

## AGENDA ITEM NO

<b>Board/Committee:</b>	<b>POLICY &amp; ORGANISATION BOARD</b>
<b>Date of Meeting:</b>	<b>9 JULY 2014</b>
<b>Title:</b>	<b>MEDIUM TERM FINANCIAL STRATEGY AND CAPITAL STRATEGY</b>
<b>Author:</b>	<b>BOROUGH TREASURER</b>
<b>Status:</b>	<b>FOR DECISION</b>

### **Purpose**

To consider the updated Medium Term Financial Strategy and the Capital Strategy.

### **Recommendation**

That the Policy and organisation Board approve the Medium Term Financial Strategy and Capital Strategy as set out in Appendix 1 and Appendix 2 respectively.

## **1 Background**

- 1.1 The Council reviews and approves the Medium Term Financial Strategy each year. Following the recent completion of the budget cycle for 2014/15, it is timely to review the strategies prior to consideration of a budget strategy for 2015/16 by this Board later in the year.
- 1.2 The General Election next year means there is additional uncertainty relating to the level of Central Government Grants in 2016/17 and later years with the position unlikely to become clearer until well into 2015/16. This therefore results in the financial forecasting beyond 2015/16 being subject to significant uncertainty and risk.

## **2 Report**

- 2.1 Budget preparation will commence in July and will incorporate requirements resulting from Council priorities identified from the Capital Strategy, Community Strategy, Corporate Plan and the associated action plans.
- 2.2 The Local Government Act 2003 requires the Council to consider whether its budget is balanced with appropriate levels of reserves commensurate with perceived budget risks.
- 2.3 Maintaining and increasing reserve levels is seen as essential as the radical changes to the financing of Local Government including rate retention and the move to the new Council Tax Support Scheme (previously Council Tax rebate) have significantly increased the risk

and uncertainty borne by this and other Councils. Such reserves can help the Council take advantage of any invest to save opportunities and provide a safeguard against both the increased risks and the significant decrease in Central Government Grant Support forecast in future years.

- 2.4 Projections contained in the Medium Term Financial Strategy indicate that the Council's General Fund budget requirements will remain relatively stable over the next 4 years following the action taken during the last 3 years to reduce commitments and work within reducing Exchequer support. Further efficiencies (such as the changes to the Environmental Health Partnership and the extension of the Internal Audit Partnership) have recently been achieved and further opportunities to achieve efficiency savings will be explored in the coming months to ensure that savings targets are met.
- 2.5 The outlook regarding the level of government grant is very uncertain particularly in relation to 2016/17 and future years and the strategy assumes that further reductions will occur of £100,000 each year of 2016/17, 2017/18 and 2018/19. This is in addition to the £740,000 reduction notified in the 2015/16 provisional grant settlement. The reduction in government grant support even if confirmed at the levels assumed in the strategy will provide a significant financial challenge to this Council but it must also be recognised that there remains a significant risk that even greater reductions will be imposed.
- 2.6 The strategy highlights that the Council has undertaken a series of service reviews achieving efficiency savings whilst still maintaining services. These measures have helped achieve a balanced budget in the current financial year and gone some way to meeting the challenges faced for 2015/16.
- 2.7 A further comprehensive review of services will be undertaken in the current year with the objective of achieving a balanced budget for 2015/16 and leave the Council best placed to meet the financial challenges anticipated for 2016/17 and later years. It is possible however that any further significant reductions in central government support (beyond those currently forecast within the strategy) may require additional measures such as:-
  - (a) Further reducing expenditure on 'back office' and lower priority services functions;
  - (b) Increase fees and charges;
  - (c) Raise Capital receipts to reduce the impact of capital investment; and,
  - (d) Consider local tax rises in excess of the current policy, possibly requiring a local referendum.
- 2.8 There is also need to continue to prioritise capital projects within the Capital Programme, particularly considering affordability and impact on

local tax levels. The Capital Strategy indicates the considerations that are necessary in order to achieve this.

### **3 Risk Assessment**

- 3.1 As highlighted above (paragraphs 2.3 and 2.5) there is considerable risk and uncertainty relating to the new Local Government financing arrangements and the levels of future Central Government grant funding (particularly with the forthcoming General Election). In view of this uncertainty maintaining adequate reserve levels is seen as essential to help mitigate against these risks.
- 3.2 Maintaining an up to date Medium Term Financial Strategy will assist in helping to identify the financial challenges facing the Council and the actions required to meet those challenges.
- 3.3 Further details of the financial risks facing the Council are shown in Appendix 1 of the Council Budget Forward to the Budget Book 2014/15.

### **4 Conclusion**

- 4.1 Both the Medium Term Financial Strategy and Capital Strategy are key documents affecting the financial future of the Council. The Board need to consider these and the potential impact on future council tax policy.

<b>Financial Services comments:</b>	<b>See Report</b>
<b>Legal Services comments:</b>	<b>As the report sets out the Council has to set balanced budgets and to undertake its functions effectively, efficiently and economically</b>
<b>Crime and Disorder</b>	<b>None</b>
<b>Equality and Diversity:</b>	<b>None</b>
<b>Service Improvement Plan implications:</b>	<b>None</b>
<b>Corporate Plan:</b>	<b>None</b>
<b>Risk Assessment:</b>	<b>See Section 3.0 of this Report.</b>
<b>Background papers:</b>	<b>See Council Budget 2014/15 Report</b>
<b>Appendices</b>	<b>1. Medium Term Financial Strategy 2014/15- 2018/19 2. Capital Strategy 2014</b>
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**GOSPORT BOROUGH COUNCIL**

**MEDIUM TERM FINANCIAL STRATEGY**

**2014/15 – 2018/19**

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## **GOSPORT BOROUGH COUNCIL**

### **MEDIUM TERM FINANCIAL STRATEGY 2014/15 – 2018/19**

#### **1.0 INTRODUCTION AND OBJECTIVES**

##### **1.1 Introduction**

The Medium Term Financial Strategy (MTFS) contains details of the main challenges affecting the Council's finances over the next few years and indicates how the Council will respond to these. It provides the overall framework for the financial investment in services from 2014 to 2019. Updated and reviewed annually, the MTFS helps to ensure that the Council's financial resources are targeted to achieve the strategic priorities and values contained within the Council's Corporate Plan.

