Capital Strategy Report

2021/22

Contents

Strategic Implications

This report relates to all the objectives in the Council's Corporate Plan 2015-2025 as it supports the Council's ability to fund capital and revenue projects and services. The approach recommended continues to build on the Council's previous success in this respect, by achieving a high level of rewards for residents in terms of service objectives supported by a strong financial position, whilst still managing the appropriate level of risk carefully as detailed in the report and appendices.

Background

This strategy gives a high-level overview of how capital expenditure, financing and treasury management activity contribute to the provision of local services along with an overview of how associated risk is managed and the implications for future financial sustainability.

Capital Expenditure

Capital expenditure is where the Council spends money on assets, such as property or vehicles that have a usable life of more than one year. In local government this includes spending on assets owned by the Council, by other bodies, as well as loans and grants to other bodies enabling them to buy or improve assets. The Council has some limited discretion on what counts as capital expenditure, for example, the Council can choose not to capitalise spend under the value of £10k, and instead charge these as a revenue cost in year.

In 2021/22 the Council is planning capital expenditure of £66m as summarised below:

Table 1 - Estimates of Capital Expenditure

Programme Area	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/23 budget £'000	2023/24 budget £'000
Climate and Environmental	0	7,075	17,885	0	16,215
Infrastructure	2,856	20,615	1,757	1,069	3,303
LAC's	5,312	10,471	887	45	0
Leisure	422	232	0	0	0
Urban Regeneration	2,613	7,546	750	0	22,277
IT	563	741	300	450	0
Housing	25,137	48,093	44,087	19,412	55,871
Total General Fund Services	**36,903**	**94,773**	**65,666**	**20,976**	**97,666**

Local Area Committee's (LAC's) have devolved authority in relation to the approval of Section 106 (S106) funded projects. S106 payments are made as part of the planning process in order to mitigate against the impact of development. As such, these projects can sometimes be complex in nature, or time is needed to assess the size and nature of the impact, before sums can be formally approved. It is therefore assumed that LAC expenditure will rise in the following years as S106 funded projects are developed.

Governance of Capital Expenditure

The current Community Investment Programme (CIP) is attached at Appendix 1A. The CIP consists of capital schemes identified by Councillors and Staff as being of benefit to the community. Schemes are approved in year by Cabinet, or if it is a scheme that falls under a Local Area, then approval can be made by the relevant LAC.

All projects are monitored by the Project Management Office (PMO), ensuring that projects are started in a controlled way and are reported upon regularly.

For each proposed scheme, alignment to Corporate Strategic aims is checked before commitment to spend is made. This is done using a Project Initiation Matrix (PIM) to flesh out a proposal into a clear concept. When the project is authorised, an approved project methodology is used to control and deliver the project and report on progress through to the appropriate Strategic Programme. A process map of the project process is shown at Appendix 1B.

For all Strategic Capital Programmes there is a Programme Board chaired by a member of Management Team and comprising Councillors, including a member of Cabinet, alongside key members of staff who are involved in the implementation and delivery of capital schemes. The aim of Programme Boards is to ensure that schemes are managed efficiently and effectively, by identifying the Council's priorities and aligning capital expenditure to meet these priorities.

Financing of Capital Expenditure

All capital expenditure must be financed, either from external sources (Government grants, developers and other contributions), the Council's own resources (revenue, reserves and capital receipts) or borrowing (borrowing and leasing). The planned financing of Capital Expenditure is as follows:

Table 2 - Capital financing

Financing	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/23 budget £'000	2023/24 budget £'000
External sources	8,538	26,735	487	0	0
Own resources	8,981	5,538	3,889	3,840	0
Borrowing	19,384	62,500	61,290	17,136	97,666
Total	**36,903**	**94,773**	**65,666**	**20,976**	**97,666**

The core financing of capital expenditure continues to be borrowing. The Council continues to borrow under the guidance of CIPFA's Prudential Code for Capital Finance in Local Authorities, which gives the Council the power to borrow.

Borrowing is only a temporary source of finance, since loans and leases must be repaid and this is therefore replaced over time by other sources of finance, 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 repay borrowing. Planned MRP repayments are shown in the table below:

Table 3 – Repayment of borrowing

Repayment of Borrowing	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/23 budget £'000	2023/24 budget £'000
MRP	4,373	5,055	5,226	5,456	5,609

The Council's full MRP Policy is approved by Council as part of the Treasury Management Strategy report. The MRP policy ensures that over the life of any asset the full borrowing is repaid.

