

GOVERNANCE COMMITTEE

WEDNESDAY, 23RD JANUARY 2019, 2.30 PM
COMMITTEE ROOM 1, TOWN HALL, CHORLEY

I am now able to enclose, for consideration at the above meeting of the Governance Committee, the following report that was unavailable when the agenda was published.

Agenda No	Item
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6	GOVERNMENT REQUIREMENTS OF THE CAPITAL STRATEGY REPORT	(Pages 35 - 44)
	To receive and consider the report of the Director (Policy and Governance).	

GARY HALL
CHIEF EXECUTIVE

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Report of	Meeting	Date
Director of Policy & Governance	Governance Committee	23/01/2019

GOVERNMENT REQUIREMENTS OF THE CAPITAL STRATEGY REPORT

PURPOSE OF REPORT

1. To update the committee on the requirements of the new Capital Strategy report to be submitted with the budget papers to Full Council on 26 February 2019.

RECOMMENDATION(S)

2. To note the government guidance and requirements of the Capital Strategy report
3. To note where the council can meet with requirements of the guidance and to note where further work will be required
4. That members provide any input into what they believe should be included in the Capital Strategy report

EXECUTIVE SUMMARY OF REPORT

5. It is a new requirement in 2019 for councils to submit a Capital Strategy report alongside the budget setting papers to Full Council. The aim of the Capital Strategy is to introduce a more strategic report that provided an overview to decision makers of the investment and borrowing risk position of the authority and the governance arrangements in place to manage those risks. This is a reaction to the increasing number of councils investing in commercial assets to generate revenue and bridge budget deficits.
6. The report also covers treasury management activity therefore it is possible to combine the treasury management strategy into the capital strategy. The capital strategy has four main sections:
 - Capital Expenditure
 - Treasury Management
 - Commercial Activity
 - Knowledge & Skills
7. This report outlines what the requirements of each section are and how the council will meet these in the report. At this stage the council is not able to meet all the requirements due to the council's Asset Management Plan still being undertaken. The report includes two appendices for members to consider the risk appetite of the council and what indicators the council could use to monitor the risk in its commercial activities.
8. It is the decision of the council as to whether it brings the existing Treasury Management Strategy into the Capital Strategy. It is proposed in this paper that they remain separate.

Confidential report Please bold as appropriate	Yes	No
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CORPORATE PRIORITIES

9. This report relates to the following Strategic Objectives:

Involving residents in improving their local area and equality of access for all		A strong local economy	
Clean, safe and healthy homes and communities		An ambitious council that does more to meet the needs of residents and the local area	✓

BACKGROUND

Guidance

10. The guidance for the reporting requirements of the capital strategy comes from two documents:
 - The Prudential Code
 - The Treasury Management Code
11. This is further supported by CIPFA’s capital strategy checklist and the MHCLG Statutory Investment Guidance.

Purpose

12. The aim of the Capital Strategy is to introduce a more strategic report that provided an overview to decision makers of the investment and borrowing risk position of the authority and the governance arrangements in place to manage those risks.
13. The Government believes that local authorities need to be better at explaining “why” not just “what” they are doing with their investment activity. Investment activity now includes capital expenditure rather than previous treasury management reports that focussed on the investment of the council’s cash.
14. The report also covers treasury management activity therefore it is possible to combine the treasury management strategy into the capital strategy. The capital strategy has four main sections:
 - Capital Expenditure
 - Treasury Management
 - Commercial Activity
 - Knowledge & Skills
15. It is not the intention of the report to duplicate work already completed, as such the report will make reference to other strategies the council has already approved. The Capital Strategy’s Treasury Management section is practically identical to the current Treasury Management Strategy. It is proposed that the Capital Strategy will therefore summarise the highlights of the Treasury Management Strategy that will be submitted to Full Council alongside the Capital Strategy.
16. The Capital Strategy is to be approved annually by Full Council alongside the budget setting papers.

CAPITAL EXPENDITURE

17. This section outlines how the capital programme fits in with the authority's wider objectives and the framework in place to ensure effective and sustainable investment. There are four separate subsections.

