ANNEX G

CAPITAL STRATEGY 2020/21

1.0 BACKGROUND

1.1 The purpose of the Capital Strategy is to demonstrate that the Council takes capital expenditure and investment decisions in line with Corporate and service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. It sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

1.2 The Capital Strategy comprises a number of distinct, but inter-related, elements as follows:

(a) Capital expenditure (Section 2)

This section includes an overview of the governance process for approval and monitoring of capital expenditure, including the Council's policies on capitalisation, and an overview of its capital expenditure and financing plans.

(b) Capital financing and borrowing (Section 3)

This section provides a projection of the Council's capital financing requirement, how this will be funded and repaid. It therefore sets out the Council's borrowing strategy and explains how it will discharge its duty to make prudent revenue provision for the repayment of debt.

(d) Alternative investments (Section 4)

This section provides an overview of those of the Council's current and proposed alternative investment activities that count as capital expenditure, including processes, due diligence and defining the Council's risk appetite in respect of these, including proportionality in respect of overall resources.

(e) Chief Financial Officer's statement (Section 5)

This section contains the Chief Financial Officer's views on the deliverability, affordability and risk associated with the capital strategy

2.0 CAPITAL EXPENDITURE

Capitalisation Policy

2.1 Expenditure is classified as capital expenditure when it results in the acquisition or construction of an asset (e.g. land, buildings, roads and bridges, vehicles, plant and equipment etc.) that:

- Will be held for use in the delivery of services, for rental to others, investment or for administrative purposes; and
- Are of continuing benefit to the Council for a period extending beyond one financial year.

Subsequent expenditure on existing assets is also classified as capital expenditure if these two criteria are met.

2.2 There may be instances where expenditure does not meet this definition but would be treated as capital expenditure, including:

- Where the Council has no direct future control or benefit from the resulting assets, but would treat the expenditure as capital if it did control or benefit from the resulting assets; and
- Where statutory regulations require the Council to capitalise expenditure that would not otherwise have expenditure implications according to accounting rules

2.3 The Council operates de-minimis limits for capital expenditure. This means that items below these limits are charged to revenue rather than capital. The limits are currently as follows:

- **General Limit:** £10,000

Governance

2.4 Policy & Resources Committee shall, during each financial year and after consultation with the relevant Overview and Scrutiny Committee(s), approve a capital expenditure programme for the next following and subsequent 2 financial years. Such programmes shall be in a form and in accordance with deadlines approved by the Chief Finance Officer and in accordance with the Council's Financial Strategy. Capital expenditure plans shall be prepared in conjunction with the Chief Finance Officer for submission to The Policy & Resources Committee and then Council for approval.

2.5 The Council's Financial and Contract Procedure Rules provide a framework for the appropriate authorisations for individual schemes to proceed and facilitate the overall management of the Capital Plan within defined resource parameters.

Capital Expenditure and Funding Plans

2.6 Capital expenditure plans are set out within the Treasury Management Strategy (6.2.2)**.**

2.7 When expenditure is classified as capital expenditure for capital financing purposes, this means that the Council is able to finance that expenditure from any of the following sources:

(a) **Capital grants and contributions** - amounts awarded to the Council in return for past or future compliance with certain stipulations.

(b) **Capital receipts** – amounts generated from the sale of assets and from the repayment of capital loans, grants or other financial assistance.

(c) **Revenue contributions** – amounts set aside from the revenue budget in the Reserve for Future Capital Funding.

(d) **Borrowing** - amounts that the Council does not need to fund immediately from cash resources, but instead charges to the revenue budget over a number of years into the future.

2.8 The implications of financing capital expenditure from 'borrowing' are explained in section 3 below.

3.0 CAPITAL FINANCING REQUIREMENT AND BORROWING

Context

3.1 The Council is required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities (referred to as the 'Prudential Code') when assessing the affordability, prudence and sustainability of its capital investment plans.

3.2 Fundamental to the prudential framework is a requirement to set a series of prudential indicators. These indicators are intended to collectively build a picture that demonstrates the impact over time of the Council's capital expenditure plans upon the revenue budget and upon borrowing and investment levels, and explain the overall controls that will ensure that the activity remains affordable, prudent and sustainable.

3.3 A summary of the actual prudential indicators for 2018/19, and the estimates for 2019/20 through to 2022/23 are provided in the Treasury Management Strategy document..

Capital Financing Requirement

3.4 When capital expenditure is funded from borrowing, this does not result in expenditure being funded immediately from cash resources, but is instead charged to the revenue budget over a number of years. It does this in accordance with its policy for the repayment of debt, which is set out in the Minimum Revenue Policy Statement, within the Treasury Strategy (6.3).

3.5 The forward projections of the CFR reflect:

- There are no capital expenditure requirements from borrowing or further credit arrangements resulting in an increase to the CFR and

- Revenue budget provision being made for the repayment of debt, which results in a reduction to the CFR).

