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Capital Strategies and Closedown Briefing West Sussex CIPFA Hub 10 September 2019

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Today's Session

1. Capital strategies

- Prudential code requirements and expectations
- How well are we meeting those expectations?
- Group discussion and feedback

2. Closedown briefing

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Capital Strategies

**the prudential
code**

For Capital Finance in Local Authorities
2017 Edition



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Capital Strategy - Overview

- New requirement for **full Council to approve an annual Capital Strategy**
- Capital Strategy to form a part of authority's **integrated revenue, capital and balance sheet planning**
- Strategy should set out **long term context in which capital expenditure and investment decisions are made**
- **Sufficient detail**
- Due consideration should be given to **risk and reward** and impact on the achievement of **priority outcomes**
- Links should be made where appropriate to **Treasury Management Strategy**
- **CFO to report explicitly on deliverability, affordability and risk associated with Capital Strategy**

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Capital Strategy – Purpose

- A story that gives a clear and concise view of how the authority:
 - determines its priorities for capital investment
 - decides how much it can afford to borrow
 - sets its risk appetite
- Should provide sufficient detail so it provides an accessible single source for the reader
- No single solution that is best practice for all authorities - should be tailored to individual circumstances
- A living document that evolves over time

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The Capital Strategy

What it is

- Tailored to reflect local circumstances
- drives the longer term horizon
- Improves capital/revenue links
- Capable of being read/understood by elected members

What it's not

- One size fits all
- Compendium of all capital/borrowing information
- Any restriction on flexibility

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Capital Strategy – Building Blocks

Capital Expenditure

- Governance
- Long term plans
- Asset management planning
- Restrictions around funds

Investments and liabilities (risks)

- Approach, due diligence, risk appetite
- Governance process for approval and monitoring
- Summary of material investments, guarantees and liabilities

Treasury Management

- Governance
- Long term planning inc. MRP
- Risk appetite, key risks and sensitivities

Skills and knowledge

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Capital Strategy – Capital Expenditure

- Overview of governance process for approval and monitoring of capital expenditure, including policies on capitalisation
- Long-term view of **capital expenditure plans** (long-term is linked to financing strategy and risks faced with reference to life of projects/assets)
- Overview of **asset management planning** including cost of past borrowing, maintenance requirements and planned disposals
- **Restrictions around borrowing or funding** eg requirements around HRA or Police Fund

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Capital Prioritisation and Evaluation (1)

- Evaluation criteria consistent with capital strategy
- Benefits
 - Is project critical to meet statutory obligations?
 - How closely aligned with corporate objectives?
- Cost
 - Value for money (benefit in relation to cost)
 - Impact on future running costs
- Deliverability/risks
 - Will project be delivered on time and within budget?
 - Any possible negative effects?

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Capital Prioritisation and Evaluation (2)

- No one correct way but must be open and transparent
- Ultimate constraint is what authority can afford in revenue and capital terms
- Most authorities use some form of weighted matrix / scoring system
- Officer groups or joint member/officer groups usually decide or make recommendations
- Hierarchy of need, or assigning schemes to different classes, eg essential, priority or desirable?

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Post-Project Reviews – Learning the Lessons

- Purpose: identify where capital programming and monitoring process can be improved
- Undertake reviews on sample or major schemes?
- Report by lead officer for completed schemes on:
 - procurement process
 - timeliness of scheme, final cost against estimate
 - outputs of scheme compared to targets in bid
- Results fed back into capital programming and planning process

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Asset Management Considerations

- Investment in assets requires a long-term view to be taken of future asset requirements, investment needs and ongoing capital and revenue consequences
- Capital strategy should provide sufficient detail on policies around classification of expenditure as capital
- Investment in new / enhanced assets should be balanced against need to maintain service potential and economic benefits of existing assets
- Capital forecast should include ongoing cost of financing and maintaining existing assets including maintenance backlogs
- Capital strategy should be clear on basis of estimates

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Service Planning and Asset Management

- Service Plans should cover needs for existing and new assets required to support existing and future service delivery
- They should specify an outline of need and suitability of assets following a robust appraisal of current and future service delivery
- Without this information capital strategy will not reflect or support current and future service delivery to achieve the corporate aims and objectives of the organisation

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Being Strategic on Asset Management

- Asset management is a strategic activity – it does **not just** involve 'property' people
- It is about supporting the delivery of strategic goals or objectives through the use of property assets – it is part of **resource and business planning**
- It is setting a vision of where you want to be, and mapping out the journey to that place – identifying where value can be added and where investment is needed to achieve objectives
- Need to develop a collaborative planning culture

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Capital Strategy and the Asset Challenge

- Do you have an active asset challenge process whereby you know why you hold every asset?
- Do assets have an alternative use?
- Are asset valuations just for the accounts?
- What about surplus assets – why are they held and what do they cost?

