

REPORT TO: Executive Board

DATE: 27 February 2020

REPORTING OFFICER: Operational Director – Finance

PORTFOLIO: Resources

TITLE: Capital Strategy 2020/21

WARDS: Borough-wide

1.0 PURPOSE OF REPORT

1.1 To consider the Council's Capital Strategy for 2020/21 and recommend it's approval by Council.

2.0 RECOMMENDATION: That Council be recommended to approve the 2020/21 Capital Strategy, as presented in the Appendix.

3.0 SUPPORTING INFORMATION

3.1 The revised 2017 Prudential and Treasury Management Code of Practice has required since 2019-20 that all councils prepare annually a Capital Strategy, which will provide the following:

- a high-level, long term overview of how capital expenditure, capital financing and treasury management activity will contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

3.2 The aim of the Capital Strategy is to ensure that the Council understands the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

3.3 The Capital Strategy should be read in conjunction with the Treasury Management Strategy Statement, found elsewhere on the Agenda, which details the expected activities of the treasury management function and incorporates the Annual Investment Strategy and the Minimum Revenue Provision (MRP) policy for 2020/21.

4.0 POLICY IMPLICATIONS

4.1 The successful delivery of the Capital Strategy will assist the Council in planning and funding its capital expenditure over the next three years, enabling the Council to use capital expenditure to assist in delivering the Council's priorities and managing the revenue cost implications.

5.0 OTHER IMPLICATIONS

5.1 None.

6.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

6.1 There are no direct implications, however, the revenue budget and capital programme support the delivery and achievement of all the Council's priorities.

7.0 RISK ANALYSIS

7.1 This report, along with the Treasury Management Strategy ensure that the Council operates within the guidelines set out in the Prudential Code. The aim at all times is to operate in an environment where risks are clearly identified and managed.

8.0 EQUALITY AND DIVERSITY ISSUES

8.1 None.

9.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972

Document	Place of Inspection	Contact Officer
Working Papers	Financial Management	Matt Guest
CIPFA TM Code	Halton Stadium	
CIPFA Prudential Code		

HALTON BOROUGH COUNCIL

CAPITAL STRATEGY

2020/21

**Revenues and Financial Management Division
Finance Department
February 2020**

CAPITAL STRATEGY STATEMENT 2020/21

1 Background

- 1.1 The Capital Strategy gives 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 is written in an accessible style to assist understanding of these, sometimes technical, areas.

2 Capital Expenditure and Financing

- 2.1 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 as to what is treated as capital expenditure, for example assets costing below £35,000 are not capitalised and are charged to revenue in year. Further detail on how the Council differentiates between revenue and capital spend is shown in the Capital Guidance included at Appendix 1.
- 2.2 All capital expenditure must be financed, either from external sources (Government grants and other contributions), the Council's own resources (revenue, reserves or capital receipts) or debt (borrowing, leasing or Private Finance Initiative).
- 2.3 Capital expenditure and financing for 2018/19 is shown below, along with estimates for 2019/20 and the following three years:

Table 1 – Capital Expenditure and Funding

	2018/19 Actual £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Capital Expenditure:					
People	3,426	7,062	3,351	-	-
Enterprise, Community & Resources	18,475	38,524	35,431	35,827	8,145
	21,901	45,586	38,782	35,827	8,145
Financed By:					
Capital receipts	(4,156)	(4,567)	(3,152)	(2,330)	(1,869)
Capital grants	(14,146)	(17,946)	(26,818)	(20,854)	(586)
Revenue	(344)	(524)	(443)	-	-
Net financing need for the year	3,255	22,549	8,369	12,643	5,690

3 Governance

- 3.1 The Council maintains a three year rolling programme of capital schemes (The Capital Programme). A summary of the three year Capital Programme is included in the Budget Report approved annually by Council. In addition a more detailed capital programme report is approved in June of each year, this contains detail of all known grant funded capital projects.
- 3.2 In line with Finance Standing Orders specific capital schemes are reported throughout the year to Executive Board with a recommendation for Council to subsequently approve. Changes to the Capital Programme during the year are reported quarterly to Council.
- 3.3 Capital project managers must complete a capital project form (Appendix 2) giving details of the financial impact of their capital schemes. The form will be completed in conjunction with Financial Management and will help to evaluate whether capital schemes are fully, correctly and effectively funded, that consideration has been given to contingency costs within the project and known future revenue costs are fully budgeted for. The project form should be included with reports to Executive Board by way of evidencing that the financial implications of schemes have been fully addressed.

