

## Appendix 1 - Thurrock Council

### Capital Strategy Report 2019/20

#### Introduction

This capital strategy is a new report for 2019/20, giving a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance Members' understanding of these sometimes technical areas.

#### Capital Expenditure and Financing

Capital expenditure is 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 or build 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 year.

- Details of the Council's policy on capitalisation are included within the annual Statement of Accounts, which can be accessed through the Council's website.

In 2019/20, the Council is planning capital expenditure of £417.250m as summarised below:

*Table 1: Prudential Indicator: Estimates of Capital Expenditure in £m*

	<b>2017/18 actual</b>	<b>2018/19 forecast</b>	<b>2019/20 forecast</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>
General Fund services	39.630	80.189	119.003	38.959	24.524
Council housing (HRA)	13.125	19.667	33.950	10.000	10.000
Capital investments	339.503	308.997	275.637	305.000	250.000
<b>TOTAL</b>	<b>392.258</b>	<b>408.853</b>	<b>417.250</b>	<b>353.959</b>	<b>284.524</b>

The main General Fund capital projects include the widening of the A13 (£33m), Purfleet redevelopment (£12m) and school expansions (£4m). The Council also plans to incur £275.637m of capital expenditure on investments, which are detailed later in this report.

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, and includes the building of 117 new homes over the forecast period (£24m).

**Governance:** Service managers bid annually in September to include projects in the Council's capital programme. Bids are collated by corporate finance who calculate the financing cost (which can be nil if the project is fully externally financed). The bids are then collated and prioritised by either Property Board, Digital Board or Service Review. The proposed programme is then considered by Director's Board. This includes a final appraisal of all bids including final consideration of service priorities and financing costs. The final proposed capital programmes is then collated and reported with recommendations to the Corporate Overview and Scrutiny committee. The final capital programme is then presented to Cabinet and to Council in February each year as part of the overall budget setting process.

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

*Table 2: Capital financing in £m*

	<b>2017/18 actual</b>	<b>2018/19 forecast</b>	<b>2019/20 forecast</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>
External sources	26.794	46.374	66.575	16.257	16.309
Own resources	13.690	14.362	22.310	10.000	10.000
Debt	351.774	348.117	328.365	327.702	258.215
<b>TOTAL</b>	<b>392.258</b>	<b>408.853</b>	<b>417.250</b>	<b>353.959</b>	<b>284.524</b>

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 the minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance and repayments of investments on maturity will repay the associated debt. Planned MRP and use of capital receipts are as follows:

*Table 3: Minimum Revenue Provision in £m*

	<b>2017/18 actual</b>	<b>2018/19 forecast</b>	<b>2019/20 forecast</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>
Own resources	0	2.811	6.353	7.958	8.695

- The Council's full minimum revenue provision statement is included in the treasury management statement appended as an annex to this document.

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 capital receipts used to replace debt. The CFR is expected to increase by £322.022m during 2019/20. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

*Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £m*

	<b>31.3.2018 actual</b>	<b>31.3.2019 forecast</b>	<b>31.3.2020 forecast</b>	<b>31.3.2021 forecast</b>	<b>31.3.2022 forecast</b>
General Fund services	172.420	203.099	249.464	264.208	263.730
Council housing (HRA)	181.843	187.473	187.473	187.473	187.473
Capital investments	339.503	648.500	924.137	1,229.137	1,479.135
<b>TOTAL CFR</b>	<b>693.766</b>	<b>1,039.072</b>	<b>1,361.074</b>	<b>1,680.818</b>	<b>1,930.338</b>

**Asset management:** To ensure that capital assets continue to be of long-term use, the Council is further developing an asset management strategy which will be completed in 2019/20.

**Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021/22. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £10m of capital receipts (total includes both GF and HRA receipts) in the coming financial year as follows:

*Table 5: Capital receipts in £m*

	<b>2017/18 actual</b>	<b>2018/19 forecast</b>	<b>2019/20 forecast</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>
Asset sales	16.057	8.700	10.000	10.000	10.000
Loans repaid	0.036	5.037	0.039	0.041	0.043
<b>TOTAL</b>	<b>16.093</b>	<b>13.737</b>	<b>10.039</b>	<b>10.041</b>	<b>10.043</b>

## **Treasury Management**

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account.

