

SUBJECT:	Capital Additions 2019-20 and Strategy Approval
DIRECTORATE:	Resources
MEETING:	Council
DATE:	19th September 2019

1 Purpose

1.1 The purpose of this strategy document is threefold:

- to add fully funded specific schemes to 2019-20 capital programme,
- to seek an exemption from the Constitution that states that any additions can only be approved by full Council,
- and to approve 2019-20 capital strategy.

2 Recommendations

2.1 To approve the additions of the schemes identified in resourcing section.

2.2 To approve a change to the Constitution whereby in future Cabinet can approve the addition of capital schemes where they are fully funded either from grant receipts or utilise 100% Section 106 funding in line with any requirements in the relevant Section 106 agreement.

2.3 To review and accept the Capital Strategy (appendix 1) for the forthcoming year.

2.4 To recognise that this is the first year that all these disciplines have been brought together in a combined Capital Strategy and that it may need to evolve as best practice becomes apparent.

3 Context

3.1 The current Constitution provides adequate guidance on the administration of capital budgetary adjustments. This affects movements between previously approved capital projects but the Constitution allows no delegation to add any new items to the capital programme, so all decisions must be made by full Council.

“the capital programme is drawn up by the Cabinet and approved by the full Council and contains details of approved expenditure on capital schemes.”

- 3.2 The Monitoring Officer is currently reviewing the detail of Constitution to ensure it remains responsive and appropriate, and agreement to revised recommendation will be reflected in revised Constitution in due course.
- 3.3 Increasingly the Council is receiving ad hoc capital grant, for example, from Welsh Government after the start of the financial year. Consequently it is impossible to get those equivalent schemes approved by full Council in its consideration of the initial capital MTFP. They are also sporadic in nature, which makes it difficult to plan for adequate full Council time to arrange their inclusion. These schemes introduce no additional financial risk to the Council or undermine the financial planning agreed with Members as they are 100% funded.
- 3.4 It is proposed to revise Constitution to allow Cabinet to consider the addition of 100% grant backed or 100% section 106 funded schemes through the periodic monitoring report rather than omit from monitoring until full Council has approved the addition. The reporting will be explicit on whether the additional funding can be used to replace existing funding or highly prescriptive to particular projects.

4 Capital Strategy

- 4.1 The 2004 Prudential code for Capital finance in Local Authorities was updated in 2017 as the Local Authority environment has changed a lot in thirteen years. The reduction in financial support to Local Authorities from Central Government now appears to be here for the long term, due to the level of austerity in the United Kingdom and much of the world in the current economic climate. The resultant stretching of resources has led to maintenance backlogs for assets that Local Authorities rely on to provide public services, an increased reliance on the acquisition of assets to earn income to supplement revenue budgets, and the consideration of increasingly complex management structures to derive more cost effective service delivery.
- 4.1 The Authority's Capital Strategy is required to define at a high level, how the Authority ensures its capital plans contribute to the provision of local public services; are affordable, prudent and sustainable; are developed with a full understanding of the risks involved; are appropriate for the Authority and suit local circumstances and that they have due regard for the long run financing implications and risks to the Authority.
- 4.2 Members may recall an initial Capital Strategy "preparedness" report was produced alongside Capital Medium Term Financial Plan and subsequently considered by in December 2018. This has been subsequently shared with Asset Management working group members for review.
- 4.3 This Capital Strategy reflects any adjustments made and outlines the processes for identifying and managing the pressures on limited capital resources and the revenue consequences of those capital decisions. It defines the key relevant controls and limits across the areas of Treasury management, Asset Management, Commercial objectives, Property Maintenance, Capital Budget setting & Capital Finance which need to be managed in a joined up way in order to best address these issues.

5 Reasons

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. It is expected that the process of producing a strategy and following it will improve the process of managing the Authorities assets both treasury and non-treasury and will help the Authority to be more efficient and focused.

6 Resource Implications

- 6.1 The following schemes are financed 100% by grant or section 106 resourcing and are proposed to be added to 2019-20 capital programme.

