Orkney Islands Council

Capital Strategy
2024 – 2029

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Contents

Introduction

The Chartered Institute of Public Finance and Accountancy (CIPFA) 2021 Prudential and Treasury Management Codes require all 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.

The aim of the Strategy is to ensure that all elected members fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite.

The Strategy forms part of the framework for financial planning and is integral to both the Medium-Term Financial Strategy (MTFS) and the Treasury Management Strategy Statement (TMSS).

Council Plan

The Council Plan 2023-2028 was approved by Council in March 2023, following consideration by the Policy and Resources Committee on 21 February 2023. The Council's strategic priorities and aims are set out in the Council Plan grouped under three priority themes – growing our economy, strengthening our communities and developing our infrastructure.

The Council Plan's aims and outcomes will be supported by a number of priorities under an overall theme – transforming our council.

The following five core principles, which underpin the new Council Plan, have been used to structure the Capital Strategy demonstrating how our capital programme priorities align with their delivery.

- Protecting our environment and combating climate change.
- Equality, fairness and inclusion: in particular for vulnerable and remote communities like the ferry linked isles.
- Sustainable and accessible services for all.
- Community wellbeing and mental health.
- Community wealth building for future generations.

The Council Plan also recognises that the Council cannot achieve everything it wants to, particularly when set against a background of COVID-19 recovery, the cost-of-living crisis, the impacts of climate change and moving towards net zero, resource constraints and rising public expectations.

The Delivery Plan 2023-2028 complements the Council Plan, and describes some of the projects, services and policies which the Council seeks to progress during the current term. The Council Plan 2023-2028 and Council Delivery Plan 2023-2028, underpin the Capital Strategy 2024 to 2029 when considering capital projects for inclusion in the Capital Programme.

Risk Management

Managing the Council's risks is an area of significant focus for senior management and elected members, and the Council adopts an integrated view to the management and qualitative assessment of risk.

To ensure that risks to delivery of the Capital Programme are effectively managed a structured framework of planning, evaluation and monitoring is maintained, which is intended to identify those schemes at risk of non or late delivery.

Capital Approach

Definition

The CIPFA / Local Authority (Scotland) Accounts Advisory Committee (LASAAC) Statement of Recommended Practice (SORP) provides the definition of capital expenditure as follows:

"Expenditure on the acquisition of a tangible asset, or expenditure which adds to, and not merely maintains, the value of an existing asset, should be capitalised, provided the fixed asset yields benefit for a period of more than one year.

The main components of capital expenditure are:

- Acquisition, reclamation, enhancement or laying out of land;
- Acquisition, construction and improvement of buildings and civil engineering works;
- Acquisition, replacement or renewal of major plant, equipment, machinery, vehicles and vessels.

For expenditure to be considered improvement or enhancement, and count as capital in nature, it must lengthen substantially the useful life of the asset, increase substantially the open market value of the asset, or increase substantially the extent to which the asset can be used. Under this definition of "improvement or enhancement," improvement works, and structural repairs should be capitalised, whereas expenditure to ensure that the fixed asset maintains its previously assessed standard of performance should be treated as revenue expenditure."

Underlying Principles

The following underlying principles are considered necessary for the delivery of a prudent, sustainable and resilient Capital Programme:

1. **Strategic priorities** – projects demonstrate direct alignment with the strategic priorities and aims as set out in the Council Plan and Delivery Plan.
2. **Affordability** – projects demonstrate that the capital investment delivers value-for-money and supports the overall financial sustainability of the Capital Programme, including, for example, the leverage of external funding opportunities.
3. **Agility** – the Council should endeavour to develop 'off the shelf' projects to react to external funding opportunities.
4. **Asset sustainability** – expenditure should be used to ensure existing assets maintain basic condition, based on existing use, to meet security and health and safety requirements.
5. **Asset development** – replace existing assets to improve their efficiency and effectiveness on a like for like basis or investment in assets to enhance service based on demographic, social, technological and environmental challenges.
6. **Asset reduction** – seek to divest via rationalisation, repurposing or asset transfer of building assets that are surplus to operational need.

7. **Revenue saving/generating** – projects which reduce operating costs, or avoid future capital or revenue costs, or generate income.
8. **Risk appetite** – the risks of the project have been fully assessed, consulted and communicated, and are at an acceptable level including, for example, consideration of the project viability in terms of resourcing and scheduling of internal staff resources and external supply-chain capacity.

Capital Project Types

Capital projects fall into two main categories: annual top-sliced improvement and replacement programmes; and other projects.

