Appendix I1 Capital Strategy

Introduction

1. In 2017 the Prudential Code and Treasury Management Code were revised to include a new requirement for local authorities to prepare a capital strategy report which will provide the following:

    - a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
    - an overview of how the associated risk is managed
    - the implications for future financial sustainability

2. The aim of the capital strategy is to outline the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite. The capital strategy is reported separately from the Treasury Management Strategy Statement with non-treasury investments being reported through the former.

3. The strategy sets out in detail the recommended capital programme for the next four years for approval by Full Council. It also includes summarised information up to 2029/30 to show the full quantum of expenditure commitments over the medium term. The strategy sets out the long term context in which capital expenditure, investment and resourcing decisions are made to contribute towards the achievement of key objectives and priorities.

4. Further work will be undertaken in future years to stretch the horizon of the capital programme review process to provide a more developed view of capital expenditure requirements beyond four years in line with other key strategies such as the Asset Management Plan and Housing Revenue Account Business Plan.

Influences on Capital Strategy

Internal Influences

5. Capital investment is guided and prioritised by the Council's key objectives as set out in its new Corporate Plan 'Ambitious for Sutton'. These plans are underpinned by the Council's shared values and will ensure that Sutton continues to enhance its reputation as a great place to live, work and raise a family.

6. These corporate aims and objectives are taken into consideration when determining appropriate capital investment and asset disposal programmes. Five key priorities in the corporate plan are:

    - Being Active Citizens
    - Making Informed Choices
    - Living Well Independently
    - Keeping Individuals & Communities Safe

- Smarter ways of working

7. More detail on each of the priorities above can be found in the full corporate plan document.

8. Other key influences on capital expenditure plans are

- The Sutton Local Plan
- Economic Development Plan
- Asset Management Plan
- Local pressures such as school places
- Local initiatives such as the Digital Strategy

<u>External Influences</u>

9. There are a range of external influences which also feed into the capital planning process shaping capital expenditure priorities and influencing the level of capital resources available to fund the programme.

10. **London Plan & Sutton Local Plan** -The London plan supports many of the Council's own strategic priorities. It designates Sutton Town Centre as an Opportunity Area, with the capacity to provide 5,000 new homes and 3,500 new jobs, both of which are possible over the 22 year period of the plan. It also supports a tram extension to Sutton Town Centre, for which the Council continues to lobby for as a necessary improvement in Sutton's and South London's transport infrastructure to enable growth. It also references the London Cancer Hub as one of London's sector-specific growth opportunities.

11. **Local Economy** -the level of resources available to fund the capital programme are affected by the local economy. Payments through the Community Infrastructure Levy (CIL) and S106 are directly linked to development together with values achieved for capital receipts from the sale of council owned vacant land or buildings. The level of right to buy receipts are affected by the local housing market and government housing policy.

12. **Austerity** -The Council’s capital investment ambitions are made against a backdrop of austerity and significant central government funding reductions. It is therefore vital that the Council’s capital strategy ensures that assets are utilised in the most appropriate way to deliver corporate objectives, meet statutory requirements and sustain core infrastructure but also support the delivery of savings or income generation in the revenue budget.

13. **External Funding Arrangements** -The Council currently receives funding from external agencies such as TFL and the GLA which support the capital programme. The priorities of these funding agencies contribute towards shaping the programme and as such affect the level of resources available to the programme as a whole.

14. **Shared Services** -the Council has a number of established partnerships in place for the delivery of shared services with other local authorities. The most relevant in terms of capital expenditure programmes include the shared IT & environmental services with the Royal Borough of Kingston Upon Thames and the South London Waste Partnership (SLWP) which is a partnership of four London boroughs (Sutton, Kingston, Merton & Croydon) for the delivery of improved and cost effective waste management services.

15. **Commercial Activity / Ambition** -The Council is involved in a number of commercial ventures including commercial property investment through the Council's Investment Property Portfolio, working in partnership with the Institute of Cancer Research (ICR) to deliver ambitions for the London Cancer Hub and providing financial support through loans and equity shares to two wholly owned subsidiaries of the Council's holding company Opportunity Sutton, Sutton Decentralised Energy Network (SDEN) and Sutton Living.

Capital Budget Setting & Capital Prioritisation

16. Each year the Council reviews its capital expenditure plans and priorities for the next four years in order to agree a capital programme. This is undertaken alongside the revenue budgeting process in order that the impact of both is considered.

17. As part of the annual capital budget setting process services are required to complete a capital bid request form with details of the capital expenditure that that they require. These forms are required to be completed for all new schemes, for existing schemes which are uncommitted (i.e. have not incurred expenditure and are not contractually committed) and for all rolling programmes of expenditure including growth to existing rolling programmes.

18. Each year a cross service officer review group is brought together to review, challenge and score bids submitted by Directorates for capital expenditure over the next four year period. The criteria against which the bids are scored are as follows:

    - The scheme is essential for the delivery of the Council's Corporate Plan objectives
    - The scheme is required to meet statutory requirements
    - The scheme is required to sustain core infrastructure
    - There is a reputational risk attached to not undertaking the proposed expenditure
    - The scheme has the ability to lever in match funding to partially fund the scheme
    - The capital expenditure on the proposed scheme achieves cost avoidance in the Council's revenue budget

19. Officers submitting the bid are asked to state which of the six criteria the capital expenditure satisfies. Each bid can satisfy more than one criteria. Each criteria is weighted by the review group and bids are scored 1-5 against the criteria that applies to them. An overall score for each scheme is achieved by adding up the individual weighted scores against each individual criteria. Schemes are then ranked according to their total scores. These scores are then used to draw up a prioritised list for consideration by the Corporate Management Team (CMT). If there are further questions on any particular schemes, the review group can undertake a more in depth review session with key officers. Examples where this has happened in the past are highways maintenance rolling programme growth and digital strategy expenditure.

