CAPITAL INVESTMENT STRATEGY 2021/22

1 Statutory Requirements

1.1 The council is required by the Prudential Code to have an annual Capital Investment Strategy and prudential indicators and limits relating to capital expenditure, affordability, external debt and investments.

1.2 This strategy must be approved by full Council before the start of the financial year and be published on the council's website.

2 Objectives

2.1 The objectives of the Capital Investment Strategy for 2021/22 are to provide a high-level overview of how capital expenditure, income and financing along with how all types of investment contribute to the provision of public services and how the associated risks are managed and the implications for future financial stability.

3 Capital Expenditure Plans

3.1 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, loans and grants to other bodies enabling them to incur capital expenditure.

3.2 Total capital expenditure is one of the risk indicators required by the prudential code and the council's capital expenditure plans over the medium term (detailed in the Council Capital Programme and Strategy Update Report) are summarised in Table 1.

Table 1 – Capital Expenditure (Prudential Indicator)

	Estimate 2020/21 £M	Estimate 2021/22 £M	Estimate 2022/23 £M	Estimate 2023/24 £M	Estimate 2024/25 £M	Estimate Total £M
Service Based Capital Expenditure	11.83	16.82	8.56	5.08	5.24	47.53
Basing View Investment Property	14.65	0.45	0.00	0.00	0.00	15.10
Property Investment Strategy	8.90	0.00	0.00	0.00	0.00	8.90
Manydown Investment	1.57	14.31	1.47	0.37	0.39	18.11
Total Capital Expenditure	**36.95**	**31.58**	**10.03**	**5.45**	**5.63**	**89.64**

3.3 The main service based capital projects are home improvement financial assistance (disabled facilities grants) of £7.17M; Transformation Programme £5.53M; play area and open space enhancements of £4.97M; council owned asset management plan works of £4.79M; sport and recreation schemes £4.45M; the 5G Living Lab scheme £3.85M; replacement vehicles £2.29M; parking and access schemes £2.28M; replacement IT £2.19M and improvements to community facilities £1.99M.

3.4 The capital programme expenditure is monitored in the following ways:-

- Through monthly budget monitoring reports to budget managers and the Senior Leadership Team (SLT);
- Through the Capital Programme Board, which meets monthly;
- Through quarterly yearly reports to Cabinet and,
- Through annual reports to full Council.

3.5 To ensure that capital assets continue to be of long term use, the council has an Asset Management Plan and ongoing revenue and capital budgets for maintenance, major repairs and enhancements. The property maintenance and running costs in 2021/22 are estimated at £8.00M and are expected to be at similar levels in future years.

3.6 A key indicator of affordability for the council to consider in setting the capital programme is the impact on the council's overall resources.

3.7 The proposed capital programme is currently financed from revenue contributions, revenue and capital reserves, external contributions and short term internal borrowing with a small requirement for external borrowing.

4 Capital Expenditure Approval Process

4.1 The process for approving schemes for capital expenditure is set out in the Capital Programme Strategy which sets out how capital expenditure will help deliver the council's long term vision and council plan priorities and how capital resources are prioritised and funding decisions are made.

4.2 The Capital Programme Strategy also sets out the various funding streams for capital expenditure including capital receipts and contributions.

5 Capital Income

5.1 When assets are no longer needed, they may be sold so that the proceeds can be spent on new assets or to repay debt. These proceeds are known as capital receipts. Repayment of capital grants, loans and capital investments also generate capital receipts and the council also receives grants and contributions towards capital expenditure.

5.2 The council's estimated capital income over the medium term as shown in table 2.

Table 2 – Capital Income

	Estimate 2020/21 £M	Estimate 2021/22 £M	Estimate 2022/23 £M	Estimate 2023/24 £M	Estimate 2024/25 £M
Asset Sales	2.37	12.52	0.02	0.02	0.02
Loans Repaid	0.64	0.64	0.64	0.67	1.21
Total Capital Receipts	**3.01**	**13.16**	**0.66**	**0.69**	**1.23**
Capital Grants	1.56	1.33	1.33	1.33	1.33
Other Grants and Contributions	3.14	1.06	0.10	0.10	0.71
Developers Contributions	1.04	1.04	1.04	1.04	1.04
Total Grants and Contributions	**5.74**	**3.43**	**2.47**	**2.47**	**3.08**

5.3 The only significant planned asset sale relates to the sale of a site in Priestley Road and an anticipated receipt from the development partner for Manydown in respect of the acquisition of the land to support the project. Loans repaid relate mainly to service based loans for new waste vehicles and loans in respect of the Manydown development. Capital grants relate to Disabled Facilities Grants from the Government. Other Grants and Contributions relate mainly to funding from the Local Enterprise Partnership (LEP) in respect of Basing View regeneration and 5G Living Lab schemes.

