CABINET

2008/09 Capital Investment Strategy Update
07 October 2008

Report of Head of Financial Services

PURPOSE OF REPORT					
To update Members on the position regarding the progress on the Capital Programme and the overall funding position, in line with the requirements of the Capital Investment Strategy, and to gain Cabinet's approval for updating both this year's capital funding assumptions and the draft funding principles for the period from 2009/10 onwards.					
Key Decision	X	**Non-Key Decision**		**Referral from Cabinet Member**	
Date Included in Forward Plan	October 2008				
This report is public, with the exception of Appendices B and C. These are exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972.					

OFFICER RECOMMENDATIONS:

1. **That the current position regarding the Capital Programme position be noted, and that the updated Capital Programme as set out at Appendix A be approved, subject to any other amendments arising from items elsewhere on the agenda.**

2. **That the 2008/09 Capital Programme funding be updated to provide for a £1.4M underlying increase in unsupported borrowing, on the basis that this be 'repaid' in 2009/10, and that this be referred on to Council for approval.**

3. **That the funding changes in recommendation (2) above be reviewed further as part of the 2009/10 Budget.**

4. **That the draft capital funding principles as set out in section 6 be approved, and that they form the initial basis on which Cabinet develops its capital programme proposals for the five year period from 2009/10 onwards, subject to:**

   - **a separate review of potential asset sales being reported back to the December Cabinet meeting;**
   - **any other potential changes in investment needs arising from the review of priorities;**
   - **the outcome of the position regarding Luneside East; and**
   - **the levels of any unsupported borrowing being reviewed regularly throughout the budget process, as the revenue position develops.**

Introduction

The Council's Capital Investment Strategy requires that an update regarding the overall capital investment and funding position be presented twice yearly. This is the first such update for 2008/09 and in terms of monitoring, it is based mainly on information to the end of August (i.e. period 5). The report makes recommendations regarding how to manage the current year's funding position, in order to make progress on key capital schemes.

This update also sets the context for Cabinet to review its capital investment priorities and plans for forthcoming years. Recommendations regarding the main funding principles are set out for consideration, and also the report sets out how the initial review of investment priorities will be undertaken. Ultimately the final proposals will be incorporated into the Capital Investment Strategy and referred on to Council as part of Cabinet's overall budget proposals.

Report Details

1 GENERAL FUND SCHEME PROGRESSION

1.1 During the year the Asset Management Working Group has met regularly to consider individual projects and monitor progress overall. As at the end of August, in total spend of only £3.3M had been incurred against the (then) forecast programme of £35M. This represents less than 10% of the budget and in the main, the position has been affected by the following issues:

- A budget of almost £10.9M is still included for the externally funded Lancaster Science Park project. In line with the report to Cabinet back in July, work is underway to re-profile the capital budget and this will be updated in the coming months.

- Several significant regeneration projects in Morecambe amounting to around £11.7M are still under appraisal or development and again, these will be updated and re-profiled as necessary in revising this year's budgets. These projects are also predominantly externally funded. (Separate reports elsewhere on the agenda make recommendations regarding the Central Park scheme, as an example).

- In terms of schemes to be funded by the City Council, section 3.1 of this report highlights the delays that have been experienced in achieving key asset sales. Members will be aware that under current Financial Regulations, capital schemes are allowed to progress only when funding is in place. Whilst this is in line with Financial Regulations and helps protect the Council's financial position, it does not help with managing the Council's property portfolio, particularly municipal buildings, and this could create significant difficulties in service delivery.

- To date, around £2M of schemes have not yet been formally cleared to progress. Some of these schemes are still under development and so have not been affected by the capital receipts position as yet. There is one notable exception, however, in relation to municipal building works.

1.2 With regard to the last point above, in the current year the Council was originally due to spend around £1.5M on municipal buildings works. So far this year some preparatory planning and design work has been undertaken, but there is now a need to resolve the funding position in order that essential works can begin. Furthermore other schemes, such as playground improvements, toilet refurbishment, Salt Ayre improvements, etc. would also eventually be affected by the delays if the funding position is not resolved soon.