Other projects should follow the Capital Project Appraisal (CPA) process in order to be considered for inclusion in the rolling 5-year Capital Programme.

The following top-sliced improvement and replacement programmes have annual budgets:

- General Fund Capital Improvement Programme
- Road Asset Replacement Programme
- IT Replacement Programme
- Plant and Vehicles Replacement Programme
- Housing Revenue Account
- Scapa Flow Oil Port Minor Capital Improvement Programme
- Miscellaneous Piers and Harbours Minor Capital Improvement Programme
- Strategic Reserve Fund Capital Improvement Programme

The operation of annual top-sliced property improvement or asset replacement programmes must follow the underlying principles of this Strategy and the CPA process, and this should be evidenced through the regular reporting of the planning, approval delivery stages to the relevant Service Committee or Sub-committee.

The existing Capital Programme for 2024/25 to 2028/29 is attached at Annex 1.

Process

The CPA process for capital projects contains five distinct stages:

- Stage 0 – Pre-CPA: Strategic Outline Case
- Stage 1 – CPA 1: Outline Business Case
- Stage 2 – CPA 2: Full Business Case
- Stage 3 - Project Delivery
- Stage 4 - Project Completion

Full details of the CPA process is available in its own guidance document.

At present, CPAs (business cases) for capital projects are assessed by the Capital Programme Board, primarily comprising the Corporate Leadership Team, before being put forward to Committee for inclusion within the Capital Programme. Programme slippages and accelerations are reported to the Policy and Resources Committee as part of capital budget monitoring processes where consideration is given to whether capital projects can be accelerated, slipped or removed. Under and over-spends on capital projects are managed within the overall programme unless they are significant in nature or require additional resource and approval.

Work has been undertaken to reconsider the CPA process, established in 2018, to build a new framework and consistent approach to mandating, evaluating and monitoring projects as they progress through the various stages of the CPA lifecycle.

Sources of Funding

The development of capital projects can be funded by several sources, as follows:

- Scottish Government General Capital Grant and other specific grants.
- Capital grants from other external sources.
- Capital receipts generated through the sale of assets.
- Capital contributions from internal reserves.
- Capital financed from current revenue income or surpluses.
- Borrowings from the Loans Fund.

Given the limited headroom available in the Council's Capital Programme the ability to leverage in external funding is essential for projects to progress and the sustainability of the Programme.

Non-General Fund projects are expected to be affordable for each respective Non-General Fund account, Housing Revenue Account (HRA) or Harbours for example.

The Council's General Capital Grant allocation for 2024/25 amounted to £5,000,000. On 18 June 2024, the Policy and Resources Committee recommended General Fund top-sliced improvement and replacement programmes for the three years (2025/26, 2026/27 and 2027/28) at a total of £5,500,000. A future review is required during financial year 2027/28 to assess the sustainability and allocation of funds to the top-sliced programmes.

Affordability

Prudential Code

The CIPFA Prudential Code, introduced in April 2004, gave councils freedom to invest in capital projects within the limitation of legislative controls, provided their programmes can be shown to be affordable, prudent and sustainable. The key mandatory indicators are:

- Capital Expenditure Limits – summary of the Council's capital expenditure plans;
- Capital Financing Requirement – measure of the Council's underlying borrowing need, including long term liabilities;
- Operational Boundary – expected maximum external debt during the course of the year; and
- Authorised Boundary – maximum limit beyond which borrowing is prohibited.

One of the purposes of the Treasury Management Strategy Statement (TMSS) is to assess the affordability of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning, to ensure that it can meet its capital spending obligations.

The TMSS is reported annually to the Policy and Resources Committee.

General Fund Headroom

The loan charges budget to repay debt is baselined at £3,500,000 with effect from 1 April 2024 and must cover the cost of any General Fund borrowing to finance capital spend as well as management of the capital programme, budgeted at a cost of £200,000.

In addition, a further sum of £200,000 is set aside in the Capital Project Appraisal Fund, established to provide revenue budgets for Services to develop CPA business cases.

These charges leave a net loan charges budget of £3,100,000, which equates to headroom for General Fund Services to borrow a maximum of approximately £25,500,000 over the next five years, from 1 April 2024 to 31 March 2029.

Headroom £m	**2024/25 Estimate**
Operational Boundary	75.0
Capital Financing Requirement	(65.0)
Revenue budget (£3.1m x 5)	15.5
TOTAL	**25.5**

Headroom is recalculated regularly on changes to the Council's Capital Programme.

