

## Capital Strategy Report 2019 / 20

### Introduction

This capital strategy is a new report for 2019 / 20, giving a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

### Capital Expenditure and Financing

Capital expenditure is where the Council spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not capitalised and are charged to revenue in year.

In 2019 / 20, the Council is planning capital expenditure of £618,000, with a potential additional £6.2m for commercial projects as summarised below:

*Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ 000s*

	2017/18 actual £000	2018/19 forecast £000	2019 / 20 budget £000	2020/21 budget £000	2021/22 budget £000
General Fund services	1,021	1,771	618	487	477
Proposed Commercial Projects	-	-	6,283	-	-
<b>TOTAL</b>	1,021	1,789	6,901	487	477

The main General Fund capital projects include the replacement of equipment and vehicles in the Parks Team, which totals £118,200.

**Governance:** Service managers bid annually in September to include projects in the Council's capital programme. Bids are collated by the finance team who calculate the financing cost (which can be nil if the project is fully externally financed). The Corporate Leadership Team (CLT) and the relevant service committees appraise all bids based on a comparison of service priorities against financing costs and makes recommendations to Finance and Corporate Services. The final capital programme is then presented to Council in February each year.

- For full details of the Council's proposed capital programme for 2019 / 20, including the project appraisals undertaken, see the Finance and Corporate Services Minutes for 24 November 2018.

Projects that generate savings or income may be progressed in year subject to a valid Business Case and Committee Approval.

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt

(borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

*Table 2: Capital financing in £ 000's*

	2017 / 18 actual £000s	2018 / 19 forecast £000s	2019 / 20 budget £000s	2020 / 21 budget £000s	2021 / 22 budget £000s
External sources	449	420	420	420	420
Own resources	572	1,369	198	67	57
Debt	-	-	6,283	-	-
<b>TOTAL</b>	<b>1,021</b>	<b>1,789</b>	<b>6,901</b>	<b>487</b>	<b>477</b>

Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

*Table 3: Replacement of debt finance in £ 000's*

	2017 / 18 actual £000's	2018 / 19 forecast £000's	2019 / 20 budget £000's	2020 / 21 budget £000's	2021 / 22 budget £000's	2022 / 23 Budget £000's
Own resources	-	-	-	126	126	126

- The Council's full minimum revenue provision statement is available here in the reports for Finance and Corporate Service Committee in January 2019.
- The figures above will not be included into the Medium Term Financial Statement until the projects have been fully approved.

The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £6.3m during 2019 / 20. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

*Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £000's*

	31.3.2018 actual £000's	31.3.2019 forecast £000's	31.3.2020 budget £000's	31.3.2021 budget £000's	31.3.2022 budget £000's
General Fund services	1,109	850	6,874	6,489	6,104
<b>TOTAL CFR</b>	<b>1,109</b>	<b>850</b>	<b>6,874</b>	<b>6,489</b>	<b>6,104</b>

- The in year movement above does not total Table 2 less Table 3 due to MRP relating to embedded finance leases that are not true capital debt repayments.

**Asset management:** To ensure that capital assets continue to be of long-term use, the Council is developing the 2019 / 20 asset management strategy.

**Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021 / 22. Repayments of capital grants, loans and investments also generate capital receipts. The Council could potentially receive £4m of capital receipts in the coming financial year as follows:

Table 5: Capital receipts in £ 000's

	2017 / 18 actual £000's	2018 / 19 forecast £000's	2019 / 20 budget £000's	2020 / 21 budget £000's	2021 / 22 budget £000's
Asset sales	-	-	-	4,000	-
Loans repaid	-	-	-	-	-
<b>TOTAL</b>	-	-	-	<b>4,000</b>	-

- The Assets sales relate to potential income from the sale of the Council offices if this project is taken forwards, however this is still at planning stage.
- The Council may also receive Capital receipts from Right to Buys of Council Houses, however it is not possible to estimate how much may be received in any one year.

### Treasury Management

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

Due to decisions taken in the past, the Council currently has £0m borrowing and £22m treasury investments at an average rate of 1.6%.

**Borrowing strategy:** The Council is currently debt free, however as there is a future intention to borrow to fund projects, then the main objectives when borrowing will be to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%).

Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities and leases) are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £000's

	31.3.2018 actual £000's	31.3.2019 forecast £000's	31.3.2020 budget £000's	31.3.2021 budget £000's	31.3.2022 budget £000's
Debt	-	-	6,283	6,157	6,031
Capital Financing Requirement	1,109	850	6,874	6,489	6,104

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Council expects to comply with this in the medium term.

**Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £10m at each year-end. This benchmark is currently -£2.8 and is forecast to rise to £8.6m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £000's

	31.3.2018 actual £000's	31.3.2019 forecast £000's	31.3.2020 budget £000's	31.3.2021 budget £000's	31.3.2022 budget £000's
Outstanding borrowing	-	-	6,300	6,174	6,048
Liability benchmark	(2,800)	800	7,200	8,500	8,600

The table shows that the Council expects to remain borrowed below its liability benchmark.

**Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2018 / 19 limit	2019 / 20 limit	2020 / 21 limit	2021 / 22 limit
Authorised limit - borrowing	10	16.5	16.5	16.5
Operational boundary - borrowing	7	7	7	7

- Further details on borrowing are on page 4 of the treasury management strategy

**Investment strategy:** Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

The Council's policy on treasury investments is to maximise investment return where satisfactory results of due diligence are found and risk mitigated, although security and liquidity are still considerations. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares

and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

*Table 8: Treasury management investments in £000's*

	31.3.2018 actual £000's	31.3.2019 forecast £000's	31.3.2020 budget £000's	31.3.2021 budget £000's	31.3.2022 budget £000's
Near-term investments	6,500	5,000	5,000	5,000	5,000
Longer-term investments	4,888	5,000	5,000	5,000	5,000
<b>TOTAL</b>	<b>11,388</b>	<b>10,000</b>	<b>10,000</b>	<b>10,000</b>	<b>10,000</b>

- Further details on treasury investments can be found on page 5 of the treasury management strategy

**Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Resources and staff, who must act in line with the treasury management strategy approved by Council. Half yearly reports on treasury management activity are presented to Overview & Scrutiny Committee. The audit committee is responsible for scrutinising treasury management decisions.

#### Investments for Service Purposes

The Council do not makes investments to assist local public services.

#### Commercial Activities

The Council currently do not have any commercial activities, however with the continuing pressures on external funding, and the implementation of the future model, consideration is being given to potential projects, which, when evaluated, will follow the governance for approval outlined on page 1 of this strategy. The potential requirement for borrowing has been considered in the relevant indicators within this strategy, and the investment and treasury strategies.

#### Liabilities

The Council is committed to making future payments to cover its pension fund deficit (valued at £26.5 m). It has also set aside £0.75 m to cover risks of Business Rates and Planning appeals.

**Governance:** Decisions on incurring new discretionary liabilities are taken by managers in consultation with the Director of Resources. The risk of liabilities crystallising and requiring payment is monitored by departments in conjunction with the finance team and are reported to committee/management as appropriate.

#### Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net

annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

*Table 9: Prudential Indicator: Proportion of financing costs to net revenue stream*

	2017 / 18 actual	2018 / 19 forecast	2019 / 20 budget	2020 / 21 budget	2021 / 22 budget
Financing costs (£m)	-	-	-	-	-
Proportion of net revenue stream	%	%	%	%	%

- The borrowing referred to in this strategy relates to proposals that are still in planning stages, therefore these haven't been included in the table above due to wider implications of potential new revenue streams that would impact on the revenue stream. This table will be updated once there is more detail on the proposed projects.

**Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for the duration of any borrowing arrangements. The Director of Resources is satisfied that the proposed capital programme is prudent, affordable and sustainable because for the main General Fund programme, there are existing reserves to fund the expenditure. For new Commercial projects, borrowing costs have been included within the financial models to then assess overall project viability. Projects will only be progressed where they prove to generate savings or an income stream to the Authority, and the Business Case will assess the risks and mitigations of the projects.

### **Knowledge and Skills**

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Resources is a qualified accountant with over 10 years' experience. The Council pays for junior staff to study towards relevant professional qualifications including Association of Chartered Certified Accountants (ACCA).

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisors and the Valuation Office as property advisors. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

- The Council's Treasury Management policy on the use of external advisers is available on request from the Council Offices.