1.3 Given the above, alternative options for funding the programme are set out later in this report.

2 GENERAL FUND PROGRAMME CHANGES

2.1 In reviewing capital schemes and monitoring information, a number of changes have been approved under delegated authority and these are summarised below:

– Cycling England (grant funded)	£13K
– Cemetery Paths (revenue funded)	£3K
– Port of Heysham (grant funded)	£8K
– Middleton Wood (revenue funded)	£2K
– Heritage Lighting (revenue funded)	£18K

2.2 In addition there is one proposed change that falls outside of the Officer delegations and therefore requires Member approval:

- **Port of Heysham**
  Additional costs of £15K have been incurred in connection with some delays in establishing site infrastructure. No alternative sources of funding have been found, hence this amendment requires Member approval. Regarding the clawback aspects of this scheme, a review of the funding set aside to meet estimated liabilities is underway and it is possible that this will also change the call on the programme in future.

2.3 An updated programme incorporating the above changes is set out at ***Appendix A*** for Members' consideration. In addition though, and as mentioned earlier, some specific scheme proposals such the Harbour Band Arena and Central Park are considered elsewhere on the agenda. These will also be reflected in the programme, should they be approved by Cabinet.

3 GENERAL FUND CAPITAL FUNDING POSITION

This section outlines the changes in funding that have arisen since the programme was approved back in February.

3.1 Capital Receipts

3.1.1 A review has been undertaken to establish the likely timing of property sales due in the current year, the outcome of which is shown overleaf:

	Per Feb. Council £'000	Per this Review £'000
Original Capital Receipts funding assumed in 2008/09	2,704	2,704
Funding for Approved Slippage	-	1,356
Additional Funding Requirement; Port of Heysham	-	15
Capital Receipts Requirement in 2008/09	**2,704**	**4,075**
Made up as follows:		
Receipts b/f from 2007/08 (received in previous years)	375	1,424
Receipts received in current year to date	-	55
Sales due - not yet completed	6,491	1,195
Receipts to be set aside (to help potential difficulties)	(1007)	-
Receipts to be c/f into 2007/08	(3,155)	-
	2,704	**2,674**
Shortfall in Funding	**--**	**1,401**

3.1.2 The table demonstrates that of the £4.075M capital receipts currently needed to finance this year's programme, only £1.479M has already been received. Of the £6.491M sales originally due to be completed in the year, only £55K has been achieved, and furthermore it is now expected that only another £1.2M is likely to be completed before next April. The remainder are either expected to slip, or have been removed pending further developments or negotiations. More information from the Head of Property Services on key sales is included at ***Appendix B: exempt***.

3.1.3 Overall, therefore, a capital funding shortfall of around £1.4M exists in this year, and this could rise to around £2.6M if expected completions do not materialise.

3.1.4 It is equally important though to keep the 5-year outlook under review. The Council has a number of key asset sales underway and other potential sales that could help the funding position significantly, if they are completed. The current disposal schedule for the 5-year period is included at ***Appendix C; exempt***. Given the current economic climate and the impact it has had so far, however, it could be that some sales will not or should not be progressed, until perhaps the medium term.

3.2 Borrowing

3.2.1 The current approved programme is based on only £270K unsupported (prudential) borrowing during 2008/09; this is the remainder currently available based on the financing assumptions approved back in February. It is possible that further changes to unsupported borrowing may arise this year in connection with vehicle acquisitions, but these would be reported in line with the agreed process.

3.2.2 Future years' unsupported borrowing assumptions are covered later in this report, and options to address the current year's difficulties centre around the use of increasing unsupported borrowing, albeit on a relatively short-term basis.

4 GENERAL FUND CAPITAL SUMMARY POSITION

4.1 Taking account of all the various changes and proposals mentioned in the sections above and as highlighted earlier, currently there is forecast to be a funding deficit of around £1.4M in the current year, although if planned capital receipts are secured over the 5-year term, potentially there could be around a £2M surplus overall. A summary of the overall funding position is given below.

