

Capital Strategy Report 2019/20

Cotswold District Council

Introduction

This capital strategy provides 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 the Council's accounting policies which are contained within the annual Statement of Accounts: Accounts 2017-18

In 2019/20, the Council is planning capital expenditure of £13 million 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	2.3	2.5	13.0	17.7	1.6
Capital investments	0	0	0	0	0
TOTAL	2.3	2.5	13.0	17.7	1.6

Over the next three years, the main General Fund capital projects include:

- Car Park investment in Cirencester £15 million;
- Replacement of recycling vehicles, recycling containers and other environmental services vehicles and equipment £5 million;
- Acquisition of a strategic site in Cirencester for economic development £2.5 million;
- Investment in Corinium Museum £1.6 million;
- Investment in Cirencester Leisure Centre £1.2 million;
- Investment in environmental services vehicles £1.7 million
- Development of site in Cirencester for additional car parking £0.7 million
- Disabled Facilities Grants £2.1 million (£0.7 million per annum)
- Electric vehicle charging points £0.5 million
- Investment in ICT and other equipment £1.0 million

Governance: Service managers bid annually in the autumn to include projects in the Council's capital programme. Bids are collated by the finance team who calculates the financing cost (which can be nil if the project is fully externally financed). The financing cost is included in the Medium Term Financial Strategy and detailed budgets for the forthcoming financial year. The Council's Overview and Scrutiny Committee considers both the Medium Term Financial Strategy and the detailed budget. The comments of the Scrutiny Committee are reported to Cabinet when the Medium Term Financial Strategy and detailed budget proposals are considered. The final capital programme and revenue budgets are then presented to Council in February each year.

- For full details of the Council's proposed capital programme see the revenue and budget papers considered by Cabinet and Council in February 2019: link to be added when Cabinet papers are published

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 and leasing). 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	0.8	0.9	1.8	0.7	0.7
Own resources	1.5	1.6	5.4	9.6	0.7
Debt	0	0	5.8	7.4	0.2
TOTAL	2.3	2.5	13.0	17.7	1.6

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 £ millions

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
Own resources	0	0	0	0.8	0.9

Minimum Revenue Provision

Before the start of the financial year, a statement of MRP policy for the forthcoming financial year must be approved by Full Council.

The broad aim of the Policy is to ensure that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure, which gave rise to the debt, provides benefits.

Where a local authority's overall CFR is £nil or a negative amount there is no requirement to charge MRP.

The move to International Financial Reporting Standards (IFRS) means that Private Finance Initiative (PFI) schemes and Operating Leases can be brought onto the Balance Sheet. Where this is the case, such items are classed in accounting terms as a form of borrowing. MRP for these items is matched against the principal repayment embedded within the PFI or lease agreement, and the impact upon the revenue account is therefore neutral.

The Council will use the Asset Life Method for calculating MRP. Under this method MRP is determined by the life of the asset for which the borrowing is undertaken. This can be calculated by either of the following methods:

- (a) Equal Instalments: where the principal repayment made is the same in each year, or
- (b) Annuity: where the principal repayments increase over the life of the asset.

The annuity method has the advantage of linking MRP to the benefits arising from capital expenditure, where these benefits are expected to increase over the life of the asset.

MRP commences in the financial year following that in which the expenditure is incurred or, in the year following that in which the relevant asset becomes operational.

The estimated life of the asset will be determined in the year that MRP commences and will not be subsequently revised. However, additional repayments can be made in any year which will reduce the level of payments in subsequent years.

If no life can be reasonably attributed to an asset, such as freehold land, the life is taken to be a maximum of 50 years. In the case of freehold land on which a building or other structure is constructed, the life of the land will be treated as equal to that of the structure.

In instances where central government permits revenue expenditure to be capitalised, the Statutory Guidance sets out the number of years over which the charge to revenue must be made. The maximum useful life for expenditure capitalised by virtue of a direction under s16(2)(b) is 20 years.