5.4 Developers' contributions do not currently include any allowance for Community Infrastructure Levy (CIL). The council introduced the levy in July 2018 (estimated annual income over the next 10 years averaging £2.00M to £3.00M per year). However, no significant income has been received at this early stage, as the levy is only payable on commencement of development. As part of future budget strategy processes there will be an annual opportunity for the council to consider, consult and agree how CIL funding is allocated to meet priority community infrastructure needs resulting from development e.g. expanded or new facilities for sport, education, transport or community facilities. This could be to address infrastructure needs due to the impact of neighbouring new development or to provide additional strategic infrastructure.

6 Capital Financing

6.1 All capital expenditure must be financed, either from external sources (government grants and other contributions), the council's own resources (reserves and capital receipts) or debt (borrowing and leasing). The planned financing of the expenditure in Table 1 is shown in Table 3.

Table 3 – Capital Financing

	Estimate 2020/21 £M	Estimate 2021/22 £M	Estimate 2022/23 £M	Estimate 2023/24 £M	Estimate 2024/25 £M	Estimate Total £M
External Sources						
Grants & Contributions	6.04	6.27	3.99	2.08	2.16	20.54
Own Resources						
Capital Receipts	16.82	17.36	3.64	2.72	3.41	43.95
Revenue Contributions	2.99	7.95	2.40	0.65	0.06	14.05
Use of Reserves						
Debt (CFR)						
Internal Borrowing	8.90	0.00	0.00	0.00	0.00	8.90
External Borrowing	2.20	0.00	0.00	0.00	0.00	2.20
Total Capital Expenditure	**36.95**	**31.58**	**10.03**	**5.45**	**5.63**	**89.64**

6.2 Debt is only a temporary source of finance, since borrowing 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). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance.

6.3 The council's cumulative outstanding amount of debt finance is referred to as the Capital Financing Requirement (CFR) and is another prudential indicator. The CFR increases with capital expenditure and reduces when capital receipts and contributions are used to replace debt. In previous years, the council has had a CFR of £NIL and has historically not had any external debt. In 2020/21, however, the council will utilise a loan from the M3 LEP (Local Enterprise Partnership) to fund part of the works at Basing View. The council's CFR is therefore expected to be £2.20M by the end of 2020/21 and is expected to remain unchanged to the end of the medium-term financial forecast period (i.e. 2024/25).

6.4 The capital financing requirement prudential indicator is a measure of the council's underlying need to borrow for a capital purpose taken from the balance sheet. This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits. The council is virtually debt free and the prudential indicator in respect of gross debt for 2020/21 is £2.20M and is expected to remain unchanged to the end of the medium-term financial forecast period (i.e. 2024/25).

6.5 The proposed future capital programme will be financed largely from existing resources. Any unfinanced capital expenditure is deemed to be "borrowing" even if the council does not need to physically borrow.

7 Overall Resources

7.1 The council's capital expenditure, capital income and financing plans will significantly reduce the council's overall resources available to fund future capital schemes. The estimated resources over the medium term can be seen in Table 4.

Table 4 – Overall Resources

	Estimate 31/3/21 £M	Estimate 31/3/22 £M	Estimate 31/3/23 £M	Estimate 31/3/24 £M	Estimate 31/3/25 £M
Supporting Capital Programme	45.97	38.49	38.37	40.15	42.42
Supporting Infrastructure	15.13	11.11	9.18	9.65	10.50
Housing and Homelessness	2.82	2.87	2.79	2.60	2.53
Supporting Investment Strategies	3.46	3.00	1.42	1.05	0.66
Supporting Revenue Plans	4.34	2.72	2.60	2.24	2.19
Available Resources	**71.72**	**58.19**	**54.36**	**55.69**	**58.30**
Invested Capital Resources	23.09	22.81	22.54	22.26	21.98
Risk Reserves	14.00	17.31	20.04	23.32	23.34
Unavailable Resources	**37.09**	**40.12**	**42.58**	**45.58**	**45.32**
	108.81	**98.31**	**96.94**	**101.27**	**103.62**

7.2 The council's overall available resources are forecast to reduce from £108.81M to £103.62M by March 2025 of which £58.30M will be available to support future capital programmes. This assumes that all capital spending plans are met.

