

# **Watford Borough Council**

## **Capital Strategy**

**2020/21**



## 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.

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

- 2.8 The Capital Investment Programme can be funded from the following sources:
- 2.9 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.
- 2.10 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.
- 2.11 Capital Receipts: Capital receipts are derived when selling assets such as land.
- 2.12 Revenue Contributions: Revenue balances from the General Fund may be used to support capital expenditure.
- 2.13 Capital Expenditure Reserves: The Council has reserves which it has put aside for capital expenditure.
- 2.14 Borrowing: The Council is allowed to borrow to support its capital expenditure as long as this is prudent, sustainable, and affordable.
- 2.15 The capital programme includes an assessment of likely available resources to finance capital expenditure this is included at Appendix 2.

### **Property investment**

- 2.16 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.
- 2.17 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.

- 2.18 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. The portfolio is currently being reviewed in the light of the Council's acquisition of Croxley Park.

### **Other investments**

- 2.19 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.
- 2.20 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.
- 2.21 All investment activity in relation to other investments is managed through the capital programme and revenue budget process. 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.
- 3.3 As part of the acquisition of Croxley Park, the Council received £24M in respect of a rent guarantee and £68M in respect of future planned programme maintenance. The Council's treasury advisers, Link, are currently advising the Council on the investment of this sum in order to best match the drawdown profile under the financial model and to balance the inflation and property risks inherent in the underlying investment.

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

- 3.4 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).
- 3.5 The table below shows the estimate of the CFR for 2020/21 and 2021/22 along with an analysis of forecast resources for 2022/23 and beyond. **This is based on the latest 2019/20 monitoring and will be updated as part of budget setting.**

	2018/19 Actual	2019/20 Forecast	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Total Proposed Capex		£57.5M	£66.5M	£32.4M	£11.0M
<u>Capital Financing -</u>					
Grants		(£3.8m)	(£7.0m)	(£1.0m)	0
Reserves		(£1.0m)	0	0	0
Capital Receipts		(£13.0m)	(£17.8m)	(£3.4m)	(£6.6m)
s.106 and CIL		(£0.3m)	0	(£3.0m)	0
Closing CFR	<b>£32.4m</b>	<b>£71.8m</b>	<b>£113.5m</b>	<b>£138.5m</b>	<b>£142.9m</b>

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

- 3.6 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 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.
- 3.7 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.
- 3.8 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.*

- 3.9 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.
- 3.10 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.

### **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 (indicators to be updated as part of budget setting)**

- 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>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>
Borrowing	£56M	£95M	£120M	£120M

#### 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.

<b>Authorised Limit</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>
Borrowing	£60M	£100M	£125M	£125M

## 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 Council's 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 2019 was £2M. In a full year the Council will use £1.5M of resources generated from Croxley Park to support its revenue budget.

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 (per latest Monitoring)

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 2019/20	Forecast Outturn	Actual to date	Previously Reported Variances	Variances for Period 6 only	Cumulative Variance @ Period 6	Latest Budget 2020/21	Latest Budget 2021/22	Latest Budget 2022/23
		£	£	£	£	£	£	£	£	£
Service Transformation	Customer Services	47,741	47,741	0	0	0	0	0	0	0
	ICT Shared Services	240,715	516,000	291,666	240,000	35,285	275,285	185,000	45,000	45,000
	ICT Client Services	1,131,331	471,046	172,128	(240,000)	(420,285)	(660,285)	730,000	485,000	485,000
	Corporate Asset Management	13,950,907	1,683,435	315,328	0	(12,267,472)	(12,267,472)	13,049,472	400,000	400,000
Community & Environmental	Waste & Recycling (inc Veolia)	2,736,935	2,736,935	324,885	0	0	0	96,810	98,260	100,230
	Parks & Open Spaces	4,939,700	5,019,700	946,492	80,000	0	80,000	305,000	285,000	265,000
	Cemeteries	1,504,779	1,504,779	75,563	0	0	0	1,055,000	0	0
	Leisure & Play	1,587,614	1,587,614	615,409	0	0	0	6,675,000	2,405,000	0
	Culture & Heritage	1,118,948	1,118,948	8,747	0	0	0	400,000	300,000	0
	Environmental Health	300,000	125,000	2,070	0	(175,000)	(175,000)	400,000	300,000	100,000
	Community Projects	1,190,000	1,190,000	0	0	0	0	500,000	0	0
Place Shaping & Performance	Watford Business Park	4,982,506	4,982,506	118,493	0	0	0	7,800,000	300,000	0
	Watford Riverwell	15,403,000	15,403,000	833,984	0	0	0	8,392,000	2,855,003	8,878,000
	Housing	285,872	285,872	0	0	0	0	50,000	50,000	50,000
	Transport & Infrastructure	4,024,850	4,041,300	1,703,840	16,450	0	16,450	2,714,800	5,410,800	0
	Development Control	80,000	80,000	0	0	0	0	0	0	0
	Property Investment Board	66,230	66,230	13,655	0	0	0	50,000	50,000	0
	Property Management	14,973,982	15,703,982	572,028	480,000	250,000	730,000	23,435,000	18,730,000	0
Strategic Finance	Capital Support Services	979,470	979,470	70,174	0	0	0	679,470	680,740	682,020
<b>TOTAL CURRENT CAPITAL PROGRAMME</b>		<b>69,544,580</b>	<b>57,543,558</b>	<b>6,064,459</b>	<b>576,450</b>	<b>(12,577,472)</b>	<b>(12,001,022)</b>	<b>66,517,552</b>	<b>32,394,803</b>	<b>11,005,250</b>

**Capital Funding 2018-2021 (per latest monitoring)**

<b>FUNDING TYPE</b>	<b>Forecast Outturn 2019/20 £</b>	<b>Budget 2020/21 £</b>	<b>Budget 2021/22 £</b>	<b>Budget 2022/23 £</b>
Grants & Contributions	3,799,000	6,989,000	1,000,000	0
Reserves	1,022,317	33,000	0	0
Capital Receipts (PIB & non PIB)	13,007,073	17,800,612	3,402,000	6,643,000
Section 106 & CIL Contributions	333,361	0	3,000,000	0
Borrowing (Internal & External)	39,381,807	41,694,940	24,992,803	4,362,250
<b>TOTAL CAPITAL FUNDING APPLIED</b>	<b>57,543,558</b>	<b>66,517,552</b>	<b>32,394,803</b>	<b>11,005,250</b>