APPENDIX B

Cyngor Bwrdeistref Sirol Pen-y-bont ar Ogwr

BRIDGEND County Borough Council

CAPITAL STRATEGY

2019-20 TO 2028-29

OVERVIEW OF STRATEGY

1.0 INTRODUCTION

The Prudential Code for Capital Financing in Local Authorities (2017) placed a requirement on local authorities to determine a Capital Strategy, to be approved by full Council, which demonstrates that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. Local Authorities should have in place a Capital Strategy that sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

This Capital Strategy is the policy framework document that sets out the principles to be used to guide the allocation of capital investment across all the Council's services and informs decisions on capital spending priorities within the Council's 10 year Capital Programme. It also reports on the delivery, affordability and risks associated with this Strategy.

1.1 AIMS AND PRINCIPLES

The Capital Strategy is presented to Council as a Policy Framework document, and links with the Corporate Plan, Treasury Management Strategy (TMS), Medium Term Financial Strategy (MTFS) and the Council's Asset Management Plan (AMP). It sets out:

- what is capital expenditure/investment and why we incur it;
- the Council's overall capital objectives, priorities and plans;
- how the Council's capital expenditure/investment will be funded/resourced
- how the Council's capital expenditure/investment plans will be appraised;
- how capital plans will be approved, monitored and reported upon; and
- the skills and knowledge required to deliver the capital plans.

The Capital Strategy should be read in conjunction with the Council's TMS which covers the Council's Investment Strategy and Borrowing Strategy and the Minimum Revenue Provision (MRP) policy which is attached as Schedule A to this document. The Council's borrowing and MRP policy are directly impacted by capital plans.

The capital programme is a key element of the MTFS. The MTFS provides a set of clear principles which drive the budget and spending decisions of the Council. There are fourteen principles in total, but the following three refer specifically to the capital programme and Strategy:

9. Capital investment decisions support the Council's corporate priorities and mitigate any statutory risks taking account of return on investment and sound option appraisals.

10. Prudential borrowing is only used to support the capital programme where it is affordable and sustainable within the Council's overall borrowing limits and the revenue budget over the long term.

11. Decisions on the treatment of surplus assets are based on an assessment of the potential contribution to the revenue budget and the capital programme.

The Capital Strategy sets out a number of guiding principles on the following:

PRINCIPLE 1 : Focus capital investment on delivery of the Council's Objectives and Priorities
• Ensuring that capital investment plans are driven by the Council's Corporate Plan.
• Ensuring decision-makers are clear on the positive contribution capital investment makes to corporate objectives
• Appraising all investments in the context of objectives/priorities
• Ensure a corporate business planning process incorporating service transformation and the impact on property assets
PRINCIPLE 2 : Ensure strong governance over decision-making
• Ensuring that proposals demonstrate that a rigorous process of options appraisal has been followed, requiring evidence of need, cost, risk, outcomes and methods of financing
• Schemes will only be added once an affordable business plan is in place and it demonstrates value for money
• All major capital schemes have a lead Project Sponsor and follow project management principles
• The approval process within the Financial Procedure Rules contained in the Constitution are strictly adhered to
PRINCIPLE 3 : Ensure capital plans are affordable, sustainable and prudent
• Promote capital investment which allows invest to save outcomes and which contribute to future MTFS savings
• Make sure assets perform at an optimal level through effective ongoing asset management and consistent with levels of investment
• Review and challenge the Council's assets, including the need, cost and performance of the estate
• Maximise the use of Internal Borrowing and maintain an under-borrowed position compared to its Capital Financing Requirement if feasible
PRINCIPLE 4 : Maximise and promote the best use of available funds
• Generate funding, where possible, from the rationalisation of existing assets with a strong Disposal Strategy
• Minimise the use of ring-fencing capital receipts to ensure a One-Council approach
• Bidding for external funds where possible and ensuring that there are effective working relationships with external funders
• Have clear policies for the consumption of our reserves
• Ensuring that there is effective pre and post project appraisal
• Ensuring up to date property information relating to condition surveys, life cycle costs and maintenance back logs
• An estates strategy which tracks lease covenant compliance

CAPITAL EXPENDITURE AND INVESTMENT

2.0 CAPITAL EXPENDITURE

Capital investment is technically described as:

"Expenditure on the acquisition, creation, or enhancement of 'long term assets'"

This generally consists of land, property and plant which have a useful life of more than 1 year, but can also include funding passed on to other bodies in order for them to undertake capital works. Expenditure outside this definition will be, by definition, revenue expenditure.

Expenditure can be capitalised where it relates to the:-

- Acquisition, reclamation, enhancement or laying out of land.
- Acquisition, construction, preparation, enhancement or replacement of roads, buildings and other structures.
- Acquisition, installation or replacement of movable or immovable plant, machinery, apparatus vehicles or vessels.

Enhancement of an existing fixed asset means:-

- To lengthen the useful life of the asset; or
- To increase substantially the open market value of the asset; or
- To increase substantially the extent to which the asset can be used for the purposes of, or in connection with, the functions of the Council.

Within the Accounting Policies for the Council, expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalised on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the Council and the cost of the item can be measured reliably. Expenditure that maintains but does not add to an asset's potential to deliver future economic benefits or service potential (i.e. repairs and maintenance) is charged as an expense when it is incurred.

