MEETING:	**AUDIT AND GOVERNANCE COMMITTEE**
DATE:	**14 FEBRUARY 2019**
TITLE:	**CAPITAL STRATEGY REPORT 2019/20**
PURPOSE:	**TO EXPLAIN AND SCRUTINISE THE PROPOSED STRATEGY FOR 2019/20**
ACTION:	**Receive the information, consider any risks arising from the strategy before it is presented to the Full Council for adoption.**
CONTACT OFFICER:	**DAFYDD L EDWARDS, HEAD OF FINANCE**
CABINET MEMBER:	**COUNCILLOR PEREDUR JENKINS**

INTRODUCTION

1. This capital strategy is a new report for 2019/20, giving 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.

CAPITAL EXPENDITURE AND FINANCING

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, with some low value assets charged to revenue in year. All assets and schemes are assessed and charged on their own merits.

    - Further explanation of the Council's policy on capitalisation can be seen in the Policy Notes of the Council's Statement of Accounts for 2017/18, see: https://www.gwynedd.llyw.cymru/en/Council/Performance-and-spending/Budgets-and-finance/Statement-of-Accounts/Gwynedd-Council.aspx

3. In 2019/20, the Council is planning capital expenditure of £35m as summarised below:

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

	2017/18 Actual £m	**2018/19 Forecast £m**	**2019/20 Budget £m**	**2020/21 Budget £m**	**2021/22 Budget £m**
General Fund Services	23.4	28.5	35.0	18.8	9.3

4. The main General Fund capital projects in 2019/20 include:
   - Asset Management Plan (to be allocated) - £11.7 m
   - Highways Refurbishment- £2.7 m
   - Housing Strategy - £2.7 m
   - 21st Century Schools - £8.7 m

5. **Governance**: The Council has a 10 year Asset Strategy, a plan of the Council's capital spending priorities based on the requirements of departments. Part of the strategy includes an unallocated sum. From this amount departments are able to bid annually for funding for capital schemes. Bids are collated by the Finance Department. The Cabinet appraises all bids based on priorities and makes recommendations. The capital bids and asset strategy are presented to Cabinet and to full Council annually.

   - For full details of the Council's capital programme, refer to **Appendix A**.

6. 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(PFI)). The planned financing of the above expenditure is as follows:

Table 2: Capital Financing in £ millions

	2017/18 Actual £m	**2018/19 Forecast £m**	**2019/20 Budget £m**	**2020/21 Budget £m**	**2021/22 Budget £m**
External Sources	11.1	15.4	15.2	6.4	2.5
Own Resources	4.5	7.1	14.3	7.5	2.7
Debt	7.8	6.0	5.5	4.9	4.1
TOTAL	**23.4**	**28.5**	**35.0**	**18.8**	**9.3**

7. 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). 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

	2017/18 Actual £m	**2018/19 Forecast £m**	**2019/20 Budget £m**	**2020/21 Budget £m**	**2021/22 Budget £m**
Own Resources	7.8	7.7	7.6	7.7	7.7

- The Council's full Minimum Revenue Provision Statement is available in **Appendix B** to the Capital Strategy Statement.

8. 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 decrease by £2.1m during 2019/20. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

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

	31.3.2018 Actual £m	**31.3.2019 Forecast £m**	**31.3.2020 Budget £m**	**31.3.2021 Budget £m**	**31.3.2022 Budget £m**
General Fund Services	177.0	177.6	175.5	172.7	169.1

9. **Asset Management:** To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy. A new Asset Strategy for the 10 year period from 2019/20 to 2028/29 has been developed. As part of the procedure to establishing the new strategy, Departments were asked to consider their capital requirements to enable them to run their services. A series of workshops were held for members to express opinion and prioritise capital schemes. The Cabinet in the committee on 19/02/2019 will be submitting its formal recommendations to the full Council for approval on 07/03/2019.

10. **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. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive capital receipts as indicated in the table below:

Table 5: Capital Receipts in £ millions

	2017/18 Actual £m	**2018/19 Forecast £m**	**2019/20 Budget £m**	**2020/21 Budget £m**	**2021/22 Budget £m**
Asset Sales	0.2	0.4	0.0	0.0	0.8

TREASURY MANAGEMENT

11. 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.

12. Due to decisions taken in the past, the Council currently has £106m borrowing at an average interest rate of 5.6% and £34m treasury investments at an average rate of 0.67%.

13. **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%).

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

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

	31.3.2018 Actual £m	**31.3.2019 Forecast £m**	**31.3.2020 Budget £m**	**31.3.2021 Budget £m**	**31.3.2022 Budget £m**
Debt (incl. PFI & leases)	106.4	106.4	104.4	103.1	101.8
Capital Financing Requirement	177.0	177.6	175.5	172.7	169.1

15. 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.

