Capital Strategy
2020/21 – 2029/30

Revised: April 2020

Content

1. INTRODUCTION AND BACKGROUND

This Capital Strategy is an overarching document which sets the policy framework for the development, management and monitoring of capital investment for the West Yorkshire Combined Authority. The strategy focuses on core principles that underpin the authority's capital programme; its short, medium and long-term objectives; the key issues and risks that will impact on the delivery of the programme; and the governance framework required to ensure the capital programme is delivered and provides value for money.

The capital strategy aligns with the key strategies and priorities including those set out in the Strategic Economic Plan. The strategy is integrated with the medium term financial strategy and treasury management strategy.

The Combined Authority will agree the capital strategy and programme annually and as necessary in the event of a significant change in circumstances. The programme includes schemes relating to the Combined Authority's own assets, schemes where we are responsible for direct delivery and schemes being delivered by our district partners.

The indicative capital programme approved 6 February 2020 is shown below:

West Yorkshire Combined Authority - Summary Capital Budget

Capital Expenditure (Programmes)	2019/20 £	2020/21 £	2021/22 £	2022/23 £	Total £
Growing business	12,810,201	14,809,439	0	0	27,619,640
Skilled People and Better Jobs	492,383	667,110	0	0	1,159,493
Clean Energy	320,148	741,887	0	0	1,062,035
Housing and Regeneration	3,284,920	6,500,000	0	0	9,784,920
West Yorkshire plus Transport Fund	51,210,000	110,670,000	183,420,000	165,990,000	511,290,000
Economic Resilience	4,647,050	4,181,524	0	0	8,828,574
Enterprise Zone Development	2,901,717	12,337,000	0	0	15,238,717
Growth Deal - Other	2,000,000	2,000,000	0	0	4,000,000
Leeds Public Transport Investment Programme	59,475,661	88,233,338	12,000,000	0	159,708,999
Local Transport Capital	16,483,691	13,129,332	13,104,000	13,104,000	55,821,023
Highways Maintenance / Pothole Action	29,997,000	29,997,000	29,997,000	29,997,000	119,988,000
Corporate Projects	5,753,154	5,503,000	206,777	0	11,462,931
Broadband	3,593,998	2,608,437	3,067,328	2,501,000	11,770,763
City Connect	16,509,299	4,924,881	92,500	0	21,526,680
Transforming Cities (small & Core)	*5,529,866*	*106,684,551*	*175,673,991*	*120,596,314*	*408,484,722*
Future Mobility Zones	*2,562,725*	*11,867,514*	*7,428,130*	*5,423,578*	*27,281,947*
Land Release Fund & One Public Estate	662,125	0	0	0	662,125
Low Emission Vehicles	3,525,000	0	0	0	3,525,000
A - Total Capital Spend	221,758,938	414,855,014	424,989,726	337,611,892	1,399,215,570

Capital Funding	2019/20 £	2020/21 £	2021/22 £	2022/23 £	Total £
Growth Deal (including b/fwd)	(128,887,320)	(129,527,273)	(48,300,000)	(48,300,000)	(355,014,593)
Leeds Public Transport Investment Programme	(70,948,197)	(88,760,803)	0		(159,709,000)
Local Transport Capital	(16,483,691)	(13,129,331)	(13,104,000)	(13,104,000)	(55,821,022)
Highways Maintenance / Pothole (DfT)	(29,997,000)	(29,997,000)	(29,997,000)	(29,997,000)	(119,988,000)
Broadband	(3,593,998)	(2,608,437)	(3,067,328)	(2,501,000)	(11,770,763)
City Connect	(16,509,299)	(4,924,881)	(92,500)	0	(21,526,680)
Transforming Cities	*(5,529,866)*	*(106,684,551)*	*(175,673,991)*	*(120,596,314)*	*(408,484,722)*
Future Mobility Zones (DfT)	*(2,562,725)*	*(11,867,514)*	*(7,428,130)*	*(5,423,578)*	*(27,281,947)*
Land Release Fund & One Public Estate	(662,125)	0	0	0	(662,125)
Low Emission Vehicles (DfT)	(3,525,000)	0	0	0	(3,525,000)
	(278,699,220)	(387,499,790)	(277,662,949)	(219,921,892)	(1,163,783,852)

	2019/20 £	2020/21 £	2021/22 £	2022/23 £	Total £
Annual (surplus) / deficit - indicative financing requirement	(56,940,283)	27,355,223	147,326,777	117,690,000	235,431,718

2. CORE PRINCIPLES THAT UNDERPIN THE CAPITAL PROGRAMME

The core principles for the capital programme are summarised below and shown in more detail at Annex A.

