SUBJECT:	**Capital Strategy 2021/22 and approval of grant funded additions to the 2020/21 Capital budget**
DIRECTORATE:	**Resources**
MEETING:	**Council**
DATE:	**11th March 2021**

1 Purpose

1.1 The purpose of the report is to:

- Present the 2021/22 Capital strategy for approval
- Approve the addition of grant funded budgets to 2020/21 capital programme

2 Recommendations

2.1 To review and approve the 2021/22 Capital Strategy (***Appendix 1)***

2.2 To approve the additions of the capital budgets financed entirely from external grants and contributions identified in ***Appendix 2*** to the 2020/21 capital budget

3 Key Issues

3.1 The Capital Strategy sets out the longer-term context in which capital investment decisions are made and demonstrates how/that the Authority takes capital investment decisions that are in line with its Corporate priorities, give consideration to both risk/reward and impact; as well as properly taking account of stewardship, value for money, prudence, sustainability and affordability.

3.2 The capital plans of the Authority are inherently linked with the treasury management activities it undertakes, and therefore this report is brought alongside the Treasury management strategy report to Council. Consideration will be given in future to combining both strategies into one report to Council.

3.3 The main considerations arising from the Capital strategy shown in ***Appendix 1*** are summarised in this report below.

3.4 **Overview**

3.5 The 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.

3.6 It highlights that in the current climate of financial constraints and a continued Medium Term Financial Projection (MTFP) revenue budget gap, that expenditure on capital needs to remain within affordable limits. Demand for capital resources remains high and therefore inevitably, prioritisation of projects, leveraging in other sources of funding and working with partners remain key to meeting this demand.

3.7 Within the context of significant demands for capital resources and limited availability, there is the need to develop our use of the various strategic plans across the organisation which drive the need for capital investment and develop alternative strategies to meet demand so the Councils own capital programme is prioritised within an affordable framework. This will include clearer and corporate visibility and assessment of demand for schools, highways and other operational assets.

3.8 **Capital Financing**

3.9 All capital expenditure incurred has to be physically financed. Once the finite available sources of internal (capital receipts, reserves/revenue) and external (grants) financing are extinguished the Authorities only recourse is to borrowing.

Capital financing in £m

	2020/21 Forecast	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**
External sources	28.3	18.0	4.9	4.9	4.9
Internal resources	5.0	2.9	2.9	1.2	1.2
Borrowing	27.8	4.1	16.5	3.0	3.1
TOTAL	**61.2**	**25.0**	**24.3**	**9.0**	**9.2**

3.10 Approval of capital expenditure funded through borrowing locks the Council into committing revenue funding over a very long period (as long as 50 years+). Minimum Revenue Provision (MRP) is required to be funded from revenue budgets to cover expected borrowing repayments and the level of MRP is increasing over the medium-term so the Authority needs to ensure its capital plans remain affordable and sustainable.

Proportion of financing costs to net revenue stream

Proportion of Financing Costs to net revenue stream	2020/21 Forecast	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Interest £m	4.0	3.5	3.7	3.8	3.6
MRP £m	6.1	6.4	6.6	6.5	6.7
Total Financing costs £m	**10.1**	**9.9**	**10.3**	**10.3**	**10.3**
Net Revenue Stream (£m)	155.1	161.5	168.9	177.6	185.0
Proportion of net revenue stream %	**6.54%**	**6.15%**	**6.08%**	**5.80%**	**5.58%**

3.11 The table above compares borrowing financing costs to the net revenue stream i.e. the amount of income from Council Tax, business rates and general government grants. There is a moderate reduction in the forecast proportion of financing costs over the MTFP window which is reflective of the total revenue stream increasing in line with expected inflationary impacts whilst the financing budgets remain broadly stable.

3.12 **Capital Receipts**

3.13 Any assets which are deemed to be surplus to service requirements will be identified for possible sale/income generation in consultation with the Estates department. The procedures governing disposals are captured in the Council's Surplus asset disposal policy.

Forecast Capital receipts

	2020/21 forecast £m	2021/22 forecast £m	2022/23 forecast £m	2023/24 forecast £m	2024/25 forecast £m
Forecast Receipts	7.8	5.0	1.3	0.1	0.1

3.14 Traditionally receipts have been earmarked to finance the Authorities 21st Century schools investment. In a change from previous practice, whilst the Council has further 21st Century schools aspirations, it is not proposed to advocate a similar approach to members in respect of tranche B. Schools based assets commonly have a useful life of 50 years +, and as such traditional long term loan funding can be sourced at competitive rates with limited annual revenue volatility. The Council derives greater revenue benefit by using capital receipts in affording replacement of short life assets, given the avoidance of proportionately more significant minimum revenue provision.

3.15 **Setting Capital Budgets**

Capital Medium Term Financial Plan

	Indicative Budget 2021/22	Indicative Budget 2022/23	Indicative Budget 2023/24	Indicative Budget 2024/25
Asset Management Schemes	1,929,276	1,929,276	1,929,276	1,929,276
School Development Schemes	14,383,334	13,681,287	50,000	50,000
Infrastructure & Transport Schemes	3,427,740	3,427,740	3,427,740	3,427,740
Regeneration Schemes	184,700	330,400	602,900	730,200
County Farms Schemes	300,773	300,773	300,773	300,773
Inclusion Schemes	1,150,000	1,150,000	1,150,000	1,150,000
ICT Schemes	361,000	203,000	0	0
Vehicles Leasing	1,500,000	1,500,000	1,500,000	1,500,000
Capitalisation Directive	2,207,500	2,207,500	507,500	507,500
Other Schemes	1,070,000	1,070,000	1,070,000	1,070,000
TOTAL EXPENDITURE	**26,514,323**	**25,799,977**	**10,538,190**	**10,665,490**

3.16 The capital MTFP and capital strategy seek to work towards a financially sustainable core capital programme, whilst balancing the need to deliver capital investment plans in line with policy commitment and need. When considering the relative merits of further capital investment, the Capital and Asset Management Working Group (CAMWG) will apply the priority matrix in the capital strategy, either endorsing or amending the proposal for onward consideration by SLT and Members through the agreed mechanisms in place.