It contains sections covering:

- Revenue – the running costs of General Fund services (affecting Council Tax levels),
- Housing Revenue Account – A statutory account which is primarily financed from Council House rents,
- Capital - the Council's plans for investment in assets used to provide benefit over more than 1 year,
- Treasury Management – management of cash flows, borrowing and investing,
- Budgeting; and,
- Risk Management.

The MTFS also provides a link to other financially related strategies including the Capital Strategy, Asset Management Plan, Treasury Management Strategy and Workforce Development Strategy.

##### **1.2 The Council's Mission**

The MTFS plays a key role in helping achieve the Council's mission of 'To work with our community to improve everyone's quality of life and deliver a sustainable future for the Borough.' by providing an efficient, effective and robust financial framework which will enable the Council to focus resources on its stated priorities.

##### **1.3 Objectives of the Strategy**

The main objectives of the Medium Term Financial Strategy are:-

To help ensure that the Council's financial resources are sufficient to achieve its stated objectives within the Corporate Plan including strategic priorities and core values;

To seek to minimise net debt and maximise income in order to provide investment in economic and efficient services within Council Tax increases below the level that would result in a referendum being required;

To ensure that the Council maintains an adequate level of General Reserves to both meet unforeseen events and help reduce vulnerability to significant fluctuations in Council Tax levels;

To provide both a link and framework to other financially related strategies;

To provide a single document to communicate the financial aims and objectives to staff and stakeholders alike; and

To provide a projection of resource requirements over a 5 year period.

## 2.0 REVENUE

### 2.1 General Fund Base Budget 2014/15

2.1.1 The current year's budget is divided into the following service areas:

<b>Gosport Borough Services</b>	<b>Gross Expenditure £'000</b>	<b>Gross Income £'000</b>	<b>Net Budget £'000</b>
Environmental Health Services	1,346	123	1,223
Parks and Leisure Activities	2,824	522	2,302
Housing Services	36,016	36,016	734
Council Housing	12,813	12,813	-1,736
Refuse Collection	1,656	325	1,331
Town Planning & Development	2,128	494	1,634
Transportation	928	911	17
Other Services and Expenses	6,363	3,935	2,438
Sub-Total	64,084	56,141	7,943
Net transfer to Balances	1,886		1,886
<b>TOTAL</b>	<b>65,970</b>	<b>56,141</b>	<b>9,829</b>

2.1.2 The net general fund budget for 2014/15 is 4.4% lower than that for 2013/14 resulting in the Borough's Council Tax rates remaining unchanged, as detailed in the following table:-

#### **Gosport-Percentage Council tax increase for 2014/15**

Council's budget needs	-11.0%
Government Grant variation	10.8%
Transfer to reserves	2.0%
Change to Council Tax base	-1.1%
Changes to Collection Fund balance	-0.7%
	<b>0.0%</b>

## 2.2 Revenue Budget Projections 2015/16 – 2018/19

2.2.1 The following table shows a forecast of the revenue budget for the next four years and takes into account any significant variations in income and expenditure that are presently known or anticipated. It must be recognised that this projection represents a central forecast and may be subject to considerable variation for a number of reasons such as changes in demand for Council services, new or amended Central Government legislation (including the Government Grant Settlement) and the external economic environment in which the Council has to operate. However, it is essential that this analysis is undertaken and updated as

necessary in order that any potential budget problems or opportunities are quickly identified and the appropriate action undertaken.

- 2.2.2 A variation in the forecasts of only approximately £56,000 affects the Borough's Council Tax rates by 1%. Major risks to the forecasts are detailed in the Council's Budget Book and include variations in demand for statutory services (such as homelessness), reduced income from Government Grants/Business Rate Retention Scheme and reduced income from fees, charges and interest receipts. The projections are particularly susceptible to political decisions on public spending levels by the coalition Government (and in any subsequent Government following the Election in 2015) in response to the national economic situation. The forecast grant levels for 2015/16 are in accordance with the provisional local Government Finance Settlement published in December 2013. Estimates of the Grant position for 2016/17 and later years remain very uncertain and for the purposes of this forecast it is currently estimated that further reductions of £100,000 in each of 2016/17, 2017/18 and 2018/19 will occur.

**PROJECTED GENERAL FUND FOR THE YEARS TO 2018/19  
(AT CURRENT PRICES)**

		(£'000)			
		2015/16	2016/17	2017/18	2018/19
A	2014/15 Base Budget	9,829	9,829	9,829	9,829
B	Budget Increases				
	Crematorium (income down)	50	50	50	50
	Tax Freeze Grant (2014/15)		50	50	50
	Tax Freeze Grant (2015/16)	(50)			
	Local Elections	(40)		(40)	
	Pensions	36	90	133	179
	MRP	40	56	61	67
	Inflation (inc pay award)	120	240	360	480
		156	486	614	826
C	Less Budget Decreases				
	New Homes Bonus income	(120)	(220)	(320)	(193)
	Local Plan	(135)	(135)	(135)	(135)
	Collection Fund Equalisation Reserve	(150)	(150)	(150)	(150)
		(405)	(505)	(605)	(478)
D	PROJECTED BUDGET TOTALS (A+B+C)	9,580	9,810	9,838	10,177
E	<b>FUNDING</b>				
	Revenue Support Grant	(1,755)	(1,591)	(1,426)	(1,258)
	Business rates Collectable /Safety Net	(5,642)	(5,811)	(5,986)	(6,165)
	Less Tariffs payable to Central Government	3,521	3,627	3,735	3,847
		(3,876)	(3,775)	(3,676)	(3,576)
F	<b>GBC COUNCIL TAX LEVY (D-E)</b>	(5,704)	(6,035)	(6,162)	(6,601)