Due to decisions taken in the past, the Council currently has £1.112bn borrowing at an average interest rate of 2.43% and £154.5m treasury investments at an average rate of 2.53%.

**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 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 2.0 to 3.0%).

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

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

	<b>31.3.2019 forecast</b>	<b>31.3.2020 forecast</b>	<b>31.3.2021 forecast</b>	<b>31.3.2022 forecast</b>
Debt (incl. PFI & leases)	1,074.889	1,353.349	1,656.951	1,900.306
Capital Financing Requirement	1,039.072	1,361.074	1,680.818	1,930.338

Statutory guidance is that debt should remain below the capital financing requirement over the medium to long term but can be over for the short term recognising borrowing requirements ahead of need for future capital expenditure. As can be seen from table 6, the Council complies with this requirement.

**Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

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

	<b>2018/19 Forecast</b>	<b>2019/20 limit</b>	<b>2020/21 limit</b>	<b>2021/22 limit</b>
Authorised limit – borrowing	1,249.400	1,452.949	1,756.751	2,000.306
Authorised limit – PFI and leases	0.600	0.400	0.200	0
Authorised limit – total external debt	1,250.00	1,453.349	1,756.951	2,000.306
Operational boundary – borrowing	1,199.400	1,352.949	1,656.751	1,900.306
Operational boundary – PFI and leases	0.600	0.400	0.200	0
Operational boundary – total external debt	1,200.00	1,353.349	1,656.951	1,900.306

- Further details on borrowing are contained in the treasury management strategy as annex 1 on this report.

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

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

- Further details on treasury investments are contained in the treasury management strategy as annex 1 to this report.

**Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance and staff, who must act in line with the treasury management strategy approved by Full Council.

**Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

<b>Refinancing rate risk indicator</b>	<b>Upper limit</b>	<b>Lower limit</b>
Under 12 months	100%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	60%	0%
10 years and within 40 years	60%	0%
Over 40 years	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

### **Investments for Service Purposes**

The Council can make investments to assist local public services, including making loans to and buying shares in local service providers, local small businesses to promote economic growth, the Council's subsidiaries that provide services. 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 break even after all costs.

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

- Further details on service investments are contained in the treasury management strategy in annex 1 2 to this report.

### **Commercial Activities**

With central government financial support to local public services declining, the Council decided to investigate various options to increase income and has subsequently made investments in line with the principles set out in the Council's Investment Strategy.

To this end on 20 November 2018 a Long Term Investment Strategy was taken to the Corporate Overview and Scrutiny Committee outlining the Council's approach to Service/Non-Treasury/Commercial Investments rather than the standard treasury investments. The report outlined the key principles involved, governance arrangements and the considerations required to ensure all investments are thoroughly scrutinised before completion.

## **Liabilities**

In addition to debt detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £178.5m at 31 March 2018). It has also set aside £6.7m to cover risks of business rates appeals and insurance claims.

**Governance:** Decisions on incurring new discretionary liabilities are taken by service managers in consultation with corporate finance and, where appropriate, the Director of Finance. The risk of liabilities crystallising and requiring payment is monitored by corporate finance.

## **Revenue Budget Implications**

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

*Table 9: Prudential Indicator: Proportion of net financing income to net revenue stream*

	<b>2018/19 forecast</b>	<b>2019/20 budget</b>	<b>2020/21 budget</b>	<b>2021/22 budget</b>
Financing costs (£m)	5,485.0	16,713.0	18,891.0	20,000.0
Proportion of net revenue stream	4.78%	14.99%	16.91%	17.54%

**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 into the future. The Director of Finance & IT is satisfied that the proposed capital programme is prudent, affordable and sustainable as set out annually in the s25 statement accompanying the setting of the annual budget.

## **Knowledge and Skills**

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Finance & IT is a qualified accountant with 32 years' experience. The Council pays for junior staff to study towards relevant professional qualifications including CIPFA, ACT (treasury), AAT & ACCA.

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. 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.