3.17 The identified backlog capital budget pressures that currently sit outside of the above capital MTFP total £133m and indicates that there is a higher call for capital expenditure than the Authority considers it can affordably finance. This means that capital schemes will have to be prioritised or the capital available has to be spread more thinly than is ideal. All stakeholders must recognise that funding capital expenditure by borrowing only defers the charge to revenue budgets to future years, but at the same time if capital maintenance works are deferred then the total life costs of supporting an asset are likely to increase. This effect is often veiled in medium term financial planning as asset lives are much longer than four years.

3.18 Annual investment included in the capital programme for property maintenance, highways maintenance, relevant specific capital grants and the 21st Century Schools programme will assist in addressing the highest priority backlog issues, focussing on worst condition first and risk. However, estate rationalisation programmes, closure/disposal of assets, asset transfers and other capital projects to refurbish or replace operational properties will also be utilised to offset the backlog funding required. This will not address the specific total backlog, but is a way of targeting the main issues in an affordable manner.

3.19 **Treasury Management**

3.20 The Treasury management strategy (TMS) for 2021/22 is considered alongside the Capital strategy at this Council and the figures within it the link directly to the impact of the borrowing resulting from the Capital strategy and the subsequent capital investment.

3.21 The Investment and borrowing strategies that the Authority will follow in 2021/22 are summarised in section 8 of ***Appendix 1*** alongside the limits and indicators that the Authority will apply in managing and mitigating ongoing treasury risks.

4 Reasons

4.1 The Authority is required to produce a Capital Strategy to satisfy the requirements of the Prudential Code of Capital Finance 2017. Many elements of the strategy are already in place and it is expected that in following an overall strategy that it will improve the process of managing the Authorities assets with the ultimate aim to ensure sustainability, and maximise the financial and social value of our assets for our communities. The ongoing challenging financial conditions mean we must have robust policies and programmes in place to ensure our estate is lean, efficient, meets the needs of service users and is fit for purpose.

4.2 Under the current Council constitution any additions to the capital budget that are financed entirely by external grant can be approved by Cabinet. However, given the late notification of many of the external grants it has not been administratively possible to bring a report to Cabinet within the necessary timescales, and therefore Council are asked to approve in this instance.

5 Options Appraisal

5.1 Not applicable.

6 Evaluation Criteria

6.1 Not applicable

7 Resource Implications

7.1 The proposed additions to the capital budget shown in ***Appendix 2*** are financed entirely by external grant and are to be added to the 2020/21 capital programme.

8 Equality and Future Generations Evaluation (including social justice, safeguarding and corporate parenting)

8.1 There is no equality and future generations impacts arising directly from this statutory report. Future generations assessments will continue to be undertaken on the capital MTFP budget report. The purpose of the Capital strategy is broadly associated with sustainability aspects of Future Generations assessment and the requirement is to more closely align capital resourcing to need into the medium term.

8.2 There are no obvious social justice, safeguarding or corporate parenting aspects arising directly from this report

9 Consultees

Chief Officer - Resources

10 Background Papers

Appendix 1 – 2021/22 Capital Strategy
Appendix 2 – Grant funded additions to the 2020/21 Capital programme

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Appendix 1 – Capital Strategy 2021/22

1 Introduction

1.1 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.

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

1.3 It highlights that in the current climate of financial constraints and a continued Medium Term Financial Projection (MTFP) revenue budget gap, that expenditure on capital needs to remain within affordable limits. Demand for capital resources remains high and therefore inevitably, prioritisation of projects, leveraging in other sources of funding and working with partners remain key to meeting this demand.

1.4 The strategy highlights the key risks and considerations:

- Capital expenditure plans for the Council need to be affordable, prudent and sustainable.

- The Council's Medium Term Financial Plan includes the revenue costs for the financing of the current capital programme to 2024/25. This will exclude any borrowing for any schemes which are self-financing over the life of the project.

- If the level of capital expenditure funded by borrowing is required to be increased from that approved in the current programme it would need to be sanctioned by full Council.

- Useable capital receipts provide a limited one-off resource to support financing of the capital programme. In recent years the Council has also made use of Welsh Government's guidance allowing flexible use of capital receipts to meet one-off costs associated with service reform. The Council has had to make use of this flexibility in 2019/20 and 2020/21 and plans to do similarly in 2021/22 and over the remaining three years of the MTFP. Useable capital receipts are forecast to reduce to £4.9m by the end of 2024/25 based on the capital MTFP. The continued use of capital receipts for this purpose is recognized as a necessary but unsustainable approach and has the added consequence of requiring the Council to fund any further and future capital investment through prudential borrowing where it cannot be met from other sources.

- As per the agreed framework (detailed in the report) the current programme needs to be maintained within the agreed limits, therefore not putting additional pressure on the capital financing budgets that have been included in the 2021/22 revenue budget.

- Within the context of significant demands for capital resources and limited availability, there is the need to develop our use of the various strategic plans across the organisation which drive the need for capital investment and develop alternative strategies to meet demand so the Councils own capital programme is prioritised within an affordable framework. This will include clearer and corporate visibility and assessment of demand for schools, highways and other operational assets.