20. This prioritisation process supports the Council in making decisions about which schemes to progress, especially when capital resources are limited.

21. Member engagement throughout the capital review process helps to set the overall strategic direction for the programme and provide the context against which it is being agreed.

Capital Resources

22. Capital resources available to fund the capital programme are reviewed annually as part of the wider capital programme review process. This includes a review of projected capital receipts from the disposal of council assets, available resources from government or third party grants, S106, Community Infrastructure Levy (CIL), right to buy receipts and sums set aside in reserves.

23. Assumptions within the Asset Management Plan feed into this review in terms of asset use and the planned disposal of surplus assets. On the HRA assumptions within the Business Plan are reviewed such as numbers of RTB sales which affects the levels of resources available through the general RTB sum, allowable debt, and net RTB receipts.

24. A general principle applied to the capital programme is that prudential borrowing is only undertaken for schemes that either generate savings or additional income to pay for the associated capital financing costs. General borrowing to support the programme is not undertaken due to the related impact on the revenue budget.

Revenue Implications from Capital Schemes

25. Services are required to identify and record any potential revenue implications from capital schemes as part of the capital bidding process. These are then taking into consideration during the scheme prioritisation process and reflected in the medium term revenue budgets where necessary.

Capacity to Deliver Schemes

26. The capacity to deliver capital schemes is initially assessed through the capital programme review bidding process. Services are required to highlight key risks for the scheme and capacity would be part of this assessment. The finance team also have close contact with project managers delivering schemes. Any capacity issues are highlighted and followed up through the in year capital monitoring processes.

Governance

27. The Strategy & Resources Committee have oversight of the capital programme with the capital budget, in year monitoring and outturn position all being considered during the year. The Strategy and Resources Committee review and approve the capital programme before it is finally approved by Full Council. HEB Committee consider and agree the HRA Business Plan of which capital expenditure plans is a part.

28. Council approval of the programme gives an allocation to budget managers in the capital programme. Separate approval is required for any significant changes to the profiling or nature of that spend in year in line with financial rules set out in the Council's financial regulations.

29. Once approved the programme is managed by officers and reported to Strategy and Resources Committee on a quarterly basis. Key issues are any reported under or over spends projected for schemes together with changes in the profiling of spending over the four year budget period. In all cases the impact of scheme outcomes including timings are assessed and in the case of projected scheme overspends options to reduce the additional expenditure are considered including re-engineering or scaling back projects or trying to secure third party external funding to reduce the pressure on scheme budgets.

30. In all events the Council will continually look to ensure that quarterly projections are as accurate as possible and a rigorous process is applied to ensure that budget managers are made accountable and the appropriate approvals are obtained (as referenced to the financial regulations) for any changes to the Council agreed four year programme.

Asset Management Plan

31. The Corporate Asset Management Strategy 2015/19 was approved by the Strategy & Resources Committee on 9 February 2015. The strategy covers all of the council's property with the exception of housing and schools. The plan is due to be reviewed and updated in 2019.

32. It categorises council property into operational buildings and non-operational buildings. Operational buildings are those from which Council services are delivered and non operational properties are those which are held for other reasons such as income generation or socio-economic purposes e.g. accommodation for voluntary and community sector organisations.

33. With the backdrop of the reduction in public expenditure, the key challenges identified for the Corporate Asset Management Strategy were:

    - to manage a reduction in the number of buildings used by the Council to both save money and to reflect the ways in which service delivery is changing
    - to generate additional income from council-owned buildings
    - to find cost effective ways of meeting additional requirements for some types of accommodation e.g. schools
    - to ensure that buildings retained by the Council are efficiently serviced and maintained, are appropriate for the new ways that services are to be delivered and can accommodate the use of appropriate technology, and;
    - to facilitate developments on both Council and non-Council owned land that contribute to economic growth of the borough

34. Progression on all key targets and milestones under the Corporate Asset Management Strategy were reported to Strategy and Resources Committee most recently on 29 October 2018.

Commercial Property Acquisitions -Investment Property Portfolio (IPP)

35. In February 2015 Strategy and Resources Committee took the decision to set up an Investment Portfolio of properties to be managed commercially. This would include existing investment buildings but also set criteria for expanding that portfolio by undertaking commercial property acquisitions. The Strategy and Resources Committee then gave approval to principles for the Investment Property Portfolio (IPP) in September 2015.

36. The twin aims of the strategy for the Investment Property Portfolio are to:

    - Support the economic viability of the borough; and
    - Deliver a secure medium to long term investment return to help sustain the delivery of council functions

37. In delivering the strategy the following priorities are to be used to guide the growth of the Investment Property Portfolio:

    - Acquisitions that help attract and sustain economic activity and investment in the borough
    - Arrangements that help manage risks and contribute towards achieving a balanced portfolio including acquisitions in or out of the borough

Possible risks for the Council

38. Property investment has its own specific risks, the principal ones being property risks, financial risks and corporate risks. The arrangements set out in this policy are designed to help minimise these risks.

    a) Property Risks – the property market is cyclical and is affected by the wider economic environment. There are also property risks that are specific to a building due to its location, condition and quality of tenants. Mitigation proposed in this policy for these risks include diversifying the portfolio (portfolio mix) to include investments that perform differently over the economic cycle. The evaluation criteria, diversity of location, due diligence tests, approval processes and accountability for implementation are also proposed to address property specific risks.

    b) Financial Risks – the primary financial risks are borrowing levels, interest rates movement, ongoing ability to service debts, the general investment market conditions and its effect on rental income. Proposals include the creation of a special reserve for the IPP and a funding strategy that allocates debt and all associated costs to the IPP so that the net revenue benefits to the Council is transparent and can be benchmarked.

    c) Corporate Risks – effective operational delivery requires staff with the requisite expertise, effective arrangements for asset management and the recognition of the reputational risks that can come from inappropriate tenants, and from legal and environmental breaches. The council has adopted a statement on ethical investments to guide the acquisition of property and management of relationships with tenants. Operational delivery will be managed through the accountability offered by an officer board and the reporting requirements on the performance of the IPP to the Strategy & Resources Committee.