The General Fund MRP charge using this method is estimated at £0 for 2019/20.

Capital Financing Requirement

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 £0.2 million 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	0	0	5.8	12.4	11.7
Capital investments	0	0	0	0	0
TOTAL CFR	0	0	5.8	12.4	11.7

Asset management: The Council recognises that management of the Council's asset base is critical to delivering efficiency savings, enhancing returns from the council assets and ensuring that assets remain in top condition to enable efficient and effective services to be delivered to residents.

It is timely to review and update the Council's Asset Management Plan and this will form part of the Council's Corporate Plan in 2019/20.

While the Asset Management Plan does require updating, the Council's Audit Committee receives information on the Council's asset portfolio as part of consideration of the financial statements.

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 expects to receive £1 million of 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	0.2	0.2	1.0	0.2	0.2
Loans repaid (Ubico)	0.4	0.4	0.4	0.4	0.4
TOTAL	0.6	0.6	1.4	0.6	0.6

- The Council is not expecting any capital receipts from the disposal of assets, however an overage clause from a previous land disposal is expected to generate a capital receipt of £0.8 million. The Asset Sale receipts in the table above represent receipts from "Right to Buy" asset disposals from Bromford Housing Association.
- The Council does not intend to make use of the flexibility to use capital receipts on service transformation projects. Instead, the revenue impact of transformational change is funded through the application of revenue earmarked reserves.

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.

As at 31 December 2018, the Council had £0 of external borrowing. The Council held over £41 million in treasury investments (£8.5 million in a variety of pooled funded and £33 million held in other treasury investments for cash flow purposes). The investments have achieved an average investment return of 1.7%.

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 and leases are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross External 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 (including leases)	0	0	5.8	12.4	11.7
Capital Financing Requirement	0	0	5.8	12.4	11.7

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 £14 million at each year-end. This benchmark is currently £28.2 million and is forecast to increase to £131.98 million 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	0	0	5.8	12.4	11.7
Liability benchmark	28.2	28.0	32.0	32.1	31.9

The table shows that the Council expects to be 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. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 8: 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	5.0	10.8	17.4	16.7
Authorised limit - PFI and leases	0	0	0	0
Authorised limit - total external debt	5.0	10.8	17.4	16.7
Operational boundary - borrowing	2.0	7.8	14.4	13.7
Operational boundary - PFI and leases	0	0	0	0
Operational boundary - total external debt	2.0	7.8	14.4	13.7

- Further details on borrowing can be found in 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 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 9: Treasury management estimate of investment balance at year-end 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	25.7	15.5	13.8	7.2	7.6
Longer-term investments	2.5	12.5	12.5	12.5	12.5
TOTAL	28.2	28.0	26.3	19.7	20.1

- Further details on treasury investments can be found in the treasury management strategy.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Chief Finance Officer and staff, who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity and performance against the Prudential Indicators are presented to the Audit Committee.

Investments for Service Purposes

The Council makes investments to assist local public services, including: making loans to local service providers, the Council's subsidiaries that provide services. 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 or generate a minimal profit after all costs.

Governance: Decisions on service investments are made by the Council on advice from the Chief Finance Officer and must meet the criteria and limits laid down in the investment strategy. Most loans are capital expenditure and purchases will therefore also be approved as part of the capital programme.

- Further details on service investments can be found in the investment strategy.

Commercial Activities

With central government financial support for local public services declining, the Council invests in commercial property purely or mainly for financial gain. Total commercial investments are currently valued at £5.1 million in assets which are situated outside of the District providing a net return after costs of 9.9%.

With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include the economic impact of the impending exit from the European Union and changes to the high street, as widely discussed in the media recently. An economic downturn could increase vacancies in commercial lettings, reducing income to the Council, or reduce the capital value of the property.

These risks are managed by the Council's Property Services team. The Council is in the process of carrying out a review of its commercial property holdings with particular regard to the risks identified above. The outcome of the review will be reported to the Overview and Scrutiny Committee and/or Cabinet as appropriate.

