

BLAENAU GWENT COUNTY BOROUGH COUNCIL – CAPITAL STRATEGY

1.1 INTRODUCTION

- 1.2 Part 1, Section 3 of the Local Government Finance Act 2003 requires that the Authority shall determine and keep under review how much it can afford to borrow. The Act is supported by the Prudential Framework for local authority capital investment and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Code).
- 1.3 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities, revised in 2017, introduced the concept of a Capital Strategy with effect from April 2019.
- 1.4 The Capital Strategy will be the mechanism through which the priorities in the Council's Corporate Plan are delivered.

2. DETERMINING A CAPITAL STRATEGY

- 2.1 In order to demonstrate that authorities take capital expenditure and investment decisions, in line with service objectives and properly takes account of:-
 - Stewardship
 - Value for money
 - Prudence and
 - Sustainability and affordability

Authorities should have in place a capital strategy that sets out the *long-term context* in which capital expenditure and investment decisions are made, primarily to deliver the priorities in the Council's Corporate Plan. This will enable due consideration *to both risk and reward* and *impact* on the achievement of priority outcomes. The capital strategy should form a part of the authority's integrated revenue, capital and balance sheet planning.
- 2.2 As local authorities become increasingly complex and diverse it is vital that those charged with governance understand the long-term context in which investment decisions are made and all the financial risks to which the authority is exposed. For example, when local authorities have increasingly wide powers around commercialisation, more authorities being subject to group arrangements and the increase in combined authority arrangements, it is no longer sufficient to consider only the individual local authority but also the residual risks and liabilities to which it is subject.
- 2.3 The capital strategy is intended to give a high level overview of how:-
 - capital expenditure
 - capital financing
 - treasury management activity

contribute to the provision of services, along with an overview of how associated risk is managed and the implications for future financial sustainability. The development of a capital strategy allows flexibility to engage with full Council to ensure that the overall strategy, governance procedures and risk appetite are fully understood by all elected members.

- 2.4 The capital strategy should be tailored to the authority's individual circumstances but should include capital expenditure, investments and liabilities and treasury management. The capital strategy should include sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured and to meet legislative requirements on reporting.
- 2.5 In considering how stewardship, value for money, prudence, sustainability and affordability can be demonstrated, local authorities should have regard to the following key areas where material.

3. LINKS TO THE CAPITAL STRATEGY

- 3.1 The report has links to the strategic themes of the Authority, taking into account cross-cutting issues where relevant. It has specific links to the following documents:

a) The Council's Corporate Plan 2018/2022

The Corporate Plan is the prime document which outlines what the Council aims to achieve. The current Plan covers the period 2018/ 2019 to 2021/2022. The core vision, core values and priorities in the Council Plan are:-

Our Core Vision

Proud Heritage, Strong Communities, Brighter Future

Our Core Values



Our Council Priorities



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- 3.2 The key objective of this Capital Strategy is to ensure that the capital funding available to the Council is spent on projects that assist the Council to deliver the priorities in the Corporate plan, including maintaining, replacing or / and upgrading existing assets. This is why the Corporate Plan features strongly in the allocation of resources in the capital programme.
- There are several other key strategic documents which align with the Council Plan. These guide how the Council works on specific aspects affecting the Council.

b) Medium Term Financial Strategy

The Capital Strategy is closely linked to the Medium Term Financial Strategy (MTFS), primarily with respect to the affordability of the capital programme. The MTFS is agreed by Council on an annual basis and forms part of the annual budget setting report.

c) Treasury Management Strategy

The Treasury Management Strategy links to the Capital Strategy in determining the Council's approach to borrowing and investments, including borrowing to fund capital expenditure. The Treasury Management Strategy is closely related to the Prudential Code and Prudential Indicators. The Council has an integrated Treasury Management Strategy and has adopted the CIPFA Code of Practice for Treasury Management in Public Services. The Treasury Management Strategy deals with borrowing and investment arising as a consequence of all the financial transactions of the Council, not exclusively those arising from capital spending.

d) Statement of Accounts

Capital expenditure incurred during the year is reflected in the Balance Sheet within the Statement of Accounts, ensuring that stewardship of assets is demonstrated. The accurate monitoring and recording of capital expenditure ensures that this document is free from material error. The Statement of Accounts is externally audited at the end of each financial year to certify that it presents a true and fair view of the financial position of the Council.

e) Strategic Asset Management Plan 2017/2022

The Strategic Asset Management Plan sets out how the Council manages and treats its property and land, ensuring that it is well placed to manage expectations, budgets and services going forward.

f) Regulatory Framework of Capital Spend

The Procurement Strategy, along with the Contract Standing Orders and Financial Regulations (part of the Council's Constitution), looks at who can supply goods and services to the Council and how these goods and services should best be obtained to secure value for money.

