WIRRAL

 CLLR JANETTE WILLIAMSON	**CABINET** **18 FEBRUARY 2019** **CAPITAL FINANCING STRATEGY 2019/20**

Councillor Janette Williamson (Cabinet Member for Finance and Income Generation) said:

"Our capital programme over the medium to long term provides for an ambitious outlook for the borough. Investment and growth feature heavily and are key drivers to improving the economic outlook and generating income to replace the grant funding we have lost and will continue to lose to 2020 as a result of government cuts.

The capital financing strategy sets out our intention for borrowing and our capital financing requirement to enable us to manage and monitor a robust capital programme to 2022/23.

The flexible use of capital receipts is a key enabler in supporting us to significantly transform and improve our services for the better over the long term as this will provide vital one off investment to completely reshape the way we provide services to avoid increasing reactive costs in the future."

REPORT SUMMARY

The Authority's treasury management activity is underpinned by CIPFA's 2017 Code of Practice on Treasury Management ("the Code"), in which there is a new requirement for Council to approve an annual Capital Strategy. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

This matter is a key decision which affects all Wards within the Borough.

RECOMMENDATIONS

1. That Members approve the Capital Strategy for 2019/20.

2. That the associated Prudential Indicators be adopted.

3 That Members note the Council's Minimum Revenue Provision policy.

4 That Members note the flexible capital receipts policy.

SUPPORTING INFORMATION

1.0 REASONS FOR RECOMMENDATIONS

1.1 In order to demonstrate that the Council takes capital expenditure and investment decisions in line with service objectives and properly takes account of value for money, prudence, sustainability and affordability the Council should have in place a capital strategy that sets out the longer term context in which capital expenditure and investment decisions are made. It should give due consideration to both risk and reward and the impact on the achievement of priority outcomes.

2.0 OTHER OPTIONS CONSIDERED

2.1 No other options have been considered.

3.0 BACKGROUND INFORMATION

THE 2017 PRUDENTIAL CODE OF PRACTICE

3.1 The Code has introduced the requirement for a new report, the Capital Strategy 2019/20, to be approved by Council. The intention is to give 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.

CAPITAL EXPENDITURE AND FINANCING

3.2 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 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.

Comparative expenditure figures are shown below and as can be seen in 2019/20, the Council is planning capital expenditure of £84.7 million.

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£000	**£000**	**£000**	**£000**	**£000**
General Schemes	37,865	43,797	72,371	27,317	6,720
Capital Investments	8,991	9,780	12,712	-	-
Total	**46,856**	**53,577**	**84,738**	**27,317**	**6,720**

Table 2: Significant Schemes included in the 2019/20 Capital Programme

Scheme	£000
Street lighting column upgrade/replacement and LED replacement	7,102
Extra Care Housing	2,590
Enterprise Resource Planning System	4,340
Schools Condition/Modernisation Schemes	3,443
Highway Maintenance (including unclassified roads)	5,165
West Kirby Flood Alleviation	2,854
Aids, adaptations and Disabled Facility Grants	5,834
Housing Infrastructure Marginal Viability Fund	3,000

3.3 The Council also plans to incur £12.7 million of capital expenditure on investments. Of this £11.4 million is to support the Strategic Acquisition Programme (SAP). This aids the key economic goals and aspirations set out in the Wirral Growth Plan and Strategic Regeneration Framework (SRF). The balance of £1.3 million is for Business Investment Grants in support of inward investment and indigenous investment capital projects.

3.4 As part of the overall budget process departments are given the opportunity to put forward new schemes that will be considered for inclusion in the capital programme. A business case submission form has been devised and refined annually by the Assets and Capital Group (ACG).

3.5 This should be used for schemes relating to the following:

- Essential Health and Safety/DDA schemes;
- Invest to save schemes, including those developed with the intention of avoiding future cost pressures;
- Those considered to be of a strategic nature, as agreed with the Investment and Change Board;
- Schemes that reflect Council priorities that could have wider economic benefits, benefits for the community or wider benefits that link in with the Wirral Plan.
- For the purpose of completeness grant funded schemes.

3.6 The following will process will then apply:

- An initial review by a sub group of the Assets and Capital Group (ACG) followed by a more formal review by the ACG;
- Any schemes with I.T. implications will be referred to the Technical Design Authority (TDA) for its recommendation;
- Schemes of a strategic nature will be referred to the Investment and Change Board (ICB) for its recommendation.