Governance

18. The requirements of this section include:

- Link between the capital programme and strategic service plans
- The pipeline process for capital projects
- The authority's policies surrounding capitalisation

19. Chorley Council's Capital Strategy will provide the following:

- The stages of scrutiny and approval a new capital project must go through including the use of project management tools, such as business cases, to ensure the benefits of the project are linked to corporate objectives, that they are sustainable and that these benefits are monitored.
- The definition of capital is outlined in the constitution

Long Term Plans

20. The requirements of this section include:

- Long term forecast of capital expenditure including disposals and borrowing
- The basis for estimating future costs and the use of sensitivity analysis to model external and internal risks.

21. Chorley Council's Capital Strategy will provide the following:

- A summary of the capital programme and how it is financed including borrowing. The council's four major capital projects - Housing Company, Primrose, Strawberry Fields and MW Extension – will be outlined separately as these provide the majority of the capital programme and therefore the greatest risk.
- Available resources including reserves and uncommitted capital receipts
- Reference to the Treasury Management Strategy and its analysis of the capital financing requirement and the limit to which the council could borrow in the future

22. It should be noted that the ambition of the Government is to provide a long term capital programme i.e. over 5 years. The council's only approved long term budget relates to the Housing Company and it is the opinion of officers that providing this information will not give any further indication of the capital programme's sustainability, affordability or risk. As such it is proposed to provide the capital programme summary for 2018/19 to 2021/22

Asset Management Plans

23. The requirements of this section include:

- Overview of the asset management plan
- Ongoing costs associated with existing assets

24. It is the council's ambition to create an asset management plan however due to the temporary difficulties in filling posts in Property Services this work has not yet been undertaken. Resources have been set aside and qualified staff recruited to begin this process however it will not be finalised prior to Full Council on 26 February 2019. As such it is the ambition of the council to include this plan in the 2019/20 Capital Strategy and

therefore provide a long-term view of the capital programme and how it manages existing assets.

25. The 2018/19 Capital Strategy will provide an analysis of the prior year spend relating to the maintenance of its assets and provide confirmation that the budget set aside in the past has been sufficient to meet these costs. Using this information, the budget set aside in future years for asset maintenance, including leisure centres, is deemed to be a prudent estimate of the budget required to manage the council assets. However this will not be confirmed until an asset management plan is created and scrutinised in the new financial year.

TREASURY MANAGEMENT

26. It is for individual authorities to decide whether to include their treasury management strategy and annual investment strategy as part of a capital strategy, or to do them separately. However, our own recommendation is that the capital strategy should be a high level corporate document dealing with the key areas of strategic context, corporate priorities, capital investment ambition, available resources, affordability, capacity to deliver, risk appetite, risk management, and determining an appropriate split between non-financial and treasury management investments in the context of ensuring the long term financial sustainability of the authority. It should also deal with significant commercial, (focused on income generation), investments in appropriate detail so that members can properly assess the particular risks in this area.
27. It is proposed that the Capital Strategy will summarise the highlights of the Treasury Management Strategy that will be submitted to Full Council alongside the Capital Strategy.

COMMERCIAL ACTIVITY

Other Investments

28. The requirements of this section include:
- Local authorities should disclose the contribution that all other investments make towards service delivery objective(s) and towards the balanced budget
 - Authorities should include sufficient information to allow the reader to understand the extent of commercial activity that the authority is involved in. This should be over the long term.
29. Chorley Council's Capital Strategy will provide the following:
- A summary of the major capital projects and existing purchased assets that generating net income to the council. This will include the income, running costs, borrowing costs and net income associated with each asset over the coming 10 years.
 - It will describe the reasons these are held by the authority including profit, regeneration, responding to market failure

Governance & Risk Management

30. The requirements of this section include:
- The policies and procedures for the approval of commercial activity
 - How the authority will use independent and external expert advice
 - Outline the authority's overall risk appetite
31. The policies, procedures and use of external advice will be covered in the first section of the Capital Strategy.
32. Chorley Council's Capital Strategy will provide the following:

- A description of the various types of risk the council faces including financial, reputational, strategic, environmental
- It will then describe the council's appetite for each risk, examples are given in appendix 1.
- The amount of capital invested and the potential volatility of the fair value compared to the initial investment
- Quantitative indicators that allow councillors and the public to assess a local authority's total risk exposure. Potential indicators are included in Appendix 2, indicators would be monitored twice a year and reported alongside the mid-year review of the Treasury Management Strategy.
- Council's risk management process and how this will be used to monitor the risks surrounding these investments

