

# **CAPITAL STRATEGY**

**2<sup>nd</sup> Draft November 2018**

## 1. Introduction

- 1.1 The purpose of the capital strategy (the Strategy) is to tell a story that gives a clear and concise view of how the council determines its priorities for capital investment, decides how much it can afford to borrow and sets its risk appetite. It is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.
- 1.2 The framework the government uses to control how much councils can afford to spend on capital investment is known as the Prudential Framework. The objectives of the Prudential Code, which sets out how this framework is to be applied, are to ensure that local authorities' capital investment plans are:
  - affordable, prudent and sustainable;
  - that treasury management decisions are taken in accordance with good professional practice; and
  - that local strategic planning, asset management planning and proper option appraisal are supported.
- 1.3 This capital strategy sets out how Watford Borough Council will achieve the objectives set out above.

## 2. CAPITAL INVESTMENT PROGRAMME

### *Capital Investment Programme - Expenditure*

- 2.1 Capital Investment is the term used to cover all expenditure by the council that can be classified as capital under legislation and proper accounting practice. This includes expenditure on:
  - property, plant and equipment
  - heritage assets, and
  - investment properties.
- 2.2 Property plant and equipment includes assets that have physical substance and are held for use in the production or supply of goods and services, for rental to others, or for administrative purposes. They are expected to be used during more than one financial year. Expenditure on the acquisition, creation or enhancement of these assets is capitalised on an accruals basis, provided that the Council is likely to benefit from the future economic benefits or service potential and the cost of the item can be measured reliably. Expenditure on repairs and maintenance is charged to the revenue account when it is incurred.
- 2.3 Heritage Assets are held with the objective of increasing knowledge, understanding and the appreciation of the Council's history and local area.
- 2.4 Investment properties are those that are used solely to earn rentals and/or for increases in value. The definition is not met if the property is used in any way for the delivery of services or production of goods or is held for sale.
- 2.5 The Council is currently has no external debt, with the exception of a loan from the Local Enterprise Partnership, so does not capitalise borrowing costs incurred whilst assets are under construction.

- 2.6 Detailed accounting policies in relation to assets and capital expenditure may be found in the annual statement of accounts.
- 2.7 Appendix 1 shows the latest MTFs position on the capital programme along with a description of the individual schemes.

### ***Capital Investment Programme - Funding***

- 2.12 The Capital Investment Programme can be funded from the following sources:
- 2.13 Government Grants & Other Contributions: These are grants for specific purposes which may be available from the Government, e.g. Disabled Facility Grants. The Council can also attract partnership funding from other local authorities and agencies e.g. Local Enterprise Partnership (LEP). The Council has also benefited in the past from other funding such as lottery grants.
- 2.14 Section 106 Contributions: These are contributions from developers to the public services and amenities required for the development. These have been in part replaced by the Community Infrastructure Levy.
- 2.15 Capital Receipts: Capital receipts are derived when selling assets such as land. The main receipt relates to the arrangements made when the Council sold its housing stock to Watford Community Housing; the Transfer Agreement included a Right to Buy (RTB) Sharing Agreement whereby the Council is entitled to a share of the post-transfer receipts from RTB sales and a 'VAT Shelter Agreement' whereby the Council benefits from the recovery of VAT on continuing works carried out by Watford Community Housing.
- 2.16 Revenue Contributions: Revenue balances from the General Fund may be used to support capital expenditure.
- 2.17 Capital Expenditure Reserves: The Council has reserves which it has put aside for capital expenditure.
- 2.19 Borrowing: The Council is allowed to borrow to support its capital expenditure as long as this is prudent, sustainable, and affordable. Whilst the Council does not currently borrow, with the exception of LEP funding, it is likely that borrowing will be required to finance the future capital programme.
- 2.20 The capital programme includes an assessment of likely available resources to finance capital expenditure this is included at Appendix 3.