All expenditure on Property, Plant and Equipment is recognised irrespective of value. Capital expenditure below £40,000 is considered non-enhancing and is immediately impaired unless cumulatively over more than one year the expenditure would amount to more than this value.

The Council currently does not make use of any capitalisation flexibilities nor capitalise any borrowing costs associated with the capital programme.

The Council's capital expenditure plans are linked to the Corporate Plan, Asset Management Plan, priorities and service delivery plans with the inclusion of the 'Future Property Needs' within the business plan template.

The Council has acquired relatively few property assets over the last few years. Its focus has been on releasing or remodelling existing assets. From time to time it has acquired property required for service developments, for example purchasing land and buildings for school modernisation projects. It has also secured £1million capital funding for commercial property investment, which has been partially spent on acquiring an income producing leased property. To date the remainder is unspent as no suitable options which meet the Council's criteria have been forthcoming. It has also recently acquired third party interests in Salt Lake car park which has enabled it take control of the regeneration and development of the site and generation of capital receipts.

In 2019-20, the Council is planning capital expenditure of £36.157 million as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2017-18 Actual £m	2018-19 Projection £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m
Council Fund services	36.584	35.474	35.677	21.713	18.794
Investment Properties	-	-	0.480	-	-
TOTAL	**36.584**	**35.474**	**36.157**	**21.713**	**18.794**

2.1 CAPITAL FINANCING

The Council receives an annual 'General Capital Funding' allocation from Welsh Government, which comprises General Capital Grant and un-hypothecated Supported Borrowing. Revenue funding to repay the supporting borrowing is included within the Revenue Support Grant. There are a number of other funding sources available to the Council and these are detailed in Schedule B attached.

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 net financing requirement (borrowing, leasing and Private Finance Initiative). The planned financing of the expenditure outlined in Table 1 is as follows:

Table 2: Capital financing

	2017-18 Actual £m	2018-19 Projection £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m
External sources	16.629	11.558	9.950	9.807	8.169
Own resources	10.102	17.999	14.978	5.659	4.387
Net Financing Requirement	9.853	5.917	11.229	6.247	6.238
TOTAL	**36.584**	**35.474**	**36.157**	**21.713**	**18.794**

The net financing requirement or '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 from revenue which is known as MRP. As well as MRP, the Council makes additional voluntary revenue contributions to pay off Prudential or Unsupported Borrowing. The Council changed its policy on MRP in 2018-19 which is why this has reduced from 2017-18 but it is still considered a prudent provision. The total of these are shown in Table 3 below:-

Table 3: Replacement of debt finance

	2017-18 Actual £m	2018-19 Projection £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m
Minimum Revenue Provision (MRP)	5.056	2.858	**2.885**	2.912	2.937
Additional Voluntary Revenue Provision	1.364	1.486	**1.995**	2.259	2.858
Total MRP & VRP	**6.420**	**4.344**	**4.880**	**5.171**	**5.795**
Other MRP on Long term Liabilities	**0.734**	**0.641**	**0.690**	**0.743**	**0.801**
Total Own Resources	**7.154**	**4.985**	**5.570**	**5.914**	**6.596**

The existing Capital Programme will be approved by Council before the start of the financial year 2019-20 as part of the MTFS.

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 by the MRP amount within the year. The CFR is expected to increase by £5.659 million during 2019-20. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement

	2017-18 Actual £m	2018-19 Projection £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m
Capital Financing Requirement (CFR)					
Opening CFR adjusted excluding PFI & other liabilities	149.203	153.239	**154.811**	161.160	162.237
Opening PFI CFR	18.235	17.640	**17.000**	16.309	15.566
Opening Innovation Centre	0.663	-	**-**	-	-
Opening Coychurch Crematorium	0.079	-	**-**	-	-
Total Opening CFR	**168.180**	**170.879**	**171.811**	**177.470**	**177.803**
Movement in CFR excluding PFI & other liabilities	3.433	1.572	**6.349**	1.076	0.433
Movement in PFI CFR	(0.595)	(0.641)	**(0.690)**	(0.743)	(0.801)
Movement in Innovation Centre CFR	(0.060)	-	**-**	-	-
Movement in Coychurch Crematorium	(0.079)	-	**-**	-	-
Total Movement in CFR	**2.699**	**0.932**	**5.659**	**0.333**	**(0.358)**
Closing CFR	**170.879**	**171.811**	**177.470**	**177.803**	**177.445**
Movement in CFR represented by :-					
Net Financing Need for Year (Table 2 Above)	9.853	5.917	**11.229**	**6.247**	6.238
Minimum and Voluntary Revenue Provisions	(6.420)	(4.344)	**(4.880)**	(5.171)	(5.795)
MRP on PFI and Other Long Term Leases (Table 3 above)	(0.734)	(0.641)	**(0.690)**	(0.743)	(0.801)
Total Movement	**2.699**	**0.932**	**5.659**	**0.333**	**(0.358)**

THE COUNCIL'S CAPITAL PLANS

3.0 CAPITAL PROGRAMME BY CORPORATE PRIORITY

Within the Corporate Plan, there are three corporate priorities namely:-

- Supporting a Successful Economy
- Helping People to be more Self-Reliant
- Smarter Use of Resources

In accordance with **PRINCIPLE 1** above, the majority of schemes within the existing Capital Programme link to the Council's Corporate Priorities, but there are also schemes that relate to Core Services and Statutory Functions.