- Approval of capital expenditure funded through borrowing locks the Council into committing revenue funding over a very long period (as long as 50 years+). With Minimum Revenue Provision (MRP) budgets increasing over the medium-term, the Authority needs to ensure its capital plans remain affordable and sustainable.

- The prudential indicators, including borrowing limits, are in line with the final budget proposals presented to Cabinet and Council in March 2021.

1.5 The strategy will be reviewed and updated on an annual basis alongside the Treasury Management Strategy given both strategies are intrinsically linked. Consideration will be given in future to combining both strategies into one report to Council.

2 The Prudential Code

2.1 The objective of the Prudential Code is to ensure, within a clear framework, that the capital expenditure plans of local authorities are:

- **AFFORDABLE -** Total capital investment of the authority remains within sustainable limits. A local authority is required to consider the resources currently available to it and those estimated to be available in the future, together with the totality of its capital plans and income and expenditure forecasts in assessing affordability.

- **PRUDENT –** The full Council set an authorised limit and operational boundary for external debt, these need to be consistent with the authority's plans for affordable capital expenditure and financing, and with its treasury management policy statement and practices. Authorities should consider a balance between **security, liquidity and yield** which reflects their own risk appetite but which prioritises security and liquidity over yield.

- **SUSTAINABLE –** taking into account the arrangements for repayment of debt (including through MRP) and consideration of risk and the potential impact on the authority's overall financial sustainability in the medium to longer term.

And that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation.

3 Capital Expenditure Management

3.1 The Code requires the Capital strategy to set out the long term context for capital expenditure investment decisions.

3.2 **Property asset management**

3.3 The Corporate Landlord Division of the Resources Directorate is the custodian of the Council's Asset management strategy in place, to ensure that the assets forming the Council's Property Estate continue to meet the needs of the Authority in the long term. As asset lives could be 60 years or more, for practical purposes, expenditure requirements for a minimum of 10 years should be assessed to prevent any deferred repair work increasing the total life costs of the assets. The main elements of the Asset Management strategy which are key to the Capital strategy are:

- A complete and accurate asset register is held & will be maintained. This will include Land & Buildings, Community assets, Heritage assets, Investment Properties and operational structures such as Sewerage pumping works.
- The required functionality & operational life of assets will be identified as a benchmark for condition assessments (e.g. from Corporate Plan)
- An increasing use of Condition surveys information (5 year rolling programme on key assets) to improve liability and responsibility data and facilitate improved decision making
- Maintenance and major works are identified from the surveys with timings optimised in order to minimise total asset life costs including maintenance and running costs
- Health and Safety works are flagged as a priority
- The Capital and Revenue spend levels per year will be identified and fed into the budget setting processes with the aim of not deferring spend which would increase extent of emergency works and total life costs
- Where costs and/or timing cannot be predicted with a reasonably high level of certainty an average forecast cost / timing should be used for planning purposes. Where the likelihood of occurrence as well as cost is highly uncertain, accounting good practice advocates a contingency plan should be put in place e.g. a preliminary design & program of works prepared, the required budget spread over several years and an earmarked reserve built up from annual repair budget
- Where an asset is held purely to generate income, as part of the business case, the recurrent expenditure required on those assets to maximise net income, will be identified and proposed for addition to budgets.
- The cost profile generated from the above process will be fed into the 4 year Capital Budget decision making process.
- Surplus assets and part assets have & will continue to be identified and an option appraisal carried out to determine if the asset should be sold to generate a capital receipt, developed and sold for a higher receipt, used to generate revenue income or transferred to a 3rd party for the benefit of the community. Under any of these

scenarios, end of life costs will need to be more transparently determined and budgeted.

3.4 **Infrastructure asset management**

3.5 Unlike property assets, Infrastructure assets are managed by the various divisions of Enterprise Directorate. They will still need to assess what expenditure is required over a minimum of 10 years to minimise the total life cost of their assets. To ensure that the Highways Network and other Infrastructure assets held by the Authority continue to meet the long term needs of the County and the Authority, the Authority will:

- Look to maintain a complete and accurate asset register for Highways Network Assets & any other assets maintained by the team including adjacent land, flood alleviation facilities and substations. The Council's infrastructure database hasn't historically had the same corporate importance as the property asset register, as it isn't used to substantiate data or support revaluations in the annual statement of accounts. An exercise will be necessary to confirm quality of data within the Highways system to support 10 year reporting of works.
- For the majority of these assets, the expectation is for necessary repairs and maintenance to keep the assets in working condition for the foreseeable future i.e. well beyond 10 years. If this is not the case, the required operational life should be recorded.
- The minimum acceptable level of condition must be defined for each asset or part asset. This is likely to be the level of condition below which lifecycle costs start to increase.
- Service officers have traditionally forecast a backlog of highways repair of circa £80m, but without explicit review. Condition surveys are carried out periodically, by a mixture of Scrim testing (skid resistance) or inspections at a predefined frequency dependent upon the type of road so deterioration of assets below the minimum standard is documented and can be forecast. This information will also be used to indicate if the number of assets falling below the minimum standard is increasing year on year indicating that budgets available need to be increased. The impact of varying budgets over the last 10 years should also be investigated to inform this process.
- Traffic & pedestrian surveys will be carried out at a periodically to better assess the future life of the assets. It is acknowledged that weather has a significant impact on the life of assets and that weather patterns are changing. This cannot be controlled but must be taken into account.
- Ensure that Health and Safety works are prioritised.