Portfolio Mix

39. The current weighting of the classes of property in the IPP, by rental income, is (October 2018) Industrial 28%, Retail 25%, Offices 42%, and Leisure 4% with most of the Council's property located within the borough and a few just across the borough boundaries with neighbouring authorities and one out of the borough.

40. Over the life of the strategy, a balanced and diversified portfolio will be achieved by:

    a) Selling low value assets and reinvesting capital receipts in directly managed property with good rental growth potential

b) Acquiring properties inside the borough, and also outside the borough where a case can be made that it is in the best interests of the council to seek lawful departure from the requirements of the Statutory Guidance on Local Authority Investments and the CIPFA Prudential Code (where such acquisitions are funded through borrowing).

c) Achieve a balanced portfolio where no single class of property is larger than 60% and none smaller than 10%.

<u>Governance</u>

41. Strategy and Resources Committee have set the policy arrangements for the IPP and receive an annual report on performance of the portfolio.

42. Operational management including acquisitions is delegated to officers, acting within their delegated powers as set out below.

- That the Chief Executive is granted delegated powers to authorise acquisitions up to £5m
- That the urgency procedure is used for acquisitions over £5m

43. An officer board (chaired by the Strategic Director of Resources) is to be accountable for the performance of the IPP and is charged with making recommendations to the Chief Executive for acquisitions. The officer board is to also include:

- Assistant Director, Asset Planning, Management and Capital Delivery
- Assistant Director, Housing and Regeneration
- Assistant Director, Customers Commissioning & Governance
- Assistant Director, Economic Development & Programme Director London Cancer Hub .

44. Disposal of assets in the IPP is to be undertaken in accordance with the Council's standing orders for asset disposals. The officer board will make recommendations to the appropriate officer where, due to disposal value, it is within officer delegated powers, and to the Strategy & Resources Committee where outside officer delegated powers.

<u>IPP Activity</u>

45. To date the Council has undertaken five acquisitions with a total value of just over £53m. Four acquisitions have been inside the borough and one in Oxford, Oxfam Headquarters. The annual gross rental income being achieved for these five properties is £3.07m and the annual net rental (after financing costs) is just over £1m. As at 31 March 18 there was £0.8m in the ringfenced IPP reserve.

46. A target of increasing the gross income from the IPP by 50% or £1.6m by 2019/20 was previously agreed alongside evaluation criteria for the portfolio. This target has been surpassed as the increase in gross income currently stands at £3.07m per annum.

47. Five key indicators are used to monitor performance of the portfolio. Performance against these indicators was last reported to the Strategy and Resources Committee on 29 October 2018 as follows:

48. Total Return -which is the annual increase in net capital value (expressed as a percentage) plus net income growth (expressed as a percentage of the capital value)

Total Portfolio

Year	Asset Value (£'000s)	Net Asset Value Growth (%)	Income Return (%)	Total Return LBS (%)	UK All Property Total Return (IPD Index) (%)
2015/16	£42,666	1.94%*	5.31%*	7.25%*	13.1% (Dec 2015)
2016/17	£75,739	1.72%*	3.78%*	5.50%*	3.5% (Dec 2016)
2017/18	£93,935	4.14%	3.61%	7.76%	11.3% (Dec 2017)

* restated values following change in methodology

By Property Type -2018 Outturn

Property Type	Asset Value (AV) (£'000s)	AV as (%) of Total Portfolio	Net Asset Value Growth (%)	Income Return (%)	Total Return (%)
Offices	£39,062	41.82%	1.56%	2.12%	3.68%
Leisure	£4,177	4.47%	0.34%	6.82%	7.16%
Industrial	£26,420	28.29%	13.54%	4.96%	18.50%
Retail	£23,736	25.41%	0.21%	4.14%	3.93%

Effective Return - Income receivable less costs, expressed as a percentage of capital value

Year	Asset Value (£'000s)	Net Income (less interest, minimum revenue provision and management)	Effective return (%)
2015/16	£44,156	£2,320	5.25%*
2016/17	£2,934	£2,934	3.84%*
2017/18	£3,242	£3,242	3.56%

* restated values following change in methodology

Growth in Asset Value and Gross Income - Percentage increase per year

Year	Asset Value (£'000s)	Asset Growth (%)	Gross Income (£'000s)	Income Growth (%)
2015/16	£44,156	1.89%	£2,809*	0.75%*
2016/17	£77,229	74.90%	£4,565*	65.77%*
2017/18	£93,395	20.93%	£5,883	17.29%*

Vacancy Rate - Expressed as a percentage of vacant space and potential rent loss compared with total lettable space and overall rent.

Year	Nr of Properties	Nr Vacant	Vacant Lettable Space	Vacancy Rate (% lettable space)	Rent Loss (if vacant for whole year)	Vacancy Rate (% of total rent)
April 2016	121	2	9,458 m2	0.87%	N/A	N/A
April 2017	111*	2	2,384 m2	0.26%	£195,003	3.34%
April 2018	111	5	2,036 m2	0.22%	£109,000	1.85%

49. Performance of the portfolio against all indicators is strong. The total return of the Council's IPP has been compared with the Investment Property Databank (IPD) UK All Property Index published by MSCI Inc, which is an acknowledged property investment benchmark indicator. The Council calculates its own total returns. The formula has been adjusted this year to improve accuracy resulting in the restatement of affected indices (previous years) to ensure like for like comparison.

Four Year Capital Programme - 2019/20 to 2022/23

50. The proposed capital programme for 2019/20 to 2022/23 is set out in detail in Appendix I2. This includes details of the corporate, education and housing capital programmes. Each are now considered in detail below.