3.6 The actual CFR for 2018/19 and forward projections for the current and forthcoming years are as follows:

	2018/19 Est. £000	2019/20 Est. £000	2020/21 Est. £000	2021/22 Est. £000	2022/23 Est. £000
CFR General Fund	1,624	1,589	1,553	1,518	1,483
CFR GF Leases	240	323	609	780	590
CFR Commercial / Non-financial investments	0	0	0	0	0
Total CFR	**1,864**	**1,912**	**2,162**	**2,298**	**2,073**
Movement in CFR	-183	47	251	136	-225
Movement in CFR represented by:-					
Net Financing need for the year	0	0	0	0	0
Less MRP & Other Financing movements	-183	47	251	136	-225
Movement in CFR	**-183**	**48**	**251**	**136**	**-225**

3.7 The forecast decrease in the CFR shows that there are no current borrowing requirements to fund capital expenditure, and therefore the gradual reduction reflects the annual minimum revenue provisions towards the repayment of debt.

External borrowing limits

3.9 The Council is only permitted to borrow externally (including via credit arrangements) up to the level implied by its Capital Financing Requirement (CFR). To ensure that external borrowing does not exceed the CFR, other than in the short term, limits are established for external debt, as follows:

- **Authorised limit –** this defines the maximum amount of external debt permitted by the Council, and represents the statutory limit determined under section 3 (1) of the Local Government Act 2003.

- **Operational boundary** – this is an estimate of the probable level of the Council's external debt, and provides the means by which external debt is managed to ensure that the 'authorised limit' is not breached.

3.10 The proposed limits, which are set out in the Treasury Strategy, make separate provision for external borrowing and other long-term liabilities, and are based upon an estimate of the most likely but not worst case scenarios. They allow sufficient headroom for fluctuations in the level of cash balances and in the level of the CFR.

3.11 Alternative investment activities included in the plan are to be classed as capital expenditure. An Alternative Investments Strategy has not yet been developed and, in the event that major initiatives are proposed, it may be necessary to review the current borrowing limits.

3.12 The agreed **Operational Boundary** and **Authorised Limits** for external debt are as follows:

Authorised Limit	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**
Debt	10,000	10,000	10,000	10,000
Other long term liabilities	1,000	1,500	1,500	1,500
Total	**11,000**	**11,500**	**11,500**	**11,500**

Operational Boundary	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**
Debt	5,000	5,000	5,000	5,000
Other long term liabilities	500	1,000	1,000	1,000
Total	**5,500**	**6,000**	**6,000**	**6,000**

Borrowing strategy

3.13 The Councils Borrowing Strategy is set out in the Treasury Strategy document (6.4).

3.14 The Council's capital borrowing is slightly lower than the underlying need to borrow, and the Council is expected to be in an under-borrowed position from 2019/20 onwards. This has been a prudent strategy as investment returns are low and counterparty risk is relatively high – this approach will be carefully monitored during 2020/21

3.15 The use of internal borrowing has been an effective strategy in recent years as:

- Rising cash balances as a result of MRP set aside mean available cash for the medium to longer term;
- It has enabled the Council to avoid significant external borrowing costs; and
- It has mitigated significantly the risks associated with investing cash in what has often been a volatile and challenging market.

3.16 Further long term external borrowing may be undertaken, in excess of the current forecasts, in the event that it is not possible or desirable to sustain the anticipated internal borrowing position.

3.17 The external borrowing requirement will be kept under review and long term external loans will be secured within the parameters established by the **authorised limit** and **operational boundary** for external debt, as set out above.

3.18 Opportunities to generate savings by refinancing or prematurely repaying existing long term debt will also be kept under review. Potential savings will be considered in the light of the current treasury position and the costs associated with such actions.

Minimum Revenue Provision

3.19 The Council sets cash resources aside from the Revenue Budget each year to repay the borrowing. This practice is referred to as the minimum revenue provision (MRP) for the repayment of debt.

3.20 The Capital Financing Requirement (CFR) provides a measure of the amount of capital expenditure which has been financed from borrowing that the Council yet to fund from cash resources.

3.21 Statutory guidance requires MRP to be provided annually on a prudent basis. In accordance with the requirement to make a prudent 'revenue provision for the repayment of debt', the Council ensures that debt is repaid over a period that is commensurate with the period over which the capital expenditure provides benefit. This is achieved by applying the methodology set out within the Policy. The revenue budget provision for MRP charges in 2019/20 has been compiled on a basis consistent with this policy

4.0. Alternative Investments

Introduction

4.1 The prolonged low interest rate environment has resulted in reduced returns on treasury management investments. Moreover, the introduction of the general power of competence has given local authorities far more flexibility in the types of activity they can engage in. These changes in the economic and regulatory landscape, combined with significant financial challenges, have led many authorities to consider different and more innovative types of investment.