4 Repayment of Borrowing:

- 4.1 Debt is only a temporary source of finance, since loans and leases must be repaid. This is therefore replaced over time by other financing, usually from revenue which is known as the Minimum Revenue Provision (MRP). Planned MRP payments are shown in the table below:

Table 2 – Minimum Revenue Provision

	2018/19 Actual £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Minimum Revenue Provision					
General Fund	2,214	2,116	2,115	1,831	1,837
Leases and PFI Schemes	952	614	535	479	558
Mersey Gateway unitary charge	5,636	5,941	6,310	6,518	6,766
Net financing need for the year	8,802	8,671	8,960	8,828	9,161

- 4.2 The table above includes MRP payable for finance leases, PFI schemes and the Mersey Gateway unitary charge. For accounting purposes these schemes are classed as borrowing and the annual payments are split between an interest charge and repayment of borrowing, which is shown as MRP above. It should be noted that leases, PFI schemes and Mersey Gateway unitary repayments have no impact on the Council's General Fund.

The Council's MRP statement is included as an appendix to the Treasury Management Strategy which should be read in conjunction with this report.

5 Outstanding Debt – Capital Financing Requirement

- 5.1 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. The table below shows the Council's Capital Financing Requirement for 2018/19 and how this is expected to change in 2019/20 and over the following three years.

Table 3 – Capital Financing Requirement

	2018/19 Actual £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Capital Financing Requirement	608,870	599,950	603,841	599,218	602,521
Movement in CFR due to:					
Net financing need for the year	3,255	22,549	8,369	12,643	5,690
PFI / Finance Leases	-	-	-	-	-
Mersey Gateway unitary charge	(3,373)	(9,988)	(4,033)	(513)	(526)
Less Minimum Revenue Provision	(8,802)	(8,670)	(8,959)	(8,827)	(9,161)
Increase / (Decrease) in CFR	(8,920)	3,891	(4,623)	3,303	(3,997)

6 Asset Management

- 6.1 To ensure that capital assets continue to be of long-term use, the Council has an asset management plan in place. This summarises how the Council manages its land and property assets and sets out the Council's strategy to ensure that these assets can make the maximum contribution to achieving the aims and the objectives of the organisation.
- 6.2 The Council's Asset Management Plan comprises a number of sections including the accommodation plans; assets disposal plan and maintenance programme which are presented to the Asset Management Working Group, on a quarterly basis.

7 Asset Disposals

- 7.1 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 the repayment of debt relating to the asset sold. The level of the Council's capital receipts reserve, the expected sales and planned expenditure is shown in the table below:

Table 4 – Capital Receipts Reserve

	2018/19 Actual £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Capital Receipts - 1st April	(10,775)	(7,741)	(3,856)	(3,106)	(2,976)
Asset Sales	(4,495)	(10,182)	(5,935)	(2,200)	(1,000)
Use of Capital Receipts					
- New Capital Expenditure	4,156	4,567	3,152	2,330	1,869
- Repayment of debt	3,373	9,500	3,533	-	
Capital Receipts - 31st March	(7,741)	(3,856)	(3,106)	(2,976)	(2,107)

8 Treasury Management

- 8.1 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.
- 8.2 The Treasury Management Strategy, elsewhere on the Agenda, details all aspects of the Treasury Management function and the associated risks as detailed below.
- Borrowing strategy
 - Investment strategy
 - Capital Financing Requirement
 - Capital Prudential Indicators
 - Treasury Indicators – Operational Boundary and Authorised Limit
 - Prospects for interest rates
 - MRP Policy

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:

- The Operational Director - Finance is a CIPFA qualified accountant with over 35 years' experience in local government finance
- The Operational Director – Economy, Enterprise and Property has over 20 years' experience in Regeneration
- The Treasury Manager is a CIMA qualified accountant with 14 years' experience in local government finance and treasury management.
- The Council ensures all staff receive appropriate training for their roles including formal training and courses to support their development.
- The Council currently employs Link Asset Services to provide treasury management services in order to access specialist skills, advice and resources

CAPITAL GUIDANCE

1. Background & Purpose

- 1.1 The difference between capital and revenue expenditure is by no means simple to establish. In recent years it has become even more difficult, with the increasingly multi-funded and complex nature of many of the Council's services.
- 1.2 There is now an increased focus on the treatment of capital and revenue expenditure from Government and other funding bodies, along with the external auditor who have previously identified and reported upon capital transactions which had been incorrectly categorised. It is therefore essential to ensure the correct accounting treatment of capital and revenue transactions.
- 1.3 This Guidance is intended to clarify the difference between capital and revenue expenditure. It will also assist those involved in managing capital projects or processing capital transactions, to ensure the correct approval, accounting treatment, coding, monitoring, control and funding of capital expenditure.

