Capital Strategy Report 2019/20

1.0 Introduction

1.1 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.

2.0 Capital Expenditure and Financing

2.1 Capital expenditure is where the Council spends money on assets, such as property, vehicles or other assets 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 £5,000 are generally not capitalised and are charged to revenue in year. Details of the Council's policy on capitalisation is provided in the annual Statement of Accounts.

2.2 In 2019/20, the Council is planning capital expenditure of £257.6M as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

£M	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
General Fund services	91.3	209.2	177.8	166.5	72.0	47.1
Council housing (HRA)	32.4	26.8	17.0	0.0	0.0	0.0
Capital investments	38.0	21.6	4.0	10.0	10.0	12.0
TOTAL	**161.6**	**257.6**	**198.7**	**176.5**	**82.0**	**59.1**

2.3 The main General Fund capital projects include (South Kilburn Estate Regeneration £96M, Investment in council subsidiary i4B £55M, Major Repairs and maintenance of the Council's housing stock £52M, School capital improvements works £18M and investments in roads and pavements £39M. The Council also plans to incur capital expenditure on investments, which are detailed later in this report in paragraph 9.3.

2.4 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately, and includes the building of new homes as well as expenditure and improving and maintaining council homes over the forecast period.

2.5 During the year capital sub-boards (led by Operational Directors) have developed a comprehensive list of possible areas for future additional capital investment to potentially draw down against the pipeline budget provision. Outline bids are collated by the PMO (Programme Management Office) in conjunction with Finance who calculate the financing cost (which can be nil if the project is fully externally financed).

2.6 This process included the assimilation of over 100 individual capital proposals with a total value of c£1bn and a spend profile spanning 3 to 5 years. This has since been reworked and consolidated to c50 projects so that they can be considered at a more strategic level. The detailed steps taken to arrive at this point are described below, however it is worth noting that at this stage, the proposals are mostly at an early draft or outline business case form. The capital programme and capital pipeline proposals 2019/20 – report sets out the potential next steps in prioritising these proposals for incorporation into the main capital programme for 2019/20 to 2021/22 which will be presented to Council in February 2019 as part of the annual budget setting cycle.

2.7 Full details of the Council's capital programme, including the project appraisals undertaken can be found within the capital programme and capital pipeline proposals 2019/20 considered by Cabinet in January 2019.

2.8 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 £ millions

£M	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
External resources	47.3	34.7	65.3	19.4	7.5	2.1
Own Resources	84.9	50.3	63.3	26.2	30.6	20.1
Debt	29.4	172.7	70.1	130.8	43.8	36.8
TOTAL	**161.6**	**257.6**	**198.7**	**176.5**	**82.0**	**59.1**

2.9 Excluding external grants and other resources most assets are funded from debt. (The position in 2018/19 to 2020/21 is somewhat unusual as the council has accumulated capital receipts and other reserves planned to be used to fund capital expenditure). As with any debt, it must be repaid over time, and for a local authority there is a statutory requirement to set aside "minimum revenue provision" (MRP) in each year's budget for debt repayment. Planned MRP to 2023/24 is as set out in the table below.

Table 3: Replacement of debt finance in £ millions

£M	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
MRP	8.9	9.2	9.9	11.0	13.1	12.8
TOTAL	**8.9**	**9.2**	**9.9**	**11.0**	**13.1**	**12.8**

2.91 The Council's full minimum revenue policy statement is presented as an Appendix to the annual Council Tax and Budget Setting Report.

2.92 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 to £855M during 2019/20, and to over £1bn, a 27% increase on the 2018/19 figure, by 2023/24. 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 £ millions

£M	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Opening CFR	**670.9**	**691.5**	**854.9**	**915.0**	**1,034.8**	**1,065.5**
Capital Expenditure	161.6	257.6	198.7	176.5	82.0	59.1
External resources	(47.3)	(34.7)	(65.3)	(19.4)	(7.5)	(2.1)
Own Resources	(84.9)	(50.3)	(63.3)	(26.2)	(30.6)	(20.1)
MRP	(8.9)	(9.2)	(9.9)	(11.0)	(13.1)	(12.8)
Closing CFR	**691.5**	**854.9**	**915.0**	**1,034.8**	**1,065.5**	**1,089.5**

3.0 Asset management

3.1 To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place. The Property and Asset Strategy 2015-19 was approved by cabinet on 1 June 2015.