- One off major works expected to be required will also be identified with a latest completion date and estimated cost. This may include large one offs which are outside the normal workload of the Operations & Design teams.
- The maintenance and major works required on an annual basis to minimise total asset life costs are identified from the surveys and used to propose budgets required for budget setting for the next 10 years. The impact on total life costs, should sufficient budget not be allocated, should also be reported to members to inform decision making, as an improvement to simply identifying an unsubstantiated backlog of repairs.
- Where costs and/or timing cannot be predicted with a high level of certainty, (similar to property assets), an average forecast cost / frequency for groups of similar assets is advocated, and use of contributions to earmarked reserve encouraged to afford the volatility of as yet unquantified significant one off future works

3.6 **Investments for Service Purposes**

3.7 The Council has historically incurred the majority of its capital expenditure on the assets required to provide its services such as schools and office space.

3.8 However it may also invest in other entities for the wider economic and societal benefits of its communities or businesses. This may include making loans or (more recently) considering taking an equity interest in local bodies or the Council's subsidiaries & joint ventures which in turn contribute to services to Monmouthshire residents. It may also include providing guarantees to other bodies. In light of the public service objective, the Council traditionally is willing to take more risk on these investments than it would with more traditional treasury investments, which are more highly regulated, however any such arrangement should only be entered into if such investments are assessed to break even after all costs are taken into account or if the benefits of the scheme are considered to be worth the net cost.

3.9 Decisions on service related investments (e.g. vibrant homes loans afforded through WG repayable grant or economic development loans) can be made by the relevant service manager provided a 100% loss can be covered by the managers existing budgets. Should additional budget/funding be required in the event of a default, then before making the service expense/investment, the Head of Finance is required to be consulted and where member approval is felt necessary that the details and risks involved presented to Cabinet for approval. The criteria and limits laid down in the strategy for treasury Investments can be used as a comparator to measure risks against. Most loans and shares are capital expenditure and unless undertaken through the Commercial Investment delegation to Investment Committee, such decision requires approval of full Council to be added to the capital programme.

3.10 A list of investments for service purposes including loans and guarantees will be maintained by the Treasury team and they will be assessed at least annually and reported as part of the annual accounts and include:

- £40,000 of seed share capital was provided to SRS Business Solutions Ltd in 2011/12 alongside an equal amount from Torfaen County Borough Council
- Foster carer loans
- Low cost home ownership equity interest.

3.11 **Commercial Activities**

3.12 Following a sustained period of financial austerity and with financial support for local public services declining, the Council has invested in commercial property and other commercial investments to support ongoing revenue budgets and promote wider economic regeneration within the County and its borders.

3.13 Early in 2017/18 the Authority completed the construction of a Solar Farm for £5m.

3.14 In 2018/19, as part of a wider approved commercial investment budget of £50m and following creation of an Investment Committee to oversee this, the Council purchased a large unit at Castlegate Business Park for £8m and completed the purchase of Newport Leisure Park for £21m.

3.15 Given the ongoing pressures, risks and challenges as a result of the Covid-19 pandemic, investment of the remaining £21m commercial investment budget has been paused for the short-term.

3.16 Commercial investments will be revalued at least annually as part of the ongoing review of the Commercial investment portfolio, and the performance of these assets assessed regularly through the service budget monitoring of Corporate Landlord service, via reporting to the Investment Committee and annually to Audit Committee.

3.17 With the increased financial returns on investment available from commercial investment, the Council naturally accepts higher risk compared with traditional treasury investments. Risk exposures for property investments include a fall in capital value, vacancies, poor tenant performance, rent increases below inflation, lack of market appeal/obsolescence/cost to rectify and changes in legislation. For other non-treasury investments such as loans and equity, risks also include – fall in market value, poor repayment performance and insolvency/costs of debt recovery.

3.18 The Council has adopted a very prudent approach to the financial management of its commercial assets, in ensuring that business cases are predicated on affording the related borrowing before providing a net return to assist with revenue budget setting. It has also elected to treat such investments as capital expenditure and incur an explicit annual minimum revenue provision in affording the related borrowing, whereas draft Welsh Government guidance permits flexibility to defer financing considerations to when property is sold, providing that the selling price can reasonably be anticipated to be greater than purchase price.

3.19 To date, commercial investments have focused primarily on property acquisition so the risks are managed by corporate landlord service assisted by external professionals where necessary. They will manage asset maintenance and the tenant/landlord interface including collecting income. They will review cashflows and assess/forecast the value, quality and diversity of the investments in order to propose any modifications required to the portfolio to increase return and/or reduce risk.

3.20 In order that commercial investments remain proportionate to the size of the authority and in keeping with principles of affordability, prudence and sustainability, the approved commercial investment budget was limited to £50m.

3.21 In the event that a property holding is deemed to be underperforming or fails to meet the related debt repayment costs, a review will be undertaken to see if it is possible to:

- Retain the asset and increase net returns
- Dispose of the asset at a net profit compared to purchase price
- Retain the asset for future capital gains
- Maximise return on capital in another way

3.22 The Authority will continue to identify any of its historical investment properties which could provide a valuable capital receipt over and above the value to the Authority of holding the asset.

3.23 The responsibility and accountability to manage the risks associated with any non-property related commercial investments will rest with the service that has advocated the investment case, and they will retain the responsibility to update Investment Committee periodically with performance against the business case presented, and assist in the annual report preparation to Audit Committee.

3.24 Decisions on commercial investments are made by the Investment Committee in line with the criteria and limits within the Asset Management Strategy.

3.25 Further details of the selection process for commercial investments, the limits agreed with Council and details of the identification and management of the risks associated with commercial investments are in the Asset Management Strategy, Asset Investment Policy and other supporting documents.

3.26 **Other assets**

3.27 In addition to the Council Property Estate and the Infrastructure Assets, the Authority also owns and rents Heritage Assets, Vehicles and Plant & Equipment:

3.28 Currently no formal review is undertaken to confirm the benefit of retaining the Heritage assets portfolio. The introduction of capital strategy applies a more regular assessment of need against liability. This is proposed to be an increasing element of the asset management plan, and as a minimum it is proposed to adopt a formal 5 year review period.

