APPENDIX 10

London Borough of Hackney – Capital Strategy 2019/20

1. Introduction and background

All local authorities are statutorily required, from 2019/20, to produce an annual high level capital strategy. This capital strategy will set out our approach to capital, where we spend our money, and how we pay for it. The strategy encompasses other key documents, notably the capital programme, the treasury strategy and the investment strategy. It also provides a commentary on our approach to commercial property, and how associated risk within the overall capital programme is managed.

2. Hackney's capital programme – expenditure profile

The capital programme primarily represents two types of expenditure - enhancing of our existing assets, and acquisition of new assets. The capital programme is, much like revenue expenditure, there to meet the Council's service delivery objectives.

Over the last two years we have spent around £270m each year, and the aggregate budgets for 2018/19 to 2021/22 are around £300m per year. As can be seen, housing/regeneration related spend accounts for an increasingly significant proportion of the overall programme.

Hackney Capital Programme Budget	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Children Adults & Community Health	16	17	17	6
Finance/Corp Resources – mixed-use schemes	87	95	70	64
Finance/Corp Resources – other	13	9	5	5
Neighbourhoods and Housing – non Housing	23	27	13	8
Non-Housing	**139**	**147**	**105**	**83**
Housing	**160**	**157**	**205**	**242**
Total projected spend	**299**	**304**	**310**	**325**

Within the General Fund, as with last year's iteration of the capital programme, the major areas of spend are the mixed-use schemes - Nile St, Tiger Way, and Britannia. These schemes are shown as a discreet line above, for ease of reference.The overall indicative programme incorporates schemes that will deliver the following:

- Enough school places to keep pace with the increased demand for Hackney schools, including indicative estimates for the requirement for a new secondary school, alongside ensuring our existing school estate is kept in a suitable state of repair.
- Regeneration of our town centres.
- Ongoing maintenance of the corporate property estate and the maintenance of the ICT infrastructure going forward following the latest investment in upgrades to the Council's main ICT platforms.
- A highways maintenance programme retained at the recurrent level of £4m pa and associated programmes in respect of ongoing street lighting, surface water drainage and road safety engineering schemes also maintained at current levels.
- The ongoing maintenance of the Council's parks, green spaces and libraries.

The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is not itself subsidised by, other local services. HRA capital expenditure is therefore recorded separately, and includes the building of circa 2,000 new homes over the forecast period.

3. Governance

Service managers bid, either through the Capital Programme Review Panel (which meets several times a year) or annually through the budget setting process to include projects in the Council's capital programme. Bids are assessed and collated by Corporate Finance. The final capital programme is presented to Cabinet and full Council each year as part of the overall budget setting process The updates via CPRP are considered by Cabinet throughout the year and if approved, added to the approved capital programme..

Capital budget monitoring occurs quarterly (conducted by the management accounting teams in conjunction with project managers) with summary reports forming part of the Overall Financial Position (OFP) process, which is considered and approved by Cabinet.

There are further governance processes around planning and monitoring of the major strands of the capital programme.

Area	Governance
HRA	Housing Delivery Board
Education Property	Nile St/Tiger Way board Britannia Board
Office/Member overarching strategic capital and major project forum	Capital Investment Board

The overall governance arrangements are currently under review to ensure that they remain robust and that the overall programme and the risks associated with its delivery are fully aired and understood at officer and member level in a transparent manner. This is particularly important as we move from an internally borrowed position to medium/longer term external borrowing in line with our increased capital financing requirement.

4. Financing the capital programme

The Housing Self-Financing Settlement of 2012 left the London Borough of Hackney in a fortunate position. £752m of HRA debt that was until that point serviced through the Housing Subsidy system was effectively repaid by the Government, leaving us debt free. This has meant that we have not needed to borrow externally on a long-term basis since 2012, to fund the capital programme. There is however internal borrowing, i.e. using balances to temporarily finance capital expenditure, notably to forward fund development of the mixed-use and regeneration schemes. This in turn has necessitated short-term (cashflow) borrowing.

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

Hackney Capital Programme	**2018/19 Forecast £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Housing	139	147	105	83
Non-Housing	160	157	205	242
Total spend	**299**	**304**	**310**	**325**
Financed by:				
Capital Receipts*	114	121	100	154
Government Grants	38	51	10	16
Reserves	72	75	74	62
Revenue	14	12	10	10
HRA Borrowing	61	45	116	83
Leasing and PFI	-	-	-	-
Total Financing	**299**	**304**	**310**	**325**

* *It should be noted that some forward funding to be financed via borrowing will be required until these capital receipts are realised through sales of residential properties made available through the development of mixed use schemes.*

5. Capital Financing Requirement

The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed (external or internal) capital expenditure and reduces with minimum revenue provision charges and capital receipts used to repay debt. Current modelling sees the aggregate CFR double from its 2017/18 figure of £399m by 2021/22, to £799m.

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement

Capital Financing Requirement At Year End	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
CFR – Non Housing	299	402	413	407	393
CFR – Housing	100	162	206	322	406
Total CFR	**399**	**564**	**619**	**729**	**799**
Net CFR movement		*165*	*55*	*110*	*70*

The increasing General Fund CFR reflects the modelled profiling of cash outflows (construction costs) and cash inflows (capital receipts) of the three mixed-use schemes. The Housing CFR increase is primarily through the same principle, for its regeneration programme and asset management of existing stock, where future rental flows pay down an element of the debt over a much longer (40 years) term. .

The CFR over the longer term (beyond 2021/22) sees it reducing, to reflect years where cash inflows exceed outflows. However there is risk in the modelling, around the volume and value of the capital receipts, taking into account a deterioration in the housing market post-Brexit.