<b>G</b>	<b>COUNCIL TAX BASE</b>	<b>24,844.1</b>	<b>24,894.1</b>	<b>24,944.1</b>	<b>24,994.1</b>
<b>H</b>	<b>ESTIMATED COUNCIL TAX INCOME (FOR NO INCREASE)</b>	<b>(5,040)</b>	<b>(5,050)</b>	<b>(5,060)</b>	<b>(5,070)</b>
<b>I</b>	<b>POTENTIAL SAVINGS REQUIRED</b>				
	<b>CUMULATIVE</b>	<b>664</b>	<b>985</b>	<b>1,102</b>	<b>1,531</b>
	<b>YEAR ON YEAR</b>	<b>664</b>	<b>321</b>	<b>117</b>	<b>429</b>

2.2.3 Whilst the figures projected in paragraph 2.2.2 represent the best projection that can currently be made, there is a lot of uncertainty regarding future levels of Exchequer support, inflation and interest rates. The most optimistic current forecast beyond 2014/15 is that following the significant reduction in grant (£740,000) in 2015/16 only small reductions will be made in grant levels in 2016/17 and future years. The forecast above assumes that only reasonably modest reductions will occur in 2016/17, 2017/18 and 2018/19. Uncertainty over this period (2016-2019) is seen as particularly high with next year's General Election adding a further significant risk factor to both the overall level of exchequer support allocated to the local government sector and indeed the possibility of changes in the distribution of grant between authorities. A further area of risk relates to the inflation provision where any significant increase in either general or wage inflation could lead to significant additional costs being incurred.

2.2.4 The Council undertook a series of service reviews in early 2013/14 with the objective of making efficiency savings whilst still maintaining service levels in order to help meet the financial challenges ahead. The savings forthcoming from this measure helped meet the financial challenges faced in 2014/15 and it was possible to budget for both no increase in this Council's Council Tax levy In addition to setting up a Collection Fund Equalisation Reserve of £149,560 providing a further protection from the risks and uncertainties associated with the new system of Business Rate Retention.

2.2.5 The Council has continued to review services following the reviews undertaken in early 2013/14 with the changes to the arrangements to the provision of the Environmental Health Service and the extension of the Internal Audit Partnership both of which achieved efficiency savings for this Council. A further comprehensive review of services will be undertaken in the current year with the objective of achieving a balanced budget for 2015/16 and leave the Council best placed to meet the financial challenges anticipated for 2016/17 and later years. It is possible however that any further significant reductions in support (beyond those currently forecast within the strategy) may require additional measures such as:-

- (a) Further reducing expenditure on 'back office' and lower priority services functions;
- (b) Increase fees and charges;
- (c) Raise Capital receipts to reduce the impact of capital investment; and,
- (d) Consider local tax rises in excess of the current policy, possibly requiring a local referendum.

## **2.3 General Fund Working Balance**

### **2.3.1 A key objective of the Strategy is:-**

'To ensure that the Council maintains an adequate level of General Reserves to both meet unforeseen events and help reduce vulnerability to significant fluctuations in Council Tax levels'

2.3.2 The Council's Working Balance minimum prudent target level of 7% of net expenditure was dropped from 2009/10 and the balance frozen at £890,000. Although still very low compared to most local authorities, £890,000 is considered to be adequate, subject to the regular review of budget risk. Gosport's working balance remains in the lowest quartile compared to other local authorities. This is considered appropriate as the Council is conscious that the balance represents local taxpayers' funds set-aside and not directly contributing to service provision.

2.3.3 It must be recognised however, that as a result of the radical changes to the financing of Local Government introduced in 2013/14 the Council is exposed to a number of new risk areas (including the collection of Business Rates, a risk previously borne by Central Government) so that the working balance should not be reduced at this time.

## **2.4 Revenue Financing Reserve**

2.4.1 The Revenue Financing Reserve (RFR) is a provision available for general use, although it is particularly targeted at:-

- helping achieve efficiencies by providing funding for spend-to-save initiatives (seen as particularly important due to the forecast of a significant reduction in Central Government Grant);
- helping to ensure that variations in annual maintenance requirements can be adequately financed; and,
- reducing exposure to risk by helping to underwrite uninsurable risks and by saving premiums where self insurance is undertaken.

2.4.2 It is considered that maintaining a viable RFR is an essential element for improved management of the Council's finances. In order to achieve this, the approved Council policy is that the RFR is debited or credited with any General Fund budget variations and Council Tax Collection Fund surpluses/deficits (subject to the working balance first being maintained at an appropriate level).

## **3. HOUSING REVENUE ACCOUNT**

### **3.1 Housing Revenue Account (HRA)**

3.1.1 The HRA comprises expenditure and income relating to stock of over 3,100 Council dwellings and over 290 leasehold properties. The services provided include management, repairs and maintenance and the rental income collection service.

3.1.2 The determination of future expenditure patterns relies upon the following key elements:

- Repair and maintenance needs of the stock
- Meeting the decent homes and post decent standards

- Aspirations of the tenants
- Rent convergence
- The resources available
- Development
- Repayment of self financing loan.

## **3.2 HRA Self Financing**

- 3.2.1 The HRA subsidy reform happened in April 2012. For Gosport this meant buying out of a negative subsidy position. Full responsibility for managing and maintaining the stock rests entirely with the Council. All income is now collected and managed locally and long term investment needs of the stock are now planned in consultation with the tenants.
- 3.2.2 The government has set a statutory debt limit for each housing authority which comprises the settlement figure for the authority plus what has previously been borrowed under the prudential code. The debt limit/cap for Gosport is £63.07m. This places a constraint on the potential for investment for this Council in the early years of self financing.
- 3.2.3 The cap on debt restricts the ability of authorities to take on additional borrowing under the prudential code, even if the borrowing is affordable for the HRA. The Localism Act does allow for the reopening of the settlement, but only in very limited circumstances.