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Asset Questions to Take-Away (1)

- Do you have up to date condition information on your operational assets?
- Have you created a timeline of what capital works are required (including replacement of components) and when?
- Have you established building condition standards across different asset types?
- Is your backlog maintenance figure set against your condition standards?
- Have you monitored the impact of cuts in maintenance budgets on asset condition (an asset truth)?

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Asset Questions to Take-Away (2)

- Do you know what properties you have leased in?
- Do you know what contractual repairing obligations you are under with those leases (dilapidation costs)?
- Are you planning to acquire new commercial property investments?
- How much capital is allocated to that and over what timescale?
- Have you assessed market risks of those investments?
- Are there legislative changes that might impact on ability to lease out commercial assets (eg Energy Act)?

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Asset Questions to Take-Away (3)

- Do you have FV measurements for operational assets and are there opportunities to exploit latent value?
- Are you working actively with partners to share property assets?
- Could this have potential to release capital?
- What asset disposals are already in the pipeline?
- Do you know when these receipts are likely to take place?
- Is capital prioritisation linked to asset strategies?
- Is there a weighting system to assess competing opportunities?
- Are lifecycle costs taken into account?

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Capital Strategy – Debt, Borrowing and Treasury Management (TM)

- Capital strategy to include:
 - Projection of external debt and use of internal borrowing to support capital expenditure (encourage to compare with capital financing requirement and establish appropriate liability benchmark)
 - Provision for repayment of debt over life of the underlying debt
 - Authorised limit and operational boundary for the following year
 - Authority's approach to TM including processes, due diligence and defining risk appetite

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Delegation of Treasury Management

- Approval of detailed TM processes may be delegated to a (sub)committee provided capital strategy includes:
 - Overview of governance process for TM including any delegations
 - Projection of external debt and internal borrowing levels over the long term
 - Limits on overall borrowing for following year
 - Authority's risk appetite for TM and key risks in servicing current and future debt, and how risks are managed
 - Summary of knowledge and skills available to the organisation and confirmation these are commensurate with risk appetite

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Capital Strategy – Commercial Activity

- Capital strategy to include:
 - Authority's approach to commercial activities
 - Processes ensuring effective due diligence
 - Defining authority's risk appetite including proportionality in respect of overall resources
 - Requirements for independent and expert advice and scrutiny arrangements
 - Where authorities have no material commercial activity - a clear statement to this effect

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Governance of Commercial Investments (1)

- Capital strategy should set out governance processes covering:
 - How risk appetite will be determined
 - Process surrounding business cases and scrutiny of final decision making
 - Arrangements for professional due diligence and obtaining advice
- Arrangements for management and reporting of performance and risk including security of investments and yield, any lifecycle costs required to maintain income

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Governance of Commercial Investments (2)

- Procedures should highlight key risks or changes in market conditions that may affect security, liquidity and/or yield of investment portfolio
- Authority should determine risk appetite for non-TM investments - Key considerations may include:
 - Extent the balanced budget is dependent on investment income
 - Amount of capital invested and potential volatility of FV compared to initial investment
 - How investment is financed (eg reserves and borrowing)
 - Liquidity of investment compared to longer term cash flow requirements of authority

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Statutory Guidance (MHCLG) Requirements

- Capital strategy to include:
 - Quantitative indicators to demonstrate risk exposure
 - Whether a non-financial asset retains sufficient FV to provide security for the capital investment – and if not – the mitigating actions to protect the capital invested
 - Approach to assessing risk of loss before entering into and while holding an investment
 - Extent authority is dependent on income generated and contingency plans for falls in income
 - Information on capacity, skills and culture and how these ensure robust decision-making and risk management including use of external professional advice