2. Introduction

- 2.1 Capital expenditure is fundamentally different in its nature, funding and methods of control from revenue expenditure. It is therefore important that expenditure is correctly treated in terms of whether it constitutes capital or revenue expenditure and is correctly coded as such within the Agresso system. In addition, both revenue and capital expenditure must be accounted for correctly in order to comply with statutory accounting regulations.

3. Capital Definition

- 3.1 All costs must be treated as revenue expenditure, unless it is correct and proper to treat them as capital expenditure.
- 3.2 Capital expenditure is defined as expenditure on the acquisition of an asset (eg. land, property, plant, equipment, vehicles) or expenditure which adds to (rather than merely maintains) the value of an existing asset, or considerably extends the life of the asset. The asset must also provide benefit to the Council for more than one year.
- 3.3 For example, the construction of a Council office building will be treated as capital expenditure. Whereas, the on-going annual running costs for that building (eg. staffing, heating, lighting, contracts, supplies) will be treated as revenue expenditure.

4. What Constitutes Capital Expenditure?

- 4.1 In order to be included in the Council's Capital Programme, capital schemes must have a total estimated cost of at least £10,000 in respect of land, property and infrastructure and £5,000 in respect of equipment, plant and vehicles. Schemes having a total cost of less than these values must be treated as revenue expenditure.

- 4.2 Directly attributable costs incurred after a capital scheme has been formally approved in detail by Council, should be treated as capital expenditure.
- 4.3 Preparatory or feasibility costs incurred “prior” to the formal approval of a capital scheme must initially be treated as revenue expenditure, as these costs may prove abortive if the scheme does not ultimately go ahead and so may not ultimately result in the creation of an asset. However, once the scheme has been formally approved and will therefore proceed, the related preparatory or feasibility costs may be treated as part of the capital scheme costs.
- 4.4 The cost of providing an extension to a building should be treated as capital expenditure, as it is likely to increase the value of the building.
- 4.5 Major structural maintenance costs such as re-roofing, re-wiring, re-plumbing, boiler replacement, full window replacement etc., which are considered to considerably extend the life of a property, should also be treated as capital expenditure.
- 4.6 However, day-to-day building maintenance and repair costs such as roof repairs, electrical and plumbing repairs, decorating, building and window repairs must be treated as revenue expenditure.
- 4.7 Individual expenditure transactions of less than £1,000 should usually be treated as revenue expenditure, unless they form part of a larger capital cost which meets the capital definition eg. the balance of capital contract payments, monthly recharges of capital fees, invoices for specific elements of capital works.
- 4.8 Professional fees in respect of Valuers, Highway Engineers, Landscape Architects, and Regeneration staff are considered to add value to the assets they deal with and may therefore be charged to the relevant capital schemes. However, it is important to ensure that sufficient capital allocation exists to fund these costs. All other staffing costs must be treated as revenue expenditure.
- 4.9 Project support and implementation costs such as room hire, printing, hospitality, training, advertising, publicity etc. must be treated as revenue expenditure.
- 4.10 Expenditure on the initial, one-off purchase of computer software may be capitalised as an intangible asset. However, the on-going cost of annual software licences, support contracts, implementation consultancy and system training must be treated as revenue expenditure.
- 4.11 Where capital schemes are part or fully externally funded, the definition of what constitutes capital expenditure applied by the external funding body may differ to that presented in this Guidance and therefore the requirements of the external funding body should take precedence.

5. The Council’s Capital Programme

Scheme Approval

- 5.1 The Council maintains a three year rolling programme of capital schemes (The Capital Programme). A summary of the three year Capital Programme is included in the Budget Report approved annually by Council. In addition a more detailed capital programme report is approved by Executive Board in June of each year, this contains detail of all known grant funded capital projects. In line with Finance Standing Orders specific capital schemes are reported throughout the year to Executive Board with a recommendation for Council to subsequently approve. Proposed new capital starts will be considered and

prioritised in the light of the Council's Medium Term Financial Strategy, the Asset Management Plan, and delivery of the Council's corporate priorities.

