APPENDIX B

FAREHAM
BOROUGH COUNCIL

CAPITAL STRATEGY 2019/20

CONTENTS

INTRODUCTION

WHAT IS THE CAPITAL STRATEGY?

1. The capital strategy is a **new document for 2019/20**, following the introduction of the revised Prudential Code 2017. It gives a high-level overview of how **capital expenditure, capital financing, asset management 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.

2. The capital strategy compliments other Council strategies, including those in the diagram below:

3. The Capital Strategy covers:

Capital Expenditure	• Estimates of Capital Expenditure • Major Schemes - General Fund & HRA • Prioritisation
Capital Financing	• External Sources • Own Resouces • Debt
Asset Management	• Asset Management Plan • Asset Disposals
Treasury Management	• Investment Strategy • Borrowing Strategy • Commercial Activities

CAPITAL EXPENDITURE

4. 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 also includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

5. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not capitalised and are charged to revenue in year.

6. The Council is planning capital expenditure of £66m in the 5-year capital programme as summarised below:

Capital Expenditure	2018/19 Revised £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	Total £'000
Total General Fund	10,086	20,178	6,499	600	2,610	39,973
HRA	4,441	8,575	5,552	4,079	3,429	26,076
Total Expenditure	**14,527**	**28,753**	**12,051**	**4,679**	**6,039**	**66,049**

7. The main General Fund capital projects include schemes at Daedalus totalling £13.4m. The Council also plans to incur £5.1m of capital expenditure on the purchase of additional commercial property.

8. The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately and includes the building of 23 new homes at Highlands Road and Bridge Road, totalling £4.6m over the forecast period. Other housing developments are also in the pipeline.

GOVERNANCE

9. To ensure the Council is able to meet the financial challenges ahead, priority is given to the following:
    - Corporate priorities
    - Providing for future liabilities
    - Maintaining and protecting public assets
    - Investing in the future by ensuring assets are sustainable, encourage economic growth and regeneration, and meet the needs of the community.

10. This will be achieved by:

- Building up finances for the future, such as the allocation of windfall income to the Capital Fund Account.
- Maximising external funding opportunities to reduce the reliance on internal resources.
- Effective project planning and management to ensure schemes are completed on time and within budget.

CAPITAL FINANCING

11. 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 and leases). The planned financing of the above expenditure is as follows:

Capital Financing	2018/19 Revised £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	Total £'000
External Sources	1,771	3,823	600	600	758	7,552
Own Resources	7,054	8,725	11,451	4,079	5,281	36,590
Debt	5,702	16,205	0	0	0	21,907
Total Financing	**14,527**	**28,753**	**12,051**	**4,679**	**6,039**	**66,049**

12. 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 by putting aside revenue resources to repay debt 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:

	2018/19 Revised £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Minimum Revenue Provision	690	906	1,296	1,334	1,372
Future Capital Receipts	-	1,800	-	-	-

13. The Council's full MRP statement is available in the Council's Treasury Management Strategy.

14. 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 when MRP and capital receipts are used to replace debt.

15. The CFR is expected to increase by £5m during 2019/20 due to the purchase of a commercial property funded by debt. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

£'000	2018/19 Revised £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
General Fund	44,487	59,846	58,610	57,336
HRA	51,141	51,141	51,141	51,141
Total CFR	**95,628**	**110,987**	**109,751**	**108,477**

ASSET MANAGEMENT

16. To ensure that capital assets continue to be of long-term use, the Council has an **Asset Management Plan** in place which sets out the overall direction and framework for the management and development of the Council's assets pulling together cross service issues into a Council-wide plan.

17. It also provides clear, forward-looking strategic goals for its property assets that show how the Council's land and buildings will be used and developed to help deliver the Council's priority actions and service delivery needs, now and in the future. The plan shows how property assets will be maintained, modernised and rationalised to ensure that they are fit for purpose.

18. The Asset Management Plan sets out the property asset requirements for the achievement of the Council's corporate objectives and therefore is consistent with this strategy which seeks to ensure that the necessary capital resources are available to achieve these objectives. To fulfil the Council's obligations to maintain its assets to a good standard, it is highly likely that substantial capital funding will be required.

ASSET DISPOSALS

19. 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.

20. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £3.2m of capital receipts in the coming financial year as follows:

	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Right to Buy Houses	900	900	900	900
Other Housing Property	1,266	16	16	16
General Fund Property	1,060	0	2,400	0
Total	**3,226**	**916**	**3,316**	**916**

TREASURY MANAGEMENT

21. 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.

22. 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.

23. At 31 March 2018, the Council had £52m borrowing at an average interest rate of 2.87% and £12m treasury investments at an average rate of 1.09%.

BORROWING STRATEGY

24. 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%).

25. Projected levels of the Council's total outstanding debt are shown below, compared with the capital financing requirement.