- Capital investment decisions reflect the aspirations and priorities included within the Strategic Economic Plan, Transport Plan and other organisational strategies;
- Schemes to be added to the capital programme will be subject to our Assurance Framework, prioritised according to strategic and economic fit, availability of resources (capacity and financial) and scheme specific funding and factors such as legal, statutory obligations, health and safety considerations, value for money and the longer-term impact on the authority's financial position.
- The cost of financing capital schemes, net of revenue benefits, are profiled over the lifetime of each scheme and incorporated into the medium-term financial strategy and annual revenue budget.
- Commissioning and procuring for capital schemes will comply with the requirements set out in our financial regulations and contracts standing orders.

3. GOVERNANCE FRAMEWORK

The Combined Authority is the accountable body for the Local Enterprise Partnership (LEP) and receives significant capital funding from government. As the accountable body it ensures that all spending decisions are overseen by locally elected politicians. A significant part of our expenditure is with district council partners who directly deliver a range of schemes to help transform the Leeds City Region economy.

The aim is for the Combined Authority to agree, with appropriate input from the LEP, the capital strategy and programme annually and in the event of a significant change in circumstances. In conjunction with the Assurance Framework, the Chief Finance Officer (Section 73) will consider the impact of proposed schemes in the capital programme with the medium term financial strategy, the capital resources available to the Combined Authority, the revenue implications of the proposed capital expenditure and any other relevant information.

Democratic decision-making and scrutiny processes provide overall political direction and ensure accountability for investment in the capital programme. These processes include:

- Combined Authority approving the plan which sets out the strategic priorities
- Combined Authority being ultimately responsible for approving the capital strategy, treasury management strategy and capital programme.
- The Combined Authority, Transport Committee and Investment Committee receiving regular capital monitoring reports, approving variations to the programme and considering new programmes / projects for inclusion in the

capital programme as part of the Assurance Framework and in line with LEP priorities.
- Managers being assigned projects in line with their responsibilities
- Overview and Scrutiny committee being able to call in decisions, receive and scrutinise reports
- All projects progressing through the capital programme follow the constitution, financial regulations and contracts standing orders.
- The capital programme is subject to internal and external audit reviews.

All capital expenditure is considered as part of a thorough appraisal / evaluation in line with the requirements of the Assurance Framework. The appraisal / evaluation will outline the key benefits that are expected to arise from projects in relation to priorities and economic and strategic fit. The evaluation will include the financial considerations such as the expected cost and funding sources identified, benefit-cost ratio, value for money and consideration of any risks to either the delivery or cost forecasts.

Approval to spend on individual capital schemes will only be given once procedural guidelines have been complied with and assessed to the satisfaction of the Assurance Framework which involves senior management, technical experts and Investment Committee, Transport Committee and Combined Authority as appropriate.

The Delivery Directorate, in support to senior managers, monitor the delivery of assigned capital programmes / projects. Any additions or variations to a capital programme / project must be considered via the Assurance Framework before being agreed by the Combined Authority directly or via related delegated authority.

4. SHORT, MEDIUM AND LONG-TERM CAPITAL PLANNING OBJECTIVES

The Combined Authority approves annually a refresh of the indicative capital programme that covers a three year period. The capital programme is a longer-term ambition, with the lifetime of new and existing assets stretching far into the future. The obligation for maintaining and improving operational buildings (including bus stations) is very long term and as such should be considered accordingly in financial and asset management planning. With regards to the latter an Asset Management Strategy is in development as at March 20202 and will be submitted for approval over the coming year.

The application and planning for the capital expenditure obligations and objectives for the Combined Authority can be considered over short, medium and long term time horizons.