	2008/9	2009/10	2010/11	2011/12	2012/13
	£'000	£'000	£'000	£'000	£'000
Total Proposed Programme	**35,705**	**6,828**	**3,748**	**2,496**	**561**
Estimated Council Funding Available (including year end capital receipts balances)	34,304	10,908	6,736	4,931	2,535
Cumulative Surplus (+) / Shortfall (-)	**-1,401**	**+4,080**	**+2,988**	**+2,435**	**+1,974**

4.2 In addition to the changes and proposals outlined above there may be further cost pressures arising from the review of capital investment needs and priorities, as referred to later in this report. For now though, the recommended way forward is as follows:

- The updated Programme of schemes as set out at ***Appendix A*** should be approved.
- To fund this year's programme, the unsupported borrowing need should be increased by £1.4M, on the basis that it be 'repaid' in 2009/10, from capital receipts. This can then be reviewed further as part of the forthcoming budget exercise.
- Work will continue on firming up the position regarding Luneside and Access to Services. In the meantime any updates will be fed into the relevant PRT meetings and Star Chamber as appropriate, and a separate report on the Luneside position will be brought to Cabinet as soon as possible.

4.3 The next general capital update report is scheduled for December Cabinet and this will provide an opportunity for another review of the position, with recommendations for further action if required.

5 COUNCIL HOUSING CAPITAL POSITION

5.1 The Council Housing capital position is much more straightforward than General Fund and the points to note are as follows:

- There has only been one amendment to the programme since March, that being slippage from 2007/08.
- As at the end of August total spend amounted to only £411K against a total programme of £3.28M. Cabinet will be aware that very high levels of slippage have been experienced in recent years and this will be addressed in the next full

update report on the Council Housing position. It is also expected that the recent exercise undertaken by Budget and Performance Panel, and challenge through the PRT process, will result in actions being taken to ensure that the annual Programme is deliverable in future, with significantly less slippage being experienced.

6 CAPITAL INVESTMENT PRIORITIES 2009/10 ONWARDS

6.1 The current Capital Investment Strategy was approved back in February and as in every year, it is necessary to review the funding principles and investment priorities underlying it to ensure they still meet the Council's requirements.

6.2 The full Strategy document will be submitted to Budget Council in March but for now, Cabinet is requested to determine the basis for developing capital programme proposals for the next five year period (i.e. 2009/10 to 2013/14). Initial proposals are set out below. Where appropriate these are based on current principles, but they will need to be reviewed and updated as the budget and planning process progresses, to respond to changing needs.

Draft Investment Priorities

i. Draft capital investment priorities will be updated as part of the current Member review of corporate priorities and non-priorities. Once the first draft of priorities has been produced and considered informally by Star Chamber, Service Heads will be requested to review the existing Programme from 2009/10 onwards, and develop any initial capital proposals accordingly. These may be reductions to the existing programme, or new bids. The draft priorities will also be considered formally later by Cabinet, at which point any changes arising from the public consultation on Corporate Plan priorities can be factored in.

ii. One key element that has been missing from the approved Programme so far relates to Access to Services developments. Arrangements are currently underway to ensure that all aspects of this (including customer services integration, electronic document management, and the wider accommodation changes) are included in the Council's spending plans for consideration at Budget Council.

Draft Funding Principles

i. The latest capital receipt forecasts for General Fund (as set out in Appendix C) will be assumed, together with the current ring-fencing arrangements for certain projects such as Access to Services and the West End. It is also recommended that the outcome of a further review of potential asset sales, in accordance with the Corporate Property Strategy, be fed through into Cabinet in time for the December meeting. This is in line with last year. Regarding Council Housing, the current Programme assumes 20 right to buy sales each year. In line with recent trends and the current economic climate this will be reviewed downwards as part of the overall budget update, and reported to Members accordingly.

ii. Current assumptions on direct revenue financing (DRF) for capital will be maintained, in that general budgetary provisions will be included in the Housing Revenue Account to support the 30-year business plan. No further specific DRF provisions will be built in for General Fund, though this may change in connection with the review of renewals funding.

iii. Prudential (i.e. unsupported) borrowing assumptions will be limited initially to short-term measures such as that proposed for this year, to ensure that the Programme is funded in each year. No overall increase will therefore be assumed. This will be a key aspect to review as the budget develops in view of emerging investment needs and priorities and the principles of the Prudential Code for borrowing – these being affordability, prudence, and sustainability.