	2018/19 Revised £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Debt at 1 April	52,017	58,017	74,017	74,017
Capital Financing Requirement (CFR)	95,628	110,987	109,751	108,477

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

AFFORDABLE BORROWING LIMIT

27. 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.

£'000	2018/19 Revised	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Operational Boundary				
Borrowing	62,000	78,000	78,000	78,000
Other long-term liabilities	4,000	4,000	4,000	4,000
Total	**66,000**	**82,000**	**82,000**	**82,000**
Authorised Limit				
Borrowing	102,000	132,000	120,000	110,000
Other long-term liabilities	6,000	6,000	6,000	6,000
Total	**108,000**	**138,000**	**126,000**	**116,000**

28. Further details on borrowing are in the Council's Treasury Management Strategy.

INVESTMENT STRATEGY

29. The Council invests its money for three broad purposes:
    - because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
    - to support local public services by lending to or buying shares in other organisations (**service investments**), and
    - to earn investment income (known as **commercial investments** where this is the main purpose

30. The Council does not currently have service investments but does have commercial investments.

Treasury Investments Policy

31. The Council's policy on treasury investments is to prioritise security and liquidity over yield, which 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.

32. Money that will be held for longer terms is invested more widely, currently in property but could also include bonds and shares, to balance the risk of loss against the risk of receiving returns below inflation.

33. 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.

34. Further details on treasury investments are in the Council's Treasury Management Strategy.

Treasury Investments Governance

35. Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance and Resources and staff, who must act in line with the treasury management strategy approved by full council. Half-yearly reports on treasury management activity are presented to the Executive. The Audit and Governance Committee is responsible for scrutinising treasury management decisions and therefore is presented with the annual Treasury Management Policy for comment, and a half yearly-report on adherence to this Policy.

Commercial Investments Policy

36. With central government financial support for local public services declining, the Council invests in commercial property purely or mainly for financial gain. Total commercial investments that have been purchased in accordance with the Council's Commercial Property Investment Acquisition Strategy are currently valued at £27.4 million with the largest being property at Southampton Road Retail Park providing a net return after all costs of 6.98%.

37. The Council's total investment portfolio is valued at £59 million and includes Fareham Shopping Centre, Faretec and industrial sites at Palmerston Business Park and Newgate Lane.

38. With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. Investing in property is not risk-free, so it is important that any acquisitions reflect the Council's risk appetite in terms of maintaining the capital value of the asset and extent to which rental income is guaranteed.

39. The principal risk exposures include vacancies and the resultant loss of income, added costs of holding a vacant property and cost of marketing and re-letting the property.

40. These risks are managed by ensuring:
    - funds available for new purchases are disaggregated to limit the overall impact that any single investment would have on the Council's finances;
    - there is a mix of property types in the portfolio e.g. retail, industrial
    - new purchases are only considered with existing tenants of "high quality" and sufficiently long tenancy term;
    - appropriate checks are carried out to ascertain the tenant's reliability before the investment is made and periodically afterwards;
    - other "due diligence" is undertaken to protect the Councils investment as far as possible such as checks on planning conditions, land contamination issues and planning policy issues.

41. The majority of investments will be held for a medium to long term in order to achieve the required return and to justify the cost of the acquisition. However, as part of the investment decision, consideration is also given to the potential ways in which the Council could "exit" from the investment, such as sale to another investor, sale for redevelopment, etc. An investment only proceeds where there is a clear exit strategy, should it be required.

Commercial Investments Governance

42. The Executive approved a Commercial Property Investment Acquisition Strategy on 7th January 2013.

43. The steps taken before a decision to purchase a property are clearly documented and tested via a challenge process involving the Head of Property Services, Director of Finance and Resources and the Executive portfolio holder for Policy Strategy and Finance.

44. Decisions on commercial investments are made by the Executive in line with the criteria outlined in the Commercial Property Investment Acquisition Strategy.

45. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

LIABILITIES

46. In addition to debt detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £61.2m as at 31 March 2018). It has also set aside provisions of £1.9m mainly to cover business rate appeals.

47. Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Director of Finance and Resources. The risk of liabilities

crystallising and requiring payment is monitored by Finance and reported as necessary.

48. Further details on liabilities in the 2017/18 Statement of Accounts.

REVENUE BUDGET IMPLICATIONS

49. 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.

50. 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.

	2018/19 Revised	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Financing costs	226,077	440,060	830,329	867,903
Proportion of net revenue stream	3%	5%	9%	9%

SUSTAINABILITY

51. 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 30 years into the future. The Director of Finance and Resources is satisfied that the proposed capital programme is prudent, affordable and sustainable.

KNOWLEDGE AND SKILLS

52. The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council also pays for junior staff to study towards relevant professional qualifications including CIPFA.

53. 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 currently employs **Arlingclose Limited** as treasury management advisers and a number of property consultants. 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.