KNOWLEDGE AND SKILLS

33. The requirements of this section include:

- The skills and knowledge available within the authority
- How the authority uses external advisers
- How the authority arranges training for staff and councillors to ensure that they have the required skills and are kept up to date

34. The Capital Strategy will cover these requirements

IMPLICATIONS OF REPORT

35. This report has implications in the following areas and the relevant Directors' comments are included:

Finance	✓	Customer Services	
Human Resources		Equality and Diversity	
Legal		Integrated Impact Assessment required?	
No significant implications in this area		Policy and Communications	

COMMENTS OF THE STATUTORY FINANCE OFFICER

36. The requirements of the Capital Strategy report are outlined in this document. The report will be taken to Full Council on 26 February 2019.

COMMENTS OF THE MONITORING OFFICER

37. The report properly states the obligation on the Council to prepare and publish a Capital Strategy. The proposed approach would satisfy this requirement.

REBCCA HUDDLESTON
DIRECTOR OF POLICY & GOVERNANCE

Report Author	Ext	Date
James Thomson	5025	16/01/19

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Appendix 1: Chorley Borough Council Risk Appetite

Chorley Borough Council is exposed to a number of investment and commercial risks:

- **Financial risk** relating to the investment of cash, market volatility, currency markets, etc
- **Economic risk** relating to whether the local / national economy is growing or contracting
- **Counterparty risk** relating to investments, loans to third parties and business transactions
- **Operational risk** arising from transactions
- **Strategic risk** relating to the decisions taken by the Council in pursuit of its corporate objectives, i.e. the purchase of major new assets.
- **Reputational risk** relating to the adverse impact of the Council's dealings
- **Environmental and social risks** arising from the adverse impact of investments
- **Governance risk** relating to the transparency and accountability of decisions and decision-makers.

Risk Appetite

The Council has no appetite for **reputational, governance and foreign currency risk**. Its approach to other risks is as follows:

Financial – subject to full due diligence and appropriate external advice the Council will have a moderate risk appetite for investment / expenditure on a range of asset classes, property and longer-term investments. Security and liquidity will be appropriate for the type of investment made. Income generation will prevail over capital appreciation. The Council will have no appetite for volatile or emerging market sector investments.

Economic – The Council will have a high risk appetite for appropriate investments / expenditure in the Borough, it has no risk appetite for investments outside the Borough. The Council will have a low appetite for interest rate risk exposure.

Counterparty – the Council will have a high appetite for highly rated counterparties and financial institutions and a low appetite for unsecured non-investment debt. All investments will be subject to careful due diligence and an assessment of the Council's corporate priorities and liquidity profile.

Operational – the Council will have a low risk appetite for all operational risk arising from factors such as: price errors, administrative errors, IT security, etc. Specific business risks are identified at business unit level and business continuity plans identify and mitigate as appropriate. There is no appetite for fraud, regulatory breaches and exceeding approved limits.

Strategic – The Council will have a high appetite for investments which further its corporate priorities, increase revenue streams and / or facilitate the efficient and effective delivery of core service objectives,

Environmental and social – the Council will have no appetite for environmental and social risk.

Appendix 2: Potential Local Quantitative Indicators Regarding Investment Risk

Debt to net service expenditure (NSE) ratio	Gross debt as a percentage of net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.
Commercial income to NSE ratio	Dependence on non-fees and charges income to deliver core services. Fees and charges should be netted off gross service expenditure to calculate NSE.
Investment cover ratio	The total net income from property investments, compared to the interest expense.
Loan to value ratio	The amount of debt compared to the total asset value.
Benchmarking of returns	As a measure against other investments and against other council's property portfolios.
Gross and net income	The income received from the investment portfolio at a gross level and net level (less costs) over time.
Operating costs	The trend in operating costs of the non-financial investment portfolio over time, as the portfolio of non-financial investments expands.
Vacancy levels and Tenant exposures for non-financial investments	Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is productive as possible.

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