More generally, prudent financial management contributes to the following Well-being Goals within the Wellbeing of Future Generations Act (Wales) 2015:-

- A prosperous Wales.
- A resilient Wales.
- A healthier Wales.
- A more equal Wales.

- A Wales of cohesive communities.
- A Wales of vibrant culture and thriving Welsh Language.
- A globally responsible Wales.

4 **CAPITAL EXPENDITURE**

4.1 Capital expenditure is defined as costs incurred by the Council in acquiring new property, plant and equipment (PPE); or costs incurred by enhancing existing PPE asset base. Capital expenditure can also be incurred in instances where the asset is owned by a third party but the Council has provided the third party with a grant. In such instances the expenditure is recorded as if incurred directly by the Council.

4.2 In accordance accounting definitions, expenditure can be capitalised when it relates to:

- *The acquisition or creation of a new fixed asset* - capitalisation will depend on the creation of rights to future economic benefits controlled by the Authority;
- *The enhancement of an existing fixed asset* - capitalisation will depend on the works substantially increasing the value of the asset, extending its useful life or increasing its use in service provision.

4.3 The Council's current asset base could be classed into two distinct areas:-

- *operational assets* i.e. those assets relating to day to day activities that will ensure the Council meets (primarily) its statutory requirements and
- *development assets* i.e. those assets which will help the Council achieve strategic aims and generate income

4.4 The Authority has a de-minimus limit for capital expenditure of £50,000. Previously, the de-minimus level was set much lower at £10,000, but was revised upwards, following the 2012/2013 external audit of accounts. The Policy will be reviewed in 2020/21

Capital expenditure that is below this de-minimus limit, is charged to a revenue budget. There are however, some exceptions including Highways capital expenditure, and Health & Safety capital expenditure. In these cases items that individually fall below this de-minimus level are allowable as capital expenditure because they are aggregated together and treated as one single item of expenditure in the year.

4.5 The Authority's core capital programme is considered by Council annually on a rolling basis and is funded from a variety of sources including capital receipts, Prudential Borrowing, General Capital Grant and Supported Borrowing Approvals. Both of the two latter funding streams are confirmed annually by Welsh Government as part of the Local Government Finance Settlement.

4.6 Changes to the programme from one year to the next include:-

- New policy directives
- New proposed schemes

- Revised scheme profiling
- Slippage and
- Changes in expenditure projections

4.7 The Authority's forecast of capital expenditure for the next three financial years, as laid out in the 2019/2020 Treasury Management Strategy is as follows:-

Capital Expenditure £000's					
	2018/19 Actual	2019/2020 Revised Estimate	2020/2021 Estimate	2021/2022 Estimate	2022/2023 Estimate
Total	13,896	19,950	22,500	18,550	13,600

The capital programme usually covers a three year period. However, the current capital programme covers the financial years 2019/20 to 2025/2026, primarily to incorporate Band B of the 21st Century Schools Programme.

Governance arrangements are as follows:-

4.8 The capital programme is considered annually by full Council as part of the revenue budget setting process.

4.9 The capital programme is monitored in-year through:-

- Regular forecast expenditure reports to budget holders
- Quarterly forecast expenditure reports to the Joint Budget Monitoring Scrutiny Committee and Executive Committee.
- Actual outturn expenditure is incorporated into the Council's annual Statement of Accounts, which is reported to the Audit Committee and subject to external audit.

4.10 If additional resources are identified, a revised capital programme will be reported to full Council for consideration. If the value of bids exceed the amount of available resources, a prioritisation methodology is followed, in order to match bids to available resources. Currently that methodology incorporates the following key elements:-

- Links to the Council's Corporate Plan
- Links to national priorities
- Statutory scheme or non-statutory scheme
- An existing legal or contractual commitment
- The availability of external grant funding
- The likelihood of revenue saving generation / cost avoidance
- National Wellbeing Goals/ Sustainability Principles

- 4.11 The bidding process is underpinned by a number of check and challenge stages, prior to the drafting of a report for Council's consideration.

5. **CAPITAL EXPENDITURE FINANCING**

- 5.1 All capital expenditure must be financed, either from external sources - government grants and other contributions; the Council's own resources - revenue contributions, reserves and capital receipts; or debt - borrowing supported and unsupported; leasing.