### **Property investment**

- 2.8 Lambert Smith Hampton (LSH) were commissioned by the Council in 2014 to undertake a strategic property review. The outcome of this process was reported to the March 2015 Cabinet which resulted in a number of decisions on the general aims of the Council, including establishing a Property Investment Board. The terms of reference include authority to agree a reinvestment programme and to determine the level of receipts to be recycled into new investments to support the Council's capital or revenue programme.
- 2.9 The Portfolio Holder for Property and Housing has delegated powers to agree to acquisitions and disposals up to £5,000,000 and the Deputy Managing Director/ Property Section Head have delegated powers to agree to acquisitions and disposals

up to £3,000,000. Both of these subject to a full written business case being prepared and signed off by Finance and Legal and the acquisition/disposal being in line with the Property Investment Board Investment Strategy.

- 2.10 The LSH review identified that the property investment portfolio is unbalanced with an overloading of retail property. Re-profiling of the portfolio over time in accordance with a property investment strategy has been agreed by the Property Investment Board with some non-conforming properties being replaced by higher yielding conforming properties.

### **Other investments**

- 2.12 Watford Borough has established a commercial trading company Watford Commercial Services Ltd, of which it has 100% ownership. At present the only activity carried out through the company is Watford's investment in Hart Homes Development LLP, of which it has a 50% share. This is a joint venture with Watford Community Housing set up to deliver housing development within the area. In addition Watford Borough Council has a direct 50% share in Hart Homes (Watford) Ltd which was set up for the ongoing management of rental properties developed by Hart Homes Development LLP.
- 2.13 Watford Borough Council has set up a Local Asset Backed Vehicle (LABV) with Kier to develop Watford Health Campus. Under the LABV model, the public sector transfers land into to the partnership and the private sector matches the value of the asset to deliver the joint venture's objectives. Empowering the joint venture (by way of land and money) to deliver the regeneration and transformation activities agreed between the parties.
- 2.14 All investment activity in relation to other investments is managed through the capital programme and revenue budget process. Because of the longer term nature of these investments, a longer term forecast has been produced at Appendix 4 which separately identifies the impact of the major projects. The activity of the joint venture and investments in partnerships and companies is included within the Group Accounts which are prepared as part of the Annual Statement of Accounts.

### ***Future Investment***

- 2.22 Future Investment Schemes will be assessed on the basis of a full business case which will include full resourcing for the project and an assessment of affordability. Priority areas for future capital investment are:
- Schemes through the joint ventures that generate a surplus and increase the supply of housing locally.
  - Schemes that generate revenue budget savings or income.
  - Schemes that allow the council to benefit from future economic regeneration potential within the local area.

## **3. TREASURY MANAGEMENT**

- 3.1 The Council is required to operate a balanced budget over the medium term which, after allowing for contributions to and from reserves, broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing the requisite

liquidity before considering investment return. The Council has purchased investment properties to improve the yield on its longer term surplus cash.

- 3.2 The Treasury Management Policy Statement, details the policies, practices, objectives and approaches to risk management of its treasury management activities, which is to be monitored by the Audit Committee. The Council's investment strategy's primary objectives are safeguarding the repayment of the principal and interest of its investments on time, and then ensuring adequate liquidity, with the investment return being the final objective. The strategy allows the Director of Finance, in consultation with the Portfolio Holder, the delegated authority to approve any variation to the Treasury Management Strategy during the year which may be brought about by investigating the opportunity to invest for greater than one year and also to invest in other investment instruments i.e. Government bonds, Gilts and investment property with a view of maximising the Council's returns without significantly increasing risk.

### ***The Council's Borrowing Need - The Capital Financing Requirement (CFR)***

- 3.3 The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure, which has not immediately been paid for, will increase the CFR. An increase in the CFR does not necessarily mean that the council will borrow externally to fund the increase. The Council manages its cash balances as a whole and may choose to use internal cash (generated by holding reserves and through timing differences between income and expenditure).
- 3.4 The table below shows the estimate of the CFR for 2019/20 and 2020/21 along with an analysis of forecast resources for 2021/22 and beyond. The forecast beyond 2020/21 include no use of reserves:

### ***Minimum Revenue Provision (MRP) Strategy and Policy Statement***

- 3.5 The Minimum Revenue Provision (MRP) is designed to pay off an element of the capital spend which has not already been financed from existing revenue or capital I resources. The Council is required to make prudent provision, by way of a charge to the revenue account, which means that the repayment of debt is enabled over a period that is reasonably commensurate with that over which the capital expenditure provides benefits.
- 3.6 The Council is also able to increase the rate it reduces its CFR by undertaking additional voluntary payments (voluntary revenue provision - VRP) in addition to any MRP; this is not currently the Council's policy.
- 3.7 Government Regulations require the Council to approve a MRP Statement in advance of each year. The following is Watford's MRP statement:

*For all unsupported borrowing (including PFI and finance leases) the MRP policy will be:*

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3)

*This option provides for a reduction in the borrowing need over the asset's estimated life. Repayments of PFI or Finance Leases are allowable to use as a proxy for the above methods.*

- 3.8 Watford Borough Council's process is to produce for approval by the Director of Finance, in consultation with the Portfolio Holder, a business case for each scheme intended to be unfunded from other resources. This will clearly show the level of MRP which is proposed to ensure that the repayment of any debt can be made in a period commensurate with the period over which the expenditure provides benefits or makes returns.
- 3.9 No MRP provision is made in respect of investments or payments in to Watford Commercial Services or the joint ventures as such investments are intended to be time-limited and allow for the repayment of debt. For finance leases the council will charge MRP to its General Fund each year dependant on the life of the underlying asset and whether there is a reasonable expectation that the Council will exercise any option to purchase at the end of the lease.

### **Cash Flow**

- 3.10 Appendix 5 contains the forecast cash flow.

### **Revenue Cost of Borrowing**

- 3.11 Where the council decides to borrow to fund capital expenditure the annual cost of borrowing is included within the revenue budget.

### **Prudential Indicators**

- 3.12 There are two limits on external debt: the 'Operational Boundary' and the 'Authorised Limit'. Both are consistent with existing plans and the proposals in the budget report for capital expenditure and financing, and with approved treasury management policy statement and practices.
- 3.13 The first key control over the treasury activity is a Performance Indicator (PI) to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

#### Treasury Management Indicator - The Operational Boundary

- 3.14 This is the limit beyond which external borrowing is not normally expected to exceed. In most cases this would link directly to the authority's plans for capital expenditure, its estimates for CFR and its estimate of cashflow requirements for the year for all purposes. The Council may need to borrow, this limit represents a contingency should the need arise.

<b>Operational Boundary</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>
Borrowing	£10M	£15M	£10M	£10M

***{to be updated for proposed capital programme}***

## Treasury Management Indicator - The Authorised Limit for External Borrowing

- 3.15 This PI, which is required to be set and revised by Members, controls the overall level of borrowing and represents the limit beyond which external long and short term borrowing is prohibited, and this limit needs to be set or revised by the Council. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (2) of the Local Government Act 2003.

Authorised Limit	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Borrowing	£12M	£12M	£12M	£12M

*{to be updated for proposed capital programme}*

### 4. Future Investments

- 4.1 The Council will continue to seek opportunities to work in partnership with others to promote economic development and the provision of housing within Watford's wider economic area. Current partners include Kier for the Watford Health Campus, along with Watford Community Housing as the main local registered social provider.
- 4.2 The council has established Watford Commercial Services to allow it to work more closely with providers and exploit future commercial opportunities. The Council currently has a joint venture with Watford Community Housing through Hart Homes Development LLP and Hart Homes Ltd.

### 5. Skills and Knowledge and Professional Advice

- 5.1 The Council has a shared service with Three Rivers District Council for the provision of the finance function allowing access to a greater range of professional skills than would otherwise be available if each council had a separate team.
- 5.2 Watford Borough Council uses Lambert Smith Hampton (LSH) to provide advice on and management of its investment property portfolio. LSH also provide ad-hoc advice where required on other projects. The Council has framework agreements in place with Grant Thornton to provide finance and accountancy advice and Trowers for legal advice. The council uses external advisers on all major projects.
- 5.3 The Council contracts with Link Asset Services for the provision of Treasury advice. Link Asset Services provide non-regulated advice on the management of the council's cash flows, investments and borrowings and a markets information service. The Councils VAT advisers are PSTax.

