Agenda item no

Report to:	**COUNCIL**
Meeting date:	**31 March 2021**
Title:	**CAPITAL STRATEGY REPORT 2021/22**
Originator:	**BOROUGH TREASURER**
Status	**FOR DECISION**

Purpose

The approval by full Council of the Capital Strategy is requirement of the Prudential code for Capital Finance in Local Authorities (Prudential Code), and the Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (Treasury Management Code) which were updated in December 2017.

Recommendations

Council is recommended to approve:

- The Capital Strategy for 2021/22

1.0 Introduction

1.1 This capital strategy gives 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.

1.2 The report covers the following broad areas

1.2.1 Capital Expenditure and Financing (2.0)
1.2.2 Treasury Management (2.1)
1.2.3 Revenue Budget Implications (2.2)
1.2.4 Knowledge and Skills (2.3)

1.0 Capital Expenditure and Financing

Capital expenditure is where the Council spends money on the acquiring, creating, enhancing or adding life or value to an existing tangible or intangible fixed asset, that will yield benefits to the council for a period of more than one year. This will include spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or itself be subsidised, by other local services. HRA capital expenditure is recorded seperately.

The planned capital expenditure between 2020/21 and 2023/24 is set out in the table below.

Capital Expenditure	2019/20 Actual £'000	2020/21 Revised £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
General Fund Services	2,956.0	4,144.0	5,163.0	1,540.0	1,139.0
HRA	5,023.0	2,950.0	6,640.0	5,850.0	6,000.0
TOTAL	**7,979.0**	**7,094.0**	**11,803.0**	**7,390.0**	**7,139.0**

The Capital Strategy has 3 core aims:

Aim 1 - To support a medium term outlook:

- Allocating known resources to Capital Investment for current and future years, ensuring that in years where capital resources are limited, critical investment can continue to be made
- Aligning known resources and spending, ensuring that we do not apply uncertain or forecast resources to current investment, thus leaving potentially unfunded obligations in the future
- Smoothing out any significant gaps between capital investment needs and capital resources available by utilising contributions from revenue

Aim 2 - To maximise the capital resources available and the flexibility of their application:

- Setting aside capital funding for "match funding" opportunities, where these are aligned with the council's strategic objectives in order to take advantage of "free" funding
- Reviewing contractually uncommitted schemes against newly emerging capital investment priorities
- Avoiding ring-fencing of capital resources, except where such ring fencing is statutory
- Using prudential borrowing for "invest to save" schemes, schemes which generate income or schemes which enhance the economy of the Borough

Aim 3 - Targeted capital investment:

- Annual review of all contractually uncommitted capital schemes which rely on non-ring-fenced funding to ensure that they remain a priority in the context of any newly emerging needs and aspirations
- Investment in programmes of a recurring nature that are essential to maintain operational effectiveness
- Invest in specific schemes that:
    - Have a significant catalytic potential to unlock the regeneration of the borough
    - Are significant in terms of the council strategies that they serve

  - Are significantly income generating or efficiency generating
  - If not implemented would cause severe disruption to service delivery

For 21/22 onwards, the Capital Programme comprises a balanced set of proposals which:

- Ensure the medium term resilience of essential core and essential services
- Continue to improve Council Housing, maintaining the affordability of good quality homes for residents, including investment in building new housing stock
- Provide substantial investment into the Borough Economy to:
  - Re-develop the Waterfront and stimulate economic activity
  - Enhance the Town Centre and assocaited heritage assets in the Town Centre area
  - Promote the visitor economy
  - Stimulate employment
- Continued investment in digital technology to support the customer experience with the Council.

Governance: For large scale schemes, the Council will follow a full business case process which will include the review of an alignment with the Council's strategic objectives, the economic case for the borough, the financial case for the Council and involve a full options appraisal and financial apprasial with appropriate risk sensitivities. All such business cases will be prepared by appropriately qualified staff with expert advice as necessary and follow a proper approval and decision making process.

Additionally, Service managers bid annually to include projects in the Council's capital programme in accordance with the Council's Core Aims. The final programme is presented to Full Council in February each year.

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). The planned financing of the above expenditure is as follows.

Capital Financing	**2019/20 Actual £'000**	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**
External Resources	1,219.0	2,146.0	1,468.0	700.0	670.0
Local Resources (excl. borrowing)	5,992.0	3,820.0	8,173.0	6,425.0	6,100.0
Borrowing	**768.0**	**1,128.0**	**2,162.0**	**265.0**	**369.0**

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.