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Statutory Guidance (MHCLG) Requirements

- Authorities must not borrow more than or in advance of needs purely to profit from investment of sums borrowed
- Where authority chooses not to comply - the capital strategy (or investment strategy) should explain:
 - Why the authority has decided not to comply with the principles in Statutory Investment Guidance or the Code
 - The authority's policies in investing the money borrowed, including management of risks eg of not achieving desired profit or borrowing costs increasing

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Capital Strategy – Other Long-Term Liabilities

- Capital strategy to include:
 - An overview of governance process for approval and monitoring and ongoing risk management of any other financial guarantees and other long-term liabilities
 - Treasury Management Code requires a register of non-TM investments and financial guarantees to be maintained and regularly reviewed, including periodic reassessment of the probability of financial guarantees being called upon
 - Register should be reconciled to financial instruments and other disclosures within statement of accounts

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Capital Strategy – Knowledge and Skills

- Capital strategy to include:
 - Summary of the knowledge and skills available to the authority and confirmation these are commensurate with the authority's risk appetite
 - Important that knowledge and skills of those charged with governance are properly covered to ensure decisions can be properly debated and understood and scrutiny functions can be effective

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Building a Capital Strategy – Guidance

CAPITAL EXPENDITURE

	Material	Reference to Other Sources	v
Does the capital strategy describe how links are made between the capital programme and strategic service plans and asset management plans?	Y	Corporate Plan, Service Plans, Asset Management Plan	
Does the capital strategy set out the pipeline process for capital projects?	Y	Terms of Reference, Standing Orders	
Does the capital strategy set out the authority's use of capitalisation flexibilities?	Y/N	Capitalisation Policies	
Does the capital strategy include a long term forecast including capital expenditure, disposals and borrowing?	Y	Medium Term Financial Plan	
Does the capital strategy set out the basis for estimating future costs, how evidence of past projects is used and the sensitivity of costs to both external and internal risks?	Y	Medium Term Financial Plan	

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Building a Capital Strategy – Guidance

COMMERCIAL ACTIVITY

	Material	Reference to Other Sources	v
Does the capital strategy state clearly whether the authority makes investments primarily for financial return?	Y	Medium Term Financial Plan	
Is the capital strategy clear on the extent to which the balanced budget and council tax calculation is dependent on commercial activity?	Y/N	Medium Term Financial Plan, Budget	
Are policies and procedures clearly set out for the approval of commercial activity including robust scrutiny arrangements?	Y/N	Standing Orders, Commercial Strategy, Investment Strategy	
Does the capital strategy outline how the authority will use independent and external expert advice, including legal advice?	Y/N	Commercial Strategy, Investment Strategy	
Is the capital strategy clear on how investments will be managed on an ongoing basis and how reporting on a routine and exception basis takes place?	Y/N	Standing Orders, Terms of Reference, Commercial Strategy, Investment Strategy	
If the authority borrows for commercial investment, does the capital strategy clearly set out the additional risks the authority is subject to, how these risks will be managed and the rationale for commercial investment?	Y/N	Treasury Strategy, Commercial Strategy, Investment Strategy	

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Capital Strategy – Format and Timeframe

- Intended to give a **high level overview** of how capital expenditure, capital financing and TM activity contribute to provision of services along with **overview** of how associated risk is managed and implications for future financial sustainability
- Format is a local choice – Code is not prescriptive
- A **long-term** view of capital expenditure plans, where long term is defined by financing strategy of and risks faced by authority with [reference to life of projects/assets](#)
- How long is the life of your assets?
- Longer than the period covered by Prudential Indicators

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Group Discussion

- On a scale of 1 to 10...where 10 means meeting the Prudential Code's expectations in full, where do you feel you are?
- What information or processes might be missing or needs further work?
- What remains your biggest challenge?

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Six Steps to a Robust Capital Strategy

1. Develop a corporate business planning process which identify asset implications
2. Review governance including capital prioritisation and option appraisal processes
3. Identify what data and intelligence you already have, identify gaps and develop action plan to fill the gaps
4. Create a capital demand and supply timeline - analyse to explore means to smooth out
5. Self knowledge of experience in capital schemes
6. Now the difficult bit – what do you do about the gap between capital demand and capital supply? Whatever your answer is – this is your strategy!

