Treasury Management Appendix 2019/20

1. Capital Expenditure and Financing

1.1 Capital expenditure is where the Council spends money on assets, such as property or vehicles, which 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 those bodies to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example, the council could set a limit on the amount capitalised and charged to revenue during the year.

1.2 In 2019/20, the Council is planning capital expenditure of £82m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
	£m	£m	£m	£m	£m
Capital Expenditure excluding HIP	272	405	48	0	0
Housing Investment Programme HIP	1	4	30	52	39
TOTAL	273	409	78	52	39

1.3 The main General Fund capital projects up to the end of 2018-19 were acquisitions of property including investment properties. From 2019-20, the focus is on regeneration within the Borough and delivery of our housing investment programme.

1.4 **Governance:** Service managers bid annually around October to include projects in the Council's capital programme. Bids are collated by the Finance Team who calculate the financing cost (which can be nil if the project is fully externally financed). Cabinet appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to Council. The final capital programme is then presented to Cabinet and to Council in February each year.

1.5 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). The planned financing of the above expenditure is as follows:

Table 2: Capital financing

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
	£m	£m	£m	£m	£m
External sources	(1)	(1)	(1)	(1)	0
Own resources	(2)	(17)	(11)	(12)	(10)
Debt	(270)	(391)	(66)	(39)	(29)
TOTAL	(273)	(409)	(78)	(52)	(39)

1.6 Debt is only a temporary source of finance, since loans and leases must be repaid. The replacement of debt finance from revenue is through the Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance.

1.7 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 increase by £300m during 2019/20. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 3: Prudential Indicator: Estimates of Capital Financing Requirement

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
	£m	£m	£m	£m	£m
Investment Properties	681	1,068	1,090	1,077	1,067
Housing and Regeneration	0	3	33	73	113
Other services	1	2	20	21	22
TOTAL CFR	682	1,073	1,143	1,171	1,202

1.8 **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds (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. Repayment of capital grants, loans and investments also generates capital receipts. The Council plans to receive £0.4m of capital receipts in the coming financial year as follows:

Table 4: Capital receipts

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
	£m	£m	£m	£m	£m
Preserved share of RTB	(1.3)	(0.5)	(0.1)	(0.1)	(0.1)
Other	0.0	0.0	(0.3)	0.0	0.0
TOTAL Capital receipts	(1.3)	(0.5)	(0.4)	(0.1)	(0.1)

2. Treasury Management

2.1 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.

2.2 Due to decisions taken in the past, the Council has £1,033m borrowing as at 31 December 2018 at an average interest rate of 1.85% and £22m medium-term treasury investments at an average rate of 4%.

2.3 **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.

2.4 Projected levels of the Council's total outstanding debt are shown below, compared with the capital financing requirement (see above at 2.7).

Table 5: Prudential Indicator: Gross Debt and the Capital Financing Requirement

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
	£m	£m	£m	£m	£m
Debt	665	1,056	1,111	1,135	1,155
CFR	682	1,073	1,143	1,171	1,202

2.5 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from Table 5, the Council expects to comply with this..

2.6 **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 of £50m at each year-end including £10m investments. This benchmark is currently £1,385m and is forecast to rise to £1,469m over the next three years.

Table 6: Borrowing and the Liability Benchmark

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
	£m	£m	£m	£m	£m
Outstanding borrowing	665	1,056	1,111	1,135	1,155
Liability benchmark	649	989	1,102	1,131	1,171

2.7 The table shows that the Council expects to borrow below its liability benchmark after the current year. Up to now, a deliberate decision has been made to borrow sums at fixed low rates for investment property acquisitions to generate rental streams that will enable increased financial sustainability. In the future, the focus will be on regeneration within the Borough and delivery of our housing investment programme, and capital expenditure and related borrowing requirements will therefore be reduced.

2.8 **Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt

	2018/19 limit	2019/20 limit	2020/21 limit	2021/22 limit
	£m	£m	£m	£m
Authorised limit – borrowing	1,350	1,350	1350	1,350
Operational boundary – borrowing	1,250	1,250	1,250	1,250

2.9 **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.

2.10 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 8: Treasury management investments

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
	£m	£m	£m	£m	£m
Near-term investments	1	22	24	26	28
Longer-term investments	21	30	35	40	45
TOTAL	22	52	59	66	73

2.11 Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance and staff, who must act in line with the treasury management strategy approved by Council. Half yearly reports on treasury management activity are presented to Council. The Overview and Scrutiny Committee is responsible for scrutinising treasury management decisions.

3. Investments for Service Purposes

3.1 The Council makes investments to assist local public services, including making loans to local service providers, local small businesses to promote economic growth, and the Council's subsidiary that provides services. 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 generate a profit overall after all costs.

3.2 Governance: Decisions on service investments are made by the relevant service manager in consultation with the Chief Finance Officer and must meet the criteria and limits laid down in the Treasury Management Strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

4. Commercial Activities

4.1 With central government financial support for local public services declining, the Council has invested in commercial property mainly for financial gain and will lend to its subsidiary Knowle Green Estates Ltd for the similar reasons. Total commercial investments are currently valued at £1,002m, the largest being the BP International Campus site providing a net return after all costs of 4%.

4.2 With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include vacancies and fall in asset capital value. . These risks are managed by having a high specification investment property portfolio, with detailed market and tenant appraisals starting before acquisition and employment of professional property and facilities management to maintain high property and tenancy standards. In order that commercial investments remain proportionate to the size of the authority, these are subject to an overall maximum investment limit of £500m.

4.3 **Governance:** Decisions on commercial investments are made by the Council in line with the criteria and limits approved by Cabinet 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.

5. Liabilities

5.1 In addition to the debt detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £44.86m). The Council has modelled potential future liabilities on its investment properties to cover future voids, rent free periods and refurbishments and is currently setting aside £6m per annum into sinking funds with an anticipated balance of £11m as at end 2018/19.

5.2 **Governance:** Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Chief Finance Officer.

6. Revenue Budget Implications

6.1 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 9: 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)	15	26	35	35	28
Proportion of net revenue stream	68%	65%	69%	71%	70%

6.2 **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 Chief Finance Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because the objective underlying investment and borrowing decisions is security and liquidity before yield, and borrowing is at fixed rates, taking advantage of low rates currently available.

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