user devices	Mid	Spend to save
Property Estate* Regulatory compliance Expansion and replacement Country Parks Expansion	Mid	Discretionary programme Spend to save
Climate Change Environmental Improvements	Mid	Spend to save

* maintenance of current properties funded from central maintenance fund (revenue budget)

Corporate Programme

Demand	£	Funding
Investing in Leicestershire Fund	High	Spend to save
Major Schemes Portfolio Risk	Med	Discretionary programme
Invest to Save Schemes	Med	Discretionary programme

External Funding

To ensure that funding is at the required level the following approach will be taken.

Children and Family Services

Preference for housing developers to directly build schools as part of developments.

Maximise DfE capital grant through up to date capacity assessments and school place data. Submit bids, where appropriate to do so, for additional DfE capital funding when available. Take opportunities to lobby the DfE for additional funding.

Adults and Communities

Work with District Councils and other partners to ensure that the Disabled Facilities Grant is at an appropriate level and how it is spent to reduce the costs of adult social care. Take opportunities to lobby the Department of Health for Social Care infrastructure grants.

Environment and Transport

Maintain Highways Infrastructure Asset Management Planning Level 3. Invest in advance design and business case development work focused on government priorities to access capital grants (which continue to often be channelled through bidding processes) and developer funding.

Section 106 Contributions / Forward Funding

Maximise section 106 contributions through recovery of the total costs of required developments and regular review of key assumptions used (at least annually).

The County Council understands the need to, and has forward funded investment in, developing infrastructure projects to enable new schools and roads to be built and unlock growth in Leicestershire before funding, mainly from section 106 developer contributions, is received. A total of £31m in forward funding is included in the proposed capital programme 2023-27 (in addition to £6m in previous years) that is planned to be repaid in the future. When the expected developer contributions are received they will be earmarked to the capital programme, to reduce the levels of borrowing required.

Forward funding presents a significant financial commitment and risk for the Council. An increased reliance on developer contributions through section 106 agreements means that it may take many years for investment to be repaid. Historic agreements may not be sufficient for the actual cost of infrastructure in the high inflation environment that is currently being experienced. The drivers of inflation are having a particularly profound impact upon construction schemes. Risks could be further compounded in the event of an economic slowdown, which could delay the housing development required before section 106 contributions are to be paid. The Council's medium and longer term financial strategies are only sustainable if this funding is recovered.

The Capital Programme includes some of the infrastructure funding for 2, out of 7, district local plans. Without appropriate funding, infrastructure relating to further plans cannot be added to the programme. The Council's limited financial resources available will need to be focused on schools, as they are the County Council's statutory responsibility, although this will need to be kept to a minimum. It is therefore critical that Local Plans are prepared with sufficient evidence to secure contributions and delivery for critical infrastructure.

The Council's approach to managing existing capital projects will therefore be:

- The funding provided by the Council is in accordance with the Council's funding strategies. The Council's medium and longer term financial strategies are only sustainable if this funding is recovered. Existing schemes are the Melton Mowbray Distributor Road (MMDR) North and East sections, MMDR south, A511 Major Road Network, and the Hinckley Hub.
- Where the Council seeks contributions from multiple developers in Area Strategies (jointly agreed strategies for specific areas), it will collect the full costs associated with highways, schools and some community infrastructure.
- The Council will ensure that delivery costs are reviewed regularly, and that inflation is applied to any cost estimates from the date that the Area Strategy is developed, not from when the relevant s106 agreement is completed.
- The justification, costs and methodology for assessing contributions will be updated and added to the Council's website as appropriate.

In order to address the significant challenge of funding infrastructure to support growth the Council's approach to managing future capital projects will be:

- The presumption that approved developments will cover the costs of all necessary infrastructure, set out by planning condition.
- Where this cannot be achieved as a result of cumulative development, the Council will collate contributions.
- However, the Council will not fund the delivery of schemes until sufficient contributions are secured.
- Where funding gaps exist, developers and local planning authorities will seek contributions from third parties (including funding organisations, i.e. relevant Government departments).
- The Council will lead and support as necessary such requests where appropriate, for example funding bids to the DfT and DfE. External funding would be required for any match funding or significant bid development costs.
- It is recognised that if the Council prioritises education contributions and delivery of additional school places due to its statutory duty, it may at times be necessary to delay delivery of highway infrastructure, meaning that the Council could in principle accept a deterioration in conditions before infrastructure is delivered. In addition, in prioritising the delivery of education infrastructure, the Council may accept a permanent deterioration in conditions if it is not financially viable to deliver the highways mitigation. However, this will not apply to infrastructure and improvements required to address severe safety impacts arising from development.
- Where the Council considers that the overall viability of the plan or development will not allow sufficient mitigation of its impacts and prospect of external funding is low, it may object to its adoption.