Corporate Capital Programme 2019/23

51. The Corporate Programme sets out planned capital expenditure totalling £41.105m over the next four years as shown in the table below. This includes expenditure on one-off schemes of £21.794m and rolling programmes of £19.311m.

	2019/20	**2020/21**	**2021/22**	**2022/23**	**TOTAL**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Planned Corporate Capital Expenditure	19,129	12,128	4,975	4,873	**41,105**
Capital Resources					
Prudential Borrowing	5,057	6,200	200	100	**11,557**
General Capital Receipts Reserve	2,610	1,593	490	1,506	**6,199**
Right to Buy Receipts	4,847	1,942	0	747	**7,536**
CIL	859	702	2,653	888	**5,102**
Private Developers	100	100	100	100	**400**
Total General Capital Resources	**13,473**	**10,537**	**3,443**	**3,341**	**30,794**
Specific Funding	5,656	1,591	1,532	1,532	**10,311**
Total Corporate Resources	**19,129**	**12,128**	**4,975**	**4,873**	**41,105**

<u>Contractually Committed Schemes</u>

52. All existing capital schemes that are underway or contractually committed and are due to continue into 2019/20 to 2022/23 are excluded from the capital programme bidding process and form a first call on available capital resources. These schemes are included in the proposed capital programme and are included within the table above.

Rolling Programmes

53. Rolling programmes of expenditure ensure that assets are replaced or maintained in an appropriate and timely fashion. This represents a significant underlying, ongoing capital expenditure pressure for the council to continue business as usual. Each year the cost of rolling programmes is approximately £3.369m.

54. Key rolling programmes for the Council include highway asset maintenance, pavement improvements and resurfacing, street lighting works, public realm and expenditure on corporate buildings. As part of the annual capital programme review services are required to submit capital bids for all rolling programmes including the continuation of programmes into the fourth year of the budget (currently 2022/23) and any growth over and above normal levels of provision over the four year budgeting period. These programmes are then assessed against the criteria set out in para 18 along with any new capital schemes to ascertain whether these schemes are targeted at key priority areas and whether planned expenditure is at appropriate levels.

55. As part of the 2019/23 review bids were submitted to continue all rolling programmes over the next four years. In addition two bids were received for rolling programme growth for highways asset maintenance and priority repairs grants following demonstrated need in both of those areas.

56. **Expenditure on Corporate and Operational Buildings** -The capital programme includes a rolling programme of Expenditure to Corporate and Operational Buildings (ECOB). Planned spend on the programme is £759k in 2019/20, £808k in 2020/21 and £762k in 2021/22 and 2022/23. An element of the works undertaken under this programme are planned but some are responsive in nature. A prioritisation process is used by the property service to determine which works are carried out and in which priority order. An outline programme of works for 2019/20 is shown at Appendix I4.

57. **Public Realm** -The programme includes a rolling programme of public realm expenditure. These resources are governed by local committees to ensure funds are directed towards local priorities in each area. The capital programme includes funding of £200k per annum over the 4 year programme which will be used by local committees alongside other resources such as CIL, to deliver high priority public realm improvements.

New Schemes

58. A number of new schemes were put forward for consideration as part of the 2019/23 capital programme review. Following the challenge and prioritisation exercise new schemes totalling £3.292m have been included within the proposed four year capital programme. This includes prevention measures for encampments & fly tipping, works to Sutton Cemetery, replacement of equipment at Sutton Life Centre, sustainable drainage systems in Sutton Schools, housing estate regeneration enabling fund, works to gypsy and travellers sites, renewal of bridge height signs, replacement flood lights at the David Weir Centre and moving traffic offence equipment.

Transport for London Schemes

59. Transport for London (TfL) have confirmed the boroughs allocation for the 2019/20 financial year. Sutton is allocated £1.059m for Corridors of which £0.169m is revenue funding, £0.1m for the Local Transport Fund and £0.050m to complete the Beddington Gateway Major Scheme. In December 2018 TfL published their Business Plan for the period 2019/20 to 2023/24 setting out how TfL will continue to invest in vital transport improvements in London and deliver the Mayor's Transport Strategy, against a backdrop of some significant financial challenges. Funding for other schemes including Bus Priority and Cycling and LIP Liveable Neighbourhoods are expected in March.

Invest to Save Schemes

60. All capital schemes that have the potential to either increase income or release revenue savings are considered as potential invest to save schemes. Under these arrangements schemes are assessed over the life of the asset that is being created or maintained or enhanced through the production of a business case. Sufficient additional income or savings must be generated to cover any related capital financing costs associated with prudential borrowing. Typically this will be interest costs and minimum revenue provision (MRP) on an annuity basis. On completion of the scheme, the service budget is reduced by the level of capital financing cost.

61. As part of the business case the full revenue impact of proposed schemes is assessed including additional costs or income from the capital expenditure both in the short and longer term. Any cost avoidance projected as part of the business case is used to support the proposals but cannot be taken into account when assessing whether there is sufficient additional income or savings to cover any capital financing costs.

62. Schemes agreed as part of this year's capital programme review are phase 2 of the energy efficiency and carbon reduction programme at Civic Offices and Denmark Road and Street Lighting LED Lights.

Corporate Capital Programme Resources

63. Resources available over the next four years to fund the capital programme have been projected. Beyond this period these are difficult to forecast.

64. **Capital Receipts** - The potential capital receipts available to support the capital programme have been reviewed. The review has looked at whether the planned receipts are still achievable, reviewed their values and identified any new receipts which could provide additional resources.

65. **Borrowing** - Borrowing for invest to save schemes over the four year period totals £11.557m. The borrowing represents total borrowing rather than 'external' borrowing. This is because the borrowing requirement for the next four years from these schemes will be assessed and planned for as part of the wider treasury management strategy. In the past this has resulted in cash balances being used as 'internal borrowing' as this is the most cash efficient use of resources in the current interest rate environment. Interest rates on cash invested are low and counterparty risk is relatively high so the treasury strategy that has been implemented is to maximise internal borrowing where possible.