The Council's cumulative outstanding amount of borrowing is measured by the Capital Financing Requirement (CFR). This increases with new borrowing-financed capital expenditure and reduces with MRP and capital receipts used to repay borrowing. The CFR is expected to rise to £608m in 2021/22. Based on current projections for capital expenditure and financing, the Council's estimated CFR is as follows:

Table 4 - Estimates of Capital Financing Requirement

Capital Financing Requirement	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/23 budget £'000	2023/24 budget £'000
CFR	494,333	551,787	607,852	619,531	711,588

Asset Management

To ensure that capital assets continue to be of long-term use, the Council has an Asset Management Strategy 2020-2025 that was approved by Cabinet in 2020. This Strategy sets out the key future objectives and how the Council will effectively manage, use and review the assets. This strategy is currently being updated and will be reported to Cabinet in the coming months.

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 used to repay borrowing. The Council is currently also permitted to spend capital receipts on service transformation projects until 2022/23.

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, whilst a shortage of cash will be met by borrowing. 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, also known as internal borrowing.

The Council's main objectives when borrowing are 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 has struck a balance between cheap variable rate short-term loans (currently available at around 0.10%) and long term fixed rate loans where the future cost is known but higher (currently between 1 and 2%). The Council continues to weigh up this balance and evaluates the market to maintain affordability, certainty and flexibility in its borrowing. The Council takes external professional advice on interest rates and Treasury Management from advisors Arlingclose to help inform this Strategy.

Projected levels of the Council's total outstanding net borrowing are shown below, compared with the CFR. The difference between the two being the level of internal borrowing used by the Council. This represents the use of reserves, working capital and revenue financing to offset the need to borrow.

Table 5 - Net Borrowing and the Capital Financing Requirement

Capital Financing Requirement	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/23 budget £'000	2023/24 budget £'000
Net Debt	484,749	542,201	598,267	609,946	702,003
CFR	494,333	551,787	607,852	619,531	711,588

Statutory guidance is that net borrowing should remain below the CFR, except in the short term. As can be seen from the table above, the Council expects to comply with this in the medium term.

The Council is legally obliged to set an affordable borrowing limit each year. In line with statutory guidance, a lower operational boundary for borrowing is also set as a warning level should borrowing begin to approach the limit. As the Council approves capital schemes throughout the year, this limit is updated and reviewed regularly and reported to Cabinet for approval by Council alongside any Community Investment Programme approvals.

Table 6 - Authorised limit and Operational Boundary for External Borrowing

Authorised Limit for External Borrowing	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/3 budget £'000	2023/24 budget £'000
Borrowing	493,333	550,787	606,852	618,531	710,588
Other Long-Term Liabilities	1,000	1,000	1,000	1,000	1,000
Total	**494,333**	**551,787**	**607,852**	**619,531**	**711,588**

Operational Boundary for External Borrowing	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/23 budget £'000	2023/24 budget £'000
Borrowing	472,333	529,787	585,852	597,531	689,588
Other Long-Term Liabilities	1,000	1,000	1,000	1,000	1,000
Total	**473,333**	**530,787**	**586,852**	**598,531**	**690,588**

Investments

Treasury Investments arise from receiving cash before it is paid out again. Investments made for service reasons or for financial gain are not generally considered to be treasury investments.

The Council's policy on treasury investments is to prioritise security and liquidity over yield, focusing 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 high-quality banks, to minimise the risk of loss. As can be seen below, in order to ensure liquidity during the current Pandemic, additional funds are being held short term, to maintain liquidity.

Money that will be held longer term is invested more widely, to balance the risk of loss against the risk of receiving returns below inflation. Long term investments may be held in pooled funds, in this instance an external Fund Manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

Table 7 - Treasury management investments

Treasury Investments	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/23 budget £'000	2023/24 budget £'000
Near-term Investments	32,500	25,000	25,000	25,000	25,000
Longer-term Investments	10,000	10,000	10,000	10,000	10,000
Total	**42,500**	**35,000**	**35,000**	**35,000**	**35,000**

The Council delegates responsibility for the monitoring and scrutiny of its Treasury Management practices and activity to the Treasury Management Review Group (TMRG), which includes Councillors and the Chief Financial Officer, and delegates responsibility for the implementation and administration of Treasury Management policies, strategies and practices to the Council's Chief Financial Officer. The Council also employs an external advisor, Arlingclose, to provide advice on how the Council can manage its investment and borrowing portfolio.