Whilst this approach significantly reduces the financial risk faced by the County Council, in the shorter term, it does not remove it entirely. Until such time as Government policy reflects and addresses the challenges faced by local authorities in meeting housing needs whilst ensuring infrastructure is available and appropriate district councils, as planning authorities, are in the best position to manage the developer contribution risk. It is therefore necessary for the district councils to work with the County Council to ensure Local Plans include policies that balance the need to support delivery of growth without exposing the County Council to further financial risk. District councils also need to work with the County Council to direct more funding towards priority infrastructure.

Discretionary Funding

The 4-year discretionary capital programme totals £239m. Funding is from the sale of County Council capital assets (capital receipts), MTFS revenue contributions and surplus reserve funds. Discretionary funding also includes prudential borrowing, which is unsupported by central government with the costs of financing the borrowing undertaken falling on the County Council's revenue budget. A total of £124m of prudential borrowing is included in the 2023-27 capital programme.

Capital receipts

Property Services are responsible for identifying additional capital receipts and maximising the sale value of surplus assets. Property Services will seek opportunities to maximise the

value of surplus land, for instance by obtaining planning permission. The targets for new capital receipts to fund the capital programme, are:

	General £m	Earmarked £m	Total £m
2023/24	9.8	2.9	12.7
2024/25	5.6	-	5.6
2025/26	1.0	-	1.0
2026/27	1.0	-	1.0
Total	17.4	2.9	20.3

The estimates are higher in the earlier years reflecting the increased confidence in the sale of those assets.

Revenue Funding

The capital programme includes a total of £95m in revenue funding of capital. On-going revenue contributions total £10m (£5.5m in 2023/24 then £1.5m p.a., allocated in the MTFS). One-off revenue contributions total £85m and are allocated in the MTFS/ earmarked funds. These have arisen from:

- Prior year underspends – cannot be relied upon going forward.
- Released MTFS risk contingency
- Surplus earmarked funds no longer required

Other

For invest to save schemes, a discount rate of 7% will be used, including inflation as part of the net present value assessment in the business case. Only projects that show a positive return using these rates will be considered for inclusion in the capital programme, unless there is an overriding policy objective that justifies a lower rate with the Director of Corporate Resources agreement.

Funding from Internal Balances

A total of £124m in funding required is included to fund the programme and enable investment in schools and highway infrastructure to be made. Over the next 10 to 15 years it is anticipated that the £37m forward funded will be repaid through the associated section 106 developer contributions.

Due to the strength of the County Council's balance sheet, it is possible to use internal cash balances to fund the capital programme on a temporary basis instead of raising new loans. Levels of cash balances held by the Council are currently c£400m, comprising the amounts held for reserves, provisions, minimum revenue provision (MRP) set aside for the repayment of debt, and working capital of the Council. The cost of raising external loans is estimated to exceeds the cost of interest lost on cash balances by circa 1% to 1.5%.

The overall cost of using internal balances to fund £124m of investment is dependent on what happens to interest and borrowing rates over the medium to long term. Current forecasts show the cost of externally borrowing £124m would be around £8m per annum for the next 40 years, in interest and repayment of principal - minimum revenue provision (MRP). Internal borrowing would still require MRP setting aside but net interest savings

could amount to £1.5m per annum. But because of the uncertainty on interest rates, this position will be kept under review as part of the treasury management strategy.

The County Council's current level of external debt is £262m. As described above this is not anticipated to increase during the MTFS.

Affordability

The impact of the discretionary programme on the revenue budget, and forecast at the end of the MTFS is:

£m	2020/21	2021/22	2022/23	2026/27
Revenue	1.5	2.5	5.5	1.5
MRP	6.2	6.2	6.2	8.3
Interest*	14.1	14.1	14.1	15.7
On-going revenue total	21.8	22.8	25.8	25.5
% Revenue budget	5.6%	5.2%	5.5%	4.1%
Voluntary MRP	0.0	12.0	0.0	0.0
One-off revenue	30.4	5.9	47.4	1.3
One-off revenue	30.4	17.9	47.4	1.3
Total	52.2	40.7	73.2	26.8
% Revenue budget	13.4%	9.2%	15.5%	4.3%

*includes reduction in income received from transferred debt interest, and interest cost of internal borrowing (2026/27).

To ensure the discretionary programme remains affordable the following approach is taken to manage the MRP and interest charges:

- No new external borrowing to finance capital expenditure unless a scenario arises where external borrowing is more favourable than using internal borrowing. The balance between internal and external borrowing will be managed proactively, with the intention of minimising long-term financing costs.
- Temporarily use internal balances from the overall council cash balances in advance of their designated use.
- Review opportunities to repay debt.
- Re-profiled MRP in 2020/21 to be commensurate with the average age of assets funded from borrowing and delay the impact on the revenue budget. It should be noted that this does not reduce the amount to be set aside but delays the period over which it is to be paid.