<u>Short to medium term (1-3 Years):</u>

Within a shorter timeframe the focus of the capital strategy is towards the delivery and implementation of any capital scheme. At this stage, the management of potential risks in the acquisition or delivery of particular capital projects is of importance for the Combined Authority.

Within the short-term timeframe, the capital programme may be amended with the introduction of urgent, high priority capital projects. The overall programme will need to be flexible to ensure it can incorporate projects arising from previously unforeseen circumstances. As part of capital programme and resource management, projects may be phased over multiple years due to factors such as complexity, resourcing, legal and planning requirements.

Medium to long-term (4-10 Years)

There is typically a long lead time from identifying investment need or opportunity and to implementation. The medium-term timescale allows the Combined Authority to develop plans for the delivery and funding across capital projects as well as the contribution of this capital expenditure toward the Combined Authority's objectives and individual service priorities.

Early evaluation can be developed to allow the Combined Authority to assess the expected benefits and costs of capital expenditure and to identify the sources of funding, specific grants, external contributions or revenue budget contribution required to fund capital projects.

The Combined Authority incorporates the capital programme expenditure and funding projections into medium term cashflow forecasting which in turn feeds into the treasury management strategy for the Combined Authority. Decisions on debt financing will be influenced by capital projections as well as forecast capital receipts.

The capital programme and the implications of the programme for the Minimum Revenue Provision (see later in the strategy for more detail) and debt financing costs are incorporated into the medium term financial strategy.

Long Term: 10 Years Plus

The Combined Authority has some longer term plans that require capital investment consideration including:

- the Strategic Economic Plan (2016 – 2036)
- West Yorkshire Plus York Transport Plan (to 2036)
- the Local Transport Plan, branded as the Local Transport Strategy (to 2040)
- Future Funding Investment Strategy (draft November 2019)
- Reinvestment of Enterprise Zone Business Rate Income (to 2042)
- Asset Management Strategy (under development December 2019)

The Combined Authority can review and develop strategies for meeting investment need in the much longer term where there is considerable uncertainty and complexity.

For example understanding economic, social and technological factors that drive regeneration and redevelopment initiatives, long-term planning issues to deliver objectives e.g. the Combined Authority's ambition to deliver on the key elements of the Strategic Economic Plan (including Clean Energy, Infrastructure for Growth), and asset management planning for long-term property need and investment.

There is a clear link between long term planning for capital and for treasury management purposes. The Combined Authority's debt portfolio contains loans that mature in up to 30-50 years time. The debt repayment profile needs to be managed alongside the longer term expectations for capital expenditure and funding forecasts.

Long-term forecasts are not easily predicted and the accuracy of all financial estimates will be limited. However, long-term forecasting is valuable in informing strategic plans taking account of the cumulative sustainability and affordability of existing and planned investment, which will need to be repaid over future periods. For major projects and investment, the funding and financial implications need to be planned well in advance.

5. COMBINED AUTHORITY STRATEGIC ECONOMIC PLAN - CAPITAL INVESTMENT PRIORITIES

Capital investment plans are driven by the Strategic Economic Plan, the Combined Authority's key strategic document that sets out the vision, ambitions, values and priorities.

Key capital commitments in the capital programme include:

- Delivery of a programme of significant transport projects including Elland station, the rail park and ride programme and a potential new bus station at Halifax;
- Supporting district partners to deliver a range of major highways, public transport and sustainable transport initiatives including schemes through the West Yorkshire plus Transport Fund, Connecting Leeds and City Connect
- Supporting district partners to deliver a range of economic benefits including delivery of major capital infrastructure through the Skills Capital and Innovation and Flood Alleviation, and Housing and Regeneration programmes
- Alleviating fuel poverty and improving homes through the Better Homes and Warm Homes programmes
- Supporting digital inclusion through the provision of broadband infrastructure in urban and rural communities through the continued Superfast West Yorkshire and York programme
- Developing smart card technology, making it easier for bus and rail users when paying for their journeys
- Accelerating economic growth through the development of 10 sites within the Leeds City Region Enterprise Zone
- Delivery of the corporate head office accommodation project and Corporate Technology Programme.