Enterprise Directorate

- 6.2 Under WG's transport grant conditions, MCC can bid for further funding for LTF, ATF, LTNF, SRIC and RSC schemes to progress further stages of schemes already in existence. All schemes within the LTF/LTNF/ATF/SRIC categories needed to be in priority order. WG issued guidance in early December 2018, and bids had to be submitted by 20 January 2019. WG grant letters were received on 16 May 2019. Table 1 shows the bids submitted and the awards that have resulted.

Code	Item	Grant financing	Purpose /reason
Existing	Abergavenny town centre	£308,000	The 2019-20 award acknowledges slippage of 2018-19 sc106 funding previously allocated to the project
New	Chepstow transport study	£50,000	
Existing	Caldicot town centre -	£50,000	Delivery of The Cross element and development of Church Rd bid
New	Monmouth town centre –	£425,000	Improving the walking and cycling environment along Upper Monnow St, Agincourt Sq., Priory St
Existing	Grass routes vehicles	£182,000	
Existing	Severn Tunnel Junction Park & ride –	£615,000	Development and design phase
New	Active travel core allocation –	£165,000	Survey, feasibility & design
Existing	Abergavenny-Llanfoist Bridge –	£50,000	Grant restricted to anticipation of FRAP appeal costs
Existing	Chepstow Bulwark 20mph	£75,150	
	Total	1,920,000	

In-Year Virement approvals.

6.4 Since the start of the year there has been a need to move some funding between projects to better align budgets with actual spend and to assist with improving the month 2 monitoring position. Some of these virements require member approval and are listed in the table below. These would normally go to ICMD but are significant in a number of cases to change the use of full Council agreed projects. So the report is being used to more transparently indicate intent.

Code	Description	From/To	Reason
97342	Carriageway Resurfacing – Various	-519,000	
97390	Waste Recycling Bags	115,000	To support Revenue Month 2 recovery plan
98064	Major Component Replacement	50,000	To support Revenue Month 2 recovery plan
95178	Site Enhancement Works – Various	27,000	To support Revenue Month 2 recovery plan
95177	Ceiling, Flooring & Heating Enhancement	100,000	To support Revenue Month 2 recovery plan
96631	Laptops	100,000	To support Revenue Month 2 recovery plan
97383	Caldicot Cross Destination	127,000	Council's match funding element as per Cabinet report 8/11/2018
97383	Caldicot Cross Destination	112,847	Sc106 funding (ASDA Caldicot Playing Fields)
97383	Caldicot Cross Destination	607,050	Grant funding
90321	Abergavenny Community Hub Development	-80,000	The Com Hub budget presumed an element be used on Borough Theatre
90330	Abergavenny Borough Theatre Works	80,000	To separately identify Borough theatre element of funding for Arts Council for Wales grant purposes
90330	Abergavenny Borough Theatre Works	210,990	Borough Theatre Improvements – Arts Council for Wales grant
98851	New Car Park Ticket Machines	-33,706	
97391	OLEV - Residential Charge point Scheme	33,706	To provide match funding for OLEV Charging point grant.
97391	OLEV - Residential Charge point Scheme	101,122	Grant funding
Total		1,032,009	

6.5 Children & Young People Directorate

The additional grant funding has been provided by Welsh Government, without match funding, to facilitate additional educational provision.

Code	Description	Amount	Reason
New	Future Schools Tranche B, feasibility and design works	700,000	65% WG funding, 35% MCC from capital receipts temporarily, but financed ultimately from prudential borrowing volunteered to 2020-24 revenue MTFP
New	Archbishop Rowan Williams Primary School – nursery provision	619,000	WG 100% grant funded
New	Trellech Primary School – nursery provision	640,000	WG 100% grant funded
New	Caldicot Primary School cluster – additional classroom and early years provision	463,318	WG 100% grant funded
New	Monmouth Welsh medium primary school	1,640,000	WG 100% grant funded
New	Small Schemes	200,000	WG 100% grant funded
New	Monmouth area nursery provision	478,000	WG 100% grant funded
Total		4,740,318	

6.6 Social Care & Health Directorate

SCH has received £80,000 to facilitate the movement from its own bespoke IT system (FLO and PLANT) to a standardised product across Welsh Councils that better integrates with Health based systems. The nature of the spending is a mixture of capital and revenue spending. £65k is likely to reflect the value of IT application, but it is proposed to treat as a revenue administered project.

