APPENDIX 10

London Borough of Hackney – Capital Strategy 2020/21

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 three years we have spent around £270m each year, and the aggregate budgets for 2019/20 to 2022/23 range between £217m and £322m per year.

Hackney Capital Programme Budget	2019/20 £m	2020/21 £m	2021/22 £m	2021/22 £m
Children, Adults & Community Services	10	13	21	15
Neighbourhoods and Housing	19	45	14	11
Finance/Corp Resources – Commercial Schemes	80	107	28	58
Finance/Corp Resources - other	10	11	8	13
Non-Housing	**119**	**176**	**71**	**97**
Housing	**126**	**146**	**145**	**178**
Total projected spend	**246**	**322**	**217**	**275**

The Commercial Schemes line above contains our three mixed use schemes (Nile St, Tiger Way, and Britannia) plus, in 2019/20, a £16m of equity/loan injection into our wholly owned

Hackney PRS company for the acquisition of 25 properties at Hoxton Press, Colville Estate. All of these schemes are delivered by the Council and operate on the basis that all profits are reinvested by the Council. The overall indicative programme incorporates schemes that will deliver the following:

- An ongoing and ambitious regeneration programme which will bring homes of different tenures to the market.
- Enough school places to keep pace with the demand for Hackney schools, including the new secondary school at the Britannia site, alongside ensuring our existing school estate is kept in a suitable state of repair.
- Regeneration of our town centres while maintaining their diversity.
- Ongoing maintenance of the corporate property estate and the maintenance of the ICT infrastructure going forward following the current investment in upgrades to the Council’s main ICT platforms.
- A highways maintenance programme retained at the current level of £4m pa and associated schemes
- The ongoing maintenance of the Council’s parks, leisure centres and green spaces and libraries, including refurbishment of Stoke Newington and Stamford Hill Libraries.
- An ongoing commitment towards delivering on our zero carbon target, including LED streetlighting

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.

3a. Governance - internal

Service managers bid, either through the Capital Programme Review Panel (CPRP) (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, where approved, are added to the 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	Strategic Partnering Board (Nile Street and Tiger Way and other schemes delivered through the Local Education Partnership) Britannia Board
Office/Member overarching strategic capital and major project forum	Capital Investment Board

3b. Governance - wholly owned subsidiaries

Hackney has established five wholly owned subsidiaries in the last 18 months, to facilitate and enable its interests on behalf of residents in the borough:

- Two residential building management companies for the respective private dwellings at the Nile St and Tiger Way mixed-use developments - these are very low risk operations, existing only to provide a building management function and funded by resident service charges
- A holding company and two subsidiaries that will purchase private sale and redundant properties primarily from the HRA, and deliver London Living Rent (HLR) and Private Rented Sector (PRS) 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 during a period of downturn in the housing market.

During 2019/20, both the residential building management companies became active. On the housing acquisition side, the holding and PRS companies became active, with the HLR company anticipated to commence trading in 2020/21. There is a memorandum of understanding between the Council and the companies which sets parameters of trading for each. Funding of the company is approved via Hackney's capital programme and as such follows the process outlined in 3a.

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 did not need to borrow externally on a long-term basis, from 2012, until the current year, during which we have borrowed £65m from PWLB. We also continue to use internal borrowing, i.e. using balances to temporarily finance capital expenditure, notably to contribute towards forward funding development of the mixed-use and regeneration schemes.

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	2020/21 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Non-Housing	119	176	71	97
Housing	126	146	145	178
Total spend	**246**	**322**	**217**	**275**
Financed by:				
Capital Receipts*	98	154	71	100
Government Grants	46	39	25	28
Reserves	6	12	10	15
Revenue	56	55	56	57
HRA Borrowing	40	62	55	76
Leasing and PFI	0	0	0	0
Total Financing	**246**	**322**	**217**	**275**

**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 increase from £484m in 2018/19 to £644m in 2022/23.

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement

Capital Financing Requirement At Year End	2018/19 Actual £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
CFR – Non Housing	374	339	304	280	334
CFR – Housing	110	132	179	233	309
Total CFR	**484**	**471**	**482**	**514**	**644**
Net CFR movement		-13	12	31	130

The movements in the General Fund CFR reflect 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 2022/23) reduces, reflecting 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 the deterioration in the housing market amid 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 £848m 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	**2019/20 opening £m**	**2019/20 estimate £m**	**2020/21 estimate £m**	**2021/22 estimate £m**	**2022/23 estimate £m**	**Total estimate £m**
General Fund	110	87	151	16	-	**364**
HRA - RTB	70	5	-	-	-	**75**
HRA - non RTB	69	44	88	91	117	**409**
Total	**249**	**136**	**239**	**107**	**117**	**848**

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 - considered at 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, 2019/20 saw LB Hackney commence long-term external borrowing (excluding the London Energy Efficiency Fund loan, principal remaining £2.4m) for the first time since 2012. We have borrowed £65m from PWLB on Equal Instalments of Principal terms, and we currently have £50m of short term borrowing. We anticipate taking on more medium to long term borrowing over 2020/21, though with the 1% increase in PWLB interest rates announced in October 2019, this could come from alternative funding sources that can now undercut PWLB.

Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities, leases 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	**2019/20**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
	Approved	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Gross Debt	219	127	123	176	251
CFR	619	471	482	514	644

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	2019/20 Approved £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Authorised limit for external debt				
Borrowing	582	532	564	694
Other long term liabilities	18	20	19	18
Total	**600**	**552**	**582**	**711**
Operational boundary for external debt				
Borrowing	552	502	534	664
Other long term liabilities	18	20	19	18
Total	**570**	**522**	**552**	**681**

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	31.3.2019 £m	31.3.2020 £m	31.3.2021 £m	31.3.2022 £m	31.3.23 £m
Near-term investments	85,575	59,469	65,111	46,611	46,611
Longer-term investments	21,700	13,700			
TOTAL	**107,275**	**73,169**	**65,111**	**46,611**	**46,611**

The above numbers are based on current level of investments including liquid cash invested in MMF, call/notice accounts. The level of cash invested in MMFs and call/notice accounts changes on a regular basis depending upon when cash receipts and payments are realised.

Hackney's 2020/21 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 22 properties, and 15 aerial masts on HRA land, with an aggregate balance sheet value of £209m as at 2018/19 (source: 18/19 accounts). The revenue return was £5.4m 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 rigorous 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

As mentioned above, Hackney has five wholly owned subsidiaries, of which four are currently active, with the HLR housing company due to become active in 2020/21.

The two residential building management companies provide only this service, are funded by resident service charges, and work primarily on a cost recovery basis. With regard to the housing acquisition side - Hackney PRS Housing Limited acquired 25 properties developed as part of the Council's regeneration programme in 2019/20. A combination of £16m equity/loan was issued to the company to acquire the units at Hoxton Press, Colville Estate, which are now all let at market rates.

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.