7 Options and Options Analysis for other Issues(including risk assessment)

7.1 With regard to the current year, basic options are as follows:

<u>To approve the updated programme as set out in Appendix A and the way forward as set out in section 4.2.</u>

The main risk attached to this course of action is that sufficient capital receipts will not be generated in future, to offset the short-term increase in borrowing. This would increase the pressure on the revenue budget and therefore on service delivery and Council Tax. Given the potential for receipts generation, this risk is felt manageable in order to deliver key capital schemes. Furthermore there would be an opportunity to take further action later during the budget process if need be. It would not be possible to contractually commit all outstanding schemes in such a short period of time, and so opportunities for other remedial action would still exist.

<u>To defer approval of the programme pending work being done to identify alternative funding sources, and / or to consider deferring or cutting schemes that have not yet started</u>.

Given that some of this work will be done as part of the budget anyway, there is little tangible benefit in deferring the programme. The recommended programme as set out represents best information available at this time and therefore the Head of Financial Services would advise reflecting this in the financial plans of the Council. It is recognised, however, that there will be significant slippage as only half of this financial year now remains – though the slippage can only be quantified once the funding position is clarified. Deferring approval could avoid some additional costs in this year (see financial implications later), but not all outstanding works could be deferred. Some key works would still need to be progressed on health and safety grounds, irrespective of any Member decision in force. This is provided for under Financial Regulations.

In considering whether to defer or cut schemes that have not yet started, only full Council may delete schemes (in their entirety) from the approved Programme. This control exists to ensure that Cabinet undertakes capital investment in line with the budget and policy framework set by Council. Risks would very much depend on the schemes being considered.

Other potential funding arrangements, such as drawing on the extra revenue funds available following the outturn, have been discounted for now as they can be picked up during the budget in any event.

7.2 With regard to future years' funding principles, options are basically to approve the principles as set out in section 6, together with the supporting reviews, or to determine alternative proposals. In doing so however, Cabinet would need to have regard to their proposed corporate priorities and the principles of the Prudential Code, namely prudence, affordability and sustainability. Risks would depend very much on the nature of any alternatives put forward.

8 **Preferred Option and Comments**

8.1 The Officer preferred options are to approve:

- the updated capital programme as set out at Appendix A and the way forward as set out at section 4.2;
- the draft capital investment and funding principles as set out in section 6.

9 **Conclusion**

9.1 As a result of delays experienced in generating capital receipts, alternative options for funding the programme need to be considered. Whilst these present significant risks for the Council, they should be manageable overall given that the 2009/10 budget process is underway and potential exists for achieving surplus resources in future years. In turn, the funding principles put forward for 2009/10 onwards seek to minimise any additional pressures on the revenue budget at this stage, although the overall position will need to be reviewed and updated over the coming months.

RELATIONSHIP TO POLICY FRAMEWORK

The capital programme supports delivery of the Council's corporate objectives.

CONCLUSION OF IMPACT ASSESSMENT
(including Diversity, Human Rights, Community Safety, Sustainability etc)

None directly arising in terms of the corporate nature of this report.

FINANCIAL IMPLICATIONS

In terms of increasing the Council's underlying unsupported borrowing requirement, this could result in additional costs in next year of around £56K. If sufficient capital receipts are achieved in next year to offset the increase in underlying borrowing, then there would be no other implications for future years.

These figures also assume that the cashflow impact would be broadly neutral. In this year, investment interest is already higher than budgeted (£65K at quarter 1), but is not possible to project accurately exactly how this will move in this year and in future years. This is because it will be affected by factors such as the amount of capital slippage and by the actual timing of completing asset sales. This risk needs to be recognised – although it is also possible that budgeted income could still be exceeded overall, because of higher investment rates being gained.

LEGAL IMPLICATIONS
Legal Services have been consulted. There are no direct legal implications arising from this report.

DEPUTY SECTION 151 OFFICER'S COMMENTS
The s151 Officer has prepared this report in line with her responsibilities.

DEPUTY MONITORING OFFICER'S COMMENTS
The Deputy Monitoring Officer has been consulted and has no comments to add.

BACKGROUND PAPERS **Council's current approved Capital Programme and Treasury Strategy.**	**Contact Officer: Nadine Muschamp** **Telephone: 01524 582117** **E-mail:nmuschamp@lancaster.gov.uk**