## **3.3 HRA Business Planning**

- 3.3.1 An HRA business plan has been developed as part of the requirement for self financing with an accompanying financial model to show that self financing is a viable option and that debt can be repaid within the timeframe. The business plan describes the Council's vision for the future of the housing stock under self financing and details how the Council intends to finance investment in the housing stock. The plan sets out the long term priorities, objectives and actions for council housing for the coming years.
- 3.3.2 The viability of the plan has been established through the completion of a detailed financial model. The model is calculated over thirty years and shows the baseline position for the HRA. It shows the impact of the increase in housing debt as a consequence of the required borrowing of £57m and the HRA's ability to both repay the debt and manage the stock over the next thirty years.
- 3.3.3 Detailed calculations are provided within the model for future rent levels, management and maintenance costs as well as capital spend, depreciation, debt repayment and working balances. This model is updated annually and rolled forward to give a continual assessment of income and expenditure over the life of the plan.

## **3.4 HRA Rent Income**

- 3.4.1 Following consultation the government issued new rent guidance for social rents from April 2015 onwards. The key areas are:
- Retaining a formula rent for each property but uplifts now restricted to CPI +1%.
  - Removing flexibility to increase rents by more than the formula uplift, except for re-lets where increases to formula or cap are expected.
  - Commitment to policy for 10 years upto 2024-25

### **3.5 Improvement and Repairs**

- 3.5.1 The Council have an Asset Management Strategy that covers the period 2013-18. It has been drawn up to complement the HRA Business Plan and sets out the medium term implications of maintaining and improving the stock. The Asset Management Strategy has been informed by the Stock Condition Survey undertaken by Savills in 2012. A rolling 5 year programme of surveys will ensure that all stock information is improved and accurate.
- 3.5.2 The Asset Management Strategy also complements the Council's Corporate Asset Management Plan of 2013. This document sets out corporate priorities and objectives for all council owned assets. The Housing Service has a number of strategic objectives, which underpin this document forming a comprehensive strategic approach to both investment (new assets or development) and re investment (maintenance of existing assets).

### **3.6 Housing Revenue Account working balance**

- 3.6.1 The HRA working balance is a reserve of the Housing Revenue Account and is "ring fenced" for this purpose.
- 3.6.2 The HRA balance as at 31 March 2014 is estimated to be in the region of £990,000 (subject to Audit). The balance is considered to be appropriate taking into account factors including the level of stock and the additional risks borne by the Council following the move to self financing.
- 3.6.3 On March 31<sup>st</sup> 2014 the HRA also had £850,000 set aside for development or the provision of new assets. It is anticipated that this sum will continue to grow in future years and be available for use in conjunction with retained receipts from the Right To Buy Scheme.

## **4.0 CAPITAL**

### **4.1 Capital Priorities and Selection Process**

- 4.1.1 In order to ensure that the Council's Capital expenditure is targeted at achieving the Council's priorities capital projects must be evaluated and prioritised before they are recommended for inclusion in the Draft Capital Programme which is considered by Members as part of the budget process.
- 4.1.2 The projects are considered by the Council's Management Team with particular attention on their affordability (particularly critical as Government grant support has reduced) and their contribution to the priorities detailed within the Corporate Plan and associated Corporate Action Statement. The Team then make recommendations to Members on the schemes to consider and pursue as part of the Council's Capital Programme.

### **4.2 Prudential Framework/Impact on Revenue Account**

- 4.2.1 The Local Government Act 2003 introduced major changes to the capital funding regime with effect from 1 April 2004. The previous system of controlling Councils capital expenditure by limiting borrowing through the use of credit approvals was replaced by a more flexible system based on affordability.

- 4.2.2 The prudential capital finance system (Prudential Framework) allows the Council to make its own borrowing decisions using agreed professional principles as set out in the Prudential Code to ensure that any new borrowing is affordable and prudent. It is accepted that use of the Code by the HRA will necessitate proper arrangements for debt repayment, although not currently required by statute.
- 4.2.3 The main advantages of the increased freedom to borrow under the Prudential Framework are:-
- (i) The ability to bring forward capital schemes that would not otherwise have been possible to fund in the short to medium term under the previous capital financing regime.
  - (ii) Spend-to-Save Schemes where the cost of the borrowing associated with the capital expenditure on a Scheme can be wholly or partly met by revenue savings arising as a result of the project being carried out.
  - (iii) The ability to raise funding up to 3 years in advance when market conditions are favourable.
- 4.2.4 The expenditure possible under (i) will be limited by the ability of the Council to afford the revenue consequences of the borrowing undertaken. In any event, the anticipated low levels of supported borrowing, capital grants and other capital funding resources together with the national pooling of Housing Capital Receipts has resulted in an increase in the need to borrow to finance Capital Expenditure.

### 4.3 Projected Expenditure

#### 4.3.1 Capital Programme 2014/15-2016/17

	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>
	<b>£,000</b>	<b>£,000</b>	<b>£,000</b>
Community (Housing)	3,915	3,990	4,070
Community (General Fund)	1,558	352	207
Economic Development	15	-	-
Policy & Organisation	274	190	175
<b>Total Capital Programme</b>	<b>5,762</b>	<b>4,532</b>	<b>4,452</b>
Revenue Contribution - HRA	3,485	3,560	3,640
Specific Capital Grants - GF	270	270	270
Developer Contributions for Open Spaces -GF	350	-	-
Other Grants and Contributions - GF	618	-	-
Capital receipts -GF	100	1,175	600
Capital Funding Requirement - GF	939	(473)	(58)
<b>Total Capital Funding</b>	<b>5,762</b>	<b>4,532</b>	<b>4,452</b>

- 4.3.2 A significant proportion of the planned capital expenditure relates to the Community Board, with the largest area of expenditure being that of improvements to housing stock. Partly as a result of the move to self financing (see 3.2) it has been possible to increase expenditure from £2,940,000 originally budgeted for 2012/13 to between £3,435,000-£3,590,000 in 2013/14, 2014/15, 2015/16 and 2016/17.