Overall

- 6.7 To assist members in understanding the extent of volatility introduced to the capital programme by ad hoc in year grant awards, the combined effect of additional grant funding is circa £7.4 million.

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

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

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

8 Consultees

Members and SLT through the previous Capital Strategy preparedness assessment included with 2019/20 capital programme

Asset Management working group

Director of Resources

Head of Commercial and Integrated Landlord Services

Group Engineer – Highways

9 Background Papers

Appendix 1 – Capital Strategy

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Appendix 1 – CAPITAL STRATEGY 2019/20

1 Purpose of Strategy

- 1.1 The Authority's Capital Strategy is required to define at a high level,
- how the Authority ensures its capital plans contribute to the provision of local public services;
 - are affordable, prudent and sustainable;
 - are developed with a full understanding of the risks involved;
 - are appropriate for the Authority and suit local circumstances
 - and that they have due regard for the long run financing implications and risks to the Authority.
- 1.2 This Capital Strategy outlines the processes for identifying and managing the pressures on finite capital resources and the revenue consequences of those capital decisions. It defines the key relevant controls and limits across the areas of Treasury management, Asset Management, Commercial objectives, Property Maintenance, Capital Budget setting & financing which needs to be managed in a joined up way in order to best address these issues.
- 1.3 To a certain extent, the Council's capital strategy can be regarded as the "binder", that brings together a variety of strategies already in place e.g. asset management strategy, treasury strategy, disposals strategy, commercial investments approach etc., and where such occurs the link with that other strategy is highlighted.

2 Glossary of terms

Capital accounting is an area which traditionally involves the use of precise technical terms. The following glossary is provided as a foreword to assist Members in their understanding of the detail of proposed Strategy.

- 2.1 **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.
- 2.2 **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 aspects, redundancies etc. 3rd party loan and investments repayment are treated capital receipts where the original expenditure met capital definitions.

- 2.3 **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.
- 2.4 **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 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.
- 2.5 **Debt (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.
- 2.6 **Minimum Revenue Provision** Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by financing from revenue which is known as Minimum revenue provision (MRP).
- 2.7 **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.
- 2.8 **Earmarked reserves.** Conversely earmarked reserves are those created and held for a specific purpose e.g. trading positions, insurance provisions, 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.

3 The "new" Prudential Code

- 3.1 The Prudential Code 'Guidance Notes for Practitioners 2018' requires a framework to be established to support:
- Local strategic planning
 - Local asset management planning

- Proper option appraisal

3.2 The objectives of the Prudential Code are to provide a framework for local authority capital finance that will ensure for individual local authorities that:

- Capital expenditure and investment plans are affordable
- All external borrowing and other long-term liabilities are within prudent and sustainable levels
- Treasury management and other investment decisions are taken in accordance with professional good practice

And that in taking decisions in relation to these bullet points that the local authority is accountable, by providing a clear and transparent framework.

3.3 Ironically in exceptional circumstances, the objective of the Prudential Code is to provide a framework that will demonstrate that there is a danger of not ensuring the above, so that the authority can take timely remedial action.

4 Capital Expenditure Management

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

Property asset management

4.2 The Corporate Landlord Division of 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.

4.3 The Council's asset management strategy was last submitted to Council on the 10th May 2018. Increasingly this will need to be a "live" document updated for periodic survey information.

Infrastructure assets management

4.4 Unlike property assets, Infrastructure assets are managed by Operations Division 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:

- Maintain a complete and accurate asset register for Highways Network Assets & any other assets maintained by the Operations 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,

Investments for Service Purposes

- 4.5 The Council has historically incurred the majority of its capital expenditure on the assets required to provide its services such as schools and offices.
- 4.6 But it may also invest in other entities in order to benefit 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 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.

- 4.6 **Governance:** 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 require approval of full Council to be added to the capital programme.
- 4.7 A list of investments for service purposes including loans and guarantees will be maintained by the Treasury team and added to the Capital Strategy going forward. 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
 - One foster carer loan, under £15,000 is expected to be outstanding at 31st March 2019
 - Low cost home ownership equity interest. – These are effectively soft loans, but an exercise is proposed to review accounting treatment to potentially bring onto Council Balance sheet. The conclusion of that review will be reported through 2020-21 capital strategy.

