Capital Strategy 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.

- For details of the Council's policy on capitalisation, see: https://www.folkestone-hythe.gov.uk/media/5151/Audited-Statement-of-Accounts-2017-18/pdf/Audited_Statement_of_Accounts_2017-181.pdf
- Additionally further clarification can be found within the Councils Financial Procedure rules

In 2019/20, the Council is planning capital expenditure of £24.93m as summarised below:

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

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
General Fund services	2.465	4.430	4.898	8.979	16.742
Council housing (HRA)	9.133	6.476	8.325	7.838	6.908
Capital investments	0.062	3.286	11.707	9.259	0
TOTAL	11.660	14.192	24.930	26.076	23.650

The main General Fund capital projects include Coast Protection works at Coronation Parade, Hythe (£2.39m), Disabled Facilities Grants (£1m) and an invest to save initiative for Temporary Accommodation (£500k). The Council also plans to incur £8.325m of capital expenditure on investments, which are detailed later in this report.

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, the Council has plans to build 200 new homes over the period of the HRA business plan, and the coming financial year includes £5.445m within the HRA Capital programme towards the delivery of this ambition.

Governance: Service managers bid annually in September through the growth proposals to include projects in the Council's capital programme. Bids are collated by Accountancy who review the bids including consideration of the available funding (including external funding). Over the coming 12 months we will be exploring more formal project appraisal and evaluation options to add strength to this process. The Corporate Leadership Team appraises all bids, supported by Accountancy, based on an evaluation of the projects against corporate priorities and funding availability and makes recommendations to the Cabinet for consideration initially through the Budget Strategy in November. The final capital programme is then presented to Cabinet in January or February and to Council in February each year.

- For full details of the Council's capital programme, see: [MTCP link]

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

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
External sources	2.250	1.006	3.656	4.669	1.269
Own resources	9.348	9.636	9.645	7.893	21.124
Debt	0.062	3.550	11.629	13.514	1.257
TOTAL	**11.660**	**14.192**	**24.950**	**26.076**	**23.650**

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 authority currently does not anticipate using capital receipts to replace debt finance so the planned MRP is as follows:

Table 3: Replacement of debt finance in £ millions

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
Own resources	0.4	0.4	0.4	0.3	1.0

- The Council's full minimum revenue provision statement is available here: [link Appendix 3 MTCP paper]

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 £11.271m 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 £ millions

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
General Fund services	11.690	12.342	12.484	16.192	16.557
Council housing (HRA)	47.416	47.416	47.416	47.619	48.161
Capital investments	6.436	8.961	20.090	29.349	28.705
TOTAL CFR	**65.542**	**68.719**	**79.990**	**93.160**	**93.423**

Asset management: To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place. This strategy was adopted in July 2017 by Cabinet and sets out how property asset management is delivered for the Council to meet its long term objectives and goals. It outlines how the long term objectives for managing the asset portfolio are met, including statutory obligations, stakeholder needs & the overall performance of property within the context of any constraints such as funding. The strategy is supported by the Asset Management Policy & Asset Management Plan also adopted by Cabinet in July 2017.

- The Council's asset management strategy can be read here: http://www.folkestone-hythe.gov.uk/moderngov/documents/g3223/Public%20reports%20pack%2019th-Jul-2017%2017.00%20Cabinet.pdf?T=10

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 plans to receive £4.23m capital receipts in the coming financial year as follows:

Table 5: Capital receipts in £ millions

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
Asset sales	2.42	2.63	4.13	1.50	1.50
Loans repaid	0.42	0.48	0.10	0.35	0.35
TOTAL	**2.84**	**3.11**	**4.23**	**1.85**	**1.85**

- Further details of planned asset disposals are on outlined in Appendix 2 of the MTCP report [link – Appendix 2 MTCP]
- The Council's Flexible Use of Capital Receipts Policy is available here: [link C/16/48 http://www.folkestone-hythe.gov.uk/moderngov/documents/g3161/Public%20reports%20pack%2014th-Sep-2016%2017.00%20Cabinet.pdf?T=10

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 £56.8m borrowing at an average interest rate of 3.38% and £43.1m treasury investments at an average rate of 1.16%.

Borrowing strategy: 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%).

Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities, 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

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Debt (incl. PFI & leases)	57.8	55.8	60.2	78.3	82.4
Capital Financing Requirement	65.5	68.7	80.0	93.2	93.4

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 £15m at each year-end. This benchmark is currently projected to be £40.0m at 31.3.19 and is forecast to rise to £77.8m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Outstanding borrowing	*57.8*	*55.8*	*60.2*	*78.3*	*82.4*
Liability benchmark	35.5	40.0	55.6	73.7	77.8

The table shows that the Council expects to remain borrowed above its liability benchmark. This is because the council intends to continue holding £15m of strategic investments in pooled funds over the medium term which should provide returns greater than the expected cost of new borrowing over the same period.

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.