7.3 The figures in Table 4 include the impact of including an annual revenue contribution to capital (via contributions to revenue reserves) over the medium term as part of the revenue budget strategy in order to generate capital resources to help fund future programmes.

7.4 The council has reviewed all of its existing capital programme commitments to ensure that they still align with the Council Plan priorities.

All future additions to the capital programme will need to have a robust business case that identifies how the scheme can be financed and how the borrowing costs and Minimum Revenue Provision are affordable and can be met from revenue budgets.

8 Annual Minimum Revenue Provision Statement for 2021/22

8.1 Councils with borrowing requirements, as measured by the Capital Financing Requirement, are required to make provision within their revenue budgets for the redemption of their debts. This provision is called the Minimum Revenue Provision (MRP).

8.2 The council expects that its Capital Financing Requirement will be £2.20M at 31 March 2021. The loan received by the council from the M3 LEP will be repaid from an anticipated growth in business rates in the enterprise zone and will not be repaid in any event until such business rates are received. As a result of this arrangement to hypothecate additional business rates receipts for the repayment of the loan the council has determined that no MRP is required during 2020/21, in accordance with CIPFA’s Prudential Code.

8.3 For any additional Capital Financing Requirement, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

9 Borrowing Requirement and Strategy for 2021/22

9.1 The council’s cash resources are forecast to fall from £121.00M to £114.00M by 2024/25 as capital receipts, contributions and reserves are used to finance the capital programme and revenue reserves are used to support the revenue budget.

9.2 Whilst as part of the Capital Programme update for the period to 2024/25 there is currently no identified needed to fund capital spend through borrowing, because it has sufficient cash resources and can effectively “internally borrow” in the short term if required, if a need to borrow arises the council has taken steps to secure preferential borrowing rates (called the Certainty Rate) from the Public Works Loan Board (PWLB – N.B. Technically HM Treasury) in case the borrowing position changes.

9.3 Were the council to consider borrowing to finance investment in the future it is important to note that HM Treasury (HMT) conducted a consultation on the future lending terms of the PWLB loans in 2020, which has led to a revision of these terms; this revision has an important impact on any plans to borrow to invest solely for the purposes of yield.

9.4 This consultation was carried out by HMT to determine how it could continue to support local authorities to invest in supporting local communities in a landscape where “in recent years a minority of local authorities have borrowed substantial sums from the PWLB to buy investment property with the primary aim of generating yield”. The Government’s desire was to put an end to this practice.

9.5 The aim of the consultation was to “to develop a proportionate and equitable way to prevent local authorities from using PWLB loans to buy commercial assets primarily for yield, without impeding their ability to pursue service delivery, housing, and regeneration under the prudential regime as they do now.”

9.6 The outcome of this consultation exercise was reported in November 2020 and HMT issued a new circular (no.162) to outline the new terms for lending to local authorities. The main features of the new lending terms are:

a) Local authorities will be asked to submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB. This process will be closely modelled on the existing Certainty Rate application;

b) As part of this, the PWLB will ask the Chief Financial Officer to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years;

c) Recognising that it isn’t possible to reliably link particular loans to specific spending, this restriction applies on a ‘whole plan’ basis – meaning that the PWLB will not lend to an LA that plans to buy investment assets primarily for yield anywhere in their capital plans, regardless of whether the transaction would notionally be financed from a source other than the PWLB;

d) When applying for a new loan, the local authority will be required to confirm that the plans they have submitted remain current and that the assurance that they do not intend to buy investment assets primarily for yield remains valid.

9.7 What this means in practice, therefore, is that any plan to buy investment assets for yield (and to buy can be defined to mean construct assets), regardless of whether or not there are plans to borrow from the PWLB for that specific investment, would mean that PWLB funds could not be accessed. The impact of that this that funds would have to be sought from elsewhere, most likely at less preferential rates and/or a higher risk, or other sources of funds, such as capital receipts and revenue financing would be required to finance capital expenditure. It also means that the expected rate of return on any investment would need to be greater to compensate for any additional costs, including initial costs such as arrangement fees, but, principally, additional borrowing costs.

10 Authorised Borrowing Limit

10.1 The Prudential Code requires the council to set external debt indicators which relate to the amount that the council can prudently borrow. These are shown in Table 5.

Table 5 – Prudential Indicator - External Debt

	2020/21	2021/22 to 2024/25
Authorised Limit for External Debt	£50.00M	£50.00M
Operational Boundary for External Debt	£25.00M	£25.00M

10.2 Under Section 3(1) of the Local Government Act 2003 the council is required to set an authorised limit for external debt. This limit is a statutory limit and is gross of investments. It represents the maximum limit for external borrowing both in the long term and for cash flow and treasury management purposes. The limit is based on a prudent but not worse case estimate with sufficient headroom to allow for operational management.