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The Council expects to receive £803m of capital receipts in the current and future financial years up to 2022/23 as shown in the table below. A vast majority of this is from sales of properties developed as part of mixed use and regeneration schemes and will be applied to the repayment of debt incurred to forward fund the schemes, in the first instance.

Capital receipts	2018/19 opening £m	2018/19 estimate £m	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m	Total £m
General Fund	46	65	89	93	66		358
HRA - RTB	53	0	0	0	0	0	53
HRA - non RTB	25	49	184	127	76	55	515
Total	**124**	**113**	**272**	**220**	**142**	**55**	**927**

6. Asset Management

To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place.

- HRA asset management strategy - goes to February 2019 cabinet - http://mginternet.hackney.gov.uk/ieListDocuments.aspx?CId=111&MId=4331
- The General Fund asset management strategy is in the process of being refreshed.

7. Treasury Management

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

i) Borrowing Strategy

As mentioned above, the Council has no long-term borrowing at present. As at February 2019, we had £42.8m in external borrowing. This is made up of a single £2.8m London Energy Efficiency Fund (LEEF) loan from the European Investment Bank to fund housing regeneration, along with £40m to cover liquid cash flow requirements, which is due to be repaid during the 2019 calendar year.

It is anticipated that the point at which we will need to borrow longer term will come during the next 12 months and the table below reflects this change.

Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities, leases [and transfers from local government reorganisation] are shown below, compared with the capital financing requirement (see above). The increase in gross debt rises in line with the borrowing requirement of the capital programme.

Prudential Indicator: Gross Debt and the Capital Financing Requirement	2018/19	2018/19	2019/20	2020/21	2021/22
	Approved	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Gross Debt	253	118	219	363	472
CFR	532	564	619	729	799

ii) Affordable borrowing limit

The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Authorised and Operational boundaries for external debt	2018/19 Approved £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Authorised limit for external debt				
Borrowing	582	669	779	849
Other long term liabilities	18	18	17	16
Total	600	687	796	865
Operational boundary for external debt				
Borrowing	552	639	749	819
Other long term liabilities	18	18	17	16
Total	570	657	766	835

iii) Investment strategy

Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

The Council's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with other local authorities, money market funds or selected high-quality financial institutions, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in corporate bonds, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

Snapshot of treasury management investments	31.3.2018 £m	31.3.2019 £m	31.3.2020 £m	31.3.2021 £m	31.3.2022 £m
Near-term investments	113.1	57.7	26.3	13.5	0
Longer-term investments	9.2	21.5	13.5	0	0
TOTAL	**122.3**	**79.2**	**39.8**	**13.5**	**0**

Hackney's 2019/20 Treasury Management Strategy can be found at appendix 3 of budget report at following link:

http://mginternet.hackney.gov.uk/ieListDocuments.aspx?CId=112&MId=4351

8. Commercial Activities

i) Commercial/Investment properties

Hackney has an investment property portfolio of 14 properties, and 20 aerial masts on HRA land, with an aggregate balance sheet value of £182m as at 2017/18 (source: 17/18 accounts). The revenue return was £2.2m in the same year.

Hackney's acquisitions each have specific purposes. An acquisition must meet requirements in terms of price (we know how much something is worth to us, and if the price is higher than that we walk away), and strategic value (does owning this asset help us to unlock value in something else we already own or help us influence a crucial piece of development in the Borough), will it safeguard jobs etc etc.

Before the Council makes an acquisition a great deal of work goes into investigating whether an apparent opportunity, truly is an opportunity. The Council has long term objectives for the sustained delivery of services and housing, and if it is to spend capital acquiring physical assets it must:

1. Know how and why the asset in question will contribute to the achievement of its long term objectives, and
2. Understand whether or not an acquisition can offer value for money. This requires a rigourous and formal valuation of the asset which we then test ourselves informally , noting that property values are only measured at a point in time and subject to markets which vary over the months and years.

Decisions on commercial investments are ultimately made through Cabinet/Full Council, but after consultation through the Capital Investment Board (a member/officer steering group)

ii) Wholly owned companies

Hackney has established five companies in the past 12 months, to facilitate and enable its interests in the borough :

- Two residential building management companies for the respective dwellings at the Nile St and Tiger Way mixed-use developments
- A holding company and two subsidiaries that will purchase properties from the HRA, and deliver London Living Rent and Private Rented Sector properties in the borough. This company set-up will also mitigate against sales risk, i.e. we would be able to transfer properties to these companies for a period of downturn in the housing market.

At the time of this report being prepared, none of the companies are operating, but at least some of the companies will become active in 2019/20.

9. Knowledge and Skills

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions.

Where Council staff do not have the knowledge and skills required or an independent view is required to corroborate officer views, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers. We use a range of property consultants from framework contracts and pwc as tax advisers.

The Commercial Property market constantly evolves with the local and global economy. The Council informs its decisions by using internally sourced knowledge and external knowledge. Internal knowledge comes from Council services which engage closely with local business, including Economic Regeneration, from the daily activity of the Strategic Property team who are constantly negotiating rent reviews and lease renewals locally, and who also provide viability modelling and negotiation for the Planning Authority.

External knowledge comes from a consistently maintained network in Hackney, the City of London and East London Property market where relationships are maintained with private landowners, and public sector stakeholders such as the City of London Corporation, LLDC, TfL, GLA etc. Hackney's Strategic Property team also maintains a professional services framework, which hosts a range of property advisers, both technical and agents, selected for their particular individual strengths and local knowledge. This arrangement encourages the more committed advisers to invest in understanding the Council's agenda, and economic circumstances, leading to a more beneficial long term relationship for all parties.