Capital Financing Requirement

The CFR is the measure of the Council's historic need to borrow for capital purposes. As at 31st March 2023 the CFR is forecast to be £208m compared with actual debt of £262m. The difference is a temporary 'over-borrowed' position pending future scheduled debt repayments and new prudential borrowing requirements. The forecast annual cost of borrowing in 2023/24 is £19.5m rising to £21.5m by 2026/27. The financing costs (external interest and MRP) are met from the revenue budget.

The planned use of internal cash balances to fund the four-year capital programme will add £124m to the CFR. Together with reductions made by MRP, the CFR is forecast to be £304m by the end of the MTFS (31 March 2027). Assuming no new borrowing is undertaken in this period, actual debt will be £255m at that time, resulting in an under-borrowed position of £49m. This can be managed as interest charges for new debt is forecast to continue to be higher than the interest that can be earned on cash balances.

The detailed approach to this is covered in the Treasury Management Strategy, approved by the County Council annually in February.

Financial Management of the Capital Programme

Prioritising the Programme

The approach to compiling the capital programme is through a combination of service requirements developed by each relevant department, statutory requirements and asset management planning.

For land and building assets, Strategic Property, in conjunction with service areas, develops all the estate strategies, asset management plans and property elements of the corporate capital and revenue programmes. They seek to ensure that the County Council is making full use of all assets, and any under-performing or surplus assets are identified and dealt with by either their disposal or investment to improve their usage. Outcomes from condition survey information together with on-going reviews of the property portfolio feed into the capital programme and revenue budget. The Corporate Asset Management Plan, which promotes the rationalisation of property assets, reducing running costs and cost-effective procurement of property and property services is reported annually to the Cabinet.

The County Council operates the Investing in Leicestershire Fund (IILP) which invests in assets to achieve both economic development and investment returns. A copy of the IILP strategy is attached to the MTFS report. The IILP operates through the Investing in Leicestershire Fund Strategy with a view to:

- Supporting the objectives of the Council's MTFS, Corporate Asset Management Plan, Strategic Plan, its Economic Growth Plan and the County-wide Local Industrial Strategy.
- Supporting growth in the county and its economic area of influence and ensure there is a more diverse range of properties and land assets available to meet the aims of economic development.
- Maximising returns on Council owned property assets.
- Supporting the delivery of front-line services through increased income generation from existing investments, or through capital investments that will reduce operating costs.
- Maintaining a diverse portfolio of energy efficient and sustainable direct property and other investment assets which support economic growth and environmental sustainability
- Supporting the Council's strategic objectives by working with partners to maintain momentum in the development of strategic sites and renewing existing employment sites and premises where there is demand thereby addressing areas of market failure.

- Contributing towards the development and implementation of a Net Zero Carbon 2030 Plan for the Council by reducing demand for energy and increasing the generation and use of renewable energy.
- Channelling new investment into schemes that:
 - Maximise the potential to address economic and social market failure;
 - Improve property assets for a direct strategic/policy purpose
 - Enhance the value and marketability of property assets enabling capital receipts to be used to support improved service delivery
- Managing investment risk by investing in diverse sectors.
- Supporting the Council in maximizing the benefit from its financial assets in a risk aware way (not including standard treasury management activity).

Current holdings plus schemes in the 2022/23 capital programme will result in a total holding of £205m (original cost). A fund of £55m has been included in the draft 2023-27 MTFS to bring the overall IILP fund to the expected maximum holding of £260m, subject to satisfactory business cases. Appraisal includes external due diligence performed before each purchase.

The corporate programme also includes additional funding of £40m for the Future Developments fund, and £21m as a capital programme portfolio risk contingency. The future developments fund is held to contribute towards schemes that have been identified but are not sufficiently detailed for inclusion in the capital programme at this time. There is a long list of projects that may require funding over the next 4 years. These include investment in infrastructure for schools and roads arising from increases in population, investment in health and social care service user accommodation, highways match funding of capital bids, and investment in the efficiency and productivity programme. The list of future developments is continually refreshed. Bids against the fund will be managed through prioritisation and where possible the identification of alternative funding sources. This approach forms part of the wider strategy to ensure that the capital programme is deliverable, affordable and the risks are understood, in line with CIPFA's requirements.

The capital programme risk portfolio is there to cover adverse impacts that would potentially affect all schemes, such as exceptional excess inflation. The schemes for which a portfolio risk allocation is more likely to be needed are those which are highly complex and difficult to predict costs or external funding and are likely to span many years. Individual schemes are expected to maintain a risk register and appropriate risk contingency for known risks. The contingency should be set at the 50% likelihood level, unless agreed by the Director of Corporate Resources.