Commercial Activities

- 4.8 With central government financial support for local public services declining, the Council has started to invest in commercial property and other commercial investments largely for financial gain. Early in 2017/18 the Authority completed the construction of a Solar Farm for £5m, which provides a net return per year after all costs of 3.4%. In 2018/19 the Council purchased a large unit on a local business park for £8m with a forecast return after all costs of 2.1%, and Newport Leisure Park for £21m (estimate annual return 2.06% after financing). The ultimate aim approved by Council was for a holistic combined portfolio of £50m acquisitions. The remaining £21m has been profiled equally into 2019-20 and 2020-21 capital programmes.
- 4.9 The new Commercial investments (2016 onwards) will be revalued at least annually as part of the ongoing review of the Commercial investment portfolio, and the performance of these assets captured quarterly through the service planning returns of Corporate Landlord service. A collective report into the performance of Commercial Investments against related business cases will also be presented to Audit Committee annually.

- 4.10 Assets acquired historically which are now held only for commercial gain had a total value of £40m at 31/3/18 providing a net return after all costs of 1.5%. Reviews of this historic portfolio are planned to ensure all risks, including of poor returns and also opportunities are evaluated and acted upon.
- 4.11 The historic Investment property portfolio is valued with sufficient frequency to ensure that the value in the Authority's accounts is materially correct each year and that any assets with a higher alternative use valuation are identified in the annual valuation process to assist with the optimisation of total returns.
- 4.12 With financial return being the main objective, the Council accepts higher risk on commercial investments than with 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, insolvency/costs of debt recovery. The Council has adopted a very prudent approach to the financial management of its commercial assets, in ensuring that business cases are predicated not only 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 WG guidance suggests a flexibility to defer financing consideration when property is sold, providing that the selling price can reasonably be anticipated to be greater than purchase price.
- 4.13 To date, commercial investments have focused 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. In order that commercial investments remain proportionate to the size of the authority, this batch of new investments is currently subject to a £50m limit during 2018/19-2020/21. Council have approved this amount subject to the financial limits and controls described in the Asset Management Strategy (Investment Policy appendix).
- 4.14 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
- 4.15 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.

- 4.16 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.
- 4.17 **Governance:** Decisions on commercial investments are made by the Investment Committee (non-treasury) in line with the criteria and limits within the Asset Management Strategy, Asset Investment Policy and other supporting documents, approved by Council on 10th May 2018. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.
- 4.18 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.

Other assets

- 4.19 In addition to the Council Property Estate and the Infrastructure Assets, the Authority also owns and rents Heritage Assets, Vehicles and Plant & Equipment:
- 4.20 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 asset management plan, and as a minimum it is proposed to adopt a formal 5 year review period.
- 4.21 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.

5 Implied Limit on Capital Expenditure (capital financing restrictions)

- 5.1 Capital expenditure has to be financed. The available sources of financing include
- Grants/External contributions – these should be maximised but opportunities are tend to be limited and specific to particular projects
 - Capital Support Grant – this is fixed by the Welsh Assembly, is finite, but is at discretion of Council how it is used.
 - Reserve/revenue funding – the Authority currently forecasts Earmarked and Total Council fund reserves to be £5.8m and £7.3m at 31st March 2020 (predicated on resolving £2.5m net revenue deficit at period 1 2019-20 monitoring report). Of the Earmarked reserves, only £1.7m of is not already provisionally allocated, so this is a limited source of capital financing

- Capital receipts - £16m of receipts are forecast to be generated between 2019/20-2022/23 on top of the £4m held at 31st March 2019. Of these, £5m has been allocated to finance capital expenditure in 19/20 and in the 19/20 capital mtfp window so £15m is forecast to become available to fund new schemes over the forthcoming period.
- Borrowing is often the only source of funding available once the limited resources above have been exhausted. In the current economic environment, with interest rates low, borrowing is a cheaper source of financing than 10 years ago, but it only delays the need to finance capital expenditure as borrowing has to be repaid in the form of interest and Minimum Revenue Provision from revenue budgets
- The Capital Financing Requirement (CFR) is the cumulative amount that the Authority has spent since it was founded on borrowing funded capital schemes that has not yet been funded. This is forecast to be £211m at 31st March 2020, excluding any borrowing for 21C schools band B or Crick Road Care home.
- The Authority’s forecast net borrowing position, £203m at 31st March 2020 is lower than the CFR level as the Authority expects to have surplus cash from working capital that it can use temporarily to fund the difference – as per Treasury strategy approval. This approach is commonly known as “internal” borrowing.
- The amount allocated to Minimum Revenue Provision (MRP) in the revenue budget, £4.5m for 2019/20, is the way that the CFR is funded over future years. The Revenue account also has to pay the interest on outstanding external debt, £3.5m for 2019/20
- Further information on Capital Financing can be found at Section 7.