6. ASSET MANAGEMENT PLANNING

The overriding objective of asset management within the Combined Authority is to achieve a corporate portfolio of property and equipment assets that is appropriate, fit for purpose and affordable. The Combined Authority's property portfolio consists mainly of operational properties (eg bus stations), investment properties (rented to tenants) and property held for development or regeneration purposes. The Combined Authority has specific reasons for owning and retaining property:

- Operational purposes e.g. assets that support core business and service delivery e.g. bus stations, office buildings and that provide a financial return (eg tenant rent)
- Regeneration, enabling strategic place shaping and economic growth.
- Delivery of major infrastructure eg in support of mass transit
- Delivery of the Enterprise Zone programme.

The Combined Authority is in the process of developing its Asset Management Strategy which will align with the Capital Strategy. It is anticipated that this strategy will include the approach to ‘invest to save’ projects, investment required, asset classes/ type, estimated revenue streams, risks, approach to lease, economic footprint, ethical value to the organisation.

Asset management is a key part of the Combined Authority’s business management arrangements and is crucial to the delivery of efficient and effective services. The ongoing management and maintenance of capital assets will be considered as part of the strategy. The asset management planning includes an objective to optimise the Combined Authority’s land and property portfolio through proactive estate management and effective corporate arrangements for the acquisition and disposal of land and property assets.

The Combined Authority will continue to realise the value of any properties that have been declared surplus to requirements in a timely manner, having regard to the prevailing market conditions.

7. COMMERCIAL ACTIVITY AND INVESTMENT PROPERTY

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines investment property as property held solely to earn rentals or for capital appreciation or both. Returns from property ownership can be both income driven (through the receipt of rent) and by way of appreciation of the underlying asset value (capital growth). The combination of these is a consideration in assessing the attractiveness of a property for acquisition.

In the context of the Capital Strategy, the Combined Authority is in the process of considering plans to use capital (including capital grant) to invest in property / land to provide a positive surplus/financial return. The Combined Authority funds the purchase of property by borrowing money or use of capital grant. The rental income paid by the tenant contributes to the cost of repaying the borrowed money each year and is part of the annual revenue budget.

The reasons for buying and owning property are primarily:

- Financial returns to fund services
- Market and economic opportunity.
- Economic development and regeneration.

Historically, owned property has provided strong returns in terms of a stable income. Property investment is not without risk as property values can fall as well as rise and changing economic conditions could cause tenants to leave with properties remaining vacant. The strategy makes it clear that the Combined Authority will continue to invest prudently on a commercial basis and to take advantage of opportunities as they present themselves, supported by our robust governance process.

8. LOANS

The Combined Authority has discretion to make loans for several reasons, though primarily for economic development. These loans are treated as capital expenditure. In making loans the Combined Authority is exposing itself to the risk that the borrower defaults on repayments and must therefore ensure it is prudent and has fully considered the risk implications, regarding both the individual loan and that the cumulative exposure of the Combined Authority is proportionate and prudent.

The Combined Authority will ensure that a full due diligence exercise is undertaken, that the formal Assurance Framework processes are used to assess the business case and associated loan risk, benefits and opportunities and that security is in place. All loans under the existing programme are agreed by the Combined Authority and are subject to close, regular monitoring.

9. CAPITAL FUNDING

Capital expenditure for the Combined Authority is financed through a variety of sources, typically:

- Capital grants from government (including Local Enterprise Partnership funding)
- Non-Government funding (eg European Funding)
- Receipts from the sale of capital assets
- The use of revenue budget contributions and general reserves
- Leasing
- Section 106 contributions
- Private Finance Initiatives (PFI)
- Borrowing
- Joint Ventures
- Equity Investment

Capital Grants:

Capital resources from Central Government can be split into two categories:

a. Ring-fenced – resources which are ring fenced to particular areas and therefore have restricted uses, specified by the funder.

   This currently encompasses most of the Government funding received by the Combined Authority.

b. Non-ring fenced – resources which are delivered through grant that can be utilised on any project (albeit that there may be an expectation of use for a specific purpose).

Non-Government Funding

Where there is a requirement to make an application to an external agency to receive external funding, and, when appropriate, to commit Combined Authority resources as matched funding to any bid for external resources, the proposal goes through the Assurance Framework for consideration / approval. The business case must demonstrate how the project aligns to the Combined Authority's priorities and how matched funding and any revenue consequences can be managed within the context of the capital and revenue budget, including consideration of the timing of which funds ae used first.