10.3 To support day to day treasury management activity it is recommended that Council approve an authorised borrowing limit of £50.00M for 2021/22. At the current time this is required to enable short term cash flow management. If funding for capital expenditure is required, this limit may need to be reviewed accordingly.

10.4 The operational boundary for external debt is based on the same estimates as the authorised limit for external debt but represents the estimate of normal activity without the additional headroom included in the authorised limit.

10.5 The code of practice specifies that over the medium term net borrowing will only be for a capital purpose. This is demonstrated by ensuring that, except in the short term, net external borrowing should not exceed the total Capital Financing Requirement in the previous year plus the estimates of any additional Capital Financing Requirements for the current and the next two financial years.

11 Investments

11.1 The council has a significant amount of investments and for the purposes of this report investment means all financial instruments and assets that are used primarily to make a return. This means it includes all of the council's investment property portfolio.

11.2 The council invests for three broad purposes:

i) Because it has surplus cash as a result of its day to day activities or cash that it holds pending the council's spending plans (known as Treasury Management investments).

ii) To support local public services by lending to other organisations (known as service based investments).

iii) To earn investment income from rents or interest (known as commercial investments where this is the main purpose).

11.3 The council's total investments, estimated at over £400M, are shown in Table 6.

<u>Table 6 – Total Investments</u>

Estimate 31/3/21		**Estimate 31/3/22**	**Estimate 31/3/23**	**Estimate 31/3/24**	**Estimate 31/3/25**
£M		**£M**	**£M**	**£M**	**£M**
121.00	Treasury Management	110.00	107.00	116.00	114.00
272.90	Existing Investment Property	272.90	272.90	272.90	272.90
32.49	Property Investment Strategy	32.49	32.49	32.49	32.49
1.92	Manydown Investments	16.05	1752	17.89	18.29
5.85	Service Based Investments	5.23	4.59	3.95	2.32
434.16		**436.67**	**434.50**	**443.23**	**440.00**

11.4 The council approved a transfer of funds from Treasury Management funds to create a Property Investment Strategy, Invest to Grow Strategy and to allow further investments in the Manydown project. The Invest to Grow Strategy was later removed.

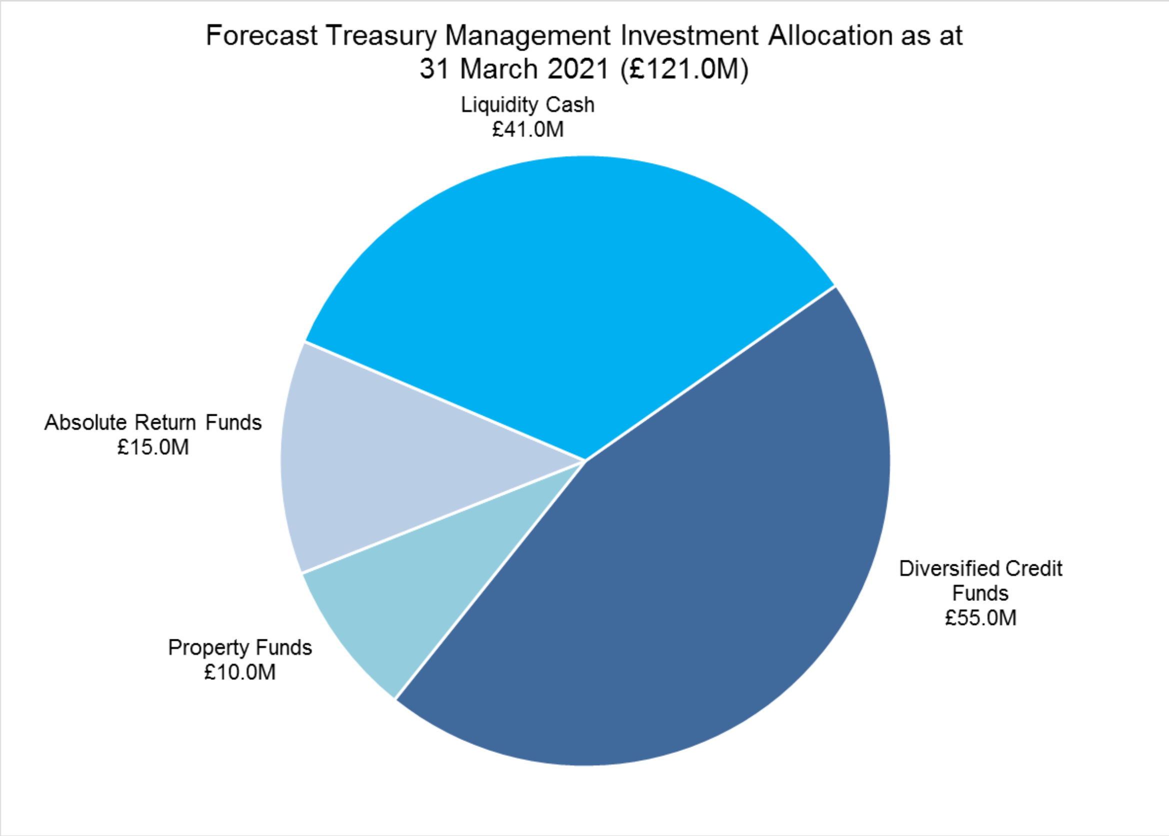
11.5 To date £23.59M has been invested in the long term via the Property Investment Strategy and a further £8.90M is expected to have been spent by the end of March 2021; after this time this element of the Capital Investment Strategy will then be fully invested.