4.0 Asset disposals

4.1 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 plans to receive £25M of capital receipts in the coming financial year as follows:

Table 5: Capital receipts in £ millions

£M	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Asset Sales	18.4	3.9	12.5	17.7	27.1	16.6
Loans Repaid	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	**18.4**	**3.9**	**12.5**	**17.7**	**27.1**	**16.6**

5.0 Treasury Management

5.1 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.

5.2 Due to decisions taken in the past, the Council currently has £396M borrowing at an average interest rate of 4.83% and £130M treasury investments at an average rate of 0.8%.

6.0 Borrowing strategy

6.1 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 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%).

6.2 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 £ millions

£M	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Debt (incl. PFI & leases)	396.0	355.0	331.0	316.0	305.0	654.0
Capital Financing Requirement	691.5	854.9	915.0	1,034.8	1,065.5	1,089.5

6.3 Statutory guidance prescribes 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 regulation.

7.0 Affordable borrowing limit

7.1 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.

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

£M	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Authorised Limit	1,100.0	1,200.0	1,200.0	1,300.0	1,400.0	1,500.0
Operational Boundary	900.0	1,000.0	1,000.0	1,100.0	1,200.0	1,300.0

7.2 Further details on borrowing are contained within the Council's treasury management strategy.

8.0 Investment strategy

8.1 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.

8.2 The Council's policy on treasury investments is to prioritise security and liquidity over yield and 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 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 £millions

£M	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Short term investments	130.0	115.0	100.0	85.0	70.0	55.0
Long term investments	83.5	105.1	109.1	119.1	129.1	141.1

8.3 Further details on treasury investments are contained within the Council's treasury management strategy.

8.4 Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Chief Finance Officer, who must act in line with the treasury management strategy approved by Council. Reports on treasury management activity are presented to Cabinet and Full Council, whilst the Audit & Standards Advisory Committee is responsible for scrutinising treasury management decisions.

9.0 Investments for Service Purposes

9.1 The Council makes investments to assist local public services, including making loans to council subsidiaries and local businesses / service providers to promote economic growth. In light of 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 / generate a profit after all costs.

9.2 Decisions on service investments are either made by Cabinet or under delegated authority, or set down in the approved investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme. Further details on service investments are contained within the investment strategy.

9.3 The proposed budget includes sums for investment in the Council's subsidiary i4B as well as the Queen's Park Joint Venture. Both schemes aim to alleviate affordable housing pressures.

10.0 Commercial Activities

10.1 The Council can invest in commercial property purely or mainly for financial gain. Total commercial investments are currently valued at £8.6M consisting of 34 individual property assets generating £0.5M PA, or a yield of 6.4%.

Table 9: Property asset types and income generated in £millions

ASSET TYPES	No. of Assets	Value £M	Income PA £M
Operational	48	165.0	0.84
Commercial	34	8.6	0.55
Community Groups	40	15.0	0.18
Education	48	280.0	0
Regeneration	35	25.0	0.12
Non HRA Housing	7	3.9	0.1
TOTAL	**212**	**497.5**	**1.79**

10.2 With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include voids, diminution of capital values, etc. These risks are managed by the existing risk management framework. In order that commercial investments remain proportionate to the size of the authority they are under constant review and contingency plans are in place should expected yields not materialise.

11.0 Liabilities

11.1 In addition to debt of £396M detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £562M - March 2016).

12.0 Revenue Budget Implications

12.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP payments 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 10: Prudential Indicator: Proportion of financing costs to net revenue stream

£M	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Financing costs	13.5	14.9	17.1	21.2	24.9	32.1
Proportion of net revenue stream %	5.1%	5.6%	6.4%	7.9%	9.3%	12.0%

12.2 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 detailed information contained within the treasury management strategy and the Budget & Council Tax Report 2019/20, as well as the prudential indicators included above demonstrates how this is prudent, affordable and sustainable.

13.0 Knowledge and Skills

13.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council pays for junior staff to study towards relevant professional qualifications including CIPFA, ACT (treasury) & AAT for example.

13.2 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 can be more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.