## **5.0 TREASURY MANAGEMENT**

### **5.1 Treasury Management Strategy**

5.1.1 The treasury management service is an important part of the overall financial management of the Council's affairs. Its importance has increased as a result of the freedoms provided by the Prudential Code. Whilst the prudential indicators consider the affordability and impact of capital expenditure decisions and set out the Council's overall capital framework, the treasury management activity covers the effective funding of these decisions. Taken together they form part of the process which ensures the Council meets the requirement of setting a balanced budget.

5.1.2 The CIPFA code of practice requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report will be produced after the year-end to report on actual activity for the year together with the mid-year position. This report includes extracts from the Treasury Management Strategy for 2014/15.

5.1.3 A key requirement of the strategy is to explain both the risks associated with the treasury service and how those risks are to be managed.

This strategy covers:

- The Council's debt and investment projections;
- The Council's estimates and limits on future debt levels;
- The expected movement in interest rates;
- The Council's borrowing and debt strategy
- The Council's investment strategy
- Treasury performance indicators;
- Specific limits on treasury activities;
- Any local treasury issues.

### **5.2 Treasury Position**

5.2.1 The Council had net borrowing of almost £69.3M at 31 March 2014.

5.2.2 The Council's capital expenditure plans will be partially financed by external funds such as capital receipts, capital grants, external contributions and deposits. The remaining element which is not able to be immediately financed from these sources will impact on the Council's borrowing need (the Capital Financing Requirement, or CFR). This borrowing or net financing need is known as unsupported capital expenditure and must be paid for from the Council's own revenue resources.

5.2.3 A key risk of the capital funding plan is that the estimated sources of external funding are subject to confirmation and/or negotiation which may cause changes to the budgeted funding pattern. For instance, anticipated asset sales may be postponed due to the continuing impact of the recession on the property market. This will become increasingly important as interest rates begin to rise.

### **5.3 Expected movement in Interest Rates**

- 5.3.1 The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2014	0.50	2.60	4.16	4.12
Jun 2014	0.50	2.60	4.30	4.30
Sep 2014	0.50	2.70	4.40	4.40
Dec 2014	0.50	2.80	4.50	4.50
Mar 2015	0.50	2.80	4.60	4.60
Jun 2015	0.50	2.90	4.70	4.70
Sep 2015	0.50	3.00	4.80	4.80
Dec 2015	0.75	3.10	4.80	4.90
Mar 2016	0.75	3.20	4.90	5.00
Jun 2016	1.00	3.20	4.90	5.00
Sep 2016	1.25	3.30	5.00	5.00
Dec 2016	1.50	3.40	5.00	5.00
Mar 2017	1.75	3.50	5.00	5.00

- 5.3.2 Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive in indicating that growth prospects are strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

- 5.3.3 The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- As for the Eurozone, concerns have subsided considerably in 2013. However, sovereign debt difficulties have not gone away and major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2014/15 and beyond;
- Borrowing interest rates have risen significantly during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring even higher borrowing costs, which are now looming ever closer, where authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt, in the near future;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

#### **5.4 Policy on borrowing in advance of need**

5.4.1 The Council has some flexibility to borrow funds for up to three years ahead. The Borough Treasurer may do this under delegated power where, for instance, a sharp rise in interest rates is expected meaning borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Borough Treasurer will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.

5.4.2 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

#### **5.5 Debt rescheduling**

5.5.1 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

5.5.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

#### **5.6 The Council's borrowing strategy**

5.6.1 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the 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. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

5.6.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2014/15 treasury operations. The Borough Treasurer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the anticipated rate to US tapering of asset purchases, or in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years
- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

5.6.3 The Council's sources of borrowing are:-

- Long-term loans (in excess of 364 days) will be raised with the PWLB or other public bodies
- Short term loans (less than 364 days) will be raised through
  - Money market loans through the London Money Market using brokers appointed at the discretion of the Borough Treasurer
  - Directly or through brokers, at the discretion of the Borough Treasurer, with other public bodies
  - Use of the Council's overdraft limit with its bankers, National Westminster Bank, up to £250,000
  - Internal funds – the cash held in internal funds can be used short term to fund capital expenditure or the repayment of debt, thus delaying the need to borrow externally

## 5.7 The Council's Investment Strategy

- The key objectives of the Council's investment strategy are security, liquidity and yield in that order.
- The Council has determined that it will only use approved counterparties from the UK
- No Investments are to exceed 3 years although most will not exceed 364 days
- A £3m limit applies with any single group other than the Council's Bank or UK Regulated Qualifying Money Market Funds
- Investments will be placed with bodies that meet the Council's creditworthiness criteria
- There is a clear operational difficulty arising from the current banking situation. Ideally investments would be invested longer to secure better returns, however uncertainty over counterparty creditworthiness and interest rates suggests short dated investments may provide lower exposure to risk.

## 6.0 BUDGET STRATEGY AND PROCESS

- 6.1 The Council's current Corporate Plan details the Council's Strategic Priorities which are categorised under four main headings namely, People, Places, Prosperity and the Pursuit of Excellence.  
The Corporate Action Statements (contained within the Corporate Plan) underpin the delivery of the Corporate Priorities. Any budgetary implications arising from the actions outlined in Service Improvement Plans (SIP) are included within the Council's initial Draft Budget. Depending on the resource constraints affecting the Council these are either ultimately approved or, if this is not possible, the unit SIP is amended to reflect this.
- 6.2 Budget preparation commences annually in July and incorporates requirements resulting from Council priorities identified from Capital Strategies, Community Strategy, Corporate Plan and departmental action plans, culminating in recommendations to Boards and Council the following January/February.
- 6.3 Budget preparation is "zero-based" where appropriate and new bids are minimised. Maintenance proposals are provided for according to the latest Asset Management Planning requirements.
- 6.4 Prudent inflation parameters are used in the build up of the initial budgets.
- 6.5 In the interest of sustainability, the Council will not generally budget to use one-off or short-term income (including grants) on expenditure that is properly part of its base budget requirements.
- 6.6 Capital projects bids are considered for inclusion within the Capital Programme in terms of affordability, including impact on local tax levels as part of the Budget Process.
- 6.7 Once the Council's budget is set and the precepting authorities' requirements known, the Council sets Council Tax levels for the forthcoming year. (This has to be done by 11 March).