Capital Receipts

Capital Receipts come from the sale of the Combined Authority's assets.

Where the sale of an asset leads to the requirement to repay grant, the capital receipt will be utilised for this purpose. Once this liability has been established and provided for, capital receipts will be available to support the capital programme as a corporate resource.

There will be no ring-fencing of capital receipts to specific projects unless the use of the receipt is governed by legislation or by a specific agreement. However, where the asset has been funded from prudential borrowing a review will be undertaken to determine whether the most cost effective option is to utilise the receipt to repay debt, considering the balance sheet position of the Combined Authority.

There is no current strategy for the use of capital receipts. However future consideration will be given to the following:

- To provide for an MRP holiday to the value of external loan payments generating a revenue budget saving;
- To consider forgoing the immediate capital receipt for longer term and sustainable income stream through development of sites or other projects.
- To invest in further economic activity in support of the SEP.

Revenue budget contributions and general reserves

An element of the revenue budget can be set aside to fund the capital programme (Direct Revenue Financing). The annual refresh of the capital programme will detail any amount that is forecast to be available in upcoming years, however with increasing revenue budget pressures and diminishing, available reserves, any such amounts will be limited and will need to be regularly reviewed.

A directorate / service area may wish to offer some of its revenue budget to support the financing of a capital project. This may be acceptable if it can be demonstrated that this funding is unrestricted.

Leasing

The Combined Authority does have the option to lease assets utilising an operating lease arrangement, though due to Prudential Borrowing this source of financing is becoming less attractive.

The International Accounting Standards Board have reviewed how leased assets are treated and in January 2016 issued a new standard for annual periods starting on or after the 1st January 2019. This will need to be reflected as part of any business case proposals.

Section 106 contributions (S106)

Our district partners make S106 agreements with developers / landowners as part of the planning approval process to ensure that new development mitigates its own impact and provides the necessary site specific infrastructure to support it. The Combined Authority accesses these contributions via the district partners as appropriate.

These contributions are site specific or can be 'pooled' for a maximum of five site specific projects. Any contributions received are 'ring-fenced' for the purpose as set out in the relevant S106 agreement and can be applied to fund schemes within the relevant capital programme.

The S106 contributions are time limited in that if they are not spent within an agreed timescale, typically 5 – 10 years, dependent on what has been agreed in the S106 agreement and any funds not spent in line with the agreement would have to be repaid to the developer, which, may include interest.

Consideration of available S106 funding should be taken into consideration when agreeing the use of the available funding and reduce the reliance on other sources of funding, predominantly borrowing.

Private Finance Initiatives (PFI)

PFI is a means by which the Combined Authority can facilitate major new infrastructure projects. PFI schemes involve partnerships between the public and private sector to fund public sector infrastructure projects with private capital.

Under PFI, a private sector contractor agrees to accept the risks associated with the design, construction and maintenance of the asset over the contract term, which is typically for a 25 year period. The public sector partner pays an annual fixed price during the contract term, part of which is subject to inflation. At the end of the term, the asset is wholly owned by the Combined Authority.

No PFI projects are currently being proposed and any future proposals would require approval by the Combined Authority having been evaluated beforehand through the Assurance Framework.

Borrowing

Any capital expenditure not financed by the above may need to be funded by borrowing, though currently the Combined Authority can only borrow money for a purpose **relevant to its transport functions**.

Existing Combined Authority debt is the consequence of historical capital expenditure. The Combined Authority can temporarily utilise other resources in lieu of external borrowing to fund capital expenditure (ie internal borrowing from cash balances).

The Combined Authority will investigate opportunities to resource capital projects using prudential borrowing where plans are sustainable, affordable and prudent. Full appraisal will take place to ensure that, where appropriate, sufficient revenue returns are generated to cover the cost of borrowing.

Where it is considered that prudential borrowing is the appropriate method of funding, but it requires additional revenue financing, the cost will be built into the revenue budget planning process. There are various debt instruments available for financing prudential borrowing and these are explored in more detail in the Treasury Management Strategy.

The Public Works Loan Board (PWLB) remains the Combined Authority's preferred source of long term borrowing given the transparency and control that its facilities continue to provide.

