Appendix E

Uttlesford District Council
Capital Strategy
2020/21

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Introduction

This capital strategy report gives 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.

Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

Capital Expenditure and Financing

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 £10,000 are not capitalised and are charged to revenue in year.

- For details of the Council's approach on capitalisation, see: Statement of Accounts 2018/19 Accounting Policies

In 2020/21, the Council is planning capital expenditure of £25m as summarised below:

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

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
General Fund services	2	7	5	1	1
Council housing (HRA)	8	9	11	6	6
Capital investments	3	4	9	23	10
TOTAL	**13**	**20**	**25**	**30**	**17**

The main General Fund capital projects include vehicles replacement programme, asset maintenance programme and ICT development. The Council also plans to incur £9m of capital expenditure in 2020/21 on phase 1 of investment 2.

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 and purchase of over 115 new homes over the forecast period.

Governance: Service managers bid annually in September to include projects in the Council's capital programme. Bids are collated by Financial Services who calculate the financing cost (which can be nil if the project is fully externally financed). Capital Officers appraise all bids based on a comparison of service priorities against financing costs and make recommendations to Corporate Management Team. The final capital programme is then presented to Cabinet and to Council in February each year.

- Full details of the Council's Capital Programme is set out in Appendix F

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 £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
External sources	2	1	0	1	0
Own resources	8	11	14	6	7
Debt	3	8	11	23	10
TOTAL	**13**	**20**	**25**	**30**	**17**

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), the full MRP statement is attached as Annex B1. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of debt finance in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Own resources	3	3	4	4	3

- The Council's full minimum revenue provision statement is attached as Annex E1

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 £6m during 2020/21. Based on the above figures for expenditure and financing, the Council's estimated CFR is set out in the following table:

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

	31/3/2019 actual	31/3/2020 forecast	31/3/2021 budget	31/3/2022 budget	31/3/2023 budget
General Fund services	7	10	9	9	8
Council housing (HRA)	85	83	81	79	77
Capital investments	50	54	63	85	94
TOTAL CFR	**142**	**147**	**153**	**173**	**179**

Asset disposals: When a capital asset is no longer considered necessary, 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 2022/23. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £4m of capital receipts in the coming financial year as follows:

Table 5: Capital receipts receivable in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Asset sales	2	2	2	2	2
Loans etc. repaid	2	2	2	2	2
TOTAL	**4**	**4**	**4**	**4**	**4**

Treasury Management

Treasury management is concerned with maintaining 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. 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. Cash balances being used can be repaid or financed through MRP this is referred to as internal borrowing, this is only applied to short-term assets or long-term assets over the short-term as set out in the Accounting Policy in statement of accounts. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

The Council currently has £96.4m long term borrowing and £11m of treasury investments at an average rate of 0.58%.

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

low cost 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 as shown below, compared with the capital financing requirement (see above).

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

	31/3/2019 actual	31/3/2020 forecast	31/3/2021 budget	31/3/2022 budget	31/3/2023 budget
Debt (incl. PFI & leases)	120	108	106	119	117
Capital Financing Requirement	142	147	153	173	179

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

Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This benchmark is currently £111m and is forecast to rise to £147m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31/3/2019 actual	31/3/2020 forecast	31/3/2021 budget	31/3/2022 budget	31/3/2023 budget
Outstanding borrowing	116	103	102	115	113
Liability benchmark	111	120	127	147	154

The table shows that the Council expects to remain borrowed under its liability benchmark. This is due to an approved decision to borrow additional sums for further investment in the Council's subsidiaries in the current year.

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 to act as a warning level should debt approach the limit.

Table 8: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit – borrowing	295	295	296	296
Authorised limit – PFI and leases	5	5	4	4
Authorised limit – total external debt	300	300	300	300
Operational boundary – borrowing	295	295	296	296
Operational boundary – PFI and leases	5	5	4	4
Operational boundary – total external debt	300	300	300	300

- Further details on borrowing are detailed in the Treasury Management Strategy (Appendix D)

Treasury 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, 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 (DMO), 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 borrowing are detailed in the Treasury Management Strategy (Appendix D).

Risk management: The effective management and control of risk are prime objectives of the Council's treasury management activities. The Treasury Management Strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance and Corporate Services and suitable trained members of the Finance Team, who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity are presented to Cabinet.

Investments for Service Purposes

The Council makes investments to assist local public services, including making loans to the Council's subsidiaries. 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.

The current investments for service purposes are valued at £52.6m giving the Council an annual net return of £1.6m in the financial year 2018/19.

