Kent County Council
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Summons to and Agenda for a Meeting on

**Thursday, 13th February, 2020**

at **9.30 am**

**Members are asked to bring the draft Budget Book 2020-21.**

DEMOCRATIC SERVICES
SESSIONS HOUSE
MAIDSTONE

Wednesday, 5 February 2020

To: All Members of the County Council

Please attend the meeting of the County Council in the Council Chamber, Sessions House, County Hall, Maidstone on Thursday, 13 February 2020 at **9.30 am** to deal with the following business. **The meeting is scheduled to end by 4.30pm.**

## Webcasting Notice

Please note: this meeting may be filmed for the live or subsequent broadcast via the Council's internet site or by any member of the public or press present.

By entering into this room you are consenting to being filmed. If you do not wish to have your image captured please let the Clerk know immediately.

## Voting at County Council Meetings

Before a vote is taken the Chairman will announce that a vote is to be taken and the division bell shall be rung for 60 seconds unless the Chairman is satisfied that all Members are present in the Chamber.

**20 seconds** are allowed for electronic voting to take place and the Chairman will announce that the vote has closed and the result.

## A G E N D A

1. Apologies for Absence
2. Declarations of Disclosable Pecuniary Interests or Other Significant Interests in items on the agenda
3. Minutes of the meetings held on 17 December 2019 and, if in order, to be approved as a correct record **(Pages 1 - 12)**
4. Chairman's Announcements
5. Capital Programme 2020-23 and Revenue Budget 2020-21 (including Council Tax setting 2020-21) **(Pages 13 - 84)**

Benjamin Watts
General Counsel
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# KENT COUNTY COUNCIL

MINUTES of a meeting of the Kent County Council held in the Council Chamber, Sessions House, County Hall, Maidstone on Tuesday, 17 December 2019.

PRESENT:
Mrs A D Allen, MBE (Chairman)
Mr G K Gibbens (Vice-Chairman)

Mr M J Angell, Mr M A C Balfour, Mr P V Barrington-King, Mr P Bartlett, Mrs C Bell, Mrs R Binks, Mr T Bond, Mr A H T Bowles, Mr D L Brazier, Mr J Burden, Miss S J Carey, Mr P B Carter, CBE, Mrs S Chandler, Mr N J D Chard, Mr J Clinch, Mrs P T Cole, Mr N J Collor, Ms K Constantine, Mr A Cook, Mr G Cooke, Mr P C Cooper, Mrs M E Crabtree, Mr D S Daley, Miss E Dawson, Mrs T Dean, MBE, Mr D Farrell, Mrs L Game, Mr R W Gough, Ms S Hamilton, Mr A R Hills, Mrs S V Hohler, Mr S Holden, Mr P J Homewood, Mr E E C Hotson, Mrs L Hurst, Mr S J G Koowaree, Mr P W A Lake, Mr R L H Long, TD, Mr R C Love, OBE, Mr G Lymer, Mr R A Marsh, Ms D Marsh, Mr P J Messenger, Mr D Murphy, Mr M J Northey, Mr P J Oakford, Mr J M Ozog, Mr R A Pascoe, Mr M D Payne, Mrs S Prendergast, Mr K Pugh, Mr H Rayner, Mr A M Ridgers, Mr C Simkins, Dr L Sullivan, Mr B J Sweetland, Mr I Thomas, Mr R J Thomas, Mr M Whiting, Mr M E Whybrow and Mr J Wright

IN ATTENDANCE: Mrs A Beer (Corporate Director of People and Communications), Mr D Cockburn (Corporate Director Strategic & Corporate Services), Ms Z Cooke (Corporate Director of Finance), Mrs B Cooper (Corporate Director of Growth, Environment and Transport), Mr M Dunkley CBE (Corporate Director for Children Young People and Education), Ms P Southern (Corporate Director, Adult Social Care and Health) and Mr B Watts (General Counsel)

**UNRESTRICTED ITEMS**

## 184. Apologies for Absence

The General Counsel reported apologies from Mrs Beresford, Mr Bird, Mr Booth, Mr Butler, Mr Chittenden, Mr Hill, Mr Hook, Mr Kite, Ida Linfield, Mr Lewis, Mr Manion, Mr McInroy and Miss Rankin

## 185. Declarations of Disclosable Pecuniary Interests or Other Significant Interests in items on the agenda

Dr Sullivan declared an interest, as her husband was employed by the County Council in the Early Help and Prevention Team.

