Cabinet – 30 January 2019

Capital and Minimum Revenue Provision Strategy 2019/20

Recommendation of the Cabinet Member for Finance

Report of the Deputy Director of Finance (S151) and Director of Corporate Services

Introduction

1. This capital strategy is a new report for 2019/20, giving a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.

Capital Expenditure and Financing

2. Capital expenditure is where the Council spends money on assets that will be used for more than one year, such as the road network, schools and economic development schemes. In local government this also includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

3. In 2019/20, the Council is planning capital expenditure of £116m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
TOTAL	£116m	£32m	£17m	£4m	£0m

4. The main capital projects include the Stafford Western Bypass, the Lichfield Southern Bypass, a Primary school at Pye Green, Hednesford, partial extension and remodelling at Bishop Lonsdale Primary Academy and the building of a new secondary school.

5. All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions –

	2019/20 budget	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
External sources	£84m	£27m	£13m	£0m	£0m
Own resources	£14m	£3m	£3m	£3m	£0m
Debt	£18m	£2m	£1m	£1m	£0m
TOTAL	**£116m**	**£32m**	**£17m**	**£4m**	**£0m**

6. 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 minimum revenue provision (MRP). Planned MRP is as follows:

Table 3: Replacement of debt finance in £ millions

	2019/20 budget	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
Own resources	£19.5m	£19.5m	£19.0m	£18.5m	£17.5m

7. The Council's full minimum revenue provision statement is attached at the end of this report

8. The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP. The CFR is expected to increase by £1.6m 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 in £ millions

	2019/20 budget	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
TOTAL CFR	**£655.8m**	**£636.9m**	**£617.5m**	**£598.5m**	**£575.2m**

9. **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £39.5m of capital receipts in the coming financial year as follows:

Table 5: Capital receipts in £ millions

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**
Asset sales	£13.8m	£13.0m	£39.5m	£1.9m

10. This is subject to re-phasing as sales progress and the figures include earmarked receipts.

11. **Governance**: Capital expenditure programmes are contained within the Medium Term Financial Strategy (MTFS) and follow the governance arrangements associated with the MTFS.

Prudential Indicators

12. We have a Treasury Management strategy and an Investment strategy which follows this report.

13. **Borrowing strategy:** Projected levels of the Council's total external loans.

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	2019/20 budget	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
External loans	**£468m**	**£468m**	**£464m**	**£459m**	**£454m**
Capital Financing Requirement	**£656m**	**£637m**	**£618m**	**£599m**	**£575m**

14. Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term.

15. **Affordable borrowing limit:** 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 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Authorised limit – borrowing	632	613	592	572	553
Authorised limit – Other liabilities	249	252	255	259	262
Authorised limit – total	881	865	847	831	815
Operational boundary – borrowing	515	522	525	521	516
Operational boundary – Other liabilities	249	252	255	259	262
Operational boundary – total	764	774	780	780	778

Revenue Budget Implications

16. 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 9: Prudential Indicator: Proportion of financing costs to net revenue stream

	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Financing costs (£m)	38.1	38.1	37.2	36.0	34.1
Proportion of net revenue stream	7.4%	7.7%	7.2%	6.7%	6.1%

Conclusion

17. There is a planned capital programme amounting to £116m in 2019/20. If any borrowing is planned then the costs of repaying it are reflected in the capital financing budget. The Prudential Indicators are included within the Capital and Minimum Revenue Provision Strategy and these show that the planned level of borrowing is affordable.

Appendix 1

Minimum Revenue Provision (MRP) Policy Statement

Introduction

Capital expenditure is expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life.

The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP), which was previously determined under Regulation, and will in future be determined under Guidance.

The Government issued guidance which came into force on 31 March 2008 which requires that a Statement on the County Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The guidance offers four main options under which MRP could be made (for information these are detailed over the page), with an overriding recommendation that the County Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits.

MRP Policy Statement 2019/20

The County Council implemented the new MRP guidance in 2009/10, and will assess their MRP for 2019/20 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The major proportion of the MRP for 2019/20 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with the recommendations and intent of Option 1 of the Guidance.

Further amounts of new capital expenditure may continue to be charged at the rate of 4%, and added to the above mentioned base Capital Financing Requirement (CFR) amount, up to an amount equivalent to the County Council's annual Supported Capital Expenditure (Revenue) allocation.

Certain expenditures reflected within the debt liability at 31 March 2019 will under delegated powers be subject to MRP under Option 3.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the County Council. However, the County Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

Asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure.

With regards to loans granted by the County Council no MRP will be charged on them. The MRP will be equated to the principal repayment of the individual loans.

Option 1: Regulatory Method
Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for “Adjustment A”) on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the SCE annual allocation.

Option 2: Capital Financing Requirement Method
This is a variation on Option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority’s outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method.
This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under Options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option.

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under Options 1 and 2, although this should not normally exceed 50 years.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an ‘MRP holiday’). This is not available under Options 1 and 2.

There are two methods of calculating charges under Option 3:

a. equal instalment method – equal annual instalments; or

b. annuity method – annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method
Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than Option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under Option 3.