**Cotswold District Council**

**Capital Strategy 2021/22**

## Introduction

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. It has been written in an accessible style to enhance understanding of these sometimes technical areas.

Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and to a local policy framework, summarised in this report.

## Capital Expenditure and Financing

Capital expenditure is where an authority 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 treated as operational expenditure, which is charged to the Council's revenue account.

- ☐ For details of the Council's policy on capitalisation, see the Council's accounting policies which are contained within the annual Statement of Accounts: Statement of Accounts 2019-20

In 2021/22, the Authority is planning capital expenditure of £18.3 m as summarised below:

*Table 1: Prudential Indicator: Estimates of Capital Expenditure*

| | 2019/20 actual £million | 2020/21 forecast £million | 2021/22 budget £million | 2022/23 budget £million | 2023/24 budget £million |
|---|---|---|---|---|---|
| General Fund services | 5.5 | 10.9 | 18.3 | 27.8 | 27.5 |

| | | | | | |
|---|---|---|---|---|---|
| Capital investments | 2.2 | 0 | 0 | 0 | 0 |
| **TOTAL** | 7.7 | 10.9 | 18.3 | 27.8 | 27.5 |

The main General Fund capital projects include provision of social housing, supporting local economic development, investment in green energy provision and projects to reduce carbon emissions. The Council will continue to support the community through the allocation of Disabled Facilities Grants, investment in community leisure and cultural facilities and investment in car park facilities.

Capital investments include loans and shares made for service purposes and property held primarily for financial return in line with the definition in the *CIPFA Treasury Management Code.* At the time of preparing this Strategy, the Council does not plan to incur any capital expenditure on investments. However, the differentiation between capital expenditure on General Fund Services and Investments will be included within the individual business cases for capital projects developed under the Council's Recovery Investment Strategy.

**Governance**: Service managers contribute annually, in the autumn, to the Council's revenue budget and capital programme. The Finance Team collates proposed changes to the Capital Programme for consideration by the Cabinet as part of the Council's budget setting process. The financing cost (which can be nil for projects funded from Council resources or external grants) 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 Overview and Scrutiny Committee are reported to Cabinet when the Medium Term Financial Strategy and detailed budget proposals are considered. Cabinet recommends the final Capital Programme and revenue budgets to Council in February each year.

In September 2020, the Council approved a Recovery Investment Strategy: Recovery Investment Strategy. Under this Strategy the Council has established a Capital Programme Investment Board which will consider business cases for projects which support the aims and objectives of the Recovery Investment Strategy. Once the Board has considered business cases the Cabinet and/or Council will consider the views of the Board when approval is sought to access capital funding.

☐ For full details of the Council's proposed capital programme see the revenue and budget papers considered by Cabinet and Council in February 2021: 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, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

*Table 2: Capital financing*

| | **2019/20 actual** | **2020/21 forecast £million** | **2021/22 budget £million** | **2022/23 budget £million** | **2023/24 budget £million** |
|---|---|---|---|---|---|
| External sources | 1.5 | 0.9 | 0.7 | 0.7 | 0.7 |
| Capital resources | 5.9 | 5.7 | 1.0 | 2.5 | 3.0 |
| Revenue resources | 0.3 | 2.1 | 0.2 | 1.0 | 0.3 |
| Debt | 0.0 | 2.2 | 16.4 | 23.6 | 23.6 |
| **TOTAL** | **7.7** | 10.9 | 18.3 | 27.8 | 27.5 |

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*

| | **2019/20 actual £million** | **2020/21 forecast £million** | **2021/22 budget £million** | **2022/23 budget £million** | **2023/24 budget £million** |
|---|---|---|---|---|---|
| Capital resources | 0 | 0 | 0.3 | 0.3 | 0.7 |
| Revenue resources | 0 | 0 | 0 | 0.3 | 0.4 |
| **TOTAL** | **0** | **0** | **0.3** | **0.6** | **1.1** |

**Minimum Revenue Provision Policy**

Before the start of the financial year, a statement of Minimum Revenue Provision Policy for the forthcoming financial year must be approved by Full Council.

The broad aim of the Policy is to ensure that Minimum Revenue Provision (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 the Council's overall Capital Financing Requirement is £nil or a negative amount there is no requirement to charge MRP.

International Financial Reporting Standards (IFRS) require Private Finance Initiative (PFI) schemes and Operating Leases to 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 the 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 the asset life method, is estimated at £0.3 million for 2021/22.