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Any Questions?



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Closedown Update - Areas To Cover

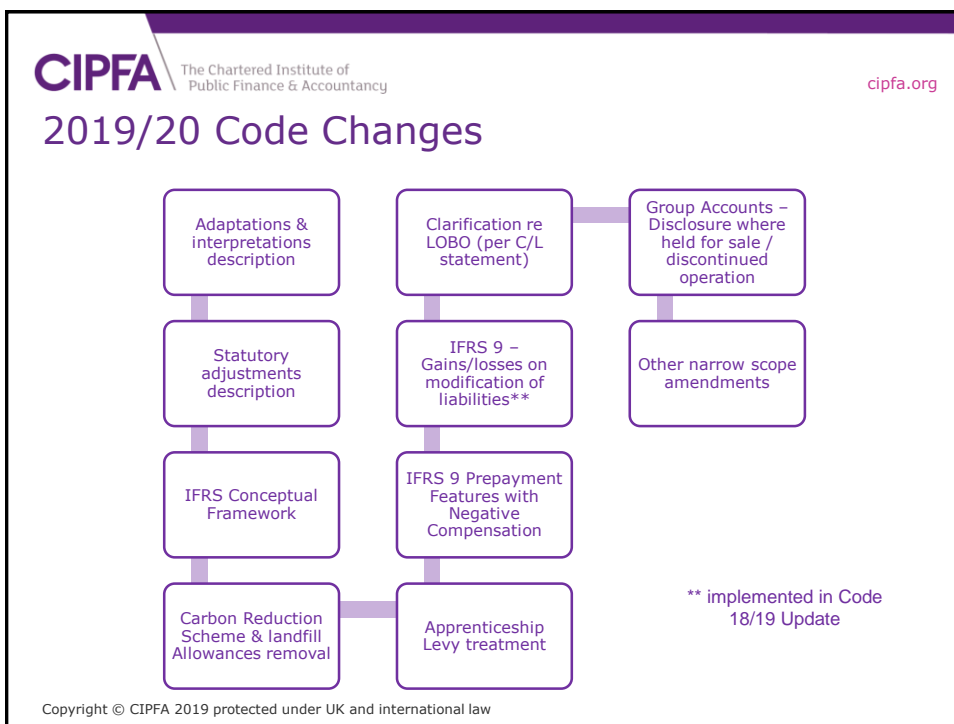
- Issues from 2018/19 closedown
- 2019/20 Code changes
- 2020/21 Code consultation
- IFRS 16 Leases – coming soon!

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2018/19 Accounts Closedown Issues

- IFRS 15 Revenue from contracts with customers
- IFRS 9 Financial Instruments
- Asset valuations
- Delays to audit sign-off

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2020/21 Code Consultation

- Clarity and streamlining principles and review of disclosure requirements (including capital, pensions, financial instruments)
- Changes in accounting standards and legislation, service concession arrangements and more!
- Lease accounting – proposed Code wording
- Closes 27 September 2019
<https://www.cipfa.org/policy-and-guidance/consultations/code-of-practice-on-local-authority-accounting-in-the-united-kingdom-202021>

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IFRS 16 – Leases

- Introduced in 2020/21 Code – transition date 1 April 2020
- Lessor accounting relatively unchanged (except sub-leases and sale and leaseback arrangements)
- Lessees – fundamental changes - no longer classifying into finance and operating leases – all leases on balance sheet – except for:
 - leases of 12 months or less (short-term leases)
 - leases of low value assets
- Lessee to recognise **right-of-use asset** and **lease liability** on balance sheet and depreciation of leased assets and interest on lease liabilities through I&E (essentially 'finance lease' accounting)

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IFRS 16 Preparation Considerations

- Lease definition includes nil consideration arrangements
- Main changes affect operating leases – are you aware of them all?
- IFRS 16 more active standard – likely to require more restatements of lease liability
- Impact on other parts of the authority
- Capital financing / prudential indicator implications

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Leasing - Reference Material and Support

- FAN leasing series – [3 October in London](#)
- 2020/21 Code Invitation to Comment ([Appendix B](#))
- CIPFA [Leasing Briefing Papers](#)
- Accounts closedown series (January / February 2020)
- FAN membership

Taking Action...

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