

## Bromsgrove Capital Strategy Report 2020/21

### 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, 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 assets. The Authority 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.

In 2020/21, the Authority is planning capital expenditure of £2.6m 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	2.6	4.9	2.6	1.4	1.7
Capital investments	0	3.3	2.0	11.3	2.0
<b>TOTAL</b>	2.6	8.2	4.6	12.7	3.7

The main General Fund capital projects include the fleet replacement programme which totals £3.3m over the life of the above budget period, £282k of wheelie bin purchases and £125k on a new digital service. The Authority also plans to incur £18.6m of capital expenditure on regenerative investments, which are detailed later in this report.

**Governance:** Service managers bid annually in November to include projects in the Authority's capital programme. Bids are collated by finance who calculate the financing cost (which can be nil if the project is fully externally financed). 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*

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
External sources	1.2	2.2	1.8	0.8	0
Own resources	0	1.4	0	3.3	0
Debt	1.4	4.6	2.8	8.6	3.7
<b>TOTAL</b>	<b>2.6</b>	<b>8.2</b>	<b>4.6</b>	<b>12.7</b>	<b>3.7</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) or by taking out new borrowing. 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	0.5	0.7	0.8	1.0	1.2

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 £2m during 2020/21. Based on the above figures for expenditure and financing, the Authority's estimated CFR is as follows:

*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	19.9	20.5	21.5	21.2	21.8
Capital investments	0	3.3	4.3	12.2	14.1
<b>TOTAL CFR</b>	<b>19.9</b>	<b>23.8</b>	<b>25.8</b>	<b>33.4</b>	<b>35.9</b>

**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 Authority 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.

### 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. 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 has an underlying need to borrow for capital purposes, which has in recent years been met through short dated borrowing. As of 15 January 2020 the authority had no borrowing and £5m treasury investments at an average rate of 0.59%.

**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 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%).

**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 assumes that cash and investment balances are kept to a minimum level of £0.2m at each year-end. This benchmark is currently £5.3m and is forecast to rise to £22.8m over the next three years.

*Table 5: Borrowing and the Liability Benchmark in £ millions*

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 forecast	31.3.2022 forecast	31.3.2023 forecast
Forecast external borrowing	13.5	16.3	18.3	29.6	31.6
Liability benchmark	5.3	9.0	11.4	19.6	22.8

The table shows that the Authority expects to remain borrowed above its liability benchmark. This is because cash outflows to date have been below the assumptions made when the loans were borrowed.

**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 6: Prudential Indicators: Authorised limit and operational boundary for external debt in £000*

	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit - borrowing	30,000	35,000	40,000	45,000
Authorised limit - PFI and leases	500	1,000	1,000	1,000
Authorised limit - total external debt	30,500	36,000	41,000	46,000
Operational boundary - borrowing	25,000	30,000	35,000	40,000
Operational boundary - PFI and leases	500	1,000	1,000	1,000
Operational boundary - total external debt	25,500	31,000	36,000	41,000

**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, 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, although no long term investing is planned at present. 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.

**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 Executive 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 council. The Audit Committee is responsible for scrutinising treasury management decisions.

### Investments for Service Purposes

The Authority may make investments to assist local public services, including potentially making loans to the Authority's subsidiaries that provide services. In light of the public service objective, the Authority is willing to take more risk than with treasury investments, however it still plans for such investments to at least break even after all costs.

**Governance:** Decisions on service investments are made by the relevant service manager in consultation with the Executive 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.

### Commercial Activities

With central government financial support for local public services declining, the Authority is planning to invest in commercial property to encourage economic growth as well as to make a financial return and may lend to a future subsidiary should one be set up for the same reasons. Total commercial investments are currently valued at £0m.

With financial return being a primary objective, the Authority accepts higher risk on commercial investment than with treasury investments. The principal risk exposures are potential falls in property values, vacancies reducing rental income etc. These risks are managed by having a risk register in place, regularly reviewing purchased assets and the market place and talking to tenants. In order that commercial investments remain proportionate to the size of the authority, these are subject to an overall maximum investment limit of £20m.

**Governance:** Decisions on commercial investments are made in line with the criteria and limits approved by council in the investment 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 £4.6m detailed above, the Authority is committed to making future payments to cover its pension fund deficit. It has also set aside £1.5m to cover risks of £1.3m of business rates appeals against rateable value, a £67k provision to cover the potential cost of a levy from the Municipal Mutual Insurance company due to previously incurred liabilities and £183k to cover the potential cost of employee benefits.

**Governance:** Decisions on incurring new discretionary liabilities are taken by service managers in consultation with the Executive Director of Finance. The risk of liabilities crystallising and requiring payment is monitored by finance and reported as required.

## 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 7: Prudential Indicator: Proportion of financing costs to net revenue stream*

	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Financing costs (£m)	949,000	1,197,000	1,537,000	1,743,000
Proportion of net revenue stream	7.5%	9.0%	12%	13.7%

**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 Executive Director of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable because of the current MTFP forecasts which show that the council is financially sustainable and taking it into account.

## Knowledge and Skills

The Authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Executive Director of Finance is a qualified accountant with more than 30 years' experience. The Authority pays for junior staff to study towards relevant professional qualifications including CIPFA and AAT.

Where Authority staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Authority currently employs Arlingclose Limited as treasury management advisers, Savills as property consultants and other as needed. This approach is more cost effective than employing such staff directly, and ensures that the Authority has access to knowledge and skills commensurate with its risk appetite.