6 Capital Disposals and Receipts

6.1 Any assets which are surplus 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.

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

Capital receipts

	2018/19 actual £m	2019/20 forecast £m	2020/21 forecast £m	2021/22 forecast £m	2022/23 forecast £m
Asset sales	9.3	8.2	6.3	1.1	0.1

- 6.3 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 receipt maximisation.
- 6.4 Traditionally receipts have been earmarked to Future schools affordability. In a change from previous practice, whilst the Council has further Future 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. This will also provide temporary headroom for re-introduction of health & safety assessment and feasibility works to derive proposed capital project certainty. Both aspects of expenditure would instead be afforded by resultant schemes if the projects are agreed by members.

7 Capital Financing

7.1 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 capital expenditure is indicated in the table below:

Capital financing in £ millions

	2018/19 actual	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget
External sources	16.8	7.9	1.4	1.4	1.4
Own resources	8.8	3.0	0.6	0.6	0.6
Debt	44.6	30.0	20.4	3.9	3.9
TOTAL	64.2	40.9	22.4	5.9	5.9

7.2 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by financing from revenue which is known as Minimum revenue provision (MRP). The proposed MRP and Set-aside resultant from debt decisions are as follows:

Replacement of debt finance in £ millions

	2018/19 actual	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget
MRP	4.4	4.7	5.3	5.1	5.6
Set-aside of Capital receipts	0.0 *	0.0	0.0	0.0	0.0
Total	4.4	4.7	5.3	5.1	5.6

7.3 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 policy received by Audit Committee annually, (Appendix 1 of the Audit Committee report on the 30th January 2019).

- 7.4 The Council's capital financing requirement is expected to increase by £25.1m during 2019/20 (based on the net growth in borrowing (debt) taken to support capital programme). Based on the above expenditure figures for expenditure and use of other forms of financing, the Council's estimated CFR is as follows:

Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 forecast	31.3.2022 forecast	31.3.2023 forecast
CFR for Capital expenditure relating to services	156.3	165.0	164.6	164.3	164.0
CFR for Capital investments	30.0	46.5	49.0	48.0	47.0
TOTAL CFR	186.3	211.5	213.6	212.3	211.0

- 7.5 This remains affordable to the Council through the annual budget assessment and the creation of related annual revenue budget for interest and minimum revenue provision liabilities therein.

8 Treasury Management

- 8.1 Treasury management is concerned with ensuring sufficient cash is available to meet the Council's spending obligations, surplus cash being invested until required, while a shortage of cash will be met by borrowing, to avoid the expense of the Authority's bank current account going overdrawn; all the while managing the various risks involved such as credit risk & interest rate risk. 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 used to partially offset capital cash shortfalls to reduce overall borrowing. The full Treasury Strategy was presented to Audit Committee on the 30th January 2019.
- 8.2 Based on historic capital expenditure and other cashflow considerations, at the 31st March 2019, the Council had £178m of borrowing at an average interest rate of 2.4% and £20m treasury investments at an average rate of 1.0%.
- 8.3 **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 the future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.9%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%).

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

Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 forecast	31.3.2022 forecast	31.3.2023 forecast
Debt (incl. PFI & leases)	178.3	203.8	200.3	198.3	197.9
Capital Financing Requirement	186.3	211.5	213.6	212.3	211.0

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

8.6 **Liability benchmark:** This calculation provides a useful comparison between the levels of gross borrowing the Council is currently contractually committed to and the minimum required level of total net external borrowing. At the end of 31st March 2019, this benchmark is expected to be £146.4m and is forecast to rise to £169.1m over the next two years and then fall slightly.