Supporting a Successful Economy

The proposed capital programme includes a number of new and existing projects which will help to support a successful economy by, for example, significant new investment in ensuring that the carriageways and footways are of a good standard to encourage the use of local services by the public and avoid the need to travel to out of town developments. There are also new allocations in respect of road safety improvements in a bid to improve access across the highway to residential and commercial areas. These supplement those existing schemes, such as the Cardiff Capital Region City Deal (CCRCD) investment which will be targeted to focus on raising economic prosperity, increasing job prospects and improving digital and transport connectivity.

Helping People to be more Self-Reliant

In addition to the two new Extra Care Schemes enabling people to live more independently than they would in residential care, there are two new schemes included within the programme which meet the corporate priority of helping people to be more self-reliant. The first is the ARCH – a healthy living and wellbeing centre, providing advice, support and signposting for a number of health intervention services, such as physiotherapy, exercise, substance misuse and lifestyle management; the other scheme involves remodelling of one of the Council's existing social services buildings to provide a 'children's accommodation hub', reducing the number of children who need to be placed out of county.

Smarter Use of Resources

One of the Council's Corporate Priorities is to ensure that we have Smarter Use of Resources and crucially this includes assets. The Council's AMP 2021 strategic aim is to have a lean sustainable estate with fewer better buildings. This is achieved through review and challenge on a geographic and service led basis. Examples of schemes within this priority include:-

- The Schools' Modernisation Programme - the Council is embarking on Band B of the 21st Century Schools Programme, which will result in further capital investment of around £70 million in the Council's schools' estate;
- Parc Afon Ewenni - the Programme Board has reviewed its depot estate and is rationalising the number of depots it holds and investing in its existing larger depot sites at Waterton and Bryncethin; and
- Porthcawl - the Council has substantial land holdings in Porthcawl which it is looking to bring forward to support regeneration of the area and to generate capital receipts.

3.1 OTHER KEY DRIVERS

As well as the Corporate Plan, there are other key drivers of the Council's capital plans. These are:

- Asset management requirements
- Health and Safety works

3.2 ASSET MANAGEMENT REQUIREMENTS

The Council's Asset Management Plan (AMP 2021) was reviewed by Wales Audit Office in 2015 as part of the Corporate Assessment and the following comment was made:

> **2015 WAO Corporate Assessment**
>
> The Council's Asset Management Plan (AMP 2021) : "*The Council has an effective approach to corporate asset management and is on course to achieve its long-term goals".* The Council's vision for property is 'to have a lean, sustainable estate" that supports delivery of the 'Best Local Services in Wales'. This is achieved by constantly reviewing and challenging our assets and whether they should be released, retained or remodelled.

The following clear principles drive the on-going challenge and management decisions relating to our assets:-

1. The AMP 2021 supports and maintains alignment with the MTFS and the Corporate Plan, linking with other resource strategies.
2. Capital investment decisions support the Council's corporate priorities and mitigate any statutory risks taking account of return on investment and sound option appraisals.
3. Decisions on the treatment of surplus assets are based on an assessment of the potential contribution to the revenue budget and the capital programme.
4. The non-operational portfolio will deliver an annual surplus over the MTFS period anticipated to be in excess of £500,000 per annum.
5. A balance will be maintained within the non-operational portfolio between, rental income, capital receipts, economic development/ community support.
6. Capital receipts generated will support the capital programme.

In 2018, the Council introduced a Corporate Landlord Model which is working to deliver the AMP 2021. The Corporate Landlord holds all buildings and associated budgets and is responsible for their effective management on a portfolio basis. The intention is that this provides greater control and oversight on matters such as statutory compliance, as well as more efficient delivery resulting in revenue and capital savings. As part of the delivery programme the Corporate Landlord will set up effective governance for the review and challenge of the assets it holds to ensure that alternative potentially more cost effective options are fully considered.

The Council also has a Highways Asset Management Plan (HAMP). The HAMP needs to take in to account the following:-

1. Much of the infrastructure serving the northern half of the county borough was originally constructed in the early 1900's and was not designed to cope with the current demands (economic, social and environmental) placed upon it.

2. The BCBC highway network is continuously growing with no sign of abatement. The Council has seen much in the way of development over the last decade, resulting in a significant increase in the amount of asset requiring management.
3. Highway Authorities have a statutory duty to maintain highways and ensure that they are available for safe use by all.

The HAMP is an essential document that sets out how the levels of service for the infrastructure network determined by the Council will be achieved. The HAMP is therefore a "living" document that will be subject to continual review and development.

3.3 HEALTH AND SAFETY WORKS

There is an earmarked reserve for Asset Management including funding for Condition Surveys. Up to date condition surveys for the whole estate will be procured which will include a planned preventative maintenance programme. This will inform the Council's budget allocation for both revenue and capital repairs, maintenance and new build. Given the limited capital and revenue funding and the currently known high level of maintenance backlog, it will require the creation of a prioritisation matrix for budget allocation. Statutory compliance and health and safety works obviously forming the highest priority. Given the potential level of funding compared to the demand for repairs and maintenance, this may lead to the closure of buildings or the drive for further capital investment in new build projects. Once fully implemented the Corporate Landlord model will be able to effectively inform the capital funding planning and decision making as it relates to asset management.