An alternative debt instrument available to the Combined Authority is the European Investment Bank (EIB) facility which was established in 2018. The EIB provides an option to provide a flexible financing offer to support the West Yorkshire plus Transport Fund. Many of the Combined Authority's schemes in the Fund meet the EIB funding criteria and this would provide an attractive alternative to the traditional PWLB lending. The UK's decision to withdraw from the European Union does not preclude this arrangement taking place.

It is not proposed at this stage that the Combined Authority enter into any other credit arrangements as defined by the regulations, other than as described above. If and when these are to be progressed then it should be recognised that they would be classified as borrowing and would need to be recognised in the operational boundary and authorised limit approval. Should any such arrangements be required these will be expected to be funded within the approved strategy.

Joint Ventures (JV)

A joint venture is a cooperative enterprise entered into by two or more entities for the purpose of a specific project or other business activity. The reason for a joint venture is usually some specific project.

JVs are commonly formal arrangements and they can be short term or long term. Often the JV creates a separate business entity, to which the owners contribute assets, have equity, and agree on how this entity may be managed. The new entity may be a corporation, limited liability company, or partnership.

In other cases, the individual entities retain their individuality and they operate under a JV agreement. In any case, the parties in the JV share in the management, profits, and losses, according to a joint venture agreement (contract).

Joint ventures are often entered into for a single purpose but they may also be formed for a continuing purpose.

The Combined Authority currently has one JV with Leeds City Council for the Next Generation Technology (NGT) assets (primarily land and buildings).

Any future JV proposals require approval by the Combined Authority having been evaluated beforehand through the Assurance Framework or other relevant approval processes.

Equity Investment

An equity investment generally refers to the buying and holding of company shares in anticipation of income from dividends and capital gains.

The Combined Authority do not currently have any equity investments. Any future proposals require approval by the Combined Authority having been evaluated beforehand through the Assurance Framework or other relevant approval processes.

10. REVENUE BUDGET IMPLICATIONS FROM CAPITAL INVESTMENT DECISIONS

In approving the inclusion of schemes and projects within the capital programme, the Combined Authority ensures all the capital and investment plans are affordable, prudent and sustainable. In doing so the Combined Authority will consider the arrangements for the repayment of debt, through a prudent MRP policy in line with MRP guidance produced by the Ministry of Housing, Communities and Local Government.

The capital financing charges and any additional running costs arising from capital investment decisions are incorporated within the annual revenue budget and medium term financial plans. This enables the Combined Authority to consider the consequences of capital investment alongside other competing priorities for revenue funding.

Long Term revenue implications of capital investment decisions

Capital investment decision making is not only about ensuring the initial allocation of capital funds meets the corporate and service priorities but ensuring the asset is fully utilised, sustainable and affordable throughout its whole life. This overarching commitment to long term affordability is a key principle in any capital investment appraisal decision. In making its capital investment decisions the Combined

Authority must have explicit regard to consider all reasonable options available. These would include sustainable revenue streams achieved through initiatives such as business rates receipts (EZ programme), tenant rental income (Bus station development) and interest earned from loans (Future Investment Fund, Growing Places Fund).

11. RISK APPETITE

This section considers the Combined Authority's risk appetite regarding its capital investments and commercial activities, i.e. the amount of risk that the Combined Authority is prepared to accept, tolerate, or be exposed to at any point in time. It is important to note that risk will always exist in some measure and cannot be removed in its entirety.

A risk review is an important aspect of the consideration of any proposed capital or investment proposal. The risks will be considered in line with the risk management strategies we have in place and commensurate with the Combined Authority's relatively low risk appetite on financial matters. The Combined Authority's risk appetite statement is summarised in the table below.