Investments for service purposes are where the Council may choose to assist local public services by making loans to local service providers, or businesses to promote economic growth, or to help enable Council objectives externally, such as by lending money to a housing developer in order to provide additional affordable housing that would not be provided by the open market. Considering the public service objective, the Council is willing to take more risk than with treasury investments. However, it still plans for such investments to break even or generate a profit after all costs.

Decisions on service investments are made by the relevant Service Manager in consultation with the Chief Financial Officer and must meet the criteria limits laid down in the Investment Strategy. Most loans and shares are capital expenditure and investments and purchases will therefore be approved as part of the CIP.

Cabinet are requested to recommend that Council approve the Investment Strategy which is contained within the separate Investment Strategy report.

Property Purchases

With central government financial support for local public services declining, the Council has purchased property in order to a meet a number of corporate objectives for Regeneration, Economic and Housing Development and achievement of its Efficiency Strategy, to enable it to continue to provide high quality local services.

Due to the nature of these transactions there is a higher risk, bringing with it a higher return. In order to mitigate the risk, the Council carries out additional due diligence on these investments. The first element that is looked at is tenant covenant strength which is their ability to pay the rent. This includes, but is not limited to, credit checks on potential tenants, meetings with the senior management of potential tenants of large value transactions and a detailed review of their accounting statements.

Secondary to tenant covenant strength is the financial business case. The Council borrows for property purchases; therefore, the Council ensures that the income from the tenant is in excess of the borrowing costs and repayment of borrowing (MRP) applicable to the purchase of the property.

In order to make the financial business case as resilient and low risk as possible, the Council adds in three additional costs, an interest rate adjustment, a void adjustment, and a maintenance adjustment. As the Council borrows at a variable rate for its commercial activity, the Council charges an interest adjustment on each property. This is where, although the Council predominantly borrows at lower variable rates, any financial business case is charged at higher long-term rates. This ensures should interest rates rise in the future, the Council will still make a financial return. This adjustment is transferred to the Interest Rate Reserve, an earmarked reserve used to mitigate the risk of future rate rises affecting the Councils ability to provide services.

The Council also charges a void adjustment to each business case. This reserves a percentage of the income so that when the initial lease period expires, the Council has enough funds set aside to cover the loss of income and void costs such as Business Rates for up to 12 months should that tenant decide not to renew a lease, leaving the Council having to find a new tenant. This adjustment is transferred to the property reserve, an earmarked reserve used to ensure a future loss of tenant does not affect the Councils ability to provide services.

The Council also has a similar maintenance reserve, where, depending on the age and condition of the building, between 5 and 10% of all income is put in reserve each year to cover future maintenance works to the buildings. This Maintenance Reserve can then be used to fund the Repairs and Renewals Programme prepared by the Property Services Team.

Decisions on property purchases are also subject to additional levels of officer scrutiny, through meetings between members of Management Team, Asset Management, Planning, Legal Services and Financial Services. The aim of these meetings is to scrutinise the due diligence that has been carried out, and to scrutinise financial business cases to ensure potential purchases are sound.

After all due diligence, property purchases are then treated as capital expenditure, and will therefore be approved as part of the capital programme.

Further information on property purchases is covered in more detail in the Investment Strategy.

Housing Investment

The Council has various methods of delivery available to achieve its Housing Delivery objectives. For instance; direct delivery, whereby the Council owns the land and acts as developer, Joint Ventures, whereby the Council works with a key partner to ensure delivery and financing arrangements, whereby the Council uses its access to finance in order to ensure delivery. More information on the Council's housing delivery strategy can be found here Housing Delivery Strategy.

These approaches reflect the nature of the Council's development activity to date, but there are different options available for how local authorities can engage in the direct delivery of housing. For instance, elsewhere on the Cabinet agenda is a report recommending the Council reopens its Housing Revenue Account, opening further possibilities for the delivery and retention of affordable housing.

The Council has different options available to fund housing delivery, and can utilise various funding streams, such as borrowing, New Homes Bonus, Government grants and S106 contributions. Regardless of the method of delivery or funding source, the Council will carry out the same due diligence with each scheme that arises to mitigate against financial risk.

Firstly, the Council will assess covenant strength of any partner should there be one, looking at the sector the partner operates within, credit checks on potential partners and meetings with the senior management of potential partners to determine their suitability through alignment with the Council on aims and objectives and financial resilience.

Secondly, a business case will be created. If the Council is borrowing to enable Housing Delivery, it will ensure any future net income from Housing delivery is in excess or equal to the interest costs and repayment of borrowing (MRP) applicable to the scheme.