For highway structures, the current basis for prioritisation is one of reactive safety repairs, where the asset is risk assessed using a standardised matrix. This risk assessment is then considered against the individual assets Bridge Condition Indices (BCI) rating. This allows the prioritisation of schemes and allocation of the available budget to ensure the best value is achieved. A similar approach is applied to carriageway and footway schemes, where combinations of technical survey, site inspections and member of public reports determine the basis for the prioritisation of works.

In 2019-20, there will be two new Earmarked Reserves as below:-

- Capital Asset Management Fund
- Highways Asset Management Fund

The intention of these is to fund those schemes that have been prioritised by the condition surveys as posing a Health and Safety risk either within buildings or within our Highways Infrastructure. The aim will be to replenish these reserves as funding allows. The monitoring of these reserves will be provided to Corporate Management Board on a quarterly basis.

3.4 COMMERCIALISATION POLICY

The Council will consider, if the opportunities arise, the purchase of land and property as an investment – to both generate an ongoing income stream or to realise an increased capital value in the future. There are two ways that an authority can generate income from investment properties namely:-

- Direct purchase of investment property – through Capital Programme
- Investment in a Property Unit Trust – through Treasury Management

The first would see authorities investing in property by directly purchasing/developing properties with the intention of securing a revenue income from that investment. Investment in property leaves the Council open to all of the risks that would go with such a policy, such as devaluations, maintenance issues and potential tenant default, as well as the potential benefits such as a long term asset on the balance sheet and rental income. The second route would be to receive income from property by investing in an appropriate property unit trust. Returns from this fund are typically in the order of 5.5%-6% per annum though at a fee from the fund manager. It is an actively managed property fund, which means that fund managers have the potential for growth in the income as, over time, higher rents can be achieved by buying properties in areas where demand is growing, by adjusting the exposure to different areas of the market and by improving the quality of the properties as appropriate.

As well as the benefit of rental income from the direct purchase of an investment property, there might also be capital appreciation of the asset though this will only be realised once the asset is sold and a capital receipt is generated which could be then recycled to purchase replacement investment properties which would not incur then capital financing costs.

A strategy based on investment in properties does have the following risks:-

- Low liquidity and flexibility
- Physical/structural issues with buildings
- Greater exposure to economic, cultural and technological changes
- Void periods

But against this it has the potential benefits of:-

- Over a longer term a higher financial return and capital growth than other current investments
- A wider range and variety of investment tools

The Council does have an existing investment portfolio which is 100% based within the County Borough and primarily the office and industrial sectors. The income streams are generally spread between the single and multi-let office investments on Bridgend Science Park, the multi-let industrial estates and the freehold ground rent investments. The portfolio therefore does not accord with the risk balance in location and sectoral terms to the majority of investment portfolios and is also management intensive, with a large number of units relative to the overall income and value. The total value of Investment Properties was £4.360 million as at 31 March 2018 which generates a rental income of £438,000 per annum.

There are limited opportunities within the existing investment portfolio to release / sell properties, as the current emphasis is to enhance income return (as opposed to capital value). The majority of the investments held are high yielding and an improved income stream is unlikely on any re-investment.

The majority of the Council's investment portfolio has grown organically. However, within the last 5 years, the Council approved £1 million within the capital programme and spent £520,000 on acquiring an office building, which generates a rental income of £56,000 per year or just over 9% return on the investment. There is a further £480,000 available but as yet no suitable options have been identified within the Bridgend area, which would produce a reasonable return and at acceptable levels of risk. The Council may in the future wish to consider expanding its property investment portfolio and in which case would need to review the criteria and investment strategy but this would be on a risk based approach.

3.5 TREASURY MANAGEMENT STRATEGY (TMS)

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.

3.6 BORROWING STRATEGY

The Council's major objectives when borrowing are:-

- to minimise the revenue costs of debt
- to manage the Council's debt maturity profile i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing
- to effect funding in any one year at the cheapest cost commensurate with future risk
- to forecast average future interest rates and borrow accordingly
- to monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movement
- to reschedule debt if appropriate, in order to take advantage of potential savings as interest rates change
- to optimise the use of all capital resources including borrowing, both supported and unsupported, usable capital receipts, revenue contributions to capital and grants and contributions

3.7 LIMITS TO BORROWING ACTIVITY

The Council's long term borrowing at 31 December 2018 was £96.87 million. External borrowing can arise as a result of both capital and revenue expenditure and timing of cash flows. As the Council has an integrated TMS, there is no association between individual loans and particular types of expenditure. The Council makes use of internal borrowing and maintains an under-borrowed position in accordance with **PRINCIPLE 3** above. The capital borrowing need (Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. Projected levels of the Council's total outstanding debt, which comprises of borrowing, PFI and Other Long Term Liabilities, are shown below compared with the Capital Financing Requirement:-

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

	2017-18 Actual £m	2018-19 Projection £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m
Debt (incl. PFI & leases)	117.891	116.691	**130.458**	135.140	142.983
Capital Financing Requirement	170.879	171.811	**177.470**	177.803	177.445

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

To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. Further details of the Liability Benchmark can be found within the Treasury Management Strategy 2019-20. It does show that an additional £29 million will need to be borrowed for the period 2019-20 to 2021-22 based on the assumptions within the Capital Programme and the use of Capital Receipts and Reserves. The actual amount will be monitored and assumptions challenged and borrowing will only be taken if there is no opportunity to use Internal Borrowing.