## 186. Appointment of Honorary Alderman

(1) The Chairman offered a very warm welcome to the meeting to Mr John Davies and Mrs Christine Davies.

(2) The Chairman stated that Mr Davies had been regarded by Group Leaders as having given eminent service both to Kent County Council and the people of Kent.

(3) RESOLVED UNANIMOUSLY that Mr Davies, a distinguished former Member of Kent County Council, be awarded the status of Honorary Alderman.

(4) The Chairman then presented Mr Davies with his Honorary Alderman badge and scroll.

(5) Mr Davies responded in his capacity as a newly appointed Honorary Alderman and expressed his thanks for the honour bestowed upon him by the County Council

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### 188. Declarations of Disclosable Pecuniary Interests or Other Significant Interests in items on the agenda

Dr Sullivan declared an interest, as her husband was employed by the County Council in the Early Help and Prevention Team.

### 189. Minutes of the meetings held on 17 October 2019 and, if in order, to be approved as a correct record

RESOLVED that the minutes of the meetings held on 17 October 2019 be approved as a correct record.

## 190. Corporate Parenting Panel - Minutes for noting

(1) The Chairman thanked all Members that had given gifts to the Corporate Parenting Panel giving tree.

(2) The Chairman stated that she had recently visited the charitable organisation 'FareShare' with Caroline Smith and Steve Gray from The Young Lives Foundation. They had been impressed by the food care packages for less fortunate individuals. As a result of the visit, 50 of Kent's care leavers would receive a very substantial package, with lots of Christmas gifts meaning that they would all get something at Christmas. She added that the care leavers would also be offered work experience and potentially apprenticeship work.

(3) The Chairman announced that a concert would take place at 4pm in Sessions House, hosted by The Children in Care Council and invited Members to attend.

(4) RESOLVED that the minutes of the meeting of the Corporate Parenting Panel on 17 September 2019 be noted.

## 191. Chairman's Announcements

### Mr Richard Carr

(1) The Chairman stated that it was with regret that she had to inform Members of the death of Mr Richard Carr, former Conservative Member for Tenterden from 1981 to 1993.

(2) The Chairman informed Members that Mr Carr's service of thanksgiving had taken place on Thursday 21 November 2019.

(3) Mrs Bell paid tribute to Mr Carr.

### Robert Neame, CBE, DL, DCL

(4) The Chairman stated that it was with regret that she had to inform Members of the death of Mr Robert Neame, former Conservative Member for Faversham from 1965 to 1989.

(5) Mr Neame had served as Leader of Kent County Council from 1982 to 1984. He also chaired a number of KCC Committees including the Superannuation Fund Committee, Finance Committee, Policy and Budget Group, Selection Group and served on the Social Services Committee and on Policy and Resources Committee.

(6) Mr Neame became a Deputy Lieutenant in 1992, an Honorary Alderman in 2010 and was a High Sheriff of Kent from 2001 to 2002.

(7) The Chairman informed Members that Mr Neame's service of thanksgiving would take place at 11:30am on 6 February 2020 at Canterbury Cathedral.

(8) Mr Carter, Mr Bowles and Mr Daly paid tribute to Mr Neame.

(9) Following all of the tributes, all Members stood in silence in memory of Mr Carr and Mr Neame.

(10) After the one-minute silence, the Chairman moved, the Vice-Chairman seconded, and it was resolved unanimously that:

> "This Council records the sense of loss it feels on the sad passing of Mr Carr and Mr Neame and extends to their family and friends our heartfelt sympathy to them in their sad bereavements."