66. External borrowing is the process of going to an external financial institution to obtain money. The Council has the option to borrow from the Public Works Loan Board (PWLB) which provide favourable interest rates to public bodies, other financial institutions or more recently other local authorities (generally for short term borrowing).

67. A possible alternative source of debt finance in the future will be to borrow via a bond issued by the Municipal Bond Agency (MBA). This will be subject to the MBA achieving a source of finance and issuing its first bond. The agency is an independent body with its own governance structure, accountable to its local authority shareholders and the LGA. It raises money on the capital markets by issuing bonds to financial institutions that are then lent on to participating local authorities. It is expected that the bond will be issued at interest rates lower than the PWLB and is expected to provide a viable alternative to the PWLB.

68. **Minimum Revenue Provision -** Where capital expenditure has been funded through the use of borrowing, the Council is required to set aside an amount from revenue each year to provide for the eventual repayment of this debt. The Council is required to provide an annual policy statement on how the new methodology has been implemented. This is set out in Annex 2 of the Treasury Management Strategy (Appendix J). There is no requirement for the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.

69. **Right to Buy Receipts** - under Right to Buy (RTB) arrangements the Council retains three shares of the capital receipt and the balance goes to Government. The three shares relate to (1) general element (2) allowable debt and (3) net retained receipts. The Council receives the general element (old 25% retained receipt element), allowable debt element and the net retained receipt (for new homes under agreement with the MHCLG). The general element can be applied against any capital expenditure and the Council has previously taken the decision to apply this funding as a resource for the capital programme. The element that is retained for debt repayment can be used to repay debt or can also be used as a resource to apply against the capital programme. A total of £7.536m from the general element and allowable debt is being applied within the 2019/23 corporate programme. The retained RTB element is largely being used to fund property acquisitions for use as temporary accommodation, the remaining works on the initial local authority new build housing programme and the planned second phase due to begin in April 2020.

70. **Community Infrastructure Levy & S106 -** From 1 April 2014 the Council has charged the new Community Infrastructure Levy (CIL) on liable developments. The CIL is split into three parts

    - Admin portion (5% for administering the scheme)
    - Neighbourhood portion (between 15 and 25% allocated locally to areas where new development has taken place)
    - Borough portion (remaining 70 to 80% must be applied against infrastructure expenditure as listed in Regulation 123 list)

71. Total CIL received to date is £4.231m with a further £4.371m projected to be received by the end of 2022/23. The projection for the borough portion has been applied to the capital programme in line with the revised Regulation 123 list, this includes setting aside 50% of all town centre receipts and 10% of all other receipts towards the possible Tram extension.

72. The programme also includes £0.060m of specific s106 funding which has been received for Nature Conservation Schemes of £0.011m and Beddington Park HLF Scheme of £0.049m.

73. **Government Grants -** grant funding received for towards the capital programme is limited but includes Transport for London (TFL) funding of £1.040m, Disabled Facilities Grant (DFG) of £6.925m, London Business Rate Pool Grant £1.7m, Lottery Funding of £0.113m and minor grants £0.253m. In each case the Council must apply these resources according to any specific grant conditions attached to the funding. A total of £10.031m is being applied across the 2019/23 programme.

74. **Private developers -** a sum of £100k per annum is included within capital programme resources which relates to an annual payment back from the developer on the Oakleigh temporary accommodation scheme.

75. **Revenue Funding -**The Council can use revenue resources directly to fund capital schemes and this has been used in the past. However given the pressure on revenue budgets this practice is now generally restricted to the use of earmarked revenue reserves which have been set up to support capital.

Housing Revenue Account Business Plan

76. The capital programme for housing including both expenditure within the general fund and HRA is shown in the table below.

	2019/20 £'000	**2020/21 £'000**	**2021/22 £'000**	**2022/23 £'000**
HRA				
Works to Council Dwellings	7,944	7,396	7,635	7,872
Property Acquisition	11,628	8,896	6,376	6,503
Phase 1 New Build Programme	700	0	0	0
Phase 2 New Build Programme	1,783	21,284	1,359	0
General Fund				
Temporary Accommodation	5,600	0	0	0
Traveller Sites Improvements	114	0	750	750
Estate Regeneration	734	121	0	0
Strategic Regeneration	5,000	0	0	0
Total Expenditure	**33,503**	**37,697**	**16,120**	**15,125**
Resources				
HRA				
Borrowing	10,119	19,787	5,744	4,552
RTB	3,992	3,893	1,991	1,951
Grant	0	6,500	0	0
Revenue	790	130	130	130
MRR	6,860	7,059	7,270	7,485
Leaseholder Contributions	294	207	235	257

General Fund				
Capital Receipts	1,414	0	525	525
RTB	0	0	0	0
Borrowing	6,500	0	0	0
Grant	3,534	121	225	225
Total Resources	**33,503**	**37,697**	**16,120**	**15,125**

Housing General Fund

77. **Strategic Housing and Regeneration Fund** - There are a number of plans set out in the local plan for housing estate and town centre regeneration across the borough. Some of these schemes will involve an element of land assembly for long term ambitions to be achieved. The majority of these regeneration schemes are at an early stage in terms of assessing viability and do not have fully worked up plans and business cases. To allow progression of these plans in the future funding has been set aside which could be accessed for approved projects that align to the strategic aims of the council in it's regeneration policy objectives and to help deliver the Sutton Town Centre Master Plan. As part of the capital programme review a sum of £5m has been set aside for this purpose. This has been funded through £3.3m from the London Business Rate Pool grant, £0.8m HRA capital receipts and £0.9m prudential borrowing. Officers are working on outline guidance and parameters for the allocation of this fund.

78. **Estate Regeneration Enabling Fund -**The Council was previously successful in securing MHCLG grant funding of £0.942m for estate regeneration. Since then the Mayor of London has issued further guidance on good practice standards for estate regeneration which are likely to increase the cost of this preparatory work including the need for resident ballots. An additional capital allocation of £0.5m has been allowed for in the capital programme for the increased cost of this work.

