Somerset West and Taunton Council

Shadow Council – 21 February 2019

Capital Strategy 2019/20

This matter is the responsibility of the Leader of the Council, Councillor John Williams

Report Author: Andrew Stark, Interim Finance Manager

1 Executive Summary

1.1 This capital strategy is a new report for 2019/20, giving a high-level overview of how capital expenditure, capital financing, and treasury management activities 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 For comparison purposes the tables in the report show the combined position for Taunton Deane Borough Council and West Somerset Council for the years up to and including 2018/19.

2 Recommendations

2.1 Shadow Council approves the 2019/20 Capital Strategy.

2.2 Shadow Council approves the Council's Minimum Revenue Provision policy as included with this report.

3 Risk Assessment

3.1 **Risk Matrix**

Description	Likelihood	Impact	Overall
The Council fails to maintain an adequate system of internal control	2	4	8
The Council has in place suitable arrangements to develop, approve and deliver its capital strategy through appropriately trained staff and with access to specialist advice.	1	4	4

Risk Scoring Matrix

Likelihood							
	5	Almost Certain	Low (5)	Medium (10)	High (15)	Very High (20)	Very High (25)
	4	Likely	Low (4)	Medium (8)	Medium (12)	High (16)	Very High (20)
	3	Possible	Low (3)	Low (6)	Medium (9)	Medium (12)	High (15)
	2	Unlikely	Low (2)	Low (4)	Low (6)	Medium (8)	Medium (10)
	1	Rare	Low (1)	Low (2)	Low (3)	Low (4)	Low (5)
			1	2	3	4	5
			Negligible	Minor	Moderate	Major	Catastrophic
			Impact				

Likelihood of risk occurring	**Indicator**	**Description (chance of occurrence)**
1. Very Unlikely	May occur in exceptional circumstances	< 10%
2. Slight	Is unlikely to, but could occur at some time	10 – 25%
3. Feasible	Fairly likely to occur at same time	25 – 50%
4. Likely	Likely to occur within the next 1-2 years, or occurs occasionally	50 – 75%
5. Very Likely	Regular occurrence (daily/weekly/monthly)	> 75%

4 Capital Expenditure and Financing

4.1 Capital expenditure is where the Council spends money on assets, such as property or vehicles, which will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10k are not capitalised and are charged to revenue in the year.

4.2 In 2019/20, the Council is planning capital expenditure of £20.309m as detailed below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Budget £m	2020/21 Budget £m	2021/22 Actual £m
General Fund	5.998	11.726	17.774	13.194	12.692
HRA	10.126	8.973	9.587	13.299	11.232
Total	**16.124**	**20.699**	**27.361**	**26.493**	**23.924**

4.3 The main General Fund capital projects also include £16.6m for growth projects.

4.4 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is, therefore, recorded separately.

4.5 Governance: Service managers bid annually in September to include projects in the Council's Capital Programme. Bids are collated by Finance and the final Capital Programme is then presented to Scrutiny, the Executive and to Full Council in February each year.

4.6 Full details of the Council's capital programme is contained in the Draft General Fund Revenue Budget and Capital Estimates 2019/20 and the Housing Revenue Account (HRA) Budget Estimates 2019/20.

4.7 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 Financing Initiative). The planned financing of the above capital expenditure is as follows:

Table 2: Capital Financing

	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Budget £m	Budget 2020/21 £m	Budget 2021/22 £m
External Sources	1.952	3.887	7.695	4.510	5.095
Own Resources	9.291	12.527	12.166	18.650	15.229
Debt	4.881	4.285	7.500	3.333	3.333
Total	**16.124**	**20.699**	**27.361**	**26.493**	**23.924**

4.8 Debt is only a temporary source of finance, since loans and leases must be repaid and this is, therefore, replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP repayments and the use of capital receipts are as follows:

Table 3: Replacement of Debt Finance

	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Budget £m	Budget 2020/21 £m	Budget 2021/22 £m
MRP	2.632	2.364	2.276	2.364	2.367

The Council's MRP policy is available as Appendix A to this report.