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.

Table 6: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2017-18 Actual £m	**2018-19 Projection £m**	**2019-20 Estimate £m**	**2020-21 Estimate £m**	**2021-22 Estimate £m**
Authorised limit – borrowing Authorised limit – other long term liabilities	140.000 30.000	145.000 30.000	**170.000** **30.000**	170.000 30.000	175.000 30.000
Authorised Limit Total	**170.000**	**175.000**	**200.000**	**200.000**	**205.000**
Operational boundary – borrowing Operational boundary – other long term liabilities	105.000 25.000	105.000 25.000	**115.000** **20.000**	120.000 20.000	130.000 20.000
Operational Boundary Limit Total	**130.000**	**130.000**	**135.000**	**140.000**	**150.000**
Total Borrowing and Long Term Liabilities	**117.891**	**116.991**	**130.758**	**137.710**	**144.283**

3.8 INVESTMENT STRATEGY

The Council's major objectives when investing are:-

- to maintain capital **security**
- to maintain **liquidity** so funds are available when expenditure is needed
- to achieve the **yield** on investments commensurate with the proper levels of security and liquidity

Cash that is likely to be spent in the near term is invested, 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 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 7: Treasury management investments

	2017-18 Actual £m	**2018-19 Projection £m**	**2019-20 Estimate £m**	**2020-21 Estimate £m**	**2021-22 Estimate £m**
Cash and Cash Equivalents	1.400	1.000	-	-	-
Short term Investments	20.000	10.000	7.000	7.000	7.000
Longer term Investments	9.000	4.000	3.000	3.000	3.000
TOTAL	**30.400**	**15.000**	**10.000**	**10.000**	**10.000**

Loans to Other Organisations
The Council can make investments to assist local public services, including making loans to small businesses to promote economic growth. The Council will assess these opportunities and will only consider if such investments break even after all costs. Loans to such organisations will be approved as part of the capital programme.

3.9 OTHER LONG TERM LIABILITIES

Private Finance Initiative
The Council has a Private Finance Initiative (PFI) arrangement for the provision of a Secondary School in Maesteg. This forms a long-term liability for the Council (with sixteen years remaining on the term) which is £17.64 million at 31 March 2018 and includes the short term PFI liability of £0.64 million which is included as current liabilities in the Council's balance sheet in the Statement of Accounts. This is a technical adjustment and is equivalent to the amount that is paid during 2019-20.

Loans to the Council
The Council has £2.40 million relating to a loan from the Welsh Government Central Capital Retained Fund for regeneration works within the Llynfi Valley which has not yet commenced. This is included within Other Long Term Liabilities of the Council.

Pension Guarantees
The Council has entered into a number of long-term contracts for services that have been outsourced to service providers. These often involve the transfer of Council employees to the new service provider. Employee's rights are protected under the provision in Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). However, pension rights are not fully covered within TUPE regulations. The Council have thus given a pension guarantee to the Awen and Halo organisations. This guarantee means that if an admitted body fails to pay its pension obligations then the Council will be responsible for taking on those obligations.

3.10 REVENUE BUDGET IMPLICATIONS

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 8: Prudential Indicator: Proportion of financing costs to net revenue stream

	2017-18 Actual £m	2018-19 Projection £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m
Capital Financing Central	8.664	6.495	6.741	7.049	7.264
Other Financing costs	3.450	3.433	3.941	4.206	4.804
TOTAL FINANCING COSTS	**12.113**	**9.928**	**10.682**	**11.254**	**12.068**
Proportion of net revenue stream	4.72%	3.73%	3.94%	4.15%	4.43%

From the table above it is evident that the proportion of the budget set aside to finance capital expenditure is due to increase over the life of the current programme, accelerating the pressure that capital expenditure, funded from debt, puts on the revenue budget.

Table 9: Central Capital Financing Revenue Budget 2019-20

	2017-18 Actual £m	2018-19 Projection £m	2019-20 Budget £m
Interest Paid	4.567	4.671	5.447
Minimum Revenue Provision (MRP)	5.056	2.858	2.885
Other Financial Instruments	0.008	0.009	0.008
Interest Received	(0.959)	(1.009)	(0.910)
Central Capital Financing Budget	**8.672**	**6.528**	**7.430**

The central revenue budget for capital financing for 2019-20 is £7.430 million as detailed above. The Projection for 2018-19 is lower than the actual spend 2017-18 because of the change in MRP Policy that Council approved in September 2018. The Interest Paid budget 2019-20 reflects the need to fund the increased costs of borrowing which is anticipated to rise over the period from 2018-19 to 2021-22 by £29 million.