11.6 As previously reported, the full planned £35.00M investment in the Manydown scheme is no longer required and now only includes provision for loans totalling £18.29M

12 <u>Treasury Management Investments</u>

12.1 The council is expected to have £121.00M of Treasury Investments as at 31 March 2021. A breakdown of the Treasury Investment Portfolio can be seen in Chart 1.

Chart 1 – Estimated Treasury Investment Portfolio 31 March 2021



12.2 Treasury Management investments are budgeted to contribute income of £2.17M to the revenue budget and also ensure that cash is readily available to fund the council's revenue and capital spending plans.

12.3 There are a number of risks associated with treasury management. The main risks are as follows:

i) **Credit and counterparty risk** (risk to capital) – the risk that a third party will fail to meet its contractual investment obligation resulting in a loss of the council's capital investment or the risk that there will be a permanent reduction in the capital value of the investment.

ii) **Liquidity risk** – the risk that the council will commit too much of its investments in fixed term investments and might have to recall investments prematurely resulting in possible additional costs or losses upon disposal of tradable securities.

iii) **Market or interest rate risk** – the risk that fluctuating interest rates will have an adverse impact on the council's investment income or the value of its investments.

iv) **Other risks** – this includes risks associated with cash management, legal requirements and fraud.

12.4 The council's risk appetite with regards to Treasury Management Investments is relatively low because the council follows the Government's investment guidance which states that the risks should be measured in terms of Security, Liquidity and Yield (returns) in that order. The council's Treasury Management Policy Statement states that the primary objective is to invest prudently having regard to security and the secondary objectives are liquidity and obtaining optimum returns.

12.5 Details on how these risks are managed and mitigated along with the governance arrangements for treasury management investments are contained within the council's annual Treasury Management Strategy.

13 Non-Treasury Investments

13.1 Non-treasury investments currently consist of service based investments and investment property.

13.2 Details of how these investments are managed, what contribution they make to the provision of public services and how the associated risks are assessed and managed are set out in the Investment Strategy (Non-Treasury) for 2021/22 in Appendix 2.

14 Revenue Budget Implications

14.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and any MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to net revenue.

Table 7 – Prudential Indicator - Proportion of Financing Costs to Net Revenue Stream

	Estimate 2020/21	Estimate 2021/22	Estimate 2022/23	Estimate 2023/24	Estimate 2024/25
Net Financing Costs/(Income) (£M)	(2.95)	(2.58)	(3.00)	(2.87)	(2.81)
Proportion of Financing Costs/(Income) to Net Revenue Stream (%)	(19%)	(17%)	(20%)	(20%)	(19%)

14.2 The proportion of financing costs to net revenue stream indicator is used to show the change over time in the level of debt financing costs (net of investment income) compared to the council's net income from council tax payers and government grant. For this council the ratio is negative as treasury management investment income significantly exceeds the financing costs associated with borrowing. It does however indicate the level of the contribution that interest and investment income makes to the comprehensive income and expenditure statement.

15 Knowledge and Skills

15.1 The council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions.

15.2 Use is made of external advisers and consultants that are specialists in their field. The council currently contracts Arlingclose Limited as treasury advisors and Jones Lang LaSalle (JLL) as property consultants.

15.3 This approach ensures that the council has access to knowledge and skill commensurate with its risk appetite.