3.29 The Vehicles and Plant, both owned and leased, are reviewed regularly by the Head of Finance in conjunction with the Transport Manager to minimise total life costs.

4 Capital Financing & the Capital Financing Requirement (our need to borrow)

4.1 All capital expenditure incurred has to be physically financed. The available sources of financing include:

- ***Grants/External contributions*** – these should be maximised but opportunities tend to be limited and specific to particular projects
- ***Capital Support Grant*** – this is fixed by the Welsh Government, is finite, but is at the discretion of Council how it is used.
- ***Reserve/revenue funding*** – the Authority currently forecasts Earmarked and total Council fund reserves to be £5.5m and £8.9m at 31st March 2021. Of the Earmarked reserves, only £609k is currently held for capital investment and therefore represents a limited source of capital financing
- ***Capital receipts*** - £6.5m of receipts are forecast to be generated over the MTFP window on top of the £7.4m forecast to be held at 31st March 2021. Of these, £9.5m has been allocated to finance capital expenditure over the MTFP window leaving only £4.4m forecast to be available to fund new schemes over the same period.

4.2 The planned financing of the capital expenditure is indicated in the table below:

Table 1: Capital financing in £m

	2020/21 Forecast	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**
External sources	28.3	18.0	4.9	4.9	4.9
Internal resources	5.0	2.9	2.9	1.2	1.2
Borrowing	27.8	4.1	16.5	3.0	3.1
TOTAL	**61.2**	**25.0**	**24.3**	**9.0**	**9.2**

4.3 Borrowing is often the only source of funding available once the limited external and internal resources have been exhausted. All borrowing has to be repaid and this includes both the actual debt principal plus interest costs on the debt.

4.4 In the current economic environment, with interest rates remaining low, borrowing is a cheaper source of financing than 10 years ago, but it only delays the need to finance capital expenditure which is ultimately met from the revenue budget in the form of interest and Minimum Revenue Provision.

4.5 The Council's cumulative outstanding amount of borrowing finance 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 replace the borrowing.

4.6 Based on current revenue and capital budgets, the Authorities CFR is expected to remain broadly similar during 2021/22. The Council's estimated CFR and related MRP charges over the medium term are as follows:

Table 2: CFR and related MRP charges

	2020/21 Forecast	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Capital Financing Requirement (Total in £m)	213.8	213.9	226.3	225.2	224.0
Minimum Revenue Provision (£m)	6.1	6.4	6.6	6.5	6.7

4.7 With the pending introduction of IFRS 16 Leases, the CFR and borrowing identified as relating to leases is likely to increase, due to the change in the way that finance leases for lessees are treated. CIPFA LASAAC has taken the decision to defer the implementation of IFRS 16 Leases until 2022/23 in response to the pressures on council finance teams as a result of the COVID-19 pandemic.

4.8 The Council's minimum revenue provision policy should remain prudent and not subject to annual change. This policy has been reviewed within last 5 years by Members, and is a feature of the annual Treasury management strategy report received at this same meeting.

5 Capital Disposals and Receipts

5.1 The Council's Asset Management plan sets out the Council's vision, priorities and key actions associated with managing our assets. The aim is to ensure sustainability, and maximise the financial and social value of our assets for our communities. The ongoing challenging financial conditions mean we must have robust policies and programmes in place to ensure our estate is lean, efficient, meets the needs of service users and is fit for purpose. The strategy also recognises the importance of maximising the income we can generate from our property assets and we have started to actively seek opportunities to increase revenue generation.

5.2 Any assets which are deemed to be surplus to service requirements will be identified for possible sale/income generation in consultation with the Estates department. The procedures governing disposals are captured in the Council's Surplus asset disposal policy.

5.3 The Council anticipates the following capital receipts in the forthcoming financial years is as follows:

Table 3: Forecast Capital receipts

	2020/21 forecast £m	**2021/22 forecast £m**	**2022/23 forecast £m**	**2023/24 forecast £m**	**2024/25 forecast £m**
Forecast Receipts	7.8	5.0	1.3	0.1	0.1

5.4 Further specific details of planned asset disposals are included in the annual Capital MTFP deliberated by Members, with specific sales proposals being an exempt appendix from public reporting requirements due to potential to compromise of receipt maximisation.

5.5 Traditionally receipts have been earmarked to finance the Authorities 21st Century schools investment. In a change from previous practice, whilst the Council has further 21st Century schools aspirations, it is not proposed to advocate a similar approach to members in respect of tranche B. Schools based assets commonly have a useful life of 50 years +, and as such traditional long term loan funding can be sourced at competitive rates with limited annual revenue volatility. The Council derives greater revenue benefit by using capital receipts in affording replacement of short life assets, given the avoidance of proportionately more significant minimum revenue provision.