**TRANStech Awards**

(11) The Chairman announced that Kent County Council's Public Transport Team had won a national award for its work in providing an electric minibus for disabled and vulnerable people. The team won the inaugural TRANStech Awards Rural Innovation category at the Awards ceremony held on 1 November 2019 at the Royal Lancaster Hotel. The Awards recognised people and organisations designing and using technology to improve transport systems.

(12) The Chairman congratulated Kent County Council's Public Transport Team on their success.

**Petition - 30mph speed limit through Chiddingstone Causeway**

(13) The Chairman invited Mr Lake to submit a petition requesting the introduction of a 30mph speed limit through Chiddingstone Causeway.

(14) The Chairman requested that Mr Payne, Cabinet Member for Environment and Transport, collect the petition and ensure that it was responded to in accordance with the Petition Scheme.

## 192. Questions

In accordance with Procedure Rule 1.17(4), 3 questions were asked and replies given. A record of all questions put and answers given at the meeting are available online with the papers for this meeting.

## 193. Report by Leader of the Council (Oral)

(1) The Leader updated the Council on events since the previous meeting, referring specifically to the general election and its implications. He stated that his new administration had been focusing on the Council's most visible services which helped to shape amenity and the quality of life across Kent

(2) Mr Gough referred to the public engagement which was taking place in relation to Kent's Strategic Statement and stated that the draft budget for 2020-21 would give added priority to focusing on improving outcomes for Kent's residents. Mr Gough emphasised the importance of the Strategic Statement and added that whilst many Members had taken part in a workshop to aid its development, further opportunities to shape it would arise in due course.

(3) Mr Gough commended the positive work which had been undertaken in relation to the Energy and Low Emissions Strategy and the strategy's vision to reduce emissions in Kent to zero. He stated that equally important was adaptation and resilience which was being led by the Cabinet Member for the new Environment portfolio.

(4) Mr Gough stated that he would be attending the first meeting of the Thames Estuary Growth Board on 18 December 2020 and would meet with Kate Willard, the newly appointed Estuary Envoy and Chair of the Thames Estuary Growth Board. He added that Kent would continue to lobby government for funding to address economic, housing and infrastructure related issues in Kent, including the Crossrail extension to Ebbsfleet.

(5) Mr Gough referred to the Kent and Medway Enterprise & Productivity Strategy which was a vital document in ensuring balanced growth across Kent and achieving the right relationship with London boroughs.

(6) Mr Gough congratulated the new Kent Members of Parliament and emphasised that he would continue to work very closely with them to present Kent's interests to Government.

(7) Mr Gough referred to the likely departure of the UK from the EU on 31 January 2020. He emphasised the huge amount of work that the County Council had put into preparedness for Brexit and the importance of continuing to be prepared for a range of eventualities post Brexit. He stated that he would write to government to urge at least a review of the Operation Brock barrier between junctions 8 and 9 of the M20. He referred to smart borders in relation to trade, security and migration and the opportunity to ensure that there were benefits for Kent. He added that Kent's relationship with its Continental neighbours would become increasingly important following Brexit.

(8) Mr Gough emphasised the importance of ensuring that Kent's interests were not taken for granted by Government when they were addressing the interests of other parts of the Country. He specifically referred to building upon the vital work relating to the Fair Funding Review, and the significant progress made with Ministers by Mr Carter, former Leader of the Council and Chairman of The County Councils Network.

(9) Mr Gough referred to the 2% Adults Social Care Council Tax precept which was welcomed, but which still left a significant funding gap and national policy change was awaited.

(10) In relation to devolution, Mr Gough stated that there was a need to make sure that Kent's two-tier system worked effectively and he emphasised the importance of delivering the County and District shared agenda.

(11) Mr Gough highlighted the significant work that had been undertaken in relation to addressing areas of concern and responding to the Kent Local Area SEND Written Statement of Action. He emphasised the importance of parental engagement and working closely with schools to ensure a greater focus of inclusion within mainstream education, stronger partnership working with colleagues in Health and the development of a joint commissioning strategy.

(12) Mr Gough welcomed the 1% transfer of funding from the Schools Block to the High Needs Block, which was supported by the Schools Funding Forum. He added that strong representations would continue to be made to government in relation to SEND funding and that structural change was required in that area is as well.