4.2 CIPFA recently issued an update to its Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (the Treasury Management Code). One of the main changes introduced by the new Code is to require authorities to incorporate all of the financial and non-financial assets held for financial return in authorities' annual capital strategies.

4.3 Separately, the Department for Communities and Local Government consulted on changes to its statutory Guidance on Local Authority Investments. As a result, updated Statutory investment guidance and MRP guidance was issued in 2018. The guidance reinforced the need for commercial investment activity to be financially sustainable, proportionate to overall resources and the Council should have access to the appropriate level of expertise to make informed decisions.

4.4 **This section of the Capital Strategy will need to be updated if the Council's own agenda for commercial investments evolves.**

4.5 It is worth highlighting that all commercial investment activities are subject to approval in accordance with the Council's governance framework for decision making.

Alternative Investment Objectives

4.6 The primary objectives of the commercial investment activities:

- Security – to protect the capital sums invested from loss; and
- Liquidity – ensuring the funds invested are available for expenditure when needed.

4.7 The generation of **yield** is distinct from these prudential objectives. However, once proper levels of security and liquidity are determined, it is then reasonable to consider what yield can be obtained consistent with these priorities.

4.8 Non-core activities and investments would primarily be undertaken by the Council in order to generate income to support the delivery of a balanced budget. Such investments would only be entered following a full assessment of the risks and having secured expert external advice (i.e. where it is relevant to do so)

4.9 To ensure that alternative investment plans are financially sustainable, the Council would need to carefully consider the internal funds available for investment and proportionate risk.

Investment Properties

4.9 Land and buildings may be aquired for investment purposes rather than for the supply of goods or services or for administrative purposes. Such assets will be classified as Investment Properties. The council already holds a number of properties in this class, and may wish to consider increasing its property portfolio.

4.10 Investment properties are measured at their fair value annually (which will ensure the valuation reflects the market conditions at the end of each reporting period). The fair value measurement will enable the Council to assess whether the underlying assets provide security for capital investment. Where the fair value of the underlying assets is no longer sufficient to provide security against loss, mitigating actions will be considered, to ensure that appropriate action is taken to protect the capital sum invested.

Loans to Third Parties

4.12 Loans to third parties could be considered, as part of a wider strategy for local economic growth for example. However they may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

4.13 Such loans should only be considered when all of the following criteria are satisfied:

- The loan is given towards expenditure which would, if incurred by the Council, be capital expenditure;
- The purpose for which the loan is given is consistent with the Council's corporate / strategic objectives and priorities;
- Due diligence is carried out that confirms the Council's legal powers to make the loan, and that assesses the risk of loss over the loan term;
- A formal loan agreement is put in place which stipulates the loan period repayment terms and loan rate (which will be set at a level that seeks to mitigate any perceived risks of a loss being charged to the General Fund, and takes appropriate account of state aid rules) and any other terms that will protect the Council from loss;
- Prior to any loan being granted, the Council's own cashflow requirements are reviewed to ensure that appropriate levels of liquidity will be maintained.

Other Alternative Investment Opportunities

4.14 There are a number of other potential opportunities the Council may want to consider, such as investment in property funds and other institutions such as Credit Unions. As stated above, this would need to be considered in the wider context of the Council's corporate priorities and appropriate due diligence and approvals sought. Such an investment should be considered as a capital expenditure decision, and therefore would form part of the Capital Programme Budget should an 'investment' be supported.

5.0 SECTION 151 OFFICER STATEMENT

Background

5.1 The Prudential Code for Capital Finance in Local Authorities (the Prudential Code) plays a key role in capital finance in local authorities. Local authorities determine their own programmes for investment that are central to the delivery of quality public services. The Prudential Code was developed by CIPFA as a professional code of practice to support local authorities in taking their decisions. Local authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

5.2 In financing capital expenditure, local authorities are governed by legislative frameworks, including the requirement to have regard to CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

5.3 In order to demonstrate that capital expenditure and investment decisions are taken in line with service objectives and properly take account of stewardship, value for money, prudence, sustainability and affordability, the Prudential Code requires authorities to have in place a Capital Strategy that sets out the long term context in which capital expenditure and investment decisions are made, and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

5.4 The Prudential Code requires the Chief Financial Officer to report explicitly on the affordability and risk associated with the Capital Strategy. The following are specific responsibilities of the Section 151 Officer:

- recommending clauses, treasury management policy/practices for approval, reviewing regularly, and monitoring compliance;
- submitting quarterly treasury management reports;
- submitting quarterly capital budget update reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority

- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed

5.5 The Capital Strategy provides an overview of the governance process for approval and monitoring of capital expenditure. These processes are well established and are highly effective in ensuring delivery of the Authority's capital investment plans. In addition, the Capital Strategy and Prudential Indicators also demonstrates that the capital expenditure, investment and financing plans of the Authority are robust, affordable and sustainable.