There are also Financing Budgets within the Directorates for Prudential Borrowing and for the payment of the PFI School and other Lease Liabilities. These are detailed in Table 10 below:-

Table 10: Directorate Capital Financing Revenue Budget 2019-20

	2017-18 Actual £m	2018-19 Projection £m	2019-20 Budget £m
Additional Voluntary MRP	1.364	1.486	2.062
PFI & Lease Liability Payments	2.086	1.947	1.981
Directorate Capital Financing Budget	**3.450**	**3.433**	**4.043**

Table 11 shows how there will be increased revenue pressure on the capital financing budgets over the MTFS period:-

Table 11: Capital Financing Revenue Budget 2019-20 and Projected Costs

	2019-20 Projection £m	2020-21 Projection £m	2021-22 Projection £m
Central Capital Financing Budget (Table 9)	**7.430**	**7.430**	**7.430**
Directorate Capital Financing Budget (Table 10)	**4.043**	**4.043**	**4.043**
Total Capital Financing Budget	**11.473**	**11.473**	**11.473**
Total Financing Costs (Table 8)	**10.682**	**11.254**	**12.068**
Under/(Over) Spend	**0.791**	**0.219**	**(0.595)**

This would be the worst case scenario with unsupported borrowing being used for future schemes. The Council will endeavour to minimise the revenue pressure by maximising alternative capital resources such earmarked reserves and capital receipts.

RESOURCING STRATEGY

4.0 FINANCIAL CONTEXT

Whilst the aims and priorities will shape decisions around capital expenditure, there is recognition that the financial resources available to meet priorities are constrained in the current economic and political climate. The context for capital expenditure decisions is as follows:

- The Council does have capital resources and expects to receive more resources in the future with an annual allocation from Welsh Government, potential s106 Monies or grant approvals.
- The Council does have a Disposal Strategy and has capital assets which it could sell and use receipts to reinvest
- The Council is currently servicing debt of £97 million with an average interest rate of 4.7%
- The Council's MTFS shows a funding gap so any additional capital expenditure which is not funded through capital resources will increase this gap unless that expenditure delivers revenue savings or income.

There has been a steady decline in the amount of general capital funding received from Welsh Government over several financial years. However, a letter from the First Minister in November 2019 identified an additional £100 million in capital funding over the period 2018-19 to 2020-21. For 2019-20 there is an additional £30 million, and Bridgend has received an increase in general capital funding of £1.336 million. There is £20 million additional funding in 2020-21 and Bridgend is expected to receive around £890,000 in this financial year (£2.226 million total).In light of the above context, it is imperative that capital expenditure plans are affordable, prudent and sustainable.

4.1 PRINCIPLES FOR ALLOCATION OF CAPITAL ALLOCATION

The governing principles which underpin the allocation of capital resources are set out in the following diagram:

	Funding Source				
Nature of Capital Expenditure	**General Capital Funding / Supported Borrowing**	**Capital Receipts / Uncommitted Reserves**	**Interest Free Loan**	**Unsupported Borrowing - Corporate Funding**	**Unsupported Borrowing - Directorate Funding**
Mandatory					
Corporate Priority					
Investments which attracts Matched Funding					
Invest to Save / Income Generation - Commercial					

	Eligible for funding from this source
	Not eligible for funding from this source

In summary the main principles of capital allocation are:

General Capital Funding and Supported Borrowing from Welsh Government will be prioritised towards mandatory capital investments. This includes investment required to meet health and safety requirements. This principle also applies to uncommitted capital receipts and capital reserves.

Beyond this, any consideration will be given to capital schemes which directly support the achievement of the Council's corporate objectives.

Unsupported (Prudential) Borrowing will be prioritised as follows:

- To mandatory capital expenditure, including health and safety requirements. This will be considered to be an inescapable budget pressure and will be included in future years' budgets as part of the annual budget setting process.

- To capital expenditure which directly supports the achievement of the Council's corporate priorities. Borrowing for such projects will be funded corporately through an increase in budget allocation, which must be approved by full Council. Such borrowing commits the Council to interest and repayments during the asset life, and therefore it must be recognised that as budgets are reduced, the financing costs must be met by budget cuts elsewhere.

- To capital expenditure which attracts a high level of matched funding. This is particularly important as the Council tries to maximise every £1 it spends on capital with schemes involving external grants or contributions from partners. The aim is for the Council to ensure that it invests in its strategic buildings and town centre infrastructure as grant funding and inward investment opportunities become available by allocating uncommitted reserves, maximising interest free loans or unsupported borrowing.

- To capital expenditure which provides a good financial return. Borrowing for such projects must be funded by the directorate, and therefore the financial benefit accruing to the directorate will be net of financing costs. This approach aligns the directorate incentives with the corporate benefit of such projects. Advantage will be taken of interest free loans where available.

CAPITAL INVESTMENT APPRAISAL

5.0 CAPITAL EXPENDITURE BIDS

The Council will maintain a rolling ten year capital programme, to be updated on an annual basis (or more frequently as required) to take into account revised priorities, new schemes and changes in the availability of funding. The current year's programme is monitored on a quarterly basis by Cabinet.

The Council's Capital Programme contains a number of recurrent Annual Allocations, which are the first call on its General Capital Funding. These allocations should be reviewed annually with a view to determining whether they are still essential, relevant and achieving the outcomes expected, and amended accordingly.

