

Appendix E

# Uttlesford District Council Capital Strategy 2021/22



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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 Authority 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 Authority 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 Authority 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.

The Council's policy on capitalisation is detailed in the Accounting Policies of the 2019/20 Statement of Accounts.

In 2021/22, the Authority is planning capital expenditure of £134m, and the amounts are summarised below:

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

	<b>2019/20 actual</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>	<b>2022/23 forecast</b>	<b>2023/24 forecast</b>
General Fund services	4	13	2	1	1
Council housing (HRA)	9	7	6	6	6
Capital investments	3	120	126	14	0
<b>TOTAL</b>	<b>16</b>	<b>140</b>	<b>134</b>	<b>21</b>	<b>6</b>

The main General Fund capital projects include a vehicle replacement programme, asset maintenance programme and ICT development, the details of all capital schemes are detailed in the Capital Programme (Appendix F). The Council also plans to incur capital expenditure on investments, details of these can be found in the Commercial Strategy (Appendix B).

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 over 100 new homes over the forecast period.

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

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Authority'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*

	<b>2019/20 actual</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>	<b>2022/23 forecast</b>	<b>2023/24 forecast</b>
External sources	1	1	0	0	0
Capital resources	8	16	5	4	4
Revenue resources	2	2	3	2	
Debt	5	121	126	15	0
<b>TOTAL</b>	<b>16</b>	<b>140</b>	<b>134</b>	<b>21</b>	<b>6</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 minimum revenue provision (MRP). The Council's full minimum revenue provision statement is set out in Annex E1.

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*

	<b>2019/20 actual</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>	<b>2022/23 forecast</b>	<b>2023/24 forecast</b>
Internal resources	1	1	1	1	1
<b>TOTAL</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>

The Authority'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 £122m during 2021/22. Based on the above figures for expenditure and financing, the Authority's estimated CFR is as follows:

*Table 4: Prudential Indicator: Capital Financing Requirement in £ millions*

	<b>31/3/2020 actual</b>	<b>31/3/2021 forecast</b>	<b>31/3/2022 forecast</b>	<b>31/3/2023 forecast</b>	<b>31/3/2024 forecast</b>
General Fund services	10	11	11	11	10
Council housing (HRA)	83	81	79	77	74
Capital investments	53	172	296	310	310
<b>TOTAL CFR</b>	<b>146</b>	<b>264</b>	<b>386</b>	<b>397</b>	<b>393</b>

**Asset management:** To ensure that capital assets continue to be of long-term use, the Authority has an Asset Management Strategy in place.

**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 2022/23. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £2m of capital receipts in the coming financial year as follows:

*Table 5: Capital receipts receivable in £ millions*

	<b>2019/20 actual</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>	<b>2022/23 forecast</b>	<b>2023/24 forecast</b>
Asset sales	3	3	2	2	2
Loans etc. repaid	2	2	2	2	3
<b>TOTAL</b>	<b>5</b>	<b>5</b>	<b>4</b>	<b>4</b>	<b>5</b>

## **Treasury Management**

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Authority's spending needs, while managing the risks involved, as set out in the Treasury Management Strategy (Appendix C). 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 Authority 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. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

Due to decisions taken in the past, the Authority currently has £206m borrowing at an average interest rate of 2.19% and £12m treasury investments at an average rate of 0.54%.

**Borrowing strategy:** The Authority'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 Authority therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.10%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5 to 2.5%).

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

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

	<b>2019/20 actual</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>	<b>2022/23 forecast</b>	<b>2023/24 forecast</b>
Debt (incl. PFI & leases)	135	254	377	389	386
Capital Financing Requirement	146	264	386	397	393

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 Authority expects to comply with this in the medium term.

**Liability benchmark:** To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This benchmark is currently £116m and is forecast to rise to 357m over the next three years, details of the calculation for this can be found in table 2 of the Treasury Management Strategy (Appendix C).

*Table 7: Borrowing and the Liability Benchmark in £ millions*

	<b>2019/20 actual</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>	<b>2022/23 forecast</b>	<b>2023/24 forecast</b>
Outstanding borrowing	117	225	260	385	382
Liability benchmark	116	220	349	361	357

The table shows that the Authority expects to remain borrowed above its liability benchmark. This is because a deliberate decision has been made to borrow additional sums for further investments

**Affordable borrowing limit:** The Authority 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 8: Prudential Indicators: Authorised limit and operational boundary for external debt in £m*

	<b>2020/21 limit</b>	<b>2021/22 limit</b>	<b>2022/23 limit</b>	<b>2023/24 limit</b>
Authorised limit – borrowing	295	416	416	416
Authorised limit – PFI and leases	5	4	4	4
Authorised limit – total external debt	300	420	420	420
Operational boundary – borrowing	295	416	416	416
Operational boundary – PFI and leases	5	4	4	4
Operational boundary – total external debt	300	420	420	420

**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 Authority’s policy on treasury investments is to prioritise security and liquidity over yield, this 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 Authority may request its money back at short notice.

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

**Risk management:** The effective management and control of risk are prime objectives of the Authority’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 staff, who must act in line with the treasury management strategy approved by council. Quarterly reports on treasury management activity are presented to Cabinet.

## Commercial Activities and Service Investment

Government funding to Local Authorities (LA's) has been reduced significantly, and there is an increased requirement for LA's to generate additional income to underpin core service delivery. The Commercial Strategy (Appendix B) sets out the current and future plans for commercial investments, including making loans to the Council's subsidiaries. The Medium Term Financial Strategy (Appendix C) sets out the financial impacts of the funding reductions and the income generated from the investments.

The Council plans on making commercial investments totalling £310m (inclusive of professional fees) over the 5 year strategy of which in year one the council forecasts a return of approximately 5%.

The principal risk exposures include tenants defaulting on their tenancy agreements resulting in loss of income from specific investments. With cost of borrowing at all time lows, the risk that the loss of income will result in the Council being unable to meet its debt repayments is negligible.

The Council's 5 year Capital Programme (Appendix F) details all the capital schemes and projects related to normal service activity capital expenditure and includes all current commercial property investments.

**Governance:** Decisions on commercial investments are made by the Director of Finance and Corporate Services in line with the criteria and limits approved by Full Council in the Commercial Strategy. Where the commercial investment is by way of loan to a subsidiary, the decision is taken by the Chief Executive in consultation with the Assistant Director Resources, as the Director of Finance and Corporate Services is a member of the subsidiary board. Property and most other commercial investments are also capital expenditure and will therefore be approved as part of the capital programme.

Capital schemes and projects relating to normal service activities are submitted via a Capital Bid by the Service Manager and these are subject to the current budget approval process.

## Liabilities

In addition to debt of £310m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £31.9m).

**Governance:** Decisions on incurring new discretionary 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 10: Prudential Indicator: Proportion of financing costs to net revenue stream*

	<b>2019/20 actual</b>	<b>2020/21 forecast</b>	<b>2021/22 forecast</b>	<b>2022/23 forecast</b>	<b>2023/24 forecast</b>
Financing costs (£m)	6	7	8	12	12
Proportion of net revenue stream	21.21%	23.90%	26.44%	31.98%	31.64%

**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 does 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.