Borrowing and the Liability Benchmark in £ millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 forecast	31.3.2022 forecast	31.3.2023 forecast
Committed gross borrowing	178.3	109.6	86.9	78.9	77.0
Forecast investments	(20.3)	(10.0)	(10.0)	(10.0)	(10.0)
Committed borrowing net of forecast investments	158.0	82.2	62.6	54.8	53.1
Minimum level of external borrowing required	158.0	193.1	189.4	187.7	186.7
Shortfall	0.0	93.5	112.5	118.8	119.7

8.7 The table shows that the Council will need to take out additional borrowing of £93.5m by 31st March 2020 in order to have sufficient cash to continue its operations. By 31st March 2020, £16.7m of budgeted property investments are forecast to require long term funding and £59m of current short term loans will have matured and will need replacing.

8.8 **Affordable borrowing limit:** Treasury management requirements also mean that the Council is legally obliged to set and adhere to an affordable borrowing limit “ceiling” (termed the

authorised limit for external debt) each year, plus a lower prudent “operational boundary” designed to act as a warning level that debt levels are approaching the limit.

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

	2018/19 limit	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit - borrowing -	203.7	219.9	229.7	227.8	227.4
Authorised limit - PFI and leases	4.5	4.5	4.5	4.5	4.5
Authorised limit - total external debt	208.2	224.4	234.2	232.3	231.9
Operational boundary - borrowing	173.5	189.7	199.5	197.6	197.2
Operational boundary - PFI & leases	3.0	3.0	3.0	3.0	3.0
Operational boundary - total external debt	176.5	192.7	202.5	200.6	200.2

8.9 Additionally, the following additional Indicators/limits are included in the Authority’s Treasury Management Strategy.

- Maturity structure of borrowing
- Credit risk indicator – average credit rating of A-
- Limit of net variable rate debt as a % of total net debt – 50%
- Interest rate exposure risk indicator – a 1% rise/fall in interest rates would be expected to impact on the Authority’s revenue account by £241,000.

These indicators and limits are set to control the level and type of borrowing to reduce refinancing risk, credit risk and interest rate risk.

Further details on borrowing can be found in Section 4 of the treasury management strategy which is at Appendix 2 of the Audit Committee report on the 30th January 2019

8.10 **Investment strategy:** Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or Commercial investments are not generally considered to be part of treasury management.

Investment of surplus cash has inherent risks for Councils, associated with sustainability of the banking sector. The resourcing of a “failed” bank is known as bail in. Government has instigated changes in bail in arrangements such that individuals are better protected from affording the cost of failure, and reduce the need for governmental intervention. It has advocated the formal splitting of retail and investment banking concerns and charged institutional investors with primary responsibility to afford bank bail in. Council deposits fall within the definition of institutional investments so they derive limited protection should a bank fail. The treasury strategy mitigates this risk by defining which institutions of good standing the Council will invest with, and sets limits as to level of investments made with individual entities/types of entities. The Council’s treasury management strategy seeks to keep invested cash balances low 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 keeping a £10m investment balance as a condition of being able to obtain professional level advice from its treasury consultants rather than retail level advice.

- 8.11 The Council’s policy on treasury investments is to prioritise security and liquidity over yield, which 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. For money that will be held for longer terms, consideration is given to investing 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 managers 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.

Treasury management investments

	31.3.2019 actual £m	31.3.2020 forecast £m	31.3.2021 forecast £m	31.3.2022 forecast £m
Near-term investments	18.4	7.0	7.0	7.0
Longer-term investments	2.0	3.0	3.0	3.0
TOTAL	20.4	10.0	10.0	10.0

- 8.12 The management of treasury investments is further detailed in the 2019/20 Treasury Management Strategy Section 5 which is an Appendix to the report taken to Audit Committee on 31st January 2019.
- 8.13 **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 strategy is reviewed annually and the 2018/19 strategy was approved by Council on the 6th March 2018. The 2019/20 Strategy was scrutinized by Audit Committee in January 2019 and adopted by full Council on 7th March 2019. In addition mid-year and treasury outturn reports on treasury management activity are presented to Audit Committee which is responsible for scrutinizing 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.
- 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 and training.