	Low ↔ High Appetite					
	1	*2*	*3*	*4*	*5*	
Legal Compliance and Regulation	1					This is something for which the CA has no appetite for and expects minimal exposure to risk. Where it relates to a service which must be provided, significant controls must be in place.
Safety and Security	1					
Finance and Resources		2				There is a preference for what are deemed to be 'safe' options where there is a reduced degree of risk. Good controls are expected to be in place where risk remains.
Reputational		2				
Environmental		2				
Service Delivery and Operational			3			The CA accepts a level of risk may remain in the delivery of services in pursuit of our corporate priorities. The chosen option must present a healthy level of reward in relation to the risk faced.
Transformational Change				4		This is an area in which the CA has an increased appetite for risk. More uncertainty can be tolerated in seeking opportunities for improvement, commercialisation or innovation.
Development and Regeneration				4		

Subject to careful due diligence, following the formal Assurance Framework or other appropriate approval processes, the Combined Authority may consider a moderately higher level of risk for strategic initiatives, where there is a direct gain to the Combined Authority's revenues or the ability to deliver its statutory duties more effectively and efficiently.

Many schemes are delivered by district partners and funded by the Combined Authority. Our partners undertake their own risk assessments for these schemes, though these risks are considered as part of the assurance approval process.

12. KNOWLEDGE AND SKILLS

The Combined Authority has professionally qualified staff across a range of disciplines including finance, legal and property, however there are a number of capital projects and programmes which will require the use or addition of specialist technical advisers or development of a new commercial team, e.g. future investment funding programme, Enterprise Zones and new rail station development.

A review of capacity and skills is continually being considered to get the Combined Authority to the level of performance required, especially in relation to commercial skill sets. A review of the internal procurement team has been completed and a new structure introduced with the required expertise. A review of financial ICT systems is also planned to ensure key functions are supported.

The Combined Authority establishes project teams from all the professional disciplines from across the Combined Authority as and when required and has a dedicated Delivery Directorate that focuses on delivering new capital proposals, directly or with district partners, once they pass through Decision Point 2 of the Assurance Framework. In addition, our Transport Services Directorate is responsible for the Combined Authority's assets including repair and maintenance, development and commercialisation of those assets.

External professional advice is taken where required and will always be sought in consideration of any major commercial property or investment decision.

13. Capital Programme Performance Monitoring

The Combined Authority Senior Management Team will review the financial performance of the capital programme on a regular basis.

Financial monitoring reports will be considered by the Combined Authority and Investment Committee at each of its meetings, together with a capital outturn report.

Where a potential cost overrun has been identified, the Combined Authority and Investment Committee will explore possible solutions in detail. It will also consider any underspending or identified surplus resources which can be reallocated to other priorities.

Where there is a delay in the commitment of programme/project resources, the Combined Authority requires programme / project managers / capital delivery leads to report the reasons for the delay and consider whether it would be appropriate to recommend the decommissioning of the project and the reallocation of non ring-fenced resources to other projects. It is recognised that there may be potential revenue consequences of doing this due to the capital accounting requirement to transfer abortive costs to revenue.

The Transport Committee meetings also includes monitoring reports on the implementation and delivery of the individual transport projects that they are responsible for in order provide additional oversight for specific schemes within their remit.

The performance of the capital programme is also measured by the prudential indicators which are reported as part of the Treasury Management Strategy and quarterly reviews with officers.

The Combined Authority annual Internal Audit Plan may also include a review of the capital programme and internal control environment that supports the decision making processes.

14. Investments for a Return

Beyond those investments for cash management purposes and for service enhancement, the Combined Authority may also make investments, with a range of economic and social objectives in mind, but with a key element being on making a return on the investment. It is these types of investments which are the focus of this section of the Capital Strategy.

The Combined Authority is an organisation heavily governed by statute and it is not a commercial organisation with the purpose of making a financial return for shareholders. Nonetheless like any organisation it does need to fund its activities and with more traditional funding sources, such as government grants, substantially decreasing, there is a need to look to more innovative ways of generating income. The financial return on investments being one such approach in addition to other intangible social and regeneration benefits these investments can yield.

The remainder of this section seeks to set out the nature of investments the Combined Authority will engage in and the circumstances in which it will do so.

<u>Financial Investments</u>

Financial Investments can fall into three categories, namely: Specified Investments, Loans and Non-specified Investments.

Specified and non-specified investments are only likely to be undertaken on either a short, or a long term basis as part of managing the Combined Authority’s cash flows and are therefore covered by the Treasury Management Strategy rather than here.

Loans may also be used for treasury management purposes, but where they are used in support of service delivery objectives this is covered by the Loans and Guarantees Financial Instruction.