79. **Improvements to Traveller and Gypsy Site Provision** -There is new expenditure within the capital programme for the improvement and expansion of existing travellers sites to satisfy the council statutory requirements (£1.5m). This assumes that the Council will secure funding from the GLA of £0.45m to support these expenditure plans.

80. **Temporary Accommodation** -The Council has previously approved capital investment in the construction of modular build temporary accommodation. This scheme is funded partially by right to buy receipts and prudential borrowing on an invest to save basis with rental income covering the capital financing costs. A total budget of £5.6m is included within the programme for potential schemes. The general fund will also benefit from cost avoidance savings within bed and breakfast accommodation budget.

81. **Property Acquisitions -**The Council is undertaking a programme of residential property acquisitions to be used for temporary accommodation. This programme was agreed by HEB Committee in June 2017. The properties were previously due to be purchased through the HRA initially with additional provision available in the general fund under invest to save arrangements to ensure that the HRA borrowing cap was not exceeded. However now that the borrowing cap on the HRA has been lifted it is planned to switch all property acquisitions through HRA borrowing and RTB receipts and the HRA business plan will now reflect this assumption. As a result the general fund capital provision will be removed and the HRA capital provision increased.

Housing Revenue Account

82. The Council's 30 year HRA Business Plan sets out plans for maintaining and investing in, its housing stock of 5,900 rented and 1,500 leaseholder properties. Each year the 30 year housing revenue account business plan is reviewed to take account of any changes to factors including reflecting changes to housing policy, economic assumptions such as building cost inflation and interest rates and changes to local conditions such as stock condition and levels of RTB sales.

83. Each year an exercise is undertaken to review building stock condition to ascertain levels of stock investment required over the next four years (in detail) but also over the longer term. This information is then used to determine a suitable programme of major works to council properties, balancing the need to hold a sufficient level of revenue reserves and ensure that revenue is set aside for the repayment of the £141m HRA subsidy loan which is due to mature in 2041/42.

84. The HRA Programme of capital expenditure over the next four years 2019/20 to 2022/23 is £89.376m. This consists of £30.847m on major works to Council housing stock, £25.126m on new build programmes and £33.403m on property acquisitions. This is to be funded by a range of different sources. £28.674m Major Repairs Reserve, £40.202m of borrowing, £11.827m RTB receipts, £6.5m grant or contributions, £0.993m leaseholders contributions and £1.180m revenue contributions.

85. **Major Works to Council Housing Stock** - Following the end of Decent Homes grant funding, ongoing works to Council Properties are being funded through the Major Repairs Reserve funding and revenue contributions. The Major Repairs Reserve is increased each year by the level of depreciation charged on existing assets. An outline housing capital programme of stock repairs and improvements for 2019/20 to 2022/23 is shown above for the first four years on the basis of the Housing Revenue Account Business Plan. Over the four year period planned works are financed by Major Repairs Reserve (MRR) of £28.674m, revenue contributions to capital of £1.180m and Leaseholder contributions of £0.993m. Appendix I3 sets out the proposed programme of capital expenditure in detail for member approval.

86. **New Build Programme** -The four year housing business plan includes outstanding work on the investment in new build housing at the Ludlow Lodge site, Richmond Green and Fellowes Road. It also includes planned works as part of phase 2 of New Build development which is benefiting from grant from the homes for Londoners GLA grant.

87. **Property Acquisitions** - As explained above there is provision within HRA budgets for property acquisitions for temporary accommodation. This will release cost avoidance savings for the general fund in its bed and breakfast accommodation revenue budgets. Given the restrictions around the borrowing cap the programme was initially agreed to be financed by RTB receipts and surplus HRA revenue for purchases from the HRA and RTB receipts and prudential borrowing for further purchases by the general fund. However now that the borrowing cap on the HRA has been lifted it is planned to switch all property acquisitions to HRA borrowing and RTB receipts and the HRA business plan will now reflect this assumption.

88. **Right to Buy (RTB) Receipts** -Under the new RTB arrangements introduced for 2012/13 the Council signed up to an agreement with Government for the use of net RTB receipts for the provision of new housing. It is estimated that £36.087m of net RTB receipts will have been retained through that agreement by the end of 2022/23.

89. A total of £11.827m net retained RTB receipts are being applied to the HRA capital programme over the next four year period. £1.806m is being applied to the new build programme and £10.021m to property acquisitions.

90. **Headroom Borrowing Cap** -Under HRA Reform a ceiling was set for the level of borrowing that the HRA would be able to undertake to support the HRA business plan. This ceiling was set at £173.9m for Sutton. The Council took out a loan to meet the self financing payment set to effectively ‘buy out’ of the subsidy system. This totalled £141m. After other adjustments this left £14.8m remaining headroom borrowing. The Council was subsequently successful in bidding for local growth funding to increase that remaining headroom by £5.307m. The Council took the decision to use this remaining borrowing capacity to support its plans for providing new build housing at Fellowes Road, Richmond Green and Ludlow Lodge.

91. A further £0.9m is being applied to the strategic housing and regeneration fund to bring the total available to £5m as outlined in para 77 above.

92. As part of Budget 2018 Government announced plans to remove the HRA borrowing cap. This was subsequently implemented through revisions to capital regulations brought in during October 2018. Officers are now reviewing plans for the HRA in light of this significant change. Recommendations will be brought to HEB in March 2019 for implementation.

Education Programme

93. The main elements of the education capital programme are the school expansion and build programme, works to maintain school buildings and devolved formula capital to schools. The details of the outline programme for 2019/23 are shown in the table below.