The Council has a Corporate Risk Register which is reported quarterly to the Council's Audit Committee and will include any significant risks arising from commercial investments. The Council is not planning any further investments at this point in time.

Governance: Decisions on commercial investments are made by the Council in line with the criteria and limits in the investment strategy. 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 are set out in the investment strategy.

Liabilities

In addition to debt, the Council is committed to making future payments to cover its pension fund deficit (valued at £39.1m), it has also set aside £1.0m to cover the financial risks associated with: successful appeals to against business rates resulting in refunds to businesses.

The Authority is a shareholder of Ubico Ltd (one seventh) and is a joint partner in Publica Group (Support) Limited (¼ owner). In both cases, should the company overspend the Council would be liable for its share of the additional costs. In both companies, sound financial management and budgetary control mitigate the risk that additional sums will be required without adequate notice.

Governance: Decisions on incurring new discretionary liabilities are taken by Cabinet or Council according to the scale of financial liability. The risk of liabilities crystallising and requiring payment is monitored by the Finance team and reported in the statement of accounts. Where liabilities arise during the year they are reported to Cabinet and Council as part of quarterly performance reports.

Further details on provisions can be found in the 2017/18 statement of accounts.

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 10: Prudential Indicator: Proportion of financing costs to net revenue stream

	2017/18 actual £000	2018/19 forecast £000	2019/20 budget £000	2020/21 budget £000	2021/22 budget £000
Financing costs	-200	-264	-488	276	483
Proportion of net revenue stream	-2%	-2%	-4%	2%	4%

- Further details on the revenue implications of capital expenditure are included in the reports to Cabinet on the 2019/20 revenue budget. These can be found on the Council's website.

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 25 years into the future. The Chief Finance Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because the impact has been included in the Medium Term Financial Strategy (MTFS) considered by Cabinet and Council in February 2019. (Link to be added when papers to Council Feb 2019 are published). The Medium Term Financial Strategy covers a 10 year period, and the forecast level of General Fund balance is positive at £2.5 million at the end of the Strategy period. The full MTFS can be accessed via the Council's website.

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 Chief Finance Officer is a qualified accountant with over 20 years' experience of working in local government finance. The Deputy Chief Finance Officer is also a qualified accountant with 17 years experience. The Council pays for junior staff to study towards relevant professional qualifications including Chartered Institute of Public Finance and Accountancy (CIPFA), Association of Certified Chartered Accountants (ACCA) and Association of Accounting Technicians.

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. The Council employs other specialist advisers to advise upon specific, extra-ordinary transactions as required. Examples of such transactions include property acquisitions, and loans to third parties. 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 has experience of investing in commercial property in recent years. The Council's property service is provided through its strategic service provider Publica Group (Support) Ltd. The team of property officers have the following qualifications/status:

- BSc Hons Real Estate Management
- Associate Member Royal Institute Chartered Surveyors
- Member Royal Institute Chartered Surveyors
- Royal Institute Chartered Surveyors Registered Valuer
- Member institute welfare & facilities management
- Technical member for institute for occupational safety and health
- Member of chartered institute of marketing

The Council's legal team have experience of carrying out due diligence checks, particularly for commercial property acquisitions, and the legal officers have the following qualifications/status:

- Fellow of the Charter Institute of Legal Executives (FCIlex)
- Associate Member of the Charter Institute of Legal Executives (FCIlex)
- Graduate of the Charter Institute of Legal Executives (FCIlex)
- Para-Legals

- Solicitors

The Property and Legal teams work together with the Finance team to support the Council's Chief Finance Officer and the Public Finance Director in developing investment proposals for the Council. External specialist advice is obtained when required to support these teams.

The Council has previously invested in a range of commercial properties which are delivering a sustainable revenue stream to the Council. Any further investment in non-treasury management transactions will be set out in this, or future iterations of this strategy.