## **7.0 RISK MANAGEMENT AND INSURANCE**

### **7.1 Risk Management**

- 7.1.1 The Council recognises the importance of an effective risk management process covering all aspects of the significant business risks that the authority faces. Although much has been achieved, ongoing development of the risk management process remains a key priority of the Council and dedicated resource has been earmarked for this purpose. In particular Risk Working groups have been formed to review areas considered to be of greater risk i.e. housing, motor, property and combined liability in order to improve the Council's overall risk performance.
- 7.1.2 The Council has an agreed Risk Management Strategy in place. Major capital schemes must be risk assessed as part of the approval process. In addition risk registers for both operational and strategic risks are in operation which assesses the financial risks as part of its overall framework. Finally, an established corporate risk management group meets to discuss key risk issues that influence the Council's day-to-day business and to further develop and critically review the risk management process.
- 7.1.3 The Budget report to Council and the Budget Book highlight the principal areas of risk to the budget with an assessment of likelihood and impact.

## **7.2 Insurance**

- 7.2.1 The Council has a range of insurance policies which help safeguard against many of the higher financial risk areas particularly relating to property, employers and public liability insurance. In collaboration with the other 10 Hampshire District Councils, this Council is currently in the process of tendering its insurance portfolio under the Hampshire Framework Agreement. A common approach is being achieved by successfully realigning renewal dates, applying common excesses and indemnity levels. The new contract commences 1 April 2015 and it is hoped that by going to the insurance market as one similar group competitive premiums can be achieved.



# **Gosport Borough Council**

## **Capital Strategy**

### **2014**

## CAPITAL STRATEGY

### 1.0 INTRODUCTION

- 1.1 The main purpose of the Capital Strategy is to outline how the Council decides what Capital Projects are supported and the process that is undertaken to make sure that these are in line with the Council's priorities and objectives.
- 1.2 The funding options and constraints relating to the funding of the programme are explored for the Capital Programme 2013-18.

### 2.0 FINANCIAL AND ASSET INFORMATION

#### Revenue Budget

The Council's gross revenue budget 2014/15 totals £65.970 Million, which after deducting gross income of £56.141 Million results in a net revenue budget of £9.829 Million.

#### Assets

The Council's asset base is dominated by its housing stock, which numbered 3,176 properties on 31 March 2014 with an estimated value of over £110 Million representing 72.1% of the total fixed asset value of over £153 Million.

