Appendix 1 - Thurrock Council

Capital Strategy Report 2020/21

Introduction

This capital strategy is a refreshed report for 2020/21, 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 £10,000 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 2020/21, the Council is planning capital expenditure of £341.471m as summarised below:

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

	2018/19 actual	**2019/20 forecast**	**2020/21 forecast**	**2021/22 forecast**	**2022/23 forecast**
General Fund services	44.643	171.592	63.723	61.180	98.998
Council housing (HRA)	21.303	30.219	27.748	29.717	19.155
Capital investments	401.176	54.170	250.000	250.000	250.000
TOTAL	**467.122**	**255.981**	**341.471**	**340.897**	**368.153**

The main General Fund capital projects include the widening of the A13, eastbound slip roads on the A13 at Lakeside, Purfleet redevelopment, refurbishment works at Thameside and Civic Offices and school expansions. The Council also plans to incur £250.0m 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 Directors' Board. This includes a final appraisal of all bids including final consideration of service priorities and financing costs. The final proposed capital programme 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

	2018/19 actual	2019/20 forecast	2020/21 forecast	2021/22 forecast	2022/23 forecast
External sources	30.557	82.234	22.174	18.891	46.750
Own resources	19.872	21.034	14.515	10.757	11.415
Debt	416.693	152.713	304.782	311.249	309.988
TOTAL	**467.122**	**255.981**	**341.471**	**340.897**	**368.153**

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

	2018/19 actual	2019/20 forecast	2020/21 forecast	2021/22 forecast	2022/23 forecast
Own resources	2.808	5.343	7.893	9.184	9.950

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 £294.713m during 2020/21. 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

	31.3.2019 actual	**31.3.2020 forecast**	**31.3.2021 forecast**	**31.3.2022 forecast**	**31.3.2023 forecast**
General Fund services	179.441	262.392	296.498	329.603	371.900
Council housing (HRA)	187.260	197.509	210.292	229.252	236.992
Capital investments	739.847	794.017	1,044.017	1,294.017	1,544.017
TOTAL CFR	**1,106.548**	**1,253.918**	**1,550.807**	**1,852.872**	**2,152.909**

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 2020/21.

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 £8m of capital receipts (total includes both GF and HRA receipts) in the coming financial year as follows:

Table 5: Capital receipts in £m

	2018/19 actual	**2019/20 forecast**	**2020/21 forecast**	**2021/22 forecast**	**2022/23 forecast**
Asset sales	12.038	2.000	8.000	8.000	8.000
Loans repaid	5.525	0.039	0.041	0.043	0.045
TOTAL	**17.563**	**2.039**	**8.041**	**80.43**	**8.045**

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 £1.327bn borrowing at an average interest rate of 2.45% and £238.2m treasury investments at an average rate of 3.01%.

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 1%) and long-term fixed rate loans where the future cost is known but higher, currently 2.5 to 3.1%).

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

	31.3.2020 forecast	**31.3.2021 forecast**	**31.3.2022 forecast**	**31.3.2023 forecast**
Debt (incl. PFI & leases)	1.327.000	1,550.808	1,852.872	2,152.909
Capital Financing Requirement	1,253.917	1,550.808	1,852.872	2,152.909

Statutory guidance is that debt should remain below the capital financing requirement over the medium to long term but can exceed this in the short term. As can be seen from table 6, the Council complies with this requirement.

Members should note that 82% of debt is short-term and issued to fund historic and current capital programmes and investments. In addition, the following context should be noted:

- Capital projects are funded through the annual Minimum Revenue Provision – ensuring there is sufficient funding to repay debts – this is currently budgeted at circa £8m per annum;

- With respect to investments (capital loans) funded from borrowing, the redemption of the investment will pay back what is borrowed (and earning the associated income on top);
- Consequently 82% of borrowing has a mechanism which repays that debt in full; and
- The remaining debt includes £191m long term debt relating to the HRA self-financing settlement, and long-term LOBO debt. The Council continues to hold the associated HRA property and considers wider options to reduce long term LOBO debt.

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

	2019/20 Forecast	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit – borrowing	1,452.949	1,683.963	1,936.565	2,196.509
Authorised limit – PFI and leases	0.400	0.200	0.000	0.000
Authorised limit – total external debt	1,453.349	1,684.163	1,936.565	2,196.509
Operational boundary – borrowing	1,352.949	1,583.963	1,836.565	2,096.509
Operational boundary – PFI and leases	0.400	0.200	0.000	0.000
Operational boundary – total external debt	1,353.349	1,584.163	1,836.565	2,096.509

Members should note that should the Council exceed the agreed limits during a specific financial year then the limits are required to be reset and approved by Members before the end of that financial year, usually at the meeting that sets limits for the following financial year.

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 Corporate Director of Finance, Property and Governance and their related staff, who must act in line with the treasury management strategy approved by Full Council and the Code..

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:

Refinancing rate risk indicator	Upper limit	Lower limit
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 Corporate Director of Finance, Governance and Property and should 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 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 25 October 2017 a Long Term Investment Strategy was approved by Council 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 £162.6m at 31 March 2019). It has also set aside £4.9m to cover risks of business rates appeals, insurance claims and other possible liabilities.

Governance: Decisions on incurring new discretional liabilities are taken by service managers in consultation with corporate finance and, where appropriate, the Corporate Director of Finance, Governance and Property. 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

	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Net Financing costs (£m)	(25,298)	(25,946)	(22,316)	(19,550)
Proportion of net revenue stream	-25.30%	-25.95%	-22.32%	-19.55%

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 Corporate Director of Finance, Governance and Property 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 Corporate Director of Finance, Governance and Property is a qualified accountant with 33 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.