Through the budget monitoring process, risks would be identified which would point to the need to utilise a proportion of the portfolio risk allocation. To access the fund there would need to be based on clear evidence that such a scenario has arisen. A full appraisal of the scheme's cost and funding would be required to ensure that delivery is still likely to be within the scheme budget and reduced risk portfolio contingency. Decisions on when money from the portfolio risk allocation is transferred to a specific project are taken by the Director of Corporate Resources following consultation with the Cabinet Lead Member for Resources.

For highways and associated infrastructure needs, the Council's key transport policy document is the Local Transport Plan. This provides the long term strategy within which the Council manages and maintains its network. In light of the continuing financial challenge the

Council's priority is only to add to the highway network where this will help to enable new housing and jobs. Furthermore, additions will normally be considered only in circumstances where specific external funding can be secured to achieve this. It is recognised that by prioritising education contributions and delivery of additional school places due to its statutory duty, it may at times be necessary to delay delivery of highway infrastructure, meaning that the Council could in principle accept a deterioration in conditions and congestion before infrastructure is delivered. However, this will not apply to infrastructure and improvements required to address severe safety impacts arising from developments.

Further improvements to the highway network will require continued pursuit of external resources such as Government grants and developer funding. Government grants include bids to funds including Growth Fund, the Growth and Housing Fund, the National Productivity Investment Fund, Local Authorities Majors Fund and the Housing Investment Fund. In order to maximise the impact of funding that can be secured for improvements, the County Council is doing more to define the roles of the various elements of the road network so that it is able to target investment where it will be of most benefit, particularly in terms of supporting economic prosperity and growth.

Bids for funding from the discretionary programme require the completion of a capital appraisal form for each project. The forms collate detailed information on the proposed project including justification against strategic outcomes, service objectives, statutory requirements and/or asset management planning, timelines, detailed costings including revenue consequences of the capital investment, and risks to delivery. All bids for land and building projects are also supplemented by a Strategic Property scoping and assessment form. Bids are then prioritised and assessed against the discretionary funding available. The revenue costs and savings associated with approved capital projects are included in the revenue budget.

Where schemes have not yet been fully developed these are included as future developments in the capital programme. As schemes are developed they are assessed against the available resources and included in the capital programme as appropriate.

Financial Management of Delivery

The key risks to the delivery of the capital programme are overspending against the approved budget, delays in the delivery of projects/programmes thereby delaying the expected benefits and potential increased costs, and delays in or non-receipt of external contributions towards the cost of the scheme.

To ensure that capital spending and the delivery of this strategy is effectively managed:

- Programmes being reviewed in light of the most up to date information around funding available and latest priorities.
- All schemes within the programme being monitored regularly, usually monthly.
- Financial progress being reported on a regular basis throughout the year and at year end to the Cabinet and Scrutiny Commission to update them on progress and any significant variations in costs.
- Projects part or wholly funded by external contributions being separately monitored to ensure compliance with any funding conditions applicable.
- All projects are assigned a project manager appropriate to the scale of the scheme.

- The procurement of projects within the capital programme following the Council's approved contract procedure rules and where applicable the Public Contract's Regulations 2015.

The County Council confirms that it complies with paragraphs 51 to 53 of the prudential code 2021. Extracts of the relevant paragraphs are included as an annex to this strategy.

Annex 1 – Prudential Code 2021

The Council confirms that it complies with paragraphs 51 to 53 of the prudential code 2021 as below.

51. The Prudential Code determines that certain acts or practices are not prudent activity for a local authority and incur risk to the affordability of local authority investment:

- In order to comply with the Prudential Code, an authority must not borrow to invest primarily for financial return.
- It is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.

52. The UK government's rules for access to PWLB lending at the date of this publication require (May 2022) statutory chief finance officers to certify that their local authority's capital spending plans do not include the acquisition of assets primarily for yield, reflecting a view that local authority borrowing powers are granted to finance direct investment in local service delivery (including housing, regeneration and local infrastructure) and for cash flow management, rather than to add debt leverage to return-seeking investment activity. Since:

- access to the PWLB is important to ensure local authorities' liquidity in the long term, and
- leveraged investment always increases downside risks, local authorities must not borrow to fund acquisitions where obtaining financial returns is the primary aim.

53. Authorities with existing commercial investments (including property) are not required by this Code to sell these investments. Such authorities may carry out prudent active management and rebalancing of their portfolios. However, authorities that have an expected need to borrow should review options for exiting their financial investments for commercial purposes and summarise the review in their annual treasury management or investment strategies. The reviews should evaluate whether to meet expected borrowing needs by taking new borrowing or by repaying investments, based on a financial appraisal that takes account of financial implications and risk reduction benefits. Authorities with commercial land and property may also invest in maximising its value, including repair, renewal and updating of the properties.