(13) In conclusion, Mr Gough thanked staff for their efforts throughout 2019 and wished everyone a Merry Christmas.

(14) Mrs Dean, on behalf of Mr Bird, the Leader of the Opposition, started by welcoming Mr Gough’s speech and the collaborative work that he had undertaken as former Cabinet Member for Children, Young People and Education.

(15) Mrs Dean welcomed the positive work which had been undertaken in relation to the Energy and Low Emissions Strategy. She emphasised the importance of ensuring that new buildings were built in a sustainable way. She also referred to the need for sufficient charging points in Kent for electric vehicles.

(16) Mrs Dean referred to Brexit and the need to be prepared for a range of eventualities.

(17) Mrs Dean emphasised the importance of the Fair Funding Review and ensuring that the right level of funding was allocated to Kent.

(18) Mrs Dean reiterated Mr Gough’s comments in relation to the additional funding from government to deliver essential services for local communities, including social care.

(19) Mrs Dean emphasised the importance of structural reform of the planning system and continuing to strengthen relationships between central government, local authorities and residents, referring specifically to differing housing targets.

(20) Mr Farrell, Leader of the Labour Group, started by thanking all of Kent County Council’s Members and staff for their hard work, dedication and service to Kent’s residents throughout the year.

(21) Mr Farrell emphasised the importance of cross-party lobbying and continuing to ensure that Kent and the financing of local Councils was at the forefront of Ministers' minds. Mr Farrell highlighted the need for planning for the Government to address the issue of long-term funding of adult social care. He also referred to the importance of taking an evidence-based and pragmatic approach in relation to stabilising Kent’s agricultural sector.

(22) Mr Whybrow, Leader of the Independents Group, supported Mr Gough’s comments in relation to the Energy and Low Emissions Strategy and the strategy’s vision to reduce emissions in Kent to zero. He added that the strategy had recently been finalised and a public consultation had been launched. Mr Whybrow expressed his concerns in relation to the climate crisis and emphasised the significant need to tackle climate change.

(23) Mr Whybrow emphasised the importance of nurturing green businesses in Kent with the help of Regional Growth Funds and prioritising public transport, walking and cycling with future LEPs and other capital bids.

(24) Mr Whybrow commended the positive work that had been undertaken by Members and officers in relation to Kent's Pollinator Action Plan.

(25) Mr Whybrow concluded by wishing all of Kent County Council's Members and staff well over the festive period.

(26) In replying to the other Leaders' comments, Mr Gough referred to Mrs Dean's comments in relation to ensuring that new buildings were built in a sustainable way. He confirmed that a report would be submitted to Full Council in May 2020 relating to Kent's Environmental Strategy, which would focus on addressing environmental issues with regards to Kent's new and existing estate.

(27) Mr Gough re-emphasised the importance of Brexit preparedness, focusing on longer-term issues in relation to potential Brexit implications. He expressed the view that a World Trade Organisation (WTO) relationship with the EU after December 2020 was relatively unlikely to happen.

(28) Mr Gough responded to comments made by Mrs Dean and Mr Farrell in relation to fair funding and reiterated the importance of ensuring that Kent's interests were well looked after. He expressed his views in relation to the sustainability of highways expenditure and the importance of maintaining a strong relationship with Ministers in central government. He also emphasised the importance of working closely with Kent's district and borough councils in relation to Kent's infrastructure.

(29) Mr Gough referred to the comments that had been made in relation to social care and commended the cross-party approach taken by government in seeking to address the significant issues within the social care sector across the country.

**194. New Safeguarding Children Multi-agency Partnership Arrangements**

(1) Mrs Chandler moved, and Mr Gough seconded the following motion:

Mrs Chandler moved, and Mr Gough seconded the following motion:

> "The County Council is asked to note the establishment of a new safeguarding children multi-agency partnership."

(2) The motion as set out in paragraph (1) was agreed without a formal vote.

(3) RESOLVED that the establishment of a new safeguarding children multi-agency partnership, be noted.