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

Commercial Activities

With central government financial support for local public services declining, the Council invests in commercial property to support the services currently provided and lends to its subsidiary trading under the Aspire name for the same reason. The Council itself plans on making commercial investments totalling £32m over the 5 year strategy of which in year one the Council forecasts a return of approximately 6%.

With financial return to support the budget being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include tenants defaulting on their tenancy agreements resulting in income to be below the interest repayment. These risks are managed by developing a varied commercial property portfolio and regularly monitoring of forecasted income.

Governance: Decisions on commercial investments are set out in the Commercial Strategy (Appendix B), which is approved by Full Council in the Commercial Strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

Liabilities

In addition to debt of £52.6m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £30.8m).

Governance: Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Director of Finance and Corporate Services. The risk of liabilities crystallising and requiring payment is monitored by Financial Services and reported quarterly to Cabinet.

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 financing costs to net revenue stream

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Financing costs (£m)	6	6	7	7	7
Proportion of net revenue stream	23.32%	25.97%	25.54%	28.28%	29.20%

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 Director of Finance and Corporate Services is satisfied that the proposed capital programme is prudent, affordable and sustainable.

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 and Corporate Services is a qualified accountant. The Council pays for junior staff to study towards relevant professional qualifications including CIPFA, AAT and ILM.

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, other specialists will differ depending on the expertise 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.

Annex B1

Annual Minimum Revenue Provision Statement – 2020/21

Where the Authority 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 Authority to have regard to the Ministry of Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

The MHCLG Guidance requires the Authority to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following are options recommended in the Guidance and locally determined prudent methods of which the Council will apply to unsupported capital expenditure:

Capital Projects

Asset life method – For new unsupported capital expenditure for assets with short lives i.e. vehicles and IT MRP will be determined by the life of the asset and charged in equal instalments in line with depreciation.

Lease life method – For assets acquired using finance lease arrangements MRP will match the portion of annual lease payment used to write-down the lease liability

Housing Revenue Account – Self-financing payment
MRP in respect of the £88.407m payment made in 2012 to exit the Housing Revenue Account subsidy system will be determined as being equal to the principal amount repaid on the loans borrowed to finance that payment.

If an asset is classified as work in progress at the end of the financial year where MRP will be charged the first instalment will take place in year 1 after the asset is operational.

Investment Projects

Acquisition of investment property
For long-term projects where an investment property is acquired; MRP will be charged over a maximum of 50 years if the projected residual value is below the original expenditure and will be calculated on the balance spread over the remaining of the 50 years since acquisition. If the projected residual value is above the original expenditure then no MRP will be charged.

Loans to subsidiaries
For long-term capital loans to other bodies MRP will be charged based fair value of the investment by the subsidiary, for infrastructure investments MRP will be charged over a maximum of 50 years if the projected residual value is below the original expenditure. Where the residual value is projected to be below the expenditure value MRP will be calculated on the balance spread over the remaining of the 50 years since acquisition.
For long-term loans to other bodies where the loan supports expenditure on fixtures and fittings MRP will be charged in equal instalments over the life of the loan.

Minimum Revenue Provision 2020/21 financial year estimates

For 2020/21 the following table illustrates the Capital Financing Requirement (CFR) which underpins the Minimum Revenue Provisions.

	Estimated CFR 31/03/2020 £'000	Estimated CFR 31/03/2021 £'000	Estimated CFR 31/03/2022 £'000	Estimated MRP 2020/21 £'000
Capital Expenditure before 01/04/2008	0	0	0	0
Unsupported Capital Expenditure after 31/03/2008	64,136	68,437	89,691	1,070
Finance Leases and Private Finance Initiative	4,487	4,345	4,191	142
Total General Fund	**68,623**	**72,782**	**93,882**	**1,212**
Assets in the Housing Revenue Account	1,000	1,000	0	1,000
HRA Subsidy Reform Payment	84,622	80,834	78,834	2,000
Total Housing Revenue Account	**85,622**	**81,834**	**78,834**	**3,000**
Total	**154,245**	**154,616**	**172,716**	**4,212**

For the financial year 2020/21 the following investment schemes have been analysed for MRP requirements:

Aspire (CRP) Ltd loans for investment

Total years	50
	£
Investment total (including all fees)	47,473,000
Residual value	49,790,000
	(2,317,000)
MRP charged	0

Aspire (CRP) loans for fit-out

Total years	20
	£
Investment total (including all fees)	4,250,000
Residual value	0
	4,250,000
MRP charged	212,500

Investment 2

Total years	50
	£
Investment total (including all fees)	31,424,848
Residual value	32,500,000
	(1,075,152)
MRP charged	0