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	90.0	96.5	97.4	96.4
Authorised limit – PFI and leases	-	-	-	-
Authorised limit – total external debt	90.0	96.5	97.4	96.4
Operational boundary – borrowing	83.3	94.0	94.9	93.9
Operational boundary – PFI and leases	-	-	-	-
Operational boundary – total external debt	83.3	94.0	94.9	93.9

- Further details on borrowing are in pages 6 to 8 of the treasury management strategy [link TMS]

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 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

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Near-term investments	(23.4)	(15.8)	(4.6)	(4.6)	(4.6)
Longer-term investments	(13.9)	(15.0)	(15.0)	(15.0)	(15.0)
TOTAL	**(37.3)**	**(30.8)**	**(19.6)**	**(19.6)**	**(19.6)**

- Further details on treasury investments are in pages 8 to 13 of the treasury management strategy [link] TMS

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Corporate Director –Customer, Support & Specialist Services 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 Cabinet. The Overview & Scrutiny Committee are responsible for scrutinising treasury management decisions.

Investments for Service Purposes

The council can lend money to its subsidiaries, its charities where the council is the trustee, its external service providers, local residents and its employees to support local public services and stimulate local economic growth. In the future the council may also lend money to joint ventures it decides to enter into to help deliver its major corporate investment initiatives.

The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the authority, upper limits on the outstanding loans to each category of borrower have been set

Additionally the council can invest in share equity, it currently only does so for its wholly owned Housing and Regeneration subsidiary company, Oportunitas Limited. In the future the council may also acquire shares in either other subsidiaries companies it may choose to establish or joint venture companies it decides to enter into to help deliver its major corporate investment initiatives.

Governance: Decisions on service investments are made by the relevant service manager in consultation with the Corporate Director – Customer Support & Specialist Services and must meet the criteria and limits laid down in the 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 in sections 3 & 4 Investment Strategy C/18/65 http://www.folkestone-hythe.gov.uk/moderngov/documents/g4464/Public%20reports%20pack%2030th-Jan-2019%2017.00%20Cabinet.pdf?T=10

Commercial Activities

With central government financial support for local public services declining, the Council has started to explore opportunities to invest in commercial property purely or mainly for financial gain. Total commercial investments are currently projected to be valued at £9.383m with the largest being Otterpool Park land, the majority of these holdings are commercial or residential land and property being held with the intention of making a capital gain or generating a new revenue stream that will be spent on local public services. Returns have therefore yet to be made on this land to date.

With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include fluctuations in future demand of the market including competition, risk of void tenancies, fall in capital values etc. These risks are managed by the project lead as well as assessed through the corporate risk register. The council has an established a proactive risk management framework, which incorporates key projects, and reports quarterly to the Audit & Governance Committee as well as annually to the Cabinet. The council is also working on a council wide transformation programme to support the needs of the medium term revenue position so as to not place sole reliance on the investment plans providing the expected yields within the anticipated timeframes.

Governance: Decisions on commercial investments are made by Cabinet and / or Full Council in line with the criteria and limits outlined within the Constitution, in specific circumstances the Executive have delegated authority to progress certain projects to the the Corporate Director - Commercial in consultation with the relevant Portfolio Holder. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

- Further details on commercial investments and limits on their use are in pages 36 to 39 of the Investment Strategy: C/18/65 http://www.folkestone-hythe.gov.uk/moderngov/documents/g4464/Public%20reports%20pack%2030th-Jan-2019%2017.00%20Cabinet.pdf?T=10
- Further details on the risk management of commercial investments are in the non-treasury management investment practices available here: [link]

Liabilities

In addition to debt of £60.2m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £70.7m at 31.3.18). It has also set aside £1.8m to cover risks of the business rates appeals.

Governance: Decisions on incurring new discretional liabilities are taken by the Corporate Director – Customer, Support & Specialist Services in liaison with service managers. The risk of liabilities crystallising and requiring payment is monitored by Accountancy and reported through the regular budget monitoring/projected outturn cycle to Cabinet if identified or through the Statement of Accounts process to the Audit & Governance Committee. New liabilities exceeding the auditors materiality threshold would be reported to full council for approval/notification as appropriate.

- Further details on liabilities and guarantees are on pages 34, and 38 to 41 of the 2017/18 statement of accounts https://www.folkestone-hythe.gov.uk/media/5151/Audited-Statement-of-Accounts-2017-18/pdf/Audited_Statement_of_Accounts_2017-181.pdf

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**
Non-HRA Financing costs (£m)	1.37	1.09	0.65	0.35	1.05
Proportion of net revenue stream	8.2%	6.6%	3.9%	2.1%	5.8%
HRA Financing costs (£m)	5.70	4.26	4.91	5.68	4.45
Proportion of net revenue stream	35.3%	26.7%	30.2%	34.3%	25.9%

- Further details on the revenue implications of capital expenditure are on page 4 of the 2019/20 revenue budget [link]

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 Corporate Director – Customer, Support Specialists of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable because it has been evaluated and risk assessed, it is considered to be a balanced portfolio with minimal risks.

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 Corporate Director – Customer, Support & Specialist Services is a qualified accountant with 30 years' experience, and Corporate Director - Commercial has a degree in Estate Management, is RICS qualified and has 30 years experience in both the private and public sector. The Council pays for staff to study towards relevant professional qualifications including ACCA, ACT (treasury).

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, Savills and Montague Evans as property consultants as well as other bodies on an ad hoc basis. 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.

- Further details on staff training can be found within the People Strategy which was considered by Personnel Committee in September http://www.folkestone-hythe.gov.uk/moderngov/documents/g4480/Public%20reports%20pack%2027th-Sep-2018%2014.00%20Personnel%20Committee.pdf?T=10 and adopted by CLT (Corporate Leadership Team) in November 2018.