6 Setting Capital Budgets

Table 4: Capital Medium Term Financial Plan

	Indicative Budget	**Indicative Budget**	**Indicative Budget**	**Indicative Budget**

	2021/22	2022/23	2023/24	2024/25
Asset Management Schemes	1,929,276	1,929,276	1,929,276	1,929,276
School Development Schemes	14,383,334	13,681,287	50,000	50,000
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Other Schemes	1,070,000	1,070,000	1,070,000	1,070,000
TOTAL EXPENDITURE	**26,514,323**	**25,799,977**	**10,538,190**	**10,665,490**

6.1 Member responsibility for assets rests with the Cabinet member for Whole Authority Resources. The main governance and approval process for capital investment is summarised as follows:

- Council approve the overall revenue and capital budgets following recommendations from Cabinet. They also approve the borrowing limits of which the capital programme will need to remain within (the Authorised limit). These limits are a key performance indicator for treasury management and ensure that capital expenditure is limited and borrowing remains within an affordable limit.
- Any variation of the Authorised borrowing limit can only be approved by Council.
- Council approve the Treasury Management, Investment & Borrowing strategies, which are intrinsically linked to capital expenditure and the capital strategy. Further details of these are provided in section 8.
- Items of capital investment are discussed and scrutinised at the Capital and Asset Management Working Group (CAMWG), which is made up of senior officers from all service areas. Discussion also includes asset disposals, where capital investment is required, prioritisation of that investment in line with the priority matrix and the overall asset management agenda.
- Recommendations on capital investment will be made by CAMWG to the Senior Leadership Team (SLT) following review of the project appraisal for onward inclusion in the capital budget and to be considered by Cabinet and Council.
- Monitoring of capital expenditure is reported to Cabinet, and includes update on capital receipts and impact on the revenue budget of the decisions made.
- The 2021/22 and forward capital budgets include investment in schemes which attract significant match funding from external bodies which services will be responsible for bidding for. The CAMWG will play a pivotal role in ensuring that this investment is properly aligned with the overall corporate plan priorities and is robustly assessed against the agreed priority matrix included below.

6.2 The identified backlog capital budget pressures that currently sit outside of the above capital MTFP total £133m and indicates that there is a higher call for capital expenditure than the Authority considers it can affordably finance. This means that capital schemes will have to be prioritised or the capital available has to be spread more thinly than is ideal. All stakeholders must recognise that funding capital expenditure by borrowing only defers the charge to revenue budgets to future years, but at the same time if capital maintenance works are deferred then the total life costs of supporting an asset are likely to increase. This effect is often veiled in medium term financial planning as asset lives are much longer than four years.

6.3 Annual investment included in the capital programme for property maintenance, highways maintenance, relevant specific capital grants and the 21st Century Schools programme will assist in addressing the highest priority backlog issues, focussing on worst condition first and risk. However, estate rationalisation programmes, closure/disposal of assets, asset transfers and other capital projects to refurbish or replace operational properties will also be utilised to offset the backlog funding required. This will not address the specific total backlog, but is a way of targeting the main issues in an affordable manner.

6.4 The below priority ranking matrix approved as part of the inaugural capital strategy assists the CAMWG and SLT with their considerations of future capital investment.

Aspect	**Indicative Rank**
Health & safety works (life & limb works)	1
Legal & regulatory obligations	1
Allow a balanced revenue budget to be set, or a net deficit in revenue spending to be positively addressed	2
Deliver corporate plan priorities	2
Attract significant 3rd party or private match funding to the County	3
Spend to save transformational works (including flexible use of capital receipts)	3
Spend to earn net income – rents, interest and dividends	3

Create sustainable income streams – business rates and council tax	3
Asset management plan outcomes	4
Addresses major infrastructure investment	4

7 Revenue Budget Implications

7.1 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. These net annual charges are known as financing costs. The table below compares these financing costs to the net revenue stream i.e. the amount of income from Council Tax, business rates and general government grants. There is a moderate reduction in the forecast proportion of financing costs over the MTFP window which is reflective of the total revenue stream increasing in line with expected inflationary impacts whilst the financing budgets remain broadly stable.

Table 5: Proportion of financing costs to net revenue stream

Proportion of Financing Costs to net revenue stream	2020/21 Forecast	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Interest £m	4.0	3.5	3.7	3.8	3.6
MRP £m	6.1	6.4	6.6	6.5	6.7
Total Financing costs £m	**10.1**	**9.9**	**10.3**	**10.3**	**10.3**
Net Revenue Stream (£m)	155.1	161.5	168.9	177.6	185.0
Proportion of net revenue stream %	**6.54%**	**6.15%**	**6.08%**	**5.80%**	**5.58%**

7.2 **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 afterwards. The Director of Resources is satisfied that the proposed capital programme is prudent, affordable and sustainable because the financing costs have been spread over no more than, the lower of 50 years and the expected life of the resultant asset, so the assets will be paid for by the Council tax payers benefitting from them over the life of the assets. The financing costs for assets funded by borrowing are included in each annual revenue budget which is balanced before approval by Council.

8 Treasury Management

8.1 The Treasury management strategy (TMS) is considered alongside the Capital strategy at Council and the figures within it the link directly to the impact of the borrowing resulting from the Capital strategy and the subsequent capital investment.

8.2 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 limits the need to take out actual borrowing by using positive cash flows, largely from reserves, to fund capital expenditure funded by borrowing, known as internal borrowing.

8.3 Based on historic capital expenditure and due to decisions taken in the past, the Council currently has £171.3m borrowing at a weighted average interest rate of 1.98% and £22.7m treasury investments at a weighted average rate of 0.53%.

8.4 **Borrowing strategy**

8.5 Whilst the Council has significant long term borrowing requirements, the Council's current strategy of funding capital expenditure is through utilising internal resources such as reserves (called 'internal borrowing') rather than undertaking new borrowing i.e. we defer taking out new long term borrowing and fund capital expenditure from day to day positive cash-flows for as long as we can.

8.6 By using this strategy, the Council can also minimise cash holding at a time when counterparty risk remains high. The interest rates achievable on the Council's investments are also significantly lower than the current rates payable on long term borrowing and this remains a primary driver for our current 'internally borrowed' strategy.

8.7 Whilst this strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current low longer term borrowing rates may rise in the future. The market position is being constantly monitored in order to minimise this risk.

8.8 The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.1%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5% to 2.5%).