The Council is required to set aside prudent revenue provision for debt repayment (MRP) where borrowing or credit arrangements are used to finance General Fund capital expenditure. The Council's policy is to calculate MRP on expenditure that is funded by unsupported prudential borrowing by reference to the asset's useful life using the annuity method, starting in the year after the asset becomes operational. Updated guidance from the MHCLG in February 2018 introduced a maximum useful life of 50 years for MRP purposes including any expenditure incurred on investment properties that provide a revenue stream, except where a longer life is supported by an opinion from a suitably qualified professional adviser.

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 repayments and capital receipts used to replace debt. The CFR is expected to increase by £1.479m during 2021/22. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Capital Financing Requirement	**2019/20 Actual £'000**	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**
CFR - Non Housing	20,799.0	21,535.0	23,014.0	22,472.0	22,045.0
CFR - Housing	61,676.0	61,676.0	61,676.0	61,676.0	61,676.0
Total CFR	**82,475.0**	**83,211.0**	**84,690.0**	**84,148.0**	**83,721.0**
Net movement in CFR	**768.0**	**736.0**	**1,479.0**	**(542.0)**	**(427.0)**
Movement in CFR is represented by					
Net financing need for the year	768.0	1,128.0	2,162.0	265.0	369.0
*Less MRP/VRP/other movements	0.0	(392.0)	(683.0)	(807.0)	(796.0)
Movement in CFR	**768.0**	**736.0**	**1,479.0**	**(542.0)**	**(427.0)**

1.1. 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 expects at 31 March 2021 to have around £72.m borrowing at an average interest rate of 2.7% and £10m treasury investments at an average rate of 0.03%.

Borrowing Strategy: The Council's main objectives when borrowing is 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 0.1% to 0.3%) and long-term fixed rate loans where the future cost is known but higher (currently 1.2% to 2.1%).

Projected levels of the Council's total outstanding debt (solely borrowing) are shown below, compared with the capital financing requirement.

Portfolio Position	**2019/20 Actual £'000**	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**
External Debt	71,950.0	71,950.0	73,950.0	74,950.0	74,950.0
Other Long Term Liabilities	0.0	0.0	0.0	0.0	0.0
Gross Debt at 31 March	**71,950.0**	**71,950.0**	**73,950.0**	**74,950.0**	**74,950.0**
CFR	**84,475.0**	**83,211.0**	**84,690.0**	**84,148.0**	**83,721.0**
Under/ (over) borrowing	**10,525.0**	**11,261.0**	**10,740.0**	**9,198.0**	**8,771.0**

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

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

Authorised Limit	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**
	85.8	88.8	88.9	88.8

Operational Boundary	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**
	78.1	80.1	81.1	81.1

Treasury 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 prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. 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 term consideration is given to investing in higher yielding investments particularly pooled funds to balance the risk of loss against the risk of receiving returns below inflation. For both near-term and longer-term investments held in pooled funds, an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

Investment levels are expected to range from £10m to £17m with up to £4m being invested in long term pooled funds.

Risk management: The effective management and control of risk are prime objectives of the Council's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Borough Treasurer (S151 Officer) and staff, who must act in line with the treasury management strategy approved by Council. The Policy and Organisation Board is responsible for scrutinising treasury management decisions.

1.2. 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. The proportion of financing cost to net revenue stream is set out below.

%	2019/20 Actual	2020/21 Revised	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Non-HRA	3.9%	3.6%	4.7%	6.6%	5.6%
HRA	34.4%	33.5%	33.0%	31.7%	30.6%

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 up to 50 years into the future. The Borough Treasurer (S151 Officer) is satisfied that the proposed Capital Programme is prudent, affordable and sustainable because:

- Any prudential borrowing undertaken has been considered having regard for the CIPFA prudential code.
- Prudential borrowing undertaken has been for "Invest to Save Schemes" only
- The timing of borrowing decisions have been taken on the basis of the expected optimum time to minimise the overall cost of borrowing - determined on a net present value basis and informed by expert external advisors forecasts of interest rate projections
- The Council has a robust Medium Term Financial Strategy to support the delivery of its future savings requirements

1.3. 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 Borough Treasurer and S151 officer is a qualified accountant as is the Head of Finance.

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 advisers.

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.

2.0 Conclusion

The Capital Strategy Report ensures the Council complies with CIPFA's latest prudential code for Capital Finance in Local Authorities.

Financial implications:	As contained in the report.
Legal implications:	It is a legal requirement that a Capital Strategy report is considered by the Council prior to the start of the financial year
Service Improvement Plan implications:	This report is required in order that to fulfil statutory requirements associated with the achievement of both service improvement plan and corporate plan targets.
Corporate Plan:	
Risk Assessment:	As contained in the report
Background papers:	
Author:	Borough Treasurer