The Combined Authority is in the process of developing a Future Investment Strategy (as at February 2020).

Non-Financial Investments

For the purposes of this strategy a non-financial investment is a non-financial asset held by the Combined Authority primarily, or partially to generate a surplus. This might be through an anticipated appreciation in the capital value of the asset, or by way of delivering a regular income stream, or a combination of both. However, in the current financial climate the emphasis is likely to be on assets that generate a regular income stream.

Although the Combined Authority remains open minded to consider a range of opportunities the high likelihood is that non-financial investments will involve property assets. Chosen carefully, property offers the opportunity for a higher yield and less volatility than financial investments, however, it is an illiquid asset and carries with it the inherent risk of being unable to respond quickly enough to changes in market conditions.

The Combined Authority is in the process of developing its Asset Management Strategy which will align with the Capital Strategy. It is anticipated that this strategy will include investment required, asset classes/ type, estimated revenue streams, risks, approach to lease, economic footprint, ethical value to the organisation.

15. Minimum Revenue Provision

Minimum Revenue Provision (MRP) is the charge to the revenue budget made in respect of paying off the principal sum of the borrowing undertaken to finance the capital programme. MRP, which is largely defined by regulation, is aimed at ensuring that the Combined Authority does not have time expired/fully depreciated assets whilst still holding associated outstanding debt.

For borrowing up to prior April 2019 annual MRP is calculated using 4% on debt outstanding. For capital expenditure incurred on or after 1 April 2019 and funded through borrowing, MRP is calculated using the asset life annuity method. Using this method MRP is calculated in a similar way as calculating the capital repayment element of a fixed rate repayment mortgage. In accordance with provisions in the guidance, MRP will be first charged in the year following the date that an asset becomes operational.

The asset life annuity method calculation requires estimated useful lives of assets to be input into the calculations. These life periods will be determined under delegated powers to the Chief Financial Officer, regarding the statutory guidance, and are detailed in the Accounting Policies. However, the Combined Authority reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the asset life annuity method would not be appropriate.

Where capital expenditure cannot be related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

Recognising the impact of MRP on the revenue budget is an important element in determining the affordability and sustainability of borrowing to fund an asset. Essentially, if there is no on-going capacity within the revenue budget to afford the MRP then the borrowing should not be taken out in the first place. Therefore, a robust business case demonstrating a rate of return in excess of costs (including MRP) is important and to be considered as schemes progress through the Assurance Framework.

Annex A

CORE PRINCIPLES UNDERPINNING THE CAPITAL PROGRAMME

In considering schemes for inclusion in the capital programme, regard will be had to the following principles undertaken via the formal Assurance Framework:

- strong strategic fit with existing SEP priorities;
- schemes to be included in the Capital Programme should follow an appropriate level of due diligence and assurance regarding deliverability /practicability (eg formal Assurance Framework);
- prior to mobilisation, all projects should be supported by an affordable and sustainable plan, including carefully consideration of value for money and options appraisal (eg benefit cost ratios);
- environmental and social sustainability issues should be built into project appraisal where appropriate
- capital appraisal should also promote schemes which provide a direct gain to the Combined Authority's revenues, including revenue savings, within agreed risk appetite, e.g. business rate growth, commercial investment return and "invest to save" outcomes;
- the financial implications of capital investment decisions will be properly appraised as part of the Assurance Framework;
- available resources will be identified for investment over the capital planning period;
- available capital funding will be optimised e.g. through surplus asset disposal strategy, maximising use of planning gain, by corporately pooling capital receipts and by exploring external financing sources;
- that capital funding decisions minimise or mitigate the ongoing revenue implications of capital investment decisions i.e. assessment made of lifetime cost and liabilities;
- the financial implications of capital investment decisions should be fully integrated into revenue budget and longer term financial plans i.e. lifetime cost and liabilities;
- robust governance arrangements are in place for all programmes and projects, clearly defining responsibility for the delivery of individual schemes within the capital programme;
- all capital schemes follow appropriate project management arrangements;
- there are effective working relationships with district partners and other delivery partners;
- that projects are reviewed on completion to ensure key learning opportunities are maximised;
- that projects are monitored throughout and upon completion to ensure anticipated benefits have been realised.

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