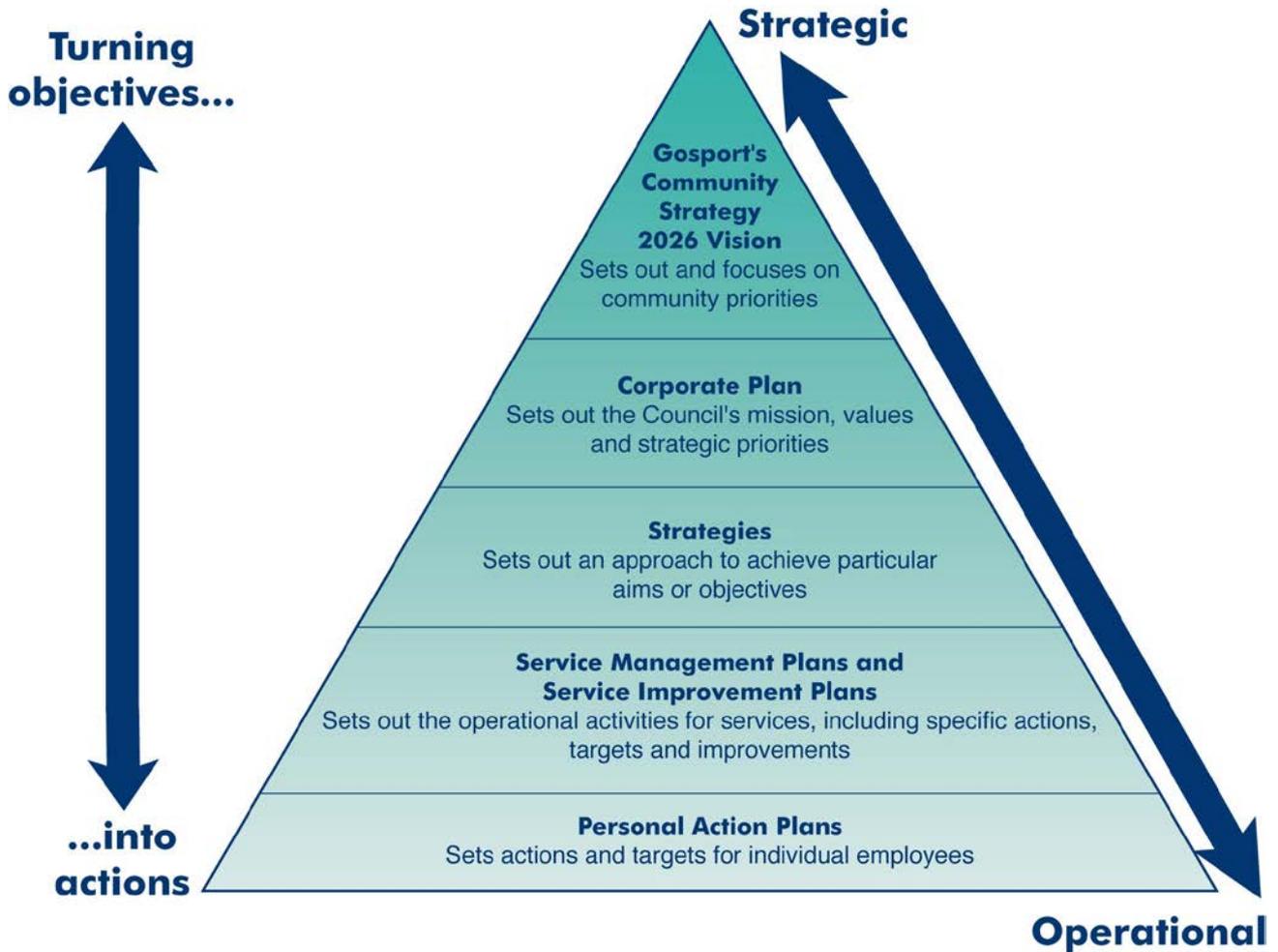
#### Council Assets 2013/14

	2013/14 £'000
Council Dwellings	110,672
Land & Buildings	21,890
Vehicles, Plant & Equipment	876
Infrastructure	8,658
Community Assets	3,498
Surplus Assets	68
Assets Under Construction	134
Heritage Assets	209
Investment Property	6,938
Intangible Assets	557
	<b>153,500</b>

- 2.1 The relatively high proportion of Infrastructure Assets (£8.7M) is primarily due to the coastal nature of the Borough and includes sea defence features such as sea walls and pontoons. The Community Assets (£3.5M) include land set aside for recreation and leisure purposes (including the 27 designated parks within the Borough).

### 3.0 THE COUNCIL'S OBJECTIVES

3.1 The diagram below shows how the Council's objectives are identified and incorporated within the strategies and plans of the Council to ensure that the limited resources available are targeted to the areas considered most important.



3.2 The Corporate Plan which is reviewed annually and is the key document for setting out the Council's objectives detailing the Council's Mission, values and strategic priorities many arising from the Community Strategy/2026 Vision.

The Council's mission is:

**'To work with our community to improve everyone's quality of life and deliver a sustainable future for the Borough'.**

A number of Core Values are also identified under the headings of Participation, Performance, Partnership, People and Political Processes to help the Council to meet its aspiration to be recognised as an open and responsive organisation, regarded as excellent and at the centre of the community.

The Corporate Plan also lists the Council's Strategic Priorities under the four main headings of:

- People**
- Places**
- Prosperity**
- Pursuit of Efficiency & Effectiveness**

People, Places and Prosperity are the cornerstones of Gosport's 2026 Vision whilst Pursuit of Excellence embraces the core values.

The Council's Strategic Priorities are a combination of the priorities of local people, national priorities set by Central Government and the challenges arising from Gosport's changing social, economic and environmental context.

- 3.3 As shown in the diagram the principal purpose of the various Strategies of the Council are to help set out a framework to assist the achievement of the objectives and strategic priorities of the Council. The Capital Strategy seeks to ensure that the Council's limited Capital Resources are best used to achieve this objective.

#### **4.0 THE SELECTION AND PRIORITISATION OF CAPITAL PROJECTS**

- 4.1 In order to ensure that the Council's Capital expenditure is targeted at achieving the Council's Priorities capital projects must be evaluated and prioritised before they are recommended for inclusion in the Draft Capital Programme which is considered by Members as part of the budget process.
- 4.2 The projects are considered by the Council's Management Team with particular attention on their affordability (particularly critical as Government grant support has reduced) and their contribution to the priorities detailed within the Corporate Plan and associated Corporate Action Statement. The Team then make recommendations to Members on the schemes to consider and pursue as part of the Council's Capital Programme.

#### **5.0 FINANCING THE CAPITAL PROGRAMME**

- 5.1 The Local Government Act 2003 introduced major changes to the capital funding regime with effect from 1 April 2004. The previous system of controlling Councils capital expenditure by limiting borrowing through the use of credit approvals was replaced by a more flexible system based on affordability.
- 5.2 The prudential capital finance system (Prudential Framework) allows the Council to make its own borrowing decisions using agreed professional principles (as set out in the Prudential Code which has been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA)) to ensure that any new borrowing is affordable and prudent.
- 5.3 The main advantages of the increased freedom to borrow under the Prudential Framework are: -
- (i) The ability to bring forward capital schemes that would not otherwise have been possible to fund in the short to medium term under the previous capital financing regime.
  - (ii) Spend-to-Save Schemes where the cost of the borrowing associated with the capital expenditure on a Scheme can be wholly or partly met by revenue savings arising as a result of the project being carried out.
  - (iii) The ability to raise funding up to 3 years in advance when market conditions are favourable.
- 5.4 The capital expenditure possible through the prudential framework will be limited by the ability of the Council to afford the revenue consequences of the borrowing undertaken placing an increasing reliance on other sources of Capital Funding. These include:

## **5.5 Internal Funding**

### **Usable Capital Receipts-Receipts arising from the disposal of Council Land, buildings and other assets.**

Whilst 100% of the receipts arising from the disposal of General Fund Assets can usually be used to fund capital projects the rules regarding the disposal of HRA assets are more complex. Non Right To Buy (RTB) receipts are no longer subject to pooling. In April 2012 this authority signed an agreement with the DCLG regarding RTB receipts under which the Council is able to retain a greater proportion of receipts on the understanding that they are applied to investment in affordable housing up to a maximum of 30% of the funding for each scheme.

### **Revenue Contributions to Capital-**

Revenue funding of capital projects represents another funding option although, due to revenue budget pressures, it has generally not been possible to fund such contributions from the General Fund. The current expectation of further reductions in Central Government Grant in the next three years makes it unlikely that this position will change in the near future.

Such contributions from the Housing Revenue Account (ring fenced for Housing Capital Expenditure) have historically played an important funding role in supporting the Housing Stock Improvement Programme. As a result of the introduction of self financing and the discontinuation of the Major Repairs Allowance this has become an even more significant source of funding of HRA capital expenditure.