	2019/20	**2020/21**	**2021/22**	**2022/23**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Expansion / New Build					
Minor Projects for Primary/Secondary expansions	213	0	0	0	**213**
Hackbridge Primary	1,121	74	0	0	**1,195**
Belmont Secondary	13,034	569	0	0	**13,603**
SEN Expansions	146	0	0	0	**146**
Total Expansion / New Build	**14,514**	**643**	**0**	**0**	**15,157**
Works to Maintain School Buildings	1,550	700	600	500	**3,350**
Devolved Formula Capital	732	120	120	120	**1,092**
Healthy Pupil Capital	101	0	0	0	**101**
Corporate Resources - Foster Carers Adaptations & Computers for Looked after children	28	28	28	28	**112**
Total Education Programme	**16,925**	**1,491**	**748**	**648**	**19,812**

Schools Capital Maintenance

94. Works to maintain school buildings is funded from the Schools Condition Allocation (SCA) grant received annually from government. Despite schools being in an overall good condition, surveys from 2012 identified a backlog of over £13m priority works in schools, the available grant is being used to address the highest priority works. Schools are invited annually to bid for projects to keep school buildings wind and watertight and to prevent further deterioration or possible school closures. These will be reviewed by the AMP Steering Group in January 2019 with the 2019/20 capital programme agreed by Schools' Forum by March 2019.

Schools Expansion

95. Funding for primary school expansion has predominantly been through the Basic Need grant. All medium term planned primary expansions are now complete except for the expansion at Hackbridge Primary School which has been delayed from the originally completion date of April 2019. The delay is due to the non performance of the main contractor (Lakehouse,) as a result of their serious financial problems. A notice of termination has been issued by the Council. The process can be challenged by Lakehouse, but once it has been contractually accepted (14 Days), the Council will be legally able to put a plan of action in place with a third party contractor to reprogramme & complete the contract. The likely time scale is difficult to predict, but the process of appointing a third party contractor & re-engaging the sub-contractors is likely to take circa 3 months. Additional costs will be incurred & at this time it is impossible to give an indication of these. The costs will have to be met from the unallocated basic needs grant that is still available.

96. The delivery of expansion of secondary and further SEN provision is now largely being achieved through free school provision at the new Harris Academy at Belmont and plans for 'Free School 1' and the proposed 'Free School 2' at Rosehill. The delivery of the Harris Academy was led by LBS and was partially funded by the Education, Skills and Funding Agency/Department for Education (ESFA/DfE), including the costs associated with temporary school provision at Cumbrian House pending completion of the new build school. Plans for 'Free School 2' are being led by the ESFA/DfE and would expect to be fully funded by them, although it would appear likely that the ESFA/DfE will make a request to the Council to support the funding of any temporary provision in 2020 prior to the delivery of the new provision in 2021.

97. The Council's final basic need allocation of £1.698m is due to be received in 2019/20. The allocation for 2020/21 has been confirmed as zero. As such it is thought that the Council shouldn't expect to receive any further basic need funding in the foreseeable future. The government therefore expects that any new school places are delivered through free schools or expansions funded by the ESFA, although it remains a Council responsibility.

98. Announcements for funding to improve school building condition, (Schools Condition Allocation), and Devolved Formula Capital are still to be confirmed, but are to be awarded on the same basis as for 2018/19, according to numbers of maintained school pupils. These numbers are decreasing each year as schools convert to Academy status and the actual grant allocations will reduce accordingly.

99. The resources currently being applied to the Education programme over the next four years are summarised in the table below.

Education Capital Programme Schemes & Projected Resources

	2019/20	2020/21	2021/22	2022/23	Total
	£'000	£'000	£'000	£'000	£'000
Total Planned Education Expenditure	16,925	1,491	748	648	**19,812**
Education Resources					
Corporate Resources - Capital Receipts	28	28	28	28	**112**
Basic Needs Allocation	1,698	0	0	0	**1,698**
Prior Yr Basic Need Grant	7,933	0	0	0	**7,933**
ESFA funding new free school	8,937	0	0	0	**8,937**
Special Provision Fund	616	617	0	0	**1,233**
Schools Condition Allocation	1,550	700	600	500	**3,350**
Devolved Formula Capital to Schools	732	120	120	120	**1,092**
Healthy Pupils Capital Grant	101	0	0	0	**101**
Total Resources	**21,595**	**1,465**	**748**	**648**	**24,456**
Surplus / (Deficit)	**4,670**	**(26)**	**0**	**0**	**4,644**

100. There is currently an unallocated remaining balance of basic need funding of £4.644m. The potential calls on that funding are the cost of the temporary secondary provision pending development of free school provision at Rosehill and possible SEND / specialist school provision and the additional costs as a result of the contractor issues at the new Hackbridge Primary School.

Capital Risk Management

101. There are a number of risks surrounding the capital programme, which inevitably increase at a time of economic uncertainty. These risks are reviewed and managed as part of the capital programme review process, in year capital monitoring and specific project and risk management arrangements for larger schemes.

102. **Cost Overspends / Project Timescale Slippage -**In the initial stages of development, major capital projects will have significant uncertainties. For example these may relate to the planning process, the views / interest of stakeholders who must be consulted, ground conditions, or the cost of refurbishing or demolishing existing buildings (e.g. the cost of asbestos removal). As such all major projects contain a defined contingency provision. The level of this contingency is set with reference to the type of project, it's complexity and risk items identified on the risk register. Typically new build projects are allocated a lower contingency of an average 2.5 to 5% and refurbishment or alternation projects an average of 3.5 to 7% depending on contract value.

103. Once a scheme begins spend and timescales for completion are monitored as part of the monthly capital programme monitoring processes.

104. **Capital Receipts -**The Council has continued to ensure regular review in terms of its assumptions for the inclusion of new capital receipts into the programme, particularly given the difficulty around some of the sites. Each year planned capital receipts are reviewed by the property and finance teams in terms of values, timescales and any known risk factors that need to be taken into account.

