Treasury Management Appendix 2021/22

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 2021/22, the Council is planning capital expenditure of £45.8m as summarised in Table 1.

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget
	£m	£m	£m	£m	£m
Housing & Regeneration	18.6	26.4	35.4	69.7	53.7
Leisure Centre Development	0.8	0.3	7.3	23.3	7.1
Community Wellbeing and Housing	0.8	0.9	1.9	0.9	0.9
Corporate Management	0.1	0.3	1.0	0.1	0.1
Compliance, Waste & Risk	0.3	0.2	0.2	0.1	1.3
Housing Opportunities	57.5	0.3	0.0	0.0	0.0
TOTAL	**78.1**	**28.4**	**45.8**	**94.1**	**63.1**

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

Table 2: Capital expenditure financing

	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget
	£m	£m	£m	£m	£m
General Fund Reserves	0.8	0.6	1.4	0.2	0.2
Homes England funding	0.0	2.8	0.0	0.0	0.0
Capital Receipts	0.6	0.2	0.3	0.1	0.6
Other funding	0.7	0.8	3.2	0.8	0.7
Total Financing	**2.1**	**4.4**	**4.9**	**1.1**	**1.5**
Net Financing Need	76.0	24.0	40.9	93.0	61.6
TOTAL	**78.1**	**28.4**	**45.8**	**94.1**	**63.1**

1.6 Debt is a temporary source of finance only, 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 £28.5m during 2021/22. 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

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
	£m	£m	£m	£m	£m
Opening CFR	1,051.1	1,116.1	1,128.2	1,156.7	1,237.1
CFR - General Fund	65.0	12.1	28.5	80.4	48.5
TOTAL CFR	**1,116.1**	**1,128.2**	**1,156.7**	**1,237.1**	**1,285.6**
Change in financing required	65.0	12.1	28.5	80.4	48.5
Movement in CFR represented by:					
Net Financing Need for the year	76.0	24.0	40.8	93.0	61.6
Less: Minimum Revenue Provision (MRP)	(11.0)	(11.9)	(12.3)	(12.6)	(13.1)
MOVEMENT IN CFR	**65.0**	**12.1**	**28.5**	**80.4**	**48.5**

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 anticipates receiving £0.25m of capital receipts in the coming financial year as follows:

Table 4: Capital receipts

	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget
£m to 3 decimal places	£m	£m	£m	£m	£m
Capital Receipts	0.565	0.148	0.250	0.100	0.576

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 £1,144m borrowing as at 30 November 2020 at an average interest rate of 2.3%, and £34.6m medium-term treasury investments at an average rate of 3.5%.

2.3 **Borrowing strategy**: When borrowing, the Council's main objectives 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 less than 0.1%) 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 1.7).

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

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
	£m	£m	£m	£m	£m
Debt	1,110	1,082	1,087	1,127	1,082
CFR	1,116	1,128	1,157	1,237	1,286

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 £1,201m and is forecast to rise to £1,393m over the next three years.

Table 6: Borrowing and the Liability Benchmark

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
	£m	£m	£m	£m	£m
Outstanding borrowing	1,110	1,082	1,087	1,127	1,082
Liability benchmark	1,049	1,061	1,090	1,170	1,218

2.7 The Council expects to borrow up to or more than its liability benchmark for 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

	2020/21 limit	2021/22 limit	2022/23 limit	2023/24 limit
	£m	£m	£m	£m
Authorised limit – borrowing	1,250	1,300	1,350	1,450
Operational boundary – borrowing	1,350	1,400	1,450	1,500

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, summarised in Table 8, may be held in pooled funds, where an external fund manager makes decisions on which investments to buy and the Council may request its money back at short notice.

Table 8: Treasury management investments

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
	£m	£m	£m	£m	£m
Near-term investments	35	91	91	91	91
Longer-term investments	31	35	40	40	40
TOTAL	**66**	**126**	**131**	**131**	**131**

2.11 **The £35m longer-term investments forecast for 2020/21 includes £32m pooled funds. The COVID-19 crisis resulted in a reduction in the capital value of these funds in March 2020 to £28m, at the time of the first lockdown. This reduction is expected to be temporary and has since partially recovered from the pre-COVID £32m level.**

2.12 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Chief Accountant 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 subsidiaries that provides services. The Council will lend to its subsidiaries Knowle Green Estates Ltd and Spelthorne Direct Services Ltd, both of which are used in delivery of services (housing-related and commercial waste respectively). 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. Officers and the Finance Portfolio Holder meet on a quarterly basis with the Council's Treasury Management advisers to review both investment and debt portfolios.

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. Total commercial investments are valued at £987m as at end March 2020 (the largest being the BP International Campus site), providing a net return after all costs of 1% (5% gross, before costs).

4.2 The Council has not acquired investment property since 2018/19, after which the Council decided to focus on regeneration and housing objectives. The Council accepted higher risk on commercial investment than with treasury investments. The principal risk exposures include property vacancies and decreases in asset capital value. These risks are managed by having a high specification investment property portfolio, with detailed market and tenant appraisals which started before acquisition, and employment of professional property and facilities management to maintain high property and tenancy standards.

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 £50m). 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 £7m per annum into sinking funds with an anticipated balance of £20m as at end 2020/21. [figures in this paragraph are to be reviewed]

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. As highlighted above, the table below ignores the rental income being generated which is equivalent to about two times the value of the interest being paid on the loans financing the commercial assets.

Table 9: Prudential Indicator: Proportion of financing costs to net revenue stream

	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget
£m to 3 decimal places	£m	£m	£m	£m	£m
Net Revenue Stream (£m)	65.640	65.529	65.402	65.924	65.267
Financing costs (£m)	22.945	23.249	23.212	23.188	23.036
Financing as % of net revenue	35.0%	35.5%	35.5%	35.2%	35.3%

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.

6.3 **IFRS 16 Leases:** Councillors are reminder that IFRS 16 has been delayed to 1 April 2022, as noted in a CIPFA LASAAC Statement on the Deferral of the Adoption of IFRS 16 Leases. In the meantime, and in preparation, officers will be conducting a balance sheet review of the financial impact on the Council, its capital strategy, TM strategy and revenue budgets, with the aim to report on this in July 2021. As part of that process, *de minimus* levels on leases will be determined so that the impact on revenue is budgeted for effectively, and that capital impacts are authorised appropriately.

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