An overall summary of the various recommendations is then produced for consideration by the Strategic Leadership Team (SLT). This provides the opportunity for any comment/amendment and strategic input prior to a final report being prepared for Members consideration at Budget Cabinet for eventual consideration by Council.

3.7 Full details of the Council's capital programme are presented in a separate report to this Committee.

3.8 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves, capital receipts and business rates growth generated within the Enterprise Zone) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 3: Capital Financing

	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£000	**£000**	**£000**	**£000**	**£000**
External Sources	17,763	14,035	30,640	7,948	2,500
Own Resources	10,608	14,076	6,000	9,655	-
Debt	18,485	25,466	48,443	9,714	4,220
Total	**46,856**	**53,577**	**85,083**	**27,317**	**6,720**

3.9 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) repayments]. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. The use of capital receipts has yet to be determined for 2019/20 onward. Notwithstanding this the latest planned MRP repayments and use of capital receipts are as follows:

Table 4**: Replacement of Debt Financing**

	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£000	**£000**	**£000**	**£000**	**£000**
MRP	11,776	12,354	13,103	15,128	15,983
Capital Receipts	10,419	14,076	-	-	-
Total	**22,195**	**26,430**	**13,103**	**15,128**	**15,983**

The Council's full Minimum Revenue Provision Statement is included at Appendix 1.

3.10 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 repayments and capital receipts used to replace debt. The CFR is expected to increase by £36.6 million during 2019/20. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 5: Prudential Indicator: Estimates of Capital Financing Requirement

	31/3/2018 actual	31/3/2019 forecast	31/3/2020 Estimate	31/3/2021 Estimate	31/3/2022 Estimate
	£000	**£000**	**£000**	**£000**	**£000**
General Fund	330,389	332,824	359,486	355,671	350,182
Capital investments	8,697	18,332	28,250	27,983	27,709
TOTAL CFR	**339,086**	**351,156**	**387,736**	**383,654**	**377,891**

3.11 **Asset Management**
To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place. The strategy sets the high level framework for managing Wirral's Public Sector land and property for the next 5 years. It has been developed to guide the collective strategic asset decisions of all partners and seeks to maximise efficiencies through a collaborative approach to the use and management of the whole asset portfolio. The Strategic Asset management Plan can be read here.
https://www.wirral.gov.uk/sites/default/files/all/About%20the%20council/Wirral%20Plan/Asset%20Strategy.pdf

3.12 **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 £5.17 million of capital receipts in the coming financial year as follows:

Table 6: Capital Receipts

	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£000	**£000**	**£000**	**£000**	**£000**
Asset Sales	6,331	13,439	5,127	TBC	TBC
Loans Repaid	204	166	50	TBC	TBC
Total	**6,535**	**13,605**	**5,177**	**-**	**-**

TBC - To be confirmed

3.13 The Council's Flexible Use of Capital Receipts Policy was approved by Budget Cabinet on 20th February 2017, as part of the Medium Term Financial Strategy 2017/21. An extract is attached at Appendix 2.

3.14 **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. 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. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

3.15 Due to decisions taken in the past, the Council currently has £248 million borrowing at an average interest rate of 4% and £30 million treasury investments at an average rate of 1.0%.

3.16 **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 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0% to 3.0%).

3.17 Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities, leases [and transfers from local government reorganisation] are shown below, compared with the capital financing requirement (see above).

Table 7: Prudential Indicator: Gross Debt and the Capital Financing Requirement

	31/3/2018 actual	**31/3/2019 forecast**	**31/3/2020 Estimate**	**31/3/2021 Estimate**	**31/3/2022 Estimate**
	£000	**£000**	**£000**	**£000**	**£000**
Debt	309,218	296,780	321,449	325,331	314,440
Capital Financing Requirement	339,086	351,156	387,736	383,654	377,891

3.18 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 7, the Council expects to comply with this in the medium term.