8.9 Projected levels of the Council's total debt (which comprises borrowing, PFI liabilities & finance leases) are shown below, compared with the capital financing requirement.

Table 6: Gross Debt and the Capital Financing Requirement in £m

Gross Debt Forecast compared to CFR £m	**2020/21 Forecast**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Debt (Inc. PFI, leases, right of use assets)	176.5	168.5	175.4	172.3	164.3
Capital Financing Requirement (Total)	213.8	213.9	226.3	225.2	224.0

8.10 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen in the table above, the Council expects to comply with this in the medium term.

8.11 **Affordable borrowing limit:** The Council is legally obliged to approve an affordable borrowing limit (also termed the 'authorised limit' for external debt) each year.

8.12 The 'Operational borrowing limits' over the medium term, have been set in line with the expected borrowing required to finance the current capital programme to 2024/25 and these act as a key management tool. If any increase to the authorised limit is required, including to borrow for investment/income generation schemes or regeneration investment (loans) this will need to be brought to Council for approval. The 'Authorised borrowing limits', provide a buffer for (i) the ability to manage day to day cash requirements and (ii) to undertake a level of borrowing early where appropriate / affordable.

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

Authorised & Operational Borrowing Limits £m	**2020/21 Forecast**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Authorised limit - borrowing	247.0	246.5	259.8	258.7	257.5
Operational boundary - PFI, leases & right of use assets	4.4	4.4	4.4	4.4	4.4
Authorised Limit - total external debt	**251.5**	**250.9**	**264.2**	**263.1**	**261.9**
Operational Boundary - borrowing	216.8	216.3	229.6	228.5	227.3
Operational Boundary - PFI, leases & right of use assets	2.9	2.9	2.9	2.9	2.9
Operational Boundary - total external debt	**219.8**	**219.2**	**232.5**	**231.4**	**230.2**

8.13 **Investment strategy**

8.14 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.

8.15 The Councils strategy is to follow the priorities of security, liquidity and yield, in that order. 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. This reduces the risk of default by diversification and the use of dedicated and experienced fund managers and also can increase return.

8.16 The Council's strategy seeks to keep invested cash balances low and in doing so reducing external borrowing, which is more cost effective than chasing investment returns. The main exception to this approach is that the Council is required to demonstrate a commitment to keeping a £10m minimum investment balance to meet the requirements of a professional client under the Mifid II regulations (Markets in financial instruments directive).

Table 8: Treasury management investments in £m

	31.3.2021 forecast £m	**31.3.2022 forecast £m**	**31.3.2023 forecast £m**	**31.3.2024 forecast £m**
Near-term	19.7	2.0	2.0	2.0
Longer-term	3.0	8.0	8.0	8.0
TOTAL	**22.7**	**10.0**	**10.0**	**10.0**

8.17 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the S151 Officer or Deputy and their staff, who must act in line with the treasury management strategy currently approved by Members. The 2021/22 Strategy was considered by Audit Committee in February 2021 and is presented alongside this report for approval by full Council. In addition mid-year and treasury outturn reports on treasury management activity are presented to Audit Committee which is responsible for scrutinising treasury management decisions.

9 Controlling Risk

9.1 A significant aspect of the Capital strategy is involved with controlling & balancing various risks i.e.

- The credit risk of treasury investments – this is controlled using credit worthy institutions, diversification, limiting maturity, maximising the use of internal borrowing.
- The refinancing risk of treasury investments – controlling the profile of debt maturities.
- The interest rate risk of treasury activities. The Authority has opted to abide by an upper limit for the amount of net variable rate borrowing, but intends to adopt a simpler, more transparent indicator of variable rate borrowing as a proportion of total.
- The risks of providing loans and guarantees for service purposes need to be acknowledged and managed from the outset.
- The risks to the total net return on assets acquired for commercial income are expected to be higher than for assets acquired for service purposes and need to be fully assessed and managed from the outset.

9.2 In undertaking business loans to 3rd parties, commercial investment acquisition and proposing alternate business models there is an inherent risk that members and officers not having sufficient knowledge and skills of the sector concerned such that the risks and benefits may not be properly understood and managed. This is addressed by appropriate assessment, training and external advice.

10 Knowledge and Skills

10.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, both the Director of Resources and Head of Commercial and Integrated Landlord Services are professionally qualified with longstanding senior practical experience. For both accountants and valuers, the Council offers particular training roles and also from a staff development perspective encourages and support wider staff to undertake study towards relevant professional qualifications and continuing professional development.

10.2 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 advisors, and Alder King as property investment advisors. 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. Arlingclose's assistance has been sourced through competitive tendering, and their fees paid independent of their advice.

11 Glossary of terms

11.1 Capital and treasury accounting is an area which traditionally involves the use of complicated technical terms. The following glossary is provided as to assist Members in their understanding.

11.2 **Capital expenditure** is defined as 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. To meet capital definitions such expenditure needs to either create an asset, significantly extend its useful life or significant enhance its use. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 do not need to be capitalised if charged to revenue in year.

11.3 **Capital receipts and disposals** When capital assets are sold, the proceeds, known as capital receipts, can only be used to finance capital expenditure or following the capitalisation directive can extraordinarily be used for service re-design, transformation, shared services etc. 3rd party loan and investments repayment are treated capital receipts where the original expenditure met capital definitions.

11.4 **Capital Financing Requirement.** The Council's cumulative outstanding amount of debt used to finance capital expenditure is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and set-aside of capital receipts used to replace debt. The capital financing requirement isn't affected by capital expenditure afforded by receipts, grants or direct revenue financing.