16. **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 assumes that cash and investment balances are kept to a minimum level of £20m at each year-end. This benchmark is currently £118m and is forecast to fall to £109m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2018 Actual £m	**31.3.2019 Forecast £m**	**31.3.2020 Budget £m**	**31.3.2021 Budget £m**	**31.3.2022 Budget £m**
Outstanding Borrowing	106.4	106.4	104.4	103.1	101.8
Liability Benchmark	109.9	109.6	107.4	105.8	104.2

17. The table shows that the Council expects to remain borrowed below its liability benchmark. This is because cash outflows to date have been lower than expected due to the negative working capital position. If the position changes any loans required will be short term.

18. **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 as a warning level should debt approach the limit.

Table 8: Prudential Indicators: Authorised Limit and Operational Boundary for External Debt in £m

	2018/19 Limit £m	**2019/20 Limit £m**	**2020/21 Limit £m**	**2021/22 Limit £m**
Authorised Limit – total external debt	190	190	200	200
Operational Boundary – total external debt	180	180	190	190

- Further details on borrowing are in the Treasury Management Strategy in **Appendix C**.

19. **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.

20. The Council'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. 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.

Table 9: Treasury Management Investments in £millions

	31.3.2018 Actual £m	31.3.2019 Forecast £m	31.3.2020 Budget £m	31.3.2021 Budget £m	31.3.2022 Budget £m
Near-Term Investments	47	10	10	10	10
Longer-Term Investments	0	10	10	10	10
TOTAL	**47**	**20**	**20**	**20**	**20**

- Further details on treasury investments are in the Treasury Management Strategy in **Appendix C**.

21. **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and staff, who must act in line with the Treasury Management Strategy approved by Full Council. Half year and full year reports on treasury management activity are presented to the Audit and Governance Committee. The Audit and Governance Committee is responsible for scrutinising treasury management decisions.

INVESTMENTS FOR SERVICE PURPOSES

22. The Council can make investments to assist local public services, including making loans to local small businesses to promote economic growth and to support the housing strategy. 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 break even after all costs.

23. **Governance:** Decisions on service investments are made by the relevant Head of service in consultation with the Head of Finance. Most loans are capital expenditure and would therefore also be approved as part of the capital programme.

LIABILITIES

24. In addition to debt of £109m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £227m). It has also set aside £8m to cover risks of provisions, of which 98% relate to Waste Sites. The Council is also at risk of having to pay for contingent liabilities relating to the capping and aftercare requirements for the Authority's landfill Sites, and also a

potential insurance liability relating to the insurance arrangements of its predecessor authorities and the closure of the Municipal Mutual Insurance (MMI) Fund. In accordance with the accounting requirements, no money has been set aside for such contigent liabilities.

25. **Governance:** Decisions on incurring new discretional liabilities are taken by Heads of Services in consultation with the Head of Finance. The risk of liabilities crystallising and requiring payment is monitored by the Finance Department. New material liabilities are reported to the Audit and Governance Committee.

- Further details on liabilities are on page 11 of the 2017/18 Statement of Accounts https://www.gwynedd.llyw.cymru/en/Council/Documents---Council/Performance-and-spending/Statement-of-Accounts-17-18/Statement-of-Accounts-2017-18.pdf

REVENUE BUDGET IMPLICATIONS

26. 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, National Non-Domestic Rates and general government grants.

Table 10: Prudential Indicator: Proportion of Financing Costs to Net Revenue Stream

	2017/18 Actual	**2018/19 Forecast**	**2019/20 Budget**	**2020/21 Budget**	**2021/22 Budget**
Financing Costs (£m)	£13.7m	£13.4m	£13.3m	£13.3m	£13.3m
Proportion of Net Revenue Stream(%)	5.9%	5.5%	5.4%	5.3%	5.3%

- Further details on the revenue implications of capital expenditure are included in the 2019/20 Budget. https://democracy.cyngor.gwynedd.gov.uk/ielistdocuments.aspx?cid=136&mid=2503&ver=4

27. **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 50 years and over into the future. The Head of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable in the long term.

KNOWLEDGE AND SKILLS

28. The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Head of Finance is a qualified accountant with a number of years' experience, and the Senior Property Manager is a chartered surveyor and member of the Royal Institute of Chartered Surveyors. The Council has qualified staff and pays for junior staff to study towards relevant professional qualifications including CIPFA, ACCA and AAT.

29. The Council currently employs Arlingclose Limited as treasury management advisers. 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.

30. The relevant staff attend CIPFA and Arlingclose training events to ensure that we are aware of the latest developments, and that knowledge and skills are kept up to date.