The Authority'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 £16.1 million during 2021/22. Based on the above figures for expenditure and financing, the Authority's estimated CFR is as follows:

*Table 4: Prudential Indicator: Estimates of Capital Financing Requirement*

| | **31.3.2020 actual £million** | **31.3.2021 forecast £million** | **31.3.2022 budget £million** | **31.3.2023 budget £million** | **31.3.2024 budget £million** |
|---|---|---|---|---|---|
| General Fund services | 0 | 2.2 | 18.3 | 41.3 | 63.8 |
| Capital investments | 0 | 0 | 0 | 0 | 0 |
| **TOTAL CFR** | **0** | **2.2** | **18.3** | **41.3** | **63.8** |

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

During 2020/21, the Council commenced a targeted review of its strategic assets. The review is being led by the Leader and Deputy Leader and Cabinet Member for Finance. Where there are opportunities to use assets more effectively to deliver the Council's priorities, business cases will be presented to the Cabinet or Council for approval.

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 Authority is currently also permitted to spend capital receipts on service transformation projects until 2022/23. Repayments of capital grants, loans and investments also generate capital receipts. The Authority plans to receive £3.9 million of capital receipts in the coming financial years as follows:

*Table 5: Capital receipts receivable*

| | 2019/20 actual £million | 2020/21 forecast £million | 2021/22 budget £million | 2022/23 budget £million | 2023/24 budget £million |
|---|---|---|---|---|---|
| Asset sales | 0.6 | 0.1 | 0.1 | 0.1 | 0.1 |
| Loans repaid (Ubico) | 0.4 | 0.8 | 0.9 | 0.9 | 0.9 |
| **TOTAL** | **1.0** | **0.9** | **1.0** | **1.0** | **1.0** |

☐ The Asset Sale receipts in the table above includes 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 Authority'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 Authority 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 is currently debt free and as at 31 December 2020 held £28.5 million in treasury investments at an average rate of 1.44%.

**Borrowing strategy:** The Authority'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 Authority therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.10%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5 to 2.5%).

The Council will use up to £2.5 million of its treasury balances to fund its borrowing requirement. This is known as internal borrowing. When interest rates are so low, it is more cost effective to use some cash in this way. The Council is losing around 0.1% on the cash investment but saving the costs of long term finance currently 1.5 to 2.5%.

Projected levels of the Authority'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*

| | **31.3.2020 actual £million** | **31.3.2021 forecast £million** | **31.3.2022 budget £million** | **31.3.2023 budget £million** | **31.3.2024 budget £million** |
|---|---|---|---|---|---|
| Debt (incl. PFI & leases) | 0 | 0 | 16.0 | 39.0 | 63.0 |
| Capital Financing Requirement | 0 | 2.2 | 18.3 | 41.3 | 63.8 |

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 Authority expects to comply with this in the medium term.

**Liability benchmark:** To compare the Authority'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 £12.5 million at each year-end. This benchmark is currently £-12.4 million, reflecting the fact that the Council is debt free and its cash balances are invested through application of the Treasury Management Strategy. Over the next three years, the liability benchmark moves to £-0.3 million reflecting a use of capital receipts and earmarked reserves and use of internal borrowing to partially fund the Capital Programme.

*Table 7: Borrowing and the Liability Benchmark*

| | **31.3.2020 actual £million** | **31.3.2021 forecast £million** | **31.3.2022 budget £million** | **31.3.2023 budget £million** | **31.3.2024 budget £million** |
|---|---|---|---|---|---|
| Outstanding borrowing | 0 | 0 | 16.0 | 39.0 | 63.0 |

| | | | | | |
|---|---|---|---|---|---|
| +Liability benchmark | -12.4 | -2.7 | -3.4 | -1.2 | -0.1 |

**Affordable borrowing limit:** The Authority 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*

| | 2020/21 limit (revised) £million | 2021/22 limit £million | 2022/23 limit £million | 2023/24 limit £million |
|---|---|---|---|---|
| Authorised limit – borrowing | 10 | 26 | 49 | 71 |
| Authorised limit – PFI and leases | 0 | 0 | 0 | 0 |
| **Authorised limit – total external debt** | **10** | **26** | **49** | **71** |
| Operational boundary – borrowing | 5 | 21 | 44 | 66 |
| Operational boundary – PFI and leases | 0 | 0 | 0 | 0 |
| **Operational boundary – total external debt** | **5** | **21** | **44** | **66** |

☐ Further details on borrowing set out in the Treasury Management Strategy.