105. **Borrowing Costs -**A provision for the revenue costs of future prudential borrowing within the capital programme has been made within the revenue budget. This allocation has been derived using estimates for interest rates over the coming four year period. There is a risk that interest rates rise above these estimates affecting the cost of this borrowing. This risk will be managed through the Council's Treasury Management Strategy ensuring that the cost of borrowing to the Council is minimised.

106. **Cost Price Inflation -**There is increased uncertainty about the cost of projects due to potential changes in the cost of materials and labour arising from changes in the value of the pound relative to other currencies.

107. **Right to Buy projections are incorrect and less net RTB receipts are available to fund the capital programme (new build and acquisitions)** - Prudent assumptions included within four year projections. Will review each year and adjust plans accordingly. RTB watch producing projections based on trends, historical data etc

108. **School Place Expansion** -The programme to expand the number of primary school places is now largely complete. However there is still some risk in terms of delivery of secondary places and any changes to need over the medium term given the low level of remaining basic need funding.

109. **Non Repayment of Loans by Third Parties -**There are a number of parameters built into the arrangements for agreeing loan and equity financing which provide some protection to the Council. In addition all loan financing is secured against assets through collateral warranties.

110. The Council undertakes regular monitoring of the financial position of its wholly owned companies as 100% shareholder. Annual reporting is also required as part of the loan agreements that are in place. This should provide an early warning of any potential issues and the Council then has the ability (through the loan arrangements) to work with the company to find solutions to prevent a loan default.

111. **Reduction in Value of Commercial Property -**The market value of properties is ascertained annually as part of the production of the statement of accounts. Commercial Property investments are intended to be holdings for the medium to longer term. Risk management mitigation as part of IPP arrangements includes active management of the portfolio including review of the performance of individual properties to feed into longer term disposal or refurbishment or reprovision decisions. The Council has an earmarked reserve in place to assist with any investment needed in properties. Despite an MRP exemption there is also the ability within revenue budgets to start MRP provision.

Other Commercial Activity

<u>Opportunity Sutton</u>

112. In July 2013 the Strategy and Resources Committee agreed to set up Opportunity Sutton Limited (OSL) a parent company with a single initial subsidiary company, Sutton Decentralised Energy Network (SDEN) and the potential for further subsidiaries to be added.

113. At that time, the Strategy and Resources Committee also recommended that Full Council agree the set up a new Council sub committee responsible for decision making and oversight on behalf of the Council as the sole shareholder and more broadly to the oversight and governance arrangements. This sub committee is called the Shareholders Board and its establishment was agreed by full Council in June 2015.

Sutton Decentralised Energy Network

114. As stated above SDEN is a wholly owned company of the Council and sits under the holding company OSL. SDEN is a sustainable energy supplier that will provide low carbon energy to homes and businesses in Sutton. The company will utilise waste heat from the Beddington Energy Recovery Facility (ERF) and existing landfill gas engines to reduce fossil fuel use, contributing to Sutton's goal of becoming a zero carbon borough by 2025.

115. In November 2015 SDEN had its outline business case agreed for phase one development of heat infrastructure into the New Mill Quarter development site managed by Barratts. The business case showed the projected positive cumulative return for phase one for the company over 25 years of £1.54m. This first phase of infrastructure is due to be completed in 2019.

116. The company has been trading since December 2017 and to date has a total of 118 customers on its first identified phase. The company is now looking at options for expanding the network across the borough with longer term ambitions to expand further across south London.

117. The council has provided SDEN with loan financing for the development of the capital costs for the heat network but also a repayable short term overdraft facility to cover immediate operating costs whilst the company builds its customer base. The loans to the company are at a commercial interest rate despite the company falling outside of state aid regulations.

Sutton Living

118. In July 2014 the Council's Strategy and Resources Committee agreed the set up a wholly owned housing development company, Sutton Living with the intention of opening up the opportunity to influence the local housing market and make a contribution to meeting London's housing need.

119. The specific objectives of the company are:

- To deliver new housing in the Borough across a range of tenures;
- To contribute towards meeting existing and forecast demand for housing both through the development of sites already identified and through development on new sites, as yet unidentified;
- To support the Council's Greater London Authority Housing Zone programme;
- To contribute to the General Fund through surpluses generated from housing developed.

120. The council is currently agreeing loan terms for the company's first development site, at Wallington Public Hall. Financing for the scheme is anticipated to be in the form of a mix of equity and loan financing. The loan will be at a commercial loan rate with interest accruing and rolling up into the loan during the construction phase. When the development is complete the financing agreements will be reviewed and a longer term financing arrangement agreed with the Council including a similar mix of equity and debt financing. Periods for review and revision will be included. Over the longer term the intention is that the Council then receive a dividend payment on its equity share.

Tram Link

121. The Council is working closely with TFL to deliver an extension of the tramlink network, firstly to Sutton Town Centre and then on to the site for the London Cancer Hub in Belmont.

London Cancer Hub

122. The Council is working in partnership with the Institute of Cancer Research (ICR) and supported by the Royal Marsden NHS Trust to create the London Cancer Hub (LCH) which has the ambition of becoming the world's leading life science district, specialising in cancer research and treatment. The Council has now purchased several tranches of land from the Epsom & St Helier University Hospitals Trust (E&SHT) as land assembly for the LCH. These land purchases have been funded by short term borrowing whilst the longer term structure and commercial arrangements of the LCH are developed.

IFRS 9

123. Each year under International Financial Reporting Standard (IFRS) 9 the council will review all loan agreements in place to assess whether there are any impairments or potential defaults on the loans that it has made to third parties. This assessment will continue a review of all financing arrangements for wholly owned companies such as Sutton Decentralised Energy Network and Sutton Living. Any assessed future impairment on these loans will need to be recognised as a charge to revenue.

Appendices

Appendix I2 - Detailed Capital Programme for 2019/20 to 2022/23
Appendix I3 - Programme of Expenditure on Works to Council Properties
Appendix I4 -Programme of Expenditure on Corporate and Operational Buildings