- 5.2 A detailed explanation of each of the main sources of funding is shown below:-

- **General Capital Grant** – This is a sum of money which is provided by the Welsh Government as part of the annual settlement. The Council is free to use the capital grant on any capital project it wishes.
- **Supported Borrowing** – The Council will borrow internally / externally to fund the expenditure. The revenue costs arising from the borrowing (Interest Costs and Minimum Revenue Provision) are funded by the Welsh Government through the annual revenue settlement, hence the term "Supported Borrowing".
- **Unsupported Borrowing** – the Council borrows internally / externally but is required to finance the revenue costs from its own resources. Projects funded by means of unsupported borrowing tend to be projects which deliver revenue savings or generate additional income and these savings are used to meet the additional revenue costs arising from the borrowing.
- **Specific Capital Grants** – The Council will be awarded capital grants which partly or fully fund the cost of a project. Capital grants usually come with restrictions surrounding the expenditure which can be funded and by when the expenditure must be incurred.
- **Revenue Contribution** – Services can make a contribution from their revenue budgets to fund projects and should deliver revenue savings/avoid future costs or generate additional income. These contributions tend to be as a match funding to a project which is mainly funded from a specific capital grant.
- **Capital Receipts** – The funds generated from the sale of assets can be used to contribute to the funding of the capital programme. These are usually generated from the sale of surplus assets (normally land or buildings).
The Council's long standing policy on usable capital receipts is that they are immediately invested internally. This helps to improve the Council's cash flow position and reduces the level of external loans that need to be raised,

which in turn reduces external interest charges from the money market. This approach is consistent with what is regarded as good practice in terms of strategic level treasury management and overall, produces savings in debt servicing costs for the Council.

However, as approved sums of usable capital receipts are subsequently used to finance part of the annual capital programme each year, appropriate allowance then needs to be made for the use of these receipts in determining the estimated level of external borrowing required for that year. Hence usable capital receipts are released on a controlled basis and the annual estimates for external interest charges are adjusted accordingly. Any request to earmark a capital receipt for a different purpose will require a report to full Council.

- **Reserves** – Funding held in reserve, e.g. unapplied capital receipts, can be used to support the capital programme.

5.3 The financing of the forecast capital expenditure shown in paragraph 4.7 above, is detailed below

Capital Expenditure £000's	2018/19 Revised Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Total	13,896	19,950	22,500	18,550	13,600
Financed by:					
Grants, Capital Receipts, revenue and other sources	9,207	14,977	19,627	16,077	11,127
Net financing need for the year from Un-hypothecated Supported Borrowing and Prudential Borrowing	4,689	4,973	2,873	2,473	2,473

5.4 Debt (including leases) is a source of finance that is used to fund a capital scheme and is repayable over time. The Council sets aside a Minimum Revenue Provision (MRP) every year for the repayment of existing debt. MRP forms part of the debt management budget and is monitored by Corporate Finance. As part of the annual Treasury Management Strategy, which is approved by full Council before the start of the new financial year), a MRP statement is presented as an appendix to the Strategy annually. This sets out the MRP Policy that is to be adopted by the Council at the start of the next financial year. The full MRP statement is set out in Appendix A of the Treasury Management Annual Strategy. The Council agreed to a significantly revised policy in December 2017.

5.5 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 Council's estimated CFR is set out in Appendix A of Treasury Management Annual Strategy and is illustrated below.

Capital Financing Requirement					
	<u>2018/19</u> <u>Revised</u> <u>Estimate</u> <u>£000</u>	<u>2019/20</u> <u>Estimate</u> <u>£000</u>	<u>2020/21</u> <u>Estimate</u> <u>£000</u>	<u>2021/22</u> <u>Estimate</u> <u>£000</u>	<u>2022/23</u> <u>Estimate</u> <u>£000</u>
CFR at start of financial year	160,950	165,028	169,311	173,557	175,422
CFR at end of financial year	165,028	169,311	173,557	175,422	173,887
Movement in CFR	4,078	4,284	4,246	1,865	-1,535