4.9 The Council's cumulative amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP repayments and capital receipts used to replace debt. Based on the above figures for expenditure and financing the Council's estimated CFR is as follows:-

Table 4: Estimated CFR

	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Budget £m	Budget 2020/21 £m	Budget 2021/22 £m
General Fund	14.402	13.859	20.904	20.399	19.894
HRA	104.848	100.729	103.355	104.829	106.338
Total	**119.250**	**114.588**	**124.259**	**125.228**	**126.232**

5 Asset Management

5.1 To ensure that capital assets continue to be of long-term use, both Taunton Deane Borough Council and West Somerset Council currently have an asset management strategy in place which drives forward new ways of managing the asset portfolio by proactive asset management.

6 Asset Disposals

6.1 When a capital asset is no longer needed it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or used to repay debt. The Council is currently also permitted to spend capital receipts on transformation projects until 2021/22. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £6.420m of capital receipts in the coming financial year as follows:

Table 5: Capital Receipts

	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Budget £m	Budget 2020/21 £m	Budget 2021/22 £m
Asset Sales	(4.303)	(3.988)	(5.902)	(4.240)	(4.410)
Loans Repaid	(488)	(518)	(518)	(518)	(518)
Total	**(4.791)**	**(4.506)**	**(6.420)**	**(4.758)**	**(4.928)**

7 Treasury Management

7.1 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. The Council is typically cash rich in the short-term as revenue is earned before it is spent but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

7.2 Due to decisions taken in the past, the Council currently has £85.5m of borrowing and treasury investments of £56.3m.

8 Borrowing Strategy

8.1 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 0.75%) and long term fixed rate loans where the future cost is known but higher (currently 2%-3%).

8.2 Projected levels of the Council's total outstanding debt are shown below, compared with the CFR (as also detailed above).

Table 6: Prudential Indicator: Gross Debt and the CFR

	2017/18 Actual £m	**2018/19 Forecast £m**	**2019/20 Budget £m**	**Budget 2020/21 £m**	**Budget 2021/22 £m**
Debt	85.500	82.500	86.500	86.333	79.666
CFR	119.250	114.588	124.259	125.228	126.232

8.3 Statutory guidance is that debt should remain below the CFR, except in the short-term. As can be seen from Table 6 the Council expects to comply with this in the medium term.

9 Affordable Borrowing Limit

9.1 The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach this limit.

	2018/19 Forecast £m	**2019/20 Budget £m**	**2020/21 Budget £m**	**2021/22 Budget £m**
Authorised Limit	244.0	244.0	244.0	244.0
Operational Boundary	212.0	212.0	212.0	212.0

9.2 Further details of existing borrowing can be found in Appendix C of the Treasury Management Strategy Statement.

10 Investment Strategy

10.1 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.

10.2 The Council's policy on treasury investments is to prioritise security and liquidity over yield, therefore to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high quality banks to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

Table 8: Treasury Management Investments

	31.03.18 Actual £m	**31.03.19 Forecast £m**	**31.03.20 Budget £m**	**31.03.21 Budget £m**	**31.03.22 Budget £m**
Short-term investments	36.744	40.333	40.000	40.000	40.000
Long term investments	16.022	16.000	16.000	16.000	16.000
Total	**52.766**	**56.333**	**56.000**	**56.000**	**56.000**

10.3 Further details of existing treasury investments can be found in Appendix C of the Treasury Management Strategy Statement.

10.4 Governance: Decisions on treasury management and borrowing are made daily and are, therefore, delegated to the s151 Officer and his staff who must act in line with the Treasury Management Strategy approved by Full Council. Reports on treasury management activities are presented to the Audit, Standards and Governance Committee.

11 Investments for Service Purposes

11.1 The Council makes investments to assist local public services, including making loans to local small businesses to promote economic growth. In light of the public service objective, the Council is willing to take more risk than with treasury investments, however, it still plans for such investments to generate a profit after all costs.

11.2 Governance: Decisions on service investments are made by the relevant service manager in consultation with the s151 officer and must meet the criteria and limits laid down in the investment strategy. Most loans are capital expenditure and purchases will, therefore, also be approved as part of the capital programme.

11.3 Further details on service investments are contained in the Investment Strategy.

12 Commercial Activities

12.1 With central government financial support for local public services declining the Council intends to diversify into investments in commercial property mainly for financial gain.