## **5.6 External Funding**

Some of the principle sources of external funding are:-

### **Specified Capital Grants**

Government grants given towards certain capital expenditure items such as Disabled Facilities Grants.

### **Developer Contributions for Open Space and Sports and Recreation Facilities**

Sums paid by a developer in accordance with a specified formula to facilitate new or upgraded leisure facilities.

### **Developers Contributions for Social Housing**

Sums paid by a developer in accordance with a specified formula to be used for the provision of Social or Affordable Housing.

### **Other Grants and Partnership Contributions**

All other external grants and contributions from other sources.

**6.0 THE CAPITAL PROGRAMME 2014/15-2016/17**

6.1 A summary of the Council's Capital Programme and proposed funding for the next 3 years is set out in the table below. More detailed breakdowns of the programme is available in the Council's Budget Book 2014/5.

	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>
	<b>£,000</b>	<b>£,000</b>	<b>£,000</b>
Community (Housing)	3,915	3,990	4,070
Community (General Fund)	1,558	352	207
Economic Development	15	-	-
Policy & Organisation	274	190	175
<b>Total Capital Programme</b>	<b>5,762</b>	<b>4,532</b>	<b>4,452</b>
Revenue Contribution - HRA	3,485	3,560	3,640
Specific Capital Grants - GF	270	270	270
Developer Contributions for Open Spaces -GF	350	-	-
Other Grants and Contributions - GF	618	-	-
Capital receipts -GF	100	1,175	600
Capital Funding Requirement - GF	939	(473)	(58)
<b>Total Capital Funding</b>	<b>5,762</b>	<b>4,532</b>	<b>4,452</b>

A significant proportion of the planned capital expenditure relates to the Community Board, with the largest area of expenditure being that of improvements to housing stock. Partly as a result of the move to self financing it has been possible to increase expenditure from £2,940,000 originally budgeted for 2012/13 to between £3,435,000-£3,590,000 in 2013/14, 2014/15, 2015/16 and 2016/17.

**7.0 CAPITAL PROGRAMME AND PROJECT MONITORING**

7.1 Once approved it is important the Capital Programme is delivered and a robust monitoring process is in operation. The Capital Programme is closely monitored and any variation is included in the Budget Monitor which is either distributed to Policy and Organisation Board Members or where required (such as when a virement or supplementary estimate is needed) is taken to the Board for decision. In addition the programme is revisited as part of the annual budget process with scheme progress being monitored and scheduled projects re-phased or deleted as necessary.

7.2 In addition to the above process a specific project group for larger projects is established when required to progress and monitor the progress of the scheme. The project team would also report back regularly to Council Management Team and if issues arise requiring political decision to the appropriate Council Board.

## **8.0 POST IMPLEMENTATION REVIEW**

- 8.1 The lead officer for major (over £100,000) Capital Projects will notify the Head of Accountancy when the project is completed and a Post Implementation Review form is to be supplied. The feedback on these forms will then be considered by Council Management Team.
- 8.2 The form provides details on how successfully the project has been delivered specifically in relation to the following:-
- (1) Timing-was the project started/completed by the anticipated dates?
  - (2) Cost-was the Scheme completed in accordance with the allocated budget?
  - (3) Objectives-did the scheme achieve the anticipated outputs/outcomes?

## **9.0 PARTNERSHIP WORKING**

- 9.1 Working in partnership with other organisations from both the private and public sector is an important way of ensuring the limited Capital Resources available are used efficiently to help maximise their contribution towards achieving the Corporate Objectives and Priorities. Partnership working may range from key overarching Partnerships such as those arising from the Local Strategic Partnership, preferred partners in specific Service areas such as the Key Housing Association Partners or 'one off' schemes where the organisation's and the Council's priorities coincide.
- 9.2 The Capital Scheme Proposal Form specifically requests information on how the scheme will Develop partnership working, financial and non financial input from other partners and asks how the scheme will contribute to the partners' strategies and priorities.

## **10.0 MEDIUM TERM FINANCIAL STRATEGY**

- 10.1 The Medium Term Financial Strategy provides an overall framework for the financial investment in services for a five year period. It therefore is closely linked with the Capital Strategy and shows the effect on the overall revenue budget and associated Council Tax levels of the financing charges arising from the Capital Programme.
- 10.2 It is important, therefore, that any significant alterations in the Capital Strategy are promptly used to update the Medium Term Financial Strategy to help fully understand the impact of such changes on the Council's Finances as a whole.

## **11.0 ASSET MANAGEMENT PLAN**

- 11.1 The Council's Asset Management Plan helps develop a process to achieve efficient effective and economical management of its assets. The linkages to the Capital Strategy and Programme are strong with capital expenditure on Council Assets being a significant element of the Programme particularly relating to the Council's Housing Stock.
- 11.2 It is important that the Council's property assets are maintained as they play a vital role in the delivery of the Councils Statutory Services and the delivery of its Corporate Priorities. The Asset Management Plan informs the Council on the improvement and maintenance requirement of the Council Assets with the larger schemes being included in the Capital Programme.

## **12.0 HOUSING BUSINESS PLAN**

- 12.1 The Housing Business Plan is a long term plan for managing the authority's housing Assets and financing the necessary investments. It is a key element in ensuring the effective long term management and maintenance of the Council Housing Stock. The importance of the plan has

further increased following the introduction of self financing of the HRA with a greater responsibility and risk being borne by the Council.

- 12.2 The Plan should be consistent with the Authorities wider corporate objectives and Housing Strategy and will inform on the level of Capital Expenditure required on the Housing stock necessary to achieve the Decent Homes and energy efficiency targets.

### **13.0 REVIEW OF THE CAPITAL STRATEGY**

- 13.1 The Capital Strategy is reviewed annually to take account of any changes in legislation, capital expenditure requirements, funding position or process improvements. Any significant changes are considered by Council Management Team and consequent amendments to the strategy are submitted to Policy and Organisation Board for consideration and approval.