6. TREASURY MANAGEMENT

- 6.1 The Chartered Institute of Public Finance & Accountancy defines treasury management as “The management of the organisation’s borrowing; investments and cash flows; its banking; money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks”.
- 6.2 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. Investment balances tend to be high at the start of the financial year as revenue income is received before it is spent, but reduce in the long-term as capital expenditure is incurred before being financed.
- 6.3 Due to decisions taken in the past, the Council currently has £157m debt outstanding as at 31 March 2019, at an average interest rate of 2.85%. In addition, £43,000 was earned on investments at an average rate of 0.62%.
- 6.4 The Annual Treasury Management Strategy is approved by Full Council prior to the start of the new financial year and sets out the Council’s Borrowing Strategy; Investment Strategy and respective prudential indicators.
- 6.5 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

The Treasury Strategy - the first, and most important report covers:

- The capital plans (including prudential indicators)
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and an assessment of whether the treasury strategy is being met or whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Pre-scrutiny of the Strategy and monitoring of the Strategy throughout the year is carried out by the Corporate Overview Scrutiny Committee.

7. COMMERCIAL ACTIVITIES

- 7.1 A number of local authorities are investing in non-treasury management investment, for example commercial property, either via a fund manager or direct purchase of property in order to generate enhanced treasury returns above the rate of inflation. The returns generated from this type of investments can support revenue budgets in an environment when Welsh Government revenue support funding has declined year on year.
- 7.2 At present the Council does not invest in commercial property either directly (through property acquisitions) or indirectly (through a fund manager). However, the Council is seeking to develop an investment strategy in line with a more commercial approach and so this type of investment will be considered in the future.
- 7.3 With a financial rate of return being the main objective, the Council would need to fully identify the Local Authority powers underpinning any investments i.e. economic regeneration activity. In addition, the Council would need to understand that there is a degree of higher risk on commercial investment than with treasury investments. The principal risk exposures include a decline in the property market and capital being tied up in the medium/ long-term. In order to balance the three basic principles of security, liquidity and yield, consideration would need to be given to the proportion of commercial investments made.
- 7.4 Any potential commercial investment would need due diligence and expert independent external advice. Legal advice would also be required from within the Council and where necessary, externally.

8. POTENTIAL OPPORTUNITIES AND RISKS ARISING FROM THE CAPITAL STRATEGY

- 8.1. The Capital Strategy will enable the Council to focus its energy and resources to the priorities in the Corporate Plan. In addition, transparent governance

arrangements will enable improved decision making processes and financial planning into the longer term.

- 8.2. By adopting a more commercial approach, the Council will be able to secure additional revenue streams to mitigate future enforced budget reductions.
- 8.3. The level of annual savings required over the period of the medium term financial strategy will continue to be challenging with the potential to impact on the capital programme. If the funding gap is difficult to achieve, this risk could be mitigated by a further review of the capital programme to assess the feasibility of reducing capital financing costs affecting revenue. This would involve reducing capital expenditure and the associated borrowing requirement, therefore reducing interest and loan repayment costs.
- 8.4. The Council's Capital Strategy is based on an assumed level of funding from Welsh Government and from external grants and capital receipts. Given the continued uncertainty over budgets and the changes to grant funding, currently received from the European Union, there is a risk that this assumed level of grant funding may not be received. This risk can be mitigated through regular reviews of the current capital programme.
- 8.5. The Council has used internal borrowing (as opposed to external borrowing) for a number of years to fund a proportion of capital expenditure. If interest rates increase sharply in the medium term there is a risk that long term capital financing costs will impact on the affordability of new capital schemes and the revenue budget. This risk can be mitigated by regular reviews of interest rate forecasts and engagement with the Council's external treasury management advisor.
- 8.6. The strategy acknowledges the importance of maintaining existing Council assets. There is a risk that a replacement programme is not sufficient and that the standard of the assets falls to such a point that a greater level of investment is required in order to maintain services. This risk can be mitigated by ensuring that the capital programme delivers a balanced programme of enhancing current assets and developing new assets.
- 8.7. External borrowing results in a significant interest cost each year. The majority of the Council's loans are fixed and are not affected by any interest rate rises. However, any sharp rise in interest rates may impact on the affordability of future projects which are funded from new borrowing. This risk is mitigated to some extent through the Treasury Management Strategy which illustrates a mix of short term, medium term and long term loans.

9. **KNOWLEDGE AND SKILLS**

- 9.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions.
- 9.2 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 tests the market through regular competitive tendering. This ensures that performance management arrangements are in place, as laid out in the contract specification. The Council currently employs Link Asset Services 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. Performance
- 9.3 Key relevant staff will undertake training as and when opportunities arise or whenever there are changes in regulations. Treasury management training for members has and will continue to be provided by officers and treasury management advisors on an annual basis in the future.