- 5.2 Reports seeking approval for individual capital schemes should include the following financial information;
- (i) the gross cost of each scheme before any external contributions, reimbursements, or capital grants;
 - (ii) the estimated cashflows over the life of the scheme;
 - (iii) the expected revenue expenditure consequences of the scheme and how these will be funded;
 - (iv) details of any specific funding attributable to the scheme such as from capital grants, external contributions and other reimbursements.
- 5.3 The Operational Director, Finance will ensure that the estimated capital financing costs of the approved Capital Programme are incorporated within the annually set revenue budget.
- 5.4 Once a detailed scheme has been formally approved the designated Project Manager should contact the Revenues and Financial Management Division, providing details of the approval, in order for the appropriate capital accounting codes to be set-up to enable orders to be raised and expenditure incurred against the scheme.

Variations to the Capital Programme

- 5.5 Variations to the Capital Programme may be addressed by transfers (virements) between capital schemes within the Programme. This must be with the written approval of the Operational Director, Finance, and may only be up to 10% on schemes costing less than £5m or up to £500,000 on schemes costing more than £5m, as set out in the Council's Standing Orders Relating to Finance.
- 5.6 Any variations in excess of £500,000 must be reported for approval by Council. The report should include the reasons for the variation, details of how the variation might be contained or mitigated, revised cost estimates profiled over the life of the scheme, and the impact upon the scheme of the potential cost overrun.

Year-end Carry Forward / Slippage

- 5.7 Where total expenditure by year-end is less than the total capital allocation approved for a particular capital scheme, due to delays, slippage, or other exceptional circumstances, the Operational Director, Finance may choose to approve the carry forward of allocation into the following financial year. All applications for carry forward, including full details of the circumstances, must be made in writing to the Operational Director, Finance by 31st March each year.

6. Funding the Capital Programme

- 6.1 Capital expenditure may be funded from a variety of sources including capital receipts, capital grants, prudential borrowing, and revenue contributions. The Operational Director, Finance shall arrange for the financing of the Capital Programme as considered appropriate.

Capital Receipts

- 6.2 Where capital assets are sold the resulting income is termed capital receipts. Capital receipts can be used to fund additional capital expenditure or to repay outstanding capital financing debt, but they cannot be used for revenue purposes.

Capital Grants

- 6.3 Capital grants are provided with the specific purpose of funding capital expenditure. This will be stated within the grant conditions and therefore they cannot be used for revenue purposes.
- 6.4 Where funding agencies indicate that capital grants may be utilised for expenditure which does not meet the capital definition or constitute capital expenditure as per Sections 3 and 4 above, then the funding agency should be asked to re-assign part of the capital grant as a revenue grant.

Prudential Borrowing

- 6.5 The Council is able to borrow funds from approved external institutions. However, this must be in accordance with the Prudential Borrowing Code of Practice (The Prudential Code).
- 6.6 The fundamental requirements for compliance with the Prudential Code is that the Council must be able to demonstrate that its borrowing is prudent, affordable and sustainable ie. that it is able to repay the annual financing costs (principal and interest) over the life of the loan.

Revenue Contributions

- 6.7 The Council may decide to make a contribution from the revenue budget to assist with funding a capital scheme. It is “not” however possible to use capital funding for the purposes of meeting revenue expenditure.

External Contributions and Reimbursements

- 6.8 External contributions or reimbursements from partner organisations or other bodies may be received towards the funding of capital schemes.
- 6.9 Where capital schemes are part or fully funded from external funding sources, the “gross” rather than “net” cost of the scheme must be included within the Council’s Capital Programme. All approval limits etc. will then apply to the gross expenditure total for the scheme.
- 6.10 Any external funding should be claimed regularly and as early as possible, in order to minimise the cash flow costs associated with schemes.
- 6.11 Where funding organisations indicate that their contribution may be utilised for expenditure which does not meet the capital definition or constitute capital expenditure as per Sections 3 and 4 above, then the funding organisation should be asked to re-assign part of their contribution as revenue funding.

7. Capital Expenditure Controls

- 7.1 Full narrative descriptions must be input on the Agresso system in respect of all capital transactions, to support their correct accounting treatment and to assist with reporting.
- 7.2 In order to ensure that all capital expenditure is correctly treated within the accounts, the Revenues and Financial Management Division will periodically check that all transactions charged to capital schemes meet the definition of capital expenditure outlined above.
- 7.3 Where transactions are identified which do not meet the capital expenditure definition they will be transferred to the revenue account.