10 Setting Capital Budgets

- 10.1 The current philosophy for setting the capital budget is to provide the same annual level of core property and infrastructure maintenance budget, and any extra capacity volunteered to members for decision. Throughout the year, any new schemes to be added must either be self-financing or replace an existing schemes as a higher priority.
- 10.2 The need for a capital strategy to be descriptive of approach, leads to an anticipation that traditional approach will tend to increase the backlog in asset maintenance, and result in the Council allocating resources to new schemes prior to a sufficient assessment of capital funding against existing rather than new priorities.
- 10.3 Specific stock condition survey has increasingly been replaced by service manager anecdotal evidence, and treated as a lesser imperative. So there will be a greater need to explicitly assess
- The existing asset base to determine the minimum total life costs for keeping the Authority's assets in a suitable condition for provision of our services, and whether assets are superfluous. The strategic use of assets to deliver services ought to feature in Council's asset management strategy.
 - the level of assets that will be required to deliver the Corporate Plan – the most significant one is 21st Century Schools currently.

- assess what capital expenditure on Commercial assets (property/equity/loans) will be required to provide sufficient income, to supplement the current revenue budget funding sources, to keep Council tax at an acceptable level
- 10.4 In addition to the above calls on capital financing, the Authority sometimes provides loans and/or guarantees to external bodies, subsidiaries or joint ventures to fund their capital expenditure. These may be to enable our partners to contribute to the provision of our public services. If this is the case, any loan provision should be capital expenditure in nature. These also need to be factored into the capital budget.
- 10.5 Based on traditional anecdotal evidence, the result of all the above is anticipated to indicate that in the medium term there will be a higher call for capital expenditure than the Authority can finance in one year or for the future in general. 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 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 plan as asset lives are much longer than four years.
- 10.6 The Expenditure proposals in the Capital MTFP including £26.1m in 2019/20 .
- 10.7 Capital financing proposals including £21.2m of debt funded expenditure in 2019/20.
- 10.8 The profile of the forecast Capital Financing Requirement for the MTFP window and the related Liability benchmark is assessed in Section 7 above.
- 10.9 Prudential indicators: authorised and operational borrowing limits are required by the Prudential Code to show the Authority is in control of its borrowing levels. The 2019/20 authorised limit for total gross borrowing of £224.4m should not be breached during 2019/20
- 10.10 The revenue impact in 2019/20 of all of the Authority’s borrowing which is forecast to be required up to 31st March 2020, including borrowing to finance the capital expenditure built into the 2019/20 Capital MTFP, is called the ‘Financing Cost’ and includes the Minimum Revenue Provision (MRP) and the interest payable on the borrowing. It is shown as a % of the Authority’s main income streams. Financing costs can be altered by the ratio of short and long term debt held by the Authority see Section 8 above.
- 10.11 The capital budget for 2019/20 including in year revisions, is currently £40.9m excluding leasing. Council is currently planning a further £20.2m of capital expenditure. This will be updated as the 2020/21 capital mtfp is developed, see below:

Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2018/19 actual	2019/20 forecast	2020/21 forecast	2021/22 forecast	2022/23 forecast
Capital expenditure relating to services	39.6	24.2	5.8	5.9	5.9
Capital investments	30.7	16.7	2.6	0.0	0.0

TOTAL	70.3	40.9	8.4	5.9	5.9
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- 10.12 For 19/20, the main service related capital projects budgeted for are Infrastructure works £8.7m, Asset Management £6.9m, Property maintenance £2.8m, New Care Home £1.6m. Works for disabilities £1.1m & schools works £2.3m. The Council also plans to complete the £50m of capital expenditure on commercial investments from 2018/19-2020/21, and progress is indicated in Section 4.
- 10.13 **Governance:** In the last few years, due to the size of the Authority and the limits on funding available for any projects outside the 21 Century Schools Program and the commitment to the Commercial Investment Program, the process for allocating capital funding has been driven by a small senior team interacting with all key service managers directly and also working closely together.
- 10.14 As part of the 2019-20 capital budget process (19th Dec 2018 Cabinet and subsequent Select cycle), Members were volunteered a priority ranking to assist them with their considerations when replacing a project in existing capital programme with one of higher priority. This was well received, and feedback resulted in adding the aspect of using capital to assist in beneficially affecting in year revenue spending, which has been given the same priority as using capital to set a sustainable revenue budget, and members also wished to increase the priority for using capital to attract significant 3rd party or match funding to the County, which has moved from rank 5 to 3.