There is limited headroom available for the Council to undertake any significant programme of works. It is prudent to only borrow up to the Operational Boundary, and seek to leave the gap between this indicator and the Authorised Boundary as an unused contingency.

Other Considerations

Several other factors impact the affordability of the Capital Programme, including:

- **Interest Rates.** The cost of borrowing is currently high. Higher interest rates mean loans fund revenue budgets will not stretch as far. However, the Council does have the opportunity to refinance over time and realign borrowing against lower rates, where possible. In the short-term the Bank of England interest rate, and subsequent rates offered through the Public Works Loans Board (PWLB), would be entered into at a higher rate.
- **Inflation.** At periods of higher inflation, delays in the delivery of capital projects can significantly impact the approved budgets.
- **Demand and supply.** Construction materials supply chain or transportation challenges in the wider economy – a surge in demand can lead to price increases, material shortages and longer lead times.
- **Legislation.** Changes in legal requirements and government policy objectives can result in obligations for the Council. Usually, these changes attract government funding.
- **Risk management.** All risks associated with a specific capital project should be understood with appropriate strategies to manage those risks. Project risks should be considered throughout the CPA process.
- **Resource Capacity.** The Council and local supply-chain have limited resources and capacity to develop, manage and deliver capital projects. When proposing capital projects for consideration, or setting the Capital Programme, the capacity of resources needs to be considered.

Governance Framework

The Council's 5-year rolling Capital Programme will continue to be updated on an annual basis and approved by Council. This ensures a long-term approach to financial planning to identify challenges and opportunities facing the Council.

The Capital Strategy will be fully updated every five years, or as and when necessary to respond to new challenges and opportunities as these arise, and to ensure its continued alignment with the Council's strategic priorities and aims.

All capital projects will continue to be managed and monitored, and changes approved through the Policy and Resources Committee or by delegated authority, where applicable. Full details of the new governance framework and approval process for the Capital Programme can be found in the Financial Regulations, and the Capital Project Appraisal (CPA) procedure.

The Council's Section 95 Officer is the officer with overall responsibility for Capital and Treasury activities and is a qualified accountant.

Annex 1: Approved Capital Programme 2024-29

	Total Budget	2024/25	2025/26	2026/27	2027/28	2028/29
	£000	£000	£000	£000	£000	£000
General Fund Summary						
Other Housing	2,925	585	585	585	585	585
Community Social Services	5,158	2,900	2,258	0	0	0
Education	2,151	2,151	0	0	0	0
Cultural and Recreational Services	582	388	181	13	0	0
Roads	7,843	2,393	1,500	1,500	1,500	950
Transportation Services	2,457	1,073	1,088	266	30	0
Environmental services	145	145	0	0	0	0
Planning & Protective Services	1,290	1,290	0	0	0	0
Administration Services	18,540	3,569	4,000	4,000	4,000	2,971
Expenditure Total	41,091	14,494	9,612	6,364	6,115	4,506
Sources of Funding						
Capital Financed from Current Revenue	4,848	111	1,579	1,579	1,579	0
Government Grants	24,826	5,792	5,114	4,640	4,640	4,640
EU Grants	0	0	0	0	0	0
Other Grants	735	735	0	0	0	0
Capital Receipts	1,175	235	235	235	235	235
Capital Contributions	2,424	2,358	53	13	0	0
Income Total	34,008	9,231	6,981	6,467	6,454	4,875
Borrowing	7,083	5,263	2,631	(103)	(339)	(369)

	Total Budget	2024/25	2025/26	2026/27	2027/28	2028/29
Non General Fund Summary	£000	£000	£000	£000	£000	£000
Housing Revenue Account	770	770	0	0	0	0
Orkney College	0	0	0	0	0	0
Scapa Flow Oil Port	750	150	150	150	150	150
Miscellaneous Piers and Harbours	9,322	475	4,888	3,244	415	300
Strategic Reserve Fund	595	119	119	119	119	119
Expenditure Total	11,437	1,514	5,157	3,513	684	569
Sources of Funding						
Capital Financed from Current Revenue	2,984	708	569	569	569	569
Government Grants	340	340	0	0	0	0
EU Grants	0	0	0	0	0	0
Other Grants	0	0	0	0	0	0
Capital Receipts	0	0	0	0	0	0
Capital Contributions	0	0	0	0	0	0
Income Total	3,324	1,048	569	569	569	569
Borrowing	8,113	466	4,588	2,944	115	0