7.4 All capital expenditure must be incurred in accordance with the Council's Procurement Standing Orders.

8. Capital Monitoring and Reporting Requirements

8.1 Comments should be sought from the Operational Director, Finance on all draft reports to Management Team or Members regarding capital proposals, spending and funding.

8.2 It is the responsibility of each designated Capital Project Manager to monitor expenditure for their schemes, in order to ensure they remain within the approved Capital Programme allocations.

8.3 Where expenditure is anticipated to exceed allocation, Capital Project Managers should liaise with their Finance Officer at the earliest opportunity, in order to agree the corrective action required to bring the scheme back in line with the Capital Programme.

8.4 Capital Project Managers are required to provide the Revenues and Financial Management Division with estimated quarterly expenditure profiles for each of their capital schemes, by 31 May each year. Any significant revisions to the profiles should also be notified to the Revenues and Financial Management Division during the year. The profiles will be used to monitor the Capital Programme and to provide quarterly Councilwide reports to Executive Board

8.5 The Revenues and Financial Management Division will provide access to appropriate financial reports, to assist Capital Project Managers with monitoring expenditure for each of their capital schemes.

9. Accounting for Capital Expenditure

9.1 Where capital expenditure does not increase the value of an asset or considerably extend its life, then at year-end the expenditure will be deemed "impaired" and certified as such by a Valuer. The impaired expenditure will then be charged against the Council's revenue budget.

9.2 The Council operates a five year rolling programme of land and property re-valuations, whereby a fifth of the land and property assets are re-valued each year. Changes in valuation arising from this exercise are then reflected in the value of assets held on the Council's balance sheet at year-end.

9.3 Changes in the valuation of assets are required by accounting regulations to be recorded and maintained as a historic record for each individual asset. This is to enable revaluations and impairments to be identified and accounted for on an individual asset basis.

Capital Project Financial Assessment Form

Division	
Responsible Officer	
Project Name	
Brief Description of project	
Intended purpose of scheme (eg regeneration, operational, investment, maintenance of asset)	
Outcomes hoped to be achieved	
Projected total cost	
How funded (eg grant, S106, capital receipts, borrowing, revenue, other)	
Value of contingency within project costs	
Ongoing annual revenue costs	
Estimated Life of asset (in years)	
Projected start date	
Projected end date	
Sensitivity analysis (for invest to save schemes)	

Notes for completion of form

Responsible Officer	This should be the name of the officer responsible for implementing the project.
Brief description of project	Describe what the capital monies will be spent on e.g. building new commercial property to be rented out to bring in income, purchase nursing home, prepare land for sale etc.
Outcomes hoped to be achieved	describe the reason for the scheme e.g. to retain nursing beds, to generate future revenue savings, to prolong life of existing asset etc.
Projected cost	This should be the total estimated cost to complete the capital project including capitalised salary costs, landscaping the area after completion (if required) and should include a contingency for unexpected costs.
How funded	For each different funding stream state exactly where the funding is coming from and how much e.g. for grants state which grant, for S106 monies state the agreement number, if borrowing state how the borrowing is to be repaid (i.e. cost centre savings will be coming from and over what period), if revenue state cost centre, if other state exactly where funds are coming from i.e area forum (state cost centre), developer - state who. Note that the total of 'how funded' should equal the 'projected cost'.
Ongoing annual revenue costs	e.g if purchasing a nursing home what would be the annual net cost of running the home, if building a new building what would be the costs of utilities, repairs etc.
Estimated life of asset	How long do you think the asset will last. E.g a vehicle may be 5yrs or may be 7 yrs, a building in good repair may be 60yrs. For a capital project to develop land for resale this may not be applicable.
Projected start & end date	When is it proposed the project will commence and if everything goes to plan when is the project expected to be complete so that the building can be used, the land can be sold, savings can be achieved etc.
Sensitivity analysis	This is required only for those schemes where the purpose of the scheme is to generate future income and may require input from your finance officer. You should state how long it would take for the scheme to break given the assumptions you have made, and how long it would take for the scheme to break given if those assumptions where different. Eg. if the scheme was to generate future income from solar energy and you have assumed future income will increase @ 3% per year how long would it take to break even if the increase was only 2% per year, or if it was 4% per year.