3.19 **Affordable Borrowing Limit**
The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. 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

	2018/19 limit £m	2019/20 limit £m	2020/21 limit £m	2021/22 limit £m
Authorised limit – borrowing	434	416	404	395
Authorised limit – PFI and leases	65	63	61	59
Authorised limit – total external debt	**499**	**479**	**465**	**454**
Operational boundary – borrowing	424	406	394	385
Operational boundary – PFI and leases	60	58	56	54
Operational boundary – total external debt	**484**	**464**	**450**	**439**

3.20 Further details on borrowing can be found in the treasury management strategy statement.

3.21 **Investment Strategy**
The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

3.22 Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for funds that are available for longer-term investment. The majority of the Authority's surplus cash is currently invested in short-term unsecured bank deposits and money market funds.

3.23 Further details on treasury investments can be found in the treasury management strategy statement.

3.24 **Governance**
The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance & Investment who will act in accordance with the Council's Strategy Statement, Treasury Management Practices (TMPs) and CIPFA's Standard of Professional Practice on Treasury Management.

3.25 Further details on the "Policy of Delegation" can be found in the treasury management strategy statement.

3.26 The Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close in the form prescribed in its TMPs.

3.27 **Investments for Services Purposes**

The Council lends money to its subsidiaries e.g. Edsential Community Interest Co. (by way of a credit facility) and local businesses to support local public services and stimulate local economic growth. An example is the loan of £350,000 to a local business to encourage inward investment and job creation. Loans should be self-financing with returns covering financing and administrative costs plus any return.

3.28 **Governance**

The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. Appropriate due diligence is undertaken on loan applications and collateral sought to offset risk. In order to further limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the organisation, upper limits on the outstanding loans to each category of borrower have been set. Any such investment 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.

3.29 Further details about these types of investments can be found in the Investment Strategy Statement.

3.30 **Commercial Activities**

The Council invests in local commercial and residential property with the intention of making a profit that will be spent on local public services. Although there is increased national focus on property, councils have a long history of owning investment properties. Wirral's portfolio include industrial estates, commercial and leisure properties. Total commercial investments are currently valued at £30.8 million. The largest being Europa Boulevard providing a net return after all costs of £0.3 million (3.4% based on the asset value).

3.31 **Governance**

The Strategic Asset Management Plan sets out how the Council will make the best use of its buildings and land in the future. This will be linked to future property purchase for consideration.

3.32 In accordance with government guidance, the Authority considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

3.33 The Authority assesses the risk of loss before entering into and whilst holding property investments and has appropriate credit control arrangements in place to recover overdue repayments.

3.34 Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

3.35 Further details about commercial activities can be found in the Investment Strategy Statement.

3.36 **Liabilities**

In addition to the forecast debt of £296 million detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £457.3 million at 31 March 2018). Actuarial valuations are carried out every three years. Contributions are set with a view to targeting the Fund's solvency. The most recent valuation was carried out as at 31 March 2016, which showed a shortfall of assets against liabilities of £1.231 billion as at that date, equivalent to a funding level of 85%. The fund's employers are paying additional contributions over a period of up to 22 years in order to meet the shortfall.

3.37 **Revenue Budget Implications**

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP repayments 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

	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Financing costs (£m)	17.4	18.8	19.8	21.8	22.1
Proportion of net revenue stream	7.0%	6.9%	7.2%	8.0%	8.0%

3.38 **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.

3.39 The agreed Capital Programme includes projects costed at current year prices with many subject to a subsequent tender process which lead to variance in the final cost. In some areas, the design brief may not yet be finalised, again giving rise to potential price variance. This is a known risk and can be managed through phasing or reduction in specification.

3.40 In assessing the robustness of the Capital Programme the risk of being unable to fund variations outside of the Programme is minimal mainly due to the phasing of projects. If necessary, the Council can choose to freeze parts of the Programme throughout the year to ensure spend is kept within the agreed budget.

3.41 The ability to deliver the Programme within the agreed timescales. The re-profiling and slippage from previous years is fully funded but increases the pressure to deliver the anticipated 2019/20 Programme.

3.42 **Knowledge and Skills**
The structure of the Council ensures that professionally qualified and experienced staff are in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Corporate Director for Business Management, the Corporate Director for Delivery Services and the Director of Finance and Investments. The Council pays for junior staff to study towards relevant professional qualifications including CIPFA, RICS.

3.43 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, GVA as property investment and finance consultants, Lambert Smith Hampton for property valuations/appraisals/disposals and Bevan Brittan as legal consultants. 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.