In order to make the financial business case as resilient and low risk as possible, the Council also accounts for additional costs, an interest rate adjustment, a voids allowance, a repairs allowance, and a management and maintenance allowance. As the Council borrows at a variable rate for elements of housing delivery, the Council charges an interest adjustment on any scheme where borrowing has been used. This is where, although the Council predominantly borrows at lower variable rates, any financial business case is charged at higher long-term rates. This ensures should interest rates rise in the future, the Council will still make a financial return. This adjustment is transferred to the Interest Rate Reserve, an earmarked reserve used to mitigate the risk of future rate rises affecting the Councils ability to provide services.

The Council also makes allowances for void properties to cover periods where a property is untenanted, a repairs allowance, to cover minor and major repairs to the properties, and a management and maintenance allowance, which accounts for any necessary management and maintenance contracts with third parties, for instance to cover the cost of lettings, callouts and customer services. These costs are charged directly against the income in the business case, and are calculated using industry norms, further assessed using experience within the Council to ensure their prudence.

Decisions on Housing Delivery schemes are also subject to additional levels of officer scrutiny, through meetings of the Operational Housing Board, Strategic Housing Board and the Housing Projects Working Group.

Financial business cases are developed through the Project Management PIM process, and are subsequently scrutinised at the Operational Housing Board, a board consisting of staff from Housing Strategy, Asset Management, Project Management, Planning, Legal Services and Financial Services.

From here the business case is refined and amended as necessary before further scrutiny and eventual sign off from the Strategic Housing Board, a board made up of Councillors, the Chief Executive, Executive Head of Finance and Housing, Executive Head of Planning, and other key members of staff from Project Management and Legal Services.

After all due diligence, Housing schemes are then treated as capital expenditure, and will therefore be approved as part of the capital programme.

Once housing schemes are fully approved, their delivery progress is reported monthly to the Operational Housing Board, and Strategic Housing Board, through the Highlight Report process, with key metrics such as financial progress against the business case, progress against timescales, and resourcing implications being monitored.

Should housing schemes be delivered through a partnership with a separate board and governance structure, the minutes and actions from these board meetings will be reported to the Strategic Housing Board, in addition to the Highlight report Process.

Ongoing performance post completion is monitored and reported regularly to the same boards, as well as to the Housing Projects Working Group, a group consisting of Councillors, the Executive Head of Finance and Housing, and relevant members of staff, to ensure there has been and will continue to be alignment against objectives.

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 of revenue spend funded by Council Tax, Business Rates and general Government Grants.

Table 8 - Proportion of financing costs to net revenue stream

Financing costs compared to net revenue stream	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/23 budget £'000	2023/24 budget £'000
Financing Costs	6,686	6,350	8,010	9,502	9,711
Proportion of net revenue stream	**72.2%**	**61.9%**	**80.8%**	**105.6%**	**106.0%**

Whilst the table above shows that the Council is forecast to spend more on financing costs than on revenue spend net of financing costs by the end of the forecast period, what it does not show is the annual surplus that these investments have bought into the Authority to spend on services.

Table 9 - Revenue Surplus from Capital Financing

Financing costs compared to income generated	2019/20 actual £'000	2020/21 forecast £'000	2021/22 budget £'000	2022/23 budget £'000	2023/24 budget £'000
Financing Costs	6,686	6,350	8,010	9,502	9,711
Income/Savings generated by schemes funded by borrowing	18,154	19,233	18,852	19,376	19,451
Annual Surplus	**11,468**	**12,883**	**10,842**	**9,874**	**9,740**

Further details on the revenue implications of capital expenditure will be discussed in the 2021/22 Revenue Budget.

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 CFO is satisfied that the proposed capital programme is prudent, affordable and sustainable.

Knowledge and Skills

The Council employs qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The team includes:

- A Finance Team with five CIPFA qualified accountants, all with over ten years of experience in Local Government accounting, and one CIMA qualified accountant.

- An Asset Management Team including a number of Chartered Surveyors with over 10 years' experience who are members of the Royal Institution of Chartered Surveyors (RICS), two of which are RICS Registered Valuers. They are regulated by their professional body (RICS) and comply with the RICS rules in relation to conduct and Continuing Professional Development.

- A Legal Team with 7 qualified solicitors, a locum solicitor and a Chartered Legal Executive (FCILEx), including four with over 10 years' experience in Local Government; 3 with significant property and related commercial transaction knowledge; 3 with extensive planning experience; and 3 with substantial regulatory and governance background.

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 and takes advice from external property and legal advisors where appropriate. This approach is often more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Further details on officer's skills and knowledge, as well as external advisers can be found in the Investment Strategy report.