Where capital resources allow as a result of additional general capital grant, earmarked reserves or capital receipts, as part of the MTFS process, Directorates will be requested from September each year to submit Expressions of Interest for new capital schemes, outlining:

- Proposed Project
- Timescale
- Potential Cost
- Potential Revenue Savings
- Link to Corporate Priorities
- Risk of not Undertaking

These will be ranked in order of fit to:

1. **Link to corporate priorities:**
2. **High level of Risk of not progressing, based on the following criteria**

High	High risk to BCBC in terms of service delivery and/or meeting MTFS Savings e.g. Urgent/ Essential Works to prevent imminent building failure and closure. Requirement to meet approved Bridgend Change Programme Project to deliver MTFS Savings
Medium	Medium risk to BCBC in terms of service delivery and/or meeting MTFS Savings e.g. identified works required over the next 2 to 5 years. Requirement to meet Proposed Bridgend Change Programme Project to deliver MTFS Savings
Low	Low risk to BCBC in terms of service delivery and/or meeting MTFS Savings e.g. identified works desirable , Requirement to meet yet to be identified Bridgend change Programme Project to deliver MTFS Savings

3. **Service is able to meet any additional revenue costs arising from the scheme e.g. increased Business Rates, running costs.**
4. **Ability to attract matched funding / high leverage ratio.**
5. **An appropriate return on investment where appropriate.**

5.1 EVALUATION APPROACH

As stated, the Council only has a limited amount of resources, and needs to have regard to the overall affordability of the capital programme in future years. Each scheme, therefore, needs to be evaluated to ensure it meets the Council's objectives and in accordance with **PRINCIPLE 1** above.

The business plan put forward for a capital project will be reviewed to ensure it takes account of stewardship, value for money, prudence, sustainability and affordability. Investment decisions will consider risk and reward and how the project contributes to the achievement of corporate objectives. The phasing of projects over more than one financial year will be assessed to ensure timetabling of plans and budgeting is realistic and funding is available over the life of the project.

The revenue implications for each capital bid are considered at the initial evaluation stage, covering both staffing /running costs associated with the bid and the financing costs over the lifetime of the asset created. One of the Chief Finance Officer's requirements when reviewing capital bids is to ensure that the revenue implications are realistic. The options appraisal exercise undertaken for larger projects seeks to ensure that the lifetime revenue implications of a capital project are fully considered and evaluated, are affordable and are included in the MTFS in accordance with **PRINCIPLE 2** above.

Successful projects will then be required to complete a full Business Case to be considered in more detail by Corporate Management Board and Cabinet for eventual inclusion in the Capital Programme to be incorporated in the MTFS, to be approved by Council.

The Council can also make Treasury investments including overnight deposits, fixed term investment, money market funds, property funds and government bonds. These investments are made in accordance with the TMS which is approved alongside the Capital Strategy.

<u>In Year Approvals</u>

Any bids for capital funding outside of the annual MTFS bidding round should be accompanied by a full business case and be supported by the appropriate Director, Section 151 Officer and Cabinet. All funding sources should be fully identified before the bid is taken forward for Council approval for inclusion in the capital programme.

In line with the Council's Financial Procedure Rules, schemes for which external funding has been approved (grants, S106 etc) will be added to the capital programme once the funding has accepted and included in the next capital programme report to Council.

In addition, any urgent expenditure not included in any budget approval, which needs to be agreed prior to the next meeting of Council, may only be incurred with the approval of the Chief Finance Officer, subject to a maximum value of £100,000. Any such decision requires approval by either the Chief Executive Officer (or can be sub-delegated to the Section 151 Officer) under the Scheme of Delegation, Scheme B1 paragraph 2.2.

GOVERNANCE AND RISK MANAGEMENT

6.0 STRATEGY

It is important given the risks surrounding Capital Projects that the appropriate Governance framework is in place. This is highlighted in **PRINCIPLE 2** above.

The Prudential Code sets out a clear governance procedure for the setting and revising of a capital strategy and prudential indicators i.e. this should be done by the same body that takes the decisions for the local authority's budget – i.e. Full Council.

The Chief Finance Officer will prepare a Capital Programme for consideration by Corporate Management Board (CMB) and Cabinet. It must be approved by Council in accordance with the Financial Procedure Rules of the Council's Constitution.

Variations to the capital programme, other than those permitted under Rules 3.4.7 and 3.4.9 of these Rules, shall require the approval of the Council following a report of the Chief Finance Officer after taking into consideration the recommendations of the Cabinet.

6.1 CAPITAL EXPENDITURE/INVESTMENT DECISION

A monitoring process is in place which:

- Reports on variances in expenditure and slippage on schemes and seeks explanations from project managers to report back to CMB and Cabinet to inform future planning decisions
- Quarterly capital monitoring reports will be prepared for Cabinet which should include details of any virements between projects as well as projections of likely year end spend.

A post project appraisal of all projects in accordance with the Project Management Toolkit must be completed to demonstrate how objectives have been met, how final costs compared to budget and what revenue costs / savings materialised. This information will be reported back to feed future appraisal exercises.

6.2 RISK MANAGEMENT

Major capital projects require careful management to mitigate the potential risks which can arise. The effective monitoring, management and mitigation of these risks is a key part of managing the capital strategy.

General risks are those which are faced as a consequence of the nature of the major projects being undertaken. Most of these risks are outside of the Council's control but mitigations have been developed as part of the business planning and governance process.

Financial Instruments – Risk

The procedures for risk management are set out through a legal framework set out in the Local Government Act 2003 and the associated regulations.

The Council's activities expose it to a variety of financial risks, the key risks are:-

- **Credit risk** – the possibility that the counterparty to a financial asset might fail to pay amounts due to the Council;
- **Liquidity risk** – the possibility that the Council might not have cash available to meet its commitments to make payments;
- **Market risk** - the possibility that unplanned financial loss might arise for the Council as a result of changes in such measures as interest rates movements.