4.0 FINANCIAL IMPLICATIONS

4.1 There are none arising directly from this report.

5.0 LEGAL IMPLICATIONS

5.1 There are none arising directly from this report.

6.0 RESOURCE IMPLICATIONS: ICT, STAFFING AND ASSETS

6.1 There are none arising directly from this report.

7.0 RELEVANT RISKS

7.1 The Council is responsible for treasury, investment and expenditure decisions and activity and none of these are without risk. The successful identification, monitoring and control of risk are important and the main risks are:

- Loss of expertise from the Council’s in house resource;
- The fair value of the Authority’s investment property portfolio is no longer sufficient to provide security against loss;
- The cost of borrowing increases at a rate higher than estimated leads to increased revenue pressure and/or curtailment of the capital programme;
- The programme does not deliver the outcomes as intended.

8.0 ENGAGEMENT/CONSULTATION

8.1 There has been no specific consultation with regards to this report.

9.0 EQUALITY IMPLICATIONS

9.1 There are none arising directly from this report

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APPENDICES

Appendix 1 – The Minimum Revenue Provision (MRP) Statement
Appendix 2 – Flexible Use of Capital Receipts Strategy 2017/18

SUBJECT HISTORY

Council Meeting	Date
Capital monitoring reports presented to Cabinet Capital Programme – Council Capital Programme – Council	Various 6 March 2017 5 March 2018

APPENDIX 1

2019/20 MINIMUM REVENUE PROVISION (MRP) STATEMENT

1.1 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 for Housing, Communities and Local Government's (MHCLG) Guidance on Minimum Revenue Provision most recently issued in 2018.

1.2 The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

1.3 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 statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

1.4 For capital expenditure incurred before 1st April 2008, and for supported capital expenditure incurred on or after that date, MRP will be determined by charging the expenditure based on the expected useful life of the relevant assets using an annuity method, (Option 3 in England and Wales).

1.5 For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset or as the principal repayment on an annuity with an annual interest rate equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the expenditure has been incurred.

1.6 For assets acquired by finance leases or the Private Finance Initiative and for the transferred debt from Merseyside County Council, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

1.7 The Council, if it considers it prudent for a particular financial year, will set aside capital receipts to be offset by the matching MRP liability amount.

1.8 With regards to loans granted by the Council no MRP will be charged on them. The MRP will be equated to the principal repayment of the individual loans.

1.9 Capital expenditure incurred during 2019/20 will not be subject to a MRP charge until 2020/21.

2.0 The MRP Statement will be submitted to Council before the start of the 2019/20 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Council at that time.

Based on the Authority's estimate of its Capital Financing Requirement on 31st March 2019, the budget for MRP has been set as follows:

	31.03.2019 Estimated CFR £m	**2019/20 Estimated MRP £m**
Supported Capital Expenditure	170.1	2.5
Unsupported Capital Expenditure	104.7	3.0
Finance leases and Private Finance Initiative	42.7	2.6
Transferred debt	34.7	4.9
Total General Fund	**352.2**	**13.1**

APPENDIX 2

Flexible Use of Capital Receipts Strategy 2019/20

Background

1. The Government believes that it is important that individual authorities demonstrate the highest standards of accountability and transparency. The guidance on the flexible use of capital receipts recommends that each authority should prepare a strategy that includes separate disclosure of the individual projects that will be funded or part funded through capital receipts flexibility and that the strategy is approved by full Council or the equivalent. The latest guidance by the Secretary of State directs that:

2. Authorities may treat expenditure which is incurred in the design of projects that will generate on-going revenue savings in public services or that will transform service delivery to reduce costs or manage demand in future years for public service partners as capital expenditure. Such expenditure must be incurred between 1 April 2016 and 31 March 2022.

3. The Council has reviewed the Flexible Use of Capital Receipts guidance and identified the following schemes as meeting the eligibility criteria laid out in the guidance document, in that they are forecast to generate on-going revenue savings through reducing costs of service delivery. These schemes are encapsulated within Council's ambitious programme of digitalisation, regeneration and improvement. The Council's has utilised the funding since intends to use the following use of capital receipts to fund the following:

Transformation Programme 2016 – 2022	**£000**
Transformation Programme – Assets and Customers	5,740
Children's' Services Improvement Programme	11,100
EVR Scheme for whole scale efficiency restructuring	2,500
Digitalisation transformation programme	1,500
Total Programme (funded from capital receipts)	**20,800**