11.5 **Supported and unsupported borrowing.** Welsh Government in their annual settlement calculation provide a degree of funding to assist with affording borrowing decisions. Any loans afforded through this route is termed "supported" borrowing. Councils will also afford extra "prudential" borrowing as part of business case evaluations, by allocating sufficient resources within their annual revenue budget to repay such debt. This is termed "unsupported" borrowing. Both sources make up the Council's debt position.

11.6 **Minimum Revenue Provision** Debt is only a temporary source of finance, since loans must be repaid, and this is therefore replaced over time by financing from the revenue budget which is known as the Minimum revenue provision (MRP).

11.7 **Set aside of capital receipts.** Capital receipts can be used to finance new capital expenditure, to replace debt financing already in the capital program or to replace debt financing applied in earlier years. This reduces the Council's capital financing requirement (CFR). This is known as the set-aside of capital receipts and reduces future years' MRP (Minimum revenue provision) repayments, part of the cost of debt in revenue.

11.8 **Council Fund reserve.** At the end of each financial year, as a result of the difference between expenditure and income levels, the Council experiences a revenue surplus, breakeven or deficit position. These annual positions are amalgamated into the Council Fund reserve. From a prudent financial planning point of view, the Council fund, together with the net effect of schools reserves constitute the level of reserve resourcing available to deal with unanticipated financial contingencies. Members traditionally ascribe to this level being between 4%-6% of net expenditure budget.

11.9 **Earmarked reserves.** Conversely earmarked reserves are those created and held for a specific purpose e.g. service specific positions, insurance risk mitigation, and IT reserve. They do play their part in the prudent financial management, in mitigating volatility in activity between years, but as the use of them is for a specific purpose, these balance levels aren't included in general financial contingency planning assumptions.

Appendix 2 – Additional 2020/21 Grant funded capital budgets

Reference	Capital Scheme	Amount	Funding Source
90321	Abergavenny Community Hub Development	100,000.00	Welsh Government
90330	Abergavenny Borough Theatre Works	50,000.00	Abergavenny Town Council
97206	Highways Refurbishment Grant	627,717.00	Welsh Government
97385	TRI – Dev Funding Caldicot Town Centre	125,000.00	Welsh Government
97393	LTF - Bus Stop Upgrades	290,000.00	Welsh Government
97396	Green Infrastructure – Caldicot Transforming Towns Grant	397,000.00	Welsh Government
98227	Schools Maintenance Grant 2020-21	1,217,453.00	Welsh Government
98850	Llanover Digital Hub Project	5,370.00	Welsh Government
98861	WELTEG Chepstow Transport Study 2020-21	37,500.00	Welsh Government
98897	LTF Agincourt Square Public Realm Project	328,336.78	Welsh Government
98910	WG Covid19 Grant - TRO & Signing and Lining	322,000.00	Welsh Government
98911	WG Covid19 Grant - Abergavenny Lion St Cycle Contraflow	40,000.00	Welsh Government
98912	WG Covid19 Grant - Cycling Initiatives - Facilities & E-Bikes	150,000.00	Welsh Government
98913	WG Covid19 Grant - Countryside & Heritage Sites and Attractions	10,000.00	Welsh Government
98914	WG Covid19 Grant - Tintern Destination Improvements	15,000.00	Welsh Government
98915	WG Covid19 Grant - Bus Station Adjustments	50,000.00	Welsh Government
98916	WG Covid19 Grant - Marketing Campaign & Public Responses	60,500.00	Welsh Government
99204	Chepstow Boxing Club Refurbishment	44,701.00	Sports Wales
99206	Enable – Support for Independent Living WG grant	105,600.00	Welsh Government
99207	SLSP Programme - AONB Office	150,700.00	Welsh Government
99208	ATF - Caldicot Greenway	165,800.00	Welsh Government
99209	ATF - Monmouth Wye Valley Path	35,000.00	Welsh Government
99210	ATF - Monmouth School/Leisure Link	60,000.00	Welsh Government
99211	ATF - Caldicot School/Leisure	60,000.00	Welsh Government
99212	ATF Core Counters	30,500.00	Welsh Government
99213	ATF Core Llanfoist Bridge & Meadow Links	80,000.00	Welsh Government
99214	ATF - Monmouth Scheme Co-ordination	15,000.00	Welsh Government

Reference	Capital Scheme	Amount	Funding Source
99215	ATF Core Consultation	65,000.00	Welsh Government
99216	ATF Core 20mph Schemes	30,000.00	Welsh Government
99217	ATF Core Small Scheme Development	27,000.00	Welsh Government
99218	ATF Core Cycling Infrastructure Usk Hub	4,500.00	Welsh Government
99219	ATF - Monmouth Wye AT Crossing	365,000.00	Welsh Government
99220	ATF - Monmouth Kingswood Gate AFL	103,000.00	Welsh Government
99221	ATF - Monmouth Monnow Street	50,000.00	Welsh Government
99222	ATF - Caldicot Newport Road	187,685.00	Welsh Government
99223	ATF - Caldicot Church Road Connections	543,515.00	Welsh Government
99226	WG – All Wales Play Opportunities Grant 2020-21	76,709.00	Welsh Government
99227	WG – Green Recovery Circular Economy Grant 2020-21	422,000.00	Welsh Government
99228	WG – Covid 19 Thematic Response Grant – The Basics	700,000.00	Welsh Government
99229	WG – Flood Recovery Grant 2021	1,973,224.96	Welsh Government
99230	WG – Garden Waste Service Improvements 2021 – Circular Economy	424,000.00	Welsh Government
99231	WG – Reuse Shop at Five Lanes Grant – Circular Economy	161,000.00	Welsh Government
99232	WG – Reducing Single Use Plastics Grant – Circular Economy	386,000.00	Welsh Government