**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 Authority'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 Authority may request its money back at short notice.

*Table 9: Treasury management investments*

| | 31.3.2020 actual £million | 31.3.2021 forecast £million | 31.3.2022 budget £million | 31.3.2023 budget £million | 31.3.2024 budget £million |
|---|---|---|---|---|---|
| Near-term investments | 12.4 | 2.7 | 3.4 | 1.4 | 0.3 |
| Longer-term investments | 12.5 | 12.5 | 12.5 | 12.5 | 12.5 |
| **TOTAL** | **24.9** | **15.2** | **15.9** | **13.9** | **12.8** |

☐ Further details on treasury investments can be found in the Treasury Management Strategy.

**Risk management:** The effective management and control of risk are prime objectives of the Authority'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 Chief Finance Officer and staff, who must act in line with the Treasury Management Strategy approved by Council. Every six months reports on treasury management activity are presented to the Audit Committee and Council. The Audit Committee is responsible for scrutinising treasury management decisions.

**Investments for Service Purposes**

The Council makes investments to deliver local public services. Investments can include making loans to and buying shares in:

- local service providers and local small businesses to promote economic growth; and
- the Council's subsidiaries that provide services.

In light of the public service objective, the Council is willing to take more risk in these investments than with treasury investments. However, the Council still plans for such investments to at least break even or to generate a profit after all costs.

The Council has minimal transactions of this nature but recently provided a loan of £20,000 to the Barn Theatre in Cirencester to support the provision of a local cinema.

**Governance:** Decisions on service investments are made by the Council on advice from the Chief Finance Officer and must comply with 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 can be found in the Investment Strategy

## Commercial Activities

With Government financial support for local public services declining, the Authority has invested in commercial property purely or mainly for financial gain. Total commercial property investments are valued at £6.5 million as at 31 March 2020 providing a net return after all costs of 7.0%.

With financial return being the main objective, the Authority accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include: vacancy periods (voids) between tenants, costs of material repairs to property, risk of fire or flood damage. These risks are managed by: acquiring properties with long leases and with tenants with a strong covenant and insuring the property. Covid-19 will impact some tenants, with a higher risk of business failures. In the longer term, the changing nature of the high street for retail occupants may require the Council to review its commercial property holdings. These risks are managed by the Council's Property Services Team. The Council also has a Corporate Risk Register which is reported quarterly to the Council's Audit Committee and includes any significant risks arising from commercial investments.

In order that commercial investments remain proportionate to the size of the Authority, these are subject to an overall maximum investment limit of £40 million and contingency plans are in place should expected yields not materialise. The revised budget for 2020/21 includes a provision of £40,000 for reduced income from commercial rent.

**Governance:** Decisions on commercial investments are made by the Council in line with the criteria and limits approved by Council 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 on their use are in the Investment Strategy.

## Liabilities

In addition to debt, the Authority is committed to making future payments to cover its pension fund deficit (valued at £40.7 million as at 31 March 2020). It has also set aside £1.8 million to cover the financial risks associated with successful appeals 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 (one quarter owner). In both cases, should the company overspend its budget 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 liabilities are taken by Cabinet or Council according to the scale of financial liability. The risks of liabilities crystallising and requiring payment are 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 2019/20 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*

| | **2019/20 actual £000** | **2020/21 forecast £000** | **2021/22 budget £000** | **2022/23 budget £000** | **2023/24 budget £000** |
|---|---|---|---|---|---|
| Financing costs (£m) | -640 | -400 | -84 | 345 | 1,074 |
| Proportion of net revenue stream | -5% | -3% | -1% | 4% | 11% |

The funding available from Government from 2022/23 onwards is very uncertain due to changes due to be implemented to local government funding. The proportion indicator should therefore be treated as highly indicative.

- ☐ Further details on the revenue implications of capital expenditure are included in the report to Cabinet on the 2021/22 revenue budget. Link to be added when February Cabinet papers are available on 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 50 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. The forecast level of General Fund balance is positive at £2.0 million at the end of the Strategy period in March 2025.

## Knowledge and Skills

The Council is advised by 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 of 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:

- 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 has experience of carrying out due diligence checks, particularly for commercial property acquisitions, and the legal officers have the following qualifications:

- 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 Publica Finance Director in developing investment proposals for the Council.  External specialist advice is obtained when required to support these teams.

The Cabinet and Council also includes elected Members with a wealth of experience from business, banking and financial organisations.  Members will use their knowledge, skills and experience to scrutinise business cases for proposed Council investment.