Further details of these risks can be found within the Statement of Accounts' Financial Instrument Disclosures.

Inflation Risk
Construction inflation over and above that budgeted by the Council's professionals and advisers and built into project budgets could impact on the affordability of the capital programme. This is mitigated through the provision of contingencies, updating estimates regularly as they change and monitoring the impact through governance processes. This is also mitigated post the signature of contracts with construction companies and developers through fixed price contracts.

Change in Law Risk
Capital schemes need to comply with the latest law and regulations which can change leading to an impact on construction costs and may be retrospective in their nature. This is mitigated by awareness of pipeline legislative changes and through contingencies.

Market health / Commercial Values
The Council's capital programme relies on commercial activity as a key supporting strategy. This involves generation of income from property letting, generation of capital receipts from property sales in some cases post development, attracting developers to projects based on a potential share of profits and other revenue/capital financial flows. In some cases, it is likely that the Council will commit to large projects, property acquisitions or other forms of expenditure on the basis of further business case assumptions about the market value of future asset or economic values. Should market movements mean that these assumptions are inaccurate then the Council may suffer.

Management of Project Risks
Project risks are those which relate to the delivery of capital projects which in many cases can be controlled, influenced or directly mitigated in ways other than making contingencies available. These risks would mostly be related to unforeseen project delays and cost increases which could arise from a range of circumstances.

Supplier Financial Stability
Construction companies and developers contracting with the Council which experience financial instability post a significant risk. They may not be able to raise finance to cash flow operations, any potential insolvency process could lead to a costly process of changing suppliers without any guarantee of remaining within overall budget, the Council could suffer direct financial loss and any defects or other issues may not be resolvable as anticipated. To mitigate the Council carefully considers the financial robustness of any contractor and requests appropriate financial standing assurance and support wherever possible.

Risk of Revenue Write Off
The Council commits to feasibility studies on many of its significant capital schemes at the point where spend is revenue in nature or when capital spend may be written off should the scheme in question not progress. This is managed through careful consideration and approval of all expenditure potentially at risk of revenue wrote off.

Contingencies in the Capital Programme
In the initial stages of development, major capital projects will have significant uncertainties. For example, these may relate to the planning process, the views / interest of stakeholders who must be consulted, ground conditions, or the costs of rectifying or demolishing existing buildings (e.g. the cost of asbestos removal). For this reason, the Council has adopted a structured process of identifying and managing contingencies which is in line with guidance issued by HM Treasury. In the initial stages of a project these contingencies are necessarily broad estimates due to the number of unknown factors. As projects progressed the unknown factors become clearer and project managers focus on managing these in the most effective way possible, utilizing contingencies to do so as needed.

Effective Business Case Development

The Council will ensure the use of Business Cases for all larger projects. There will be a requirement for projects to maintain a risk register. Risk registers are aligned with general guidance on risk review. Highlight reports for all projects help project board and wider interested parties to be aware of progress and risks of projects on an on-going basis.

KNOWLEDGE AND SKILLS

7.0 IN-HOUSE RESOURCES

The successful implementation of the Capital Strategy necessitates the availability of people with the necessary experience of:

- developing capital projects
- acquiring and selling properties
- commissioning partners to deliver the capital programme
- managing properties as a landlord
- sourcing suitable opportunities that match the criteria set under the adopted strategy.

Within Finance, the Capital Programme and TMS are managed by professionally qualified accountants or staff with extensive Local Government finance experience. They all follow a Continuous Professional Development Plan (CPD) and attend courses on an ongoing basis to keep abreast of new developments and skills. The Council subscribes to the CIPFA Financial Advisory Network (FAN) and as a result has access to courses and documentation on developments within the capital and treasury management fields. The Council's Section 151 Officer is the officer with overall responsibility for Capital and Treasury activities and is a professionally qualified accountant and follows an ongoing CPD programme. All Treasury Management Practices (TMPs) are reviewed and updated as necessary.

All the Council's commercial projects have project teams from all the professional disciplines from across the Council and when required external professional advice is taken. Project management tools are used and there is a strong project management ethos within the Council. Throughout the Council is a good mix of professional qualified staff and staff with both commercial and local authority experience. There is a Corporate Landlord team consisting of skilled and professional staff that aim to introduce new energy efficiency measures such as upgraded heating, lighting, insulation and investigating new technological solutions that will enable staff to be fully agile and provide a better service, while an online portal is being developed that will provide information, process customer requests and enable staff to log jobs and track progress. The Regeneration Team within the Communities Directorate has been successful in applying for monies from various sources such as Welsh Government, Heritage Lottery and European monies.

7.1 EXTERNAL ADVISERS

External Advisers are used for particular property condition surveys or valuations of Investment Properties or treasury management advisers who assist with the review of the investments and borrowing of the Council. At a time where interest rates are beginning to rise, treasury management advisers will be used to provide the Council with a breakeven analysis to see whether there is any opportunity to reduce borrowing costs going forward. External Advisers compliment in-house knowledge and skills.

7.2 MEMBERS

Audit Committee has been nominated to be responsible for ensuring effective scrutiny of the TMS and policies. Audit Committee received treasury management training to assist them in their function of scrutinising treasury management, with particular emphasis on investment options available to the Council and Elected Members were also invited to attend. Members receive regular reports on the capital programme and treasury management.