### 6. Risk

- 6.1 Financial risks are closely monitored as a separately identifiable part of the corporate risk management framework. The Council's risk appetite is evolving as it becomes involved in a wider range of major property lead investments both within its economic area linked to regeneration and more widely for income generation purposes.

- 6.2 The Council takes advice from its professional advisers to both identify and mitigate the key risks it faces and ensures that all decisions are made with an understanding of the risks involved. The ongoing management of risk is a key function of the Council's Property Investment Board which routinely takes advice from LSH.
- 6.3 The council currently has an income target of £7.3M pa from its commercial investment activities. This is equivalent to 28% of its total gross income (excluding housing benefit reimbursements from government) of £26.3M in 2018/19. The Council does not receive RSG and is entirely dependent upon locally raised taxes and locally generated income to fund services. The general fund balance as at 1<sup>st</sup> April 2018 was £2M.
- 6.4 Whilst recognising the importance of generating income to support services, the Council will ensure that its external income is actively managed to safeguard the future financial sustainability of the council. In this respect it will continue to seek to balance income from its commercial investment activities against its overall level of risk and the amount of reserves available to mitigate this risk.
- 6.5 In assessing the risk of its commercial investments the Council will consider the level of risk inherent in the income stream, the security held, its ability to realise assets or other security should the need arise and the level of income received from commercial investments compared to the total income of the council.

## Capital Forecast

The capital forecast shows the forecast for the period of the current MTFS. New major schemes will be subject to individual business cases, including identification of resources and an assessment of affordability.

Service Area	Service Provision	Latest Budget 2018/19	Forecast Outturn	Actual to date	Latest Budget 2019/20	Latest Budget 2020/21	Latest Budget 2021/22
		£	£	£	£	£	£
Service Transformation	Customer Services	134,711	86,711	(7,400)	0	0	0
	ICT Shared Services	45,000	45,000	78,742	45,000	45,000	45,000
	ICT Client Services	925,796	925,796	(46,228)	485,000	485,000	485,000
Community & Environmental	Waste & Recycling (inc Veolia)	435,505	435,505	0	2,396,810	96,810	98,260
	Parks & Open Spaces	5,484,315	5,809,315	327,902	340,000	290,000	265,000
	Cemeteries	450,000	450,000	8,576	100,000	50,000	0
	Leisure & Play	1,445,851	1,445,851	20,000	20,000	250,000	0
	Culture & Heritage	562,244	562,244	47,724	0	0	0
	Environmental Health	208,204	208,204	28,717	100,000	100,000	100,000
	Community Projects	0	32,053	32,053	0	0	0
Democracy & Governance	Buildings & Projects	3,220,959	3,220,959	88,139	11,536,000	782,000	400,000
Place Shaping & Performance	Watford Business Park	5,064,042	5,064,042	514,182	0	0	0
	Watford Riverwell	13,737,053	13,737,053	768,722	3,281,000	14,159,000	100,000
	Housing	266,224	266,224	1,352	50,000	50,000	50,000
	Transport & Infrastructure	2,465,253	3,606,253	511,008	415,000	315,000	0
	Development Control	80,000	80,000	0	0	0	0
	Property Investment Board	0	125,000	(750)	0	0	0
	Property Management	5,110,529	5,110,529	705,440	2,000,000	0	0
Strategic Finance	Capital Support Services	677,470	677,470	5,114	679,470	679,470	680,740
	Business Systems	0	0	0	0	0	0
<b>TOTAL CAPITAL PROGRAMME</b>		<b>40,313,156</b>	<b>41,888,209</b>	<b>3,083,295</b>	<b>21,448,280</b>	<b>17,302,280</b>	<b>2,224,000</b>

*{per Budget Panel Q1 2019/20, the table will reflect budget proposals in final version along with explanations of key schemes}*