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 3 rd party or private match funding to the County	3
Spend to save transformational works (including permitted 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
Deliver wider economic outcomes	5

- 10.15 It is anticipated that the best points of the current arrangement will be supplemented with additional tools and/or processes so that service managers can usefully identify pressures

which have not previously been included in the Council's 4 year capital programme in the anticipation that if they score highly against an agreed list of parameters, both financial and non-financial, that Members would look favourably upon their addition in forthcoming capital programme. This suggests a move towards a more bid based approach providing members with choices. Bid documents will be accompanied by any proposed financing arrangements identified. These pressures would be assessed by the Asset management Working Group. The Bid forms and predetermined criteria ensure that selection can be organised and considered by the working group in a fashion that is consistent with member priorities.

- 10.16 Where capital expenditure is proposed to satisfy the maintaining existing assets and infrastructure, but for which funding cannot be identified in current year, the consequences and/or contingency measures will also be identified by service colleagues and capital strategy good practice suggests any decision to defer such expenditure must be acknowledged with Council systems e.g. added to risk register or appear as contingent liability in Statement of accounts.
- 10.17 Following consideration of asset management working group, selected bids will be collated by the Finance team, and consolidated into an advocated fully financed capital budget proposal. The Draft Capital MTFP is presented to Cabinet who recommends changes or further work to be done before finalisation. In a change from traditional approach, those proposals not advocated will also be included appreciating that Members may choose to review/amend proposals before their agreement.
- 10.18 The final capital programme is then presented to Cabinet and finally Council for approval before the end of March each year.
- 10.19 For details of the Council's 2019/20 capital programme, see the final budget report which went to Cabinet on the 20th February 2019
- 10.20 Progress on capital schemes and the related capital financing is monitored by Cabinet at months 2 and 7 of each financial year and at outturn as a minimum to ensure projects are completed on time, to budget and to the required specification to avoid the negative impacts of both under and overspends as well as the negative impacts on services.
- 10.21 The monitoring also includes a high level commentary of projects which overspend, overrun or did not deliver on project outcomes.

11 Revenue Budget Implications

- 11.1 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 compared these financing costs to the net revenue stream i.e. the amount of income from Council Tax, business rates and general government grants. This is projected to remain fairly flat with the forecast level of expenditure in the Capital MTFP.

Prudential Indicator: Proportion of financing costs to net revenue stream

	2018/19 actual	2019/20 forecast	2020/21 forecast	2021/22 forecast	2022/23 forecast
Financing costs (£m)	7.9	8.7	8.7	8.7	8.8
Proportion of net revenue stream	56.1%	5.6%	5.7%	5.6%	5.6%

11.2 **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. Where assets are being created over and above the current base level of capital expenditure, they are only approved if they are able to meet the finance costs associated with any new borrowing. The Director of Resources is satisfied that the proposed capital programme is prudent, affordable and sustainable because the finance 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; with the finance costs for assets funded by borrowing included in the four year medium term financial plan which is balanced before approval by Council.

12 Knowledge and Skills

12.1 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. The Council only has 2 qualified valuation staff currently, but recent restructure report addresses such. For both accountants and valuers, the Council offers particular training roles and also from staff development perspective encourages and support wider staff to undertake study towards relevant professional qualifications.

12.2 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. Alder King's services haven't been competitively tested yet, but are likely to need to, as their fee is predicated on the level of investment being presented, which wouldn't be demonstrably independent advice.

13 Reasons

- 13.1 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. It is expected that the process of producing a strategy and following it will improve the process of managing the Authorities assets both treasury and non-treasury and will help the Authority to be more efficient and focused.

14 Resource Implications

- 14.1 The capital strategy proposed brings together financial aspects from a variety of pre-existing strategies and approaches. Consequently the financial effect of adopting this capital strategy is already quantified and described above, resulting in no new resourcing requirements.
- 14.2 However the change in approach to a more evidential base of repair liability i.e. increased use of stock condition assessment, or the need for feasibility study to provide greater cost certainty, will need to be financed. In the short term it is anticipated such volatility is afforded through use of capital receipts headroom, though longer term such costs will need to be recycled into the related schemes approved by members.