**195. Presentation of the Kent Invicta Award to Mr Steve Sherry CMG OBE (Chief Executive of Royal British Legion Industries)**

(1) The Chairman welcomed Mr Sherry to the meeting to receive the Kent Invicta Award for 2019. The Kent Invicta Award recognised residents of Kent who had

achieved excellence in their chosen field or who had provided exceptional service to the County. The Chairman outlined the many contributions made to Kent by Mr Sherry which included his current position as Chief Executive of Royal British Legion Industries (RBLI) in 2010 after 38 years' service in the Army. Under Mr Sherry's leadership the RBLI was in year 5 of the 10 year plan "Improving Lives Every Day". It was also the RBLI's centenary year and there was a £22m development for the RBLI Village. Her Majesty the Queen had visited RBLI on 6th November 2019, opening a new care home Appleton Lodge and 'cutting the turf' of the new Centenary Village Development with a time capsule buried for future generations.

(2) The Chairman also congratulated Callum Peace, Oakwood Park Grammar School, who had won the competition for Key Stage 4 students across Kent to design and make a new Kent Invicta Award. The award was chosen as the winning design because of the natural materials that had been used, which were found on a local beach and recycled into the award.

(3) The Chairman formally thanked all of the students who had taken part in the competition.

(4) Members of the Council congratulated Mr Sherry on receiving the award and thanked him for his service to the country and the people of Kent.

(5) The Chairman stated that she was delighted that the Group Leaders had agreed unanimously that the Award should be presented to Mr Sherry and it gave her great pleasure, on behalf of all KCC Members, to present him with the award and 2 cheques for a total of £5,000 for his chosen charities, K Sports Football Club for Youths and the Medway and Maidstone Athletics Club.

(6) Mr Gough, Mr Daley and Dr Sullivan congratulated Mr Sherry on his award and his contribution.

(7) In accepting this award, Mr Sherry responded and expressed his thanks to Members.

**196. Kent Adult Safeguarding Board Annual Report**

(1) Mrs Bell moved and Mrs Cole seconded the following motion:

"That County Council is asked to:

(a) comment on the progress and improvements made during 2018-19, as detailed in the Annual Report from the Kent and Medway Safeguarding Adults Board and endorse the 2018-19 Annual Report attached as Appendix 1 to the report.

(2) Ms Deborah Stuart-Angus, Independent Chair of the Kent Safeguarding Adults Board, addressed the meeting and answered a number of questions from Members.

(3) The motion as set out in paragraph (1) was agreed without a formal vote.

(4) RESOLVED that the Kent and Medway Safeguarding Adults Board 2018-19 Annual Report attached as Appendix 1 to the report be noted and the comment on the progress and improvements made during 2018-19, as detailed in the Annual Report be noted.

**197. Adult Social Care and Health - top tier restructure**

(1) Mr Gough moved, and Mrs Bell seconded the following motion:

"The County Council is asked to endorse the recommendation of Personnel Committee to:

a) delete the current posts of Director of Partnerships and Director of Operations in the Adult Social Care and Health Directorate;

b) introduce two new Director ASCH roles as described in Appendix 1; and

c) agree that the two Director roles are organised on a geographical basis with one covering East Kent and the other North and West Kent as shown in the structure chart at Appendix 2."

(2) The motion as set out in paragraph (1) was agreed without a formal vote.

(3) RESOLVED that;

a) the current posts of Director of Partnerships and Director of Operations in the Adult Social Care and Health Directorate be deleted

b) two new Director ASCH roles be established as described in Appendix 1 to the report; and

c) that the two Director roles be organised on a geographical basis with one covering East Kent and the other North and West Kent as shown in the structure chart at Appendix 2 to the report.

**198. Bexley and Kent Urgent Care Joint Health Overview and Scrutiny Committee**

(1) Mr Bartlett moved, and Mr Pugh seconded the following motion:

"The County Council is asked to:

(a) approve the establishment of a new Bexley and Kent Urgent Care Joint Health Overview and Scrutiny Committee for the duration of the review; and

(b) approve the Terms of Reference."