## APPENDIX 2

### SCHEME FOR PRIORITISING CAPITAL BIDS

Criteria	Capital Bids	
	Score	Description
Measure of Quality of Service	3	Maintaining Current Service
	6	Improved Internal Service
	9	Improved External Service
Customer Impact / Quantity of Service	3	Affects < 10% of residents
	6	Affects < 50% of residents
	9	Affects all residents
Links to Strategic Plan	2	Contributes to General Theme
	4	Contributes to General Aim
	6	Contributes to Specific Objective
Impact on Partners (as defined in the Community Strategy)	1	No impact on partner agencies or joint priorities
	2	Impacts on 1 partner agency / priority
	3	Impacts several partners / priorities
Partnership Funding	1	No Partnership Funding
	2	Partly Funded by Partners
	3	Fully Funded by Partners
Equalities	1	No impact on vulnerable groups
	2	Impacts on one vulnerable group
	3	Impacts on several vulnerable groups
Asset Management	1	Not related to asset maintenance
	2	Allowing asset to continue in use
	3	Expenditure required to bring asset up to standard enabling service to continue (i.e. an element of 'backlog' repair exists)
Statutory/Discretionary Service	1	Entirely Discretionary
	2	Partly Statutory
	3	Entirely Statutory
Contractually Committed	1	No Commitment
	2	Moral Obligation (e.g. SLA)
	3	Contractually Committed
Financial Implications	1	Revenue Cost
	2	Revenue Neutral
	3	Revenue Saving
Invest to Save Will the original capital investment be repaid?	6	Return on Investment in 1 Yr
	4	Return on Investment in 3 Yr
	2	Return on Investment in 5 Yr

## Capital Funding 2018-2021

<b>FUNDING THE APPROVED CAPITAL PROGRAMME</b>				
<b>FUNDING TYPE</b>	<b>Forecast Outturn 2018/19 £</b>	<b>Budget 2019/20 £</b>	<b>Budget 2020/21 £</b>	<b>Budget 2021/22 £</b>
Grants & Contributions	1,741,435	18,000	18,000	18,000
Reserves	1,482,744	0	0	0
Capital Receipts (PIB & non PIB)	23,481,755	10,569,280	16,902,280	2,206,000
Section 106 & CIL Contributions	322,362	0	0	0
Borrowing (internal / external)	14,859,913	10,861,000	382,000	0
<b>TOTAL CAPITAL FUNDING APPLIED</b>	<b>41,888,209</b>	<b>21,448,280</b>	<b>17,302,280</b>	<b>2,224,000</b>
<b>N.B.</b> The Council applied for a loan from the Local Enterprise Partnership of £1.5m which it intends to use on the redevelopment of Watford Business Park. This loan was received in December 2015 and is expected to be repaid during financial year 2019/20				
<b>CAPITAL BALANCES AFTER FUNDING THE APPROVED CAPITAL PROGRAMME</b>				
<b>FUNDING TYPE</b>	<b>Forecast Outturn 2018/19 £</b>	<b>Budget 2019/20 £</b>	<b>Budget 2020/21 £</b>	<b>Budget 2021/22 £</b>
Grants & Contributions	73,814	73,814	73,814	73,814
Reserves	376,137	376,137	376,137	376,137
Capital Receipts (PIB & Non PIB)	1,990,186	1,208,231	2,579,773	1,373,773
Section 106 & CIL Contributions	4,383,266	4,998,266	5,613,266	6,228,266
<b>Sub Total</b>	<b>6,823,403</b>	<b>6,656,448</b>	<b>8,642,990</b>	<b>8,051,990</b>
Borrowing (internal / external)	(40,978,834)	(51,839,834)	(52,221,834)	(52,221,834)
<b>TOTAL CAPITAL FUNDING AVAILABLE</b>	<b>(34,155,431)</b>	<b>(45,183,386)</b>	<b>(43,578,844)</b>	<b>(44,169,844)</b>

*{per Budget Panel Q1 2019/20, the table will reflect budget proposals in final version}*

**Appendix 4**

**Longer Term Forecast**

*{to be updated for proposed capital programme}*

**Appendix 5**

**Cash Flow**

*{to be updated for proposed capital programme}*