12.2 With financial return being the main objective, the Council will be prepared to accept higher risk on commercial investments than with treasury investments. As the Council develops its commercial agenda a new strategy will be put before members for approval which will detail governance arrangements for commercial investments. Property and most other commercial investments are also capital expenditure and purchases will, therefore, be approved as part of the capital programme in future.

13 Liabilities

13.1 In addition to debt of £85.5m detailed above the Council is committed to making future payments to cover its pension deficit valued at £111.020m. It has also set aside £2.403m to cover provisions. The Council is also at risk of having to pay for contingent liabilities but has not put aside any money because payment is contingent on, as yet, unknown events occurring which may crystallise possible amounts due.

13.2 Governance: Decisions on incurring new discretionary liabilities are taken by service managers in consultation with the s151 Officer. The risk of liabilities crystallising and requiring payment is monitored by the finance team and reported to the s151 officer.

13.3 Further details on liabilities and guarantees can be found in the 2017/18 Statement of Accounts of Taunton Deane Borough Council and West Somerset Council.

14 Revenue Budget Implications

14.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP is charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from council tax, business rates and general government grants.

Table 9: Prudential Indicator: Proportion of Financing Costs to Net Revenue Stream

	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Budget £m	Budget 2020/21 £m	Budget 2021/22 £m
General Fund					
Net Financing Costs (£m)	0.366	0.076	-0.018	0.041	0.005
Proportion of net revenue stream (%)	1.90	0.37	-0.07	0.20	0.02
HRA					
Net Financing Costs (£m)	4.300	4.431	4.370	4.425	4.485
Proportion of net revenue stream (%)	15.99	16.63	16.51	16.53	16.28

14.2 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 into the future. The s151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable.

15 Knowledge and Skills

15.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the s151 Officer is a qualified accountant with many years' experience. The Council pays for other staff to study towards relevant professional qualifications including AAT and CCAB accounting qualifications.

15.2 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 advisers and various property consultants as required. 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.

16 Links to Corporate Aims / Priorities

16.1 The Treasury Management and Investment Strategy supports the delivery of the Corporate Aims.

17 Finance / Resource Implications

17.1 Any financial/resource implications are contained in the main body of the report.

18 Legal Implications

18.1 There are no legal comments for this report.

19 Environmental Impact Implications

19.1 There are no environmental impacts applicable to this report.

20 Safeguarding and/or Community Safety Implications

20.1 There are no safeguarding or community safety implications applicable to this report.

21 Equality and Diversity Implications

21.1 There are no equalities implications applicable to this report.

22 Social Value Implications

22.1 There are no social value implications to this report.

23 Partnership Implications

23.1 There are no partnership implications to this report.

24 Health and Wellbeing Implications

24.1 There are no health and wellbeing implications to this report.

25 Asset Management Implications

25.1 There are no asset management implications to this report.

26 Data Protection Implications

26.1 There are no data implications to this report.

27 Consultation Implications

27.1 There are no consultation implications to this report.

28 Scrutiny Comments / Recommendation(s)

28.1 To be added following the meeting as appropriate.

Democratic Path:
- **Shadow Scrutiny – Yes**
- **Shadow Executive – Yes**
- **Shadow Full Council – Yes**

Reporting Frequency: Annual

List of Appendices

Appendix A	Annual Minimum Revenue Provision Statement 2019/20

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Appendix A

Annual Minimum Revenue Provision Statement 2019/20

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the CLG Guidance) most recently issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP.

The MRP methodology was reviewed in 2016/17 to ensure that our approach was appropriate for our financial stability and was robust and prudent for future capital expenditure.

The weighted average useful life approach was deemed to be the most prudent approach and took into consideration the materiality of each asset and its recorded remaining useful life. The weighted average was then applied to the class of asset then applied across the whole fixed asset base. That gave a robust basis to support the asset life applied to MRP calculations and be appropriate for audit scrutiny.

This base calculation was reviewed for 2019/20 with the creation of the new Somerset West and Taunton Council. Any additional CFR is calculated separately and added to the MRP as a distinct calculation thus protecting the original calculation and adding to it where appropriate.

For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan.

Capital expenditure incurred during 2019/20 will not be subject to a MRP charge until 2020/21.