(2) On behalf of the Liberal Democrat Group, Mrs Dean offered to give up their proportionally allocated seat on the Committee to the Labour group. This offer was accepted without any Member indicating that were voting against.

(3) The motion was agreed without a formal vote.

(4) RESOLVED that:

(a) the establishment of a new Bexley and Kent Urgent Care Joint Health Overview and Scrutiny Committee for the duration of the review, be approved; and

(b) the Terms of Reference, as set out in appendix 1 to the report, with it being noted that the Liberal Democrat Member place on the Committee is reallocated to a Member from the Labour Group, be approved.

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From: Roger Gough, Leader of the Council
Peter Oakford, Deputy Leader and Cabinet Member for Finance, Corporate & Traded Services

To: County Council – 13th February 2020

Subject: Capital Programme 2020-23 and Revenue Budget 2020-21 (including Council Tax setting 2020-21)

Classification: Unrestricted

**Summary**:
This report is a summary of the proposed capital programme for 2020-23 and revenue budget for 2020-21. The one-year settlement from government means it is not viable to produce a meaningful medium term financial plan. The capital and revenue budget plans were set out in the draft Budget Book (black-combed) published on 6th January 2020. This was produced before the Provisional Local Government Finance Settlement announcement on 20th December and before the tax base and collection fund estimates were received from all districts. These have now been incorporated into the final draft presented for approval to full Council together with the impact on spending/savings plans. In order to keep all the information in one place the draft Budget Book has been republished as (white-combed) for Council approval.

The draft budget includes a proposed 1.995% Council Tax increase for 2020-21 i.e. up to the maximum without exceeding the 2% referendum limit. The draft budget also includes a further 1.995% Council Tax increase proposed through the Social Care Levy i.e. the maximum permitted, taking the total social care levy to 8.78% of the County Council share of Council Tax. The final decision on these Council Tax increases will be taken at the County Council meeting.

The draft budget represents the Council's response to the local budget consultation and estimated impact of the 2019 Spending Round and Provisional Local Government Finance Settlement, as well as an update to include the latest spending/saving plans and forecasts.

The County Council has a statutory duty to set an annual budget and the amount to be levied through Council Tax. In approving the budget, the County Council is not only agreeing the total amounts planned to be spent, but is also delegating authority to manage the budget in compliance with the authority's financial regulations.

Members are asked to bring to this meeting the draft Budget Book (white-combed) for Council approval released on 5th February 2020. Members should note this supersedes the black-combed draft published on 6th January 2020

Members are reminded that Section 106 of the Local Government Finance Act 1992 applies to any meeting where consideration is given to matters relating to, or which might affect, the calculation of Council Tax. Any Member of a local authority who is liable to pay Council Tax and who has any unpaid Council Tax amount overdue for at least two months, even if there is an arrangement to pay off the arrears, must declare the fact that they are in arrears and must not cast their vote on anything related to KCC's Budget or Council Tax.

## 1. Introduction

1.1 The Local Government Finance Act 1992 requires the Council to consult on and ultimately set a legal budget and Council Tax precept for the forthcoming financial year, 2020-21. Setting the Council’s revenue and capital budgets is still challenging despite the better settlement from central government. Whilst the revenue settlement has improved (from a combination of increases in government grant, retained business rates and Council Tax) it is still not sufficient to fully cover rising costs and increasing demand for council services, leading to the need to make savings/generate additional income. Similarly, the capital budget can only be delivered with substantial additional borrowing with financing implications which place added pressure on future years’ revenue budgets for the next 25 years.

1.2 The draft Budget Book sets out the detailed draft capital programme 2020-23 and detailed draft revenue budget 2020-21. The one-year settlement from Government for 2020-21 means that it is not possible to produce a meaningful medium term financial plan (MTFP). This is consistent with 2013-14 (the last time we had a one-year settlement). Section 25 of the Local Government Act 2003 requires the Chief Financial Officer to report on the robustness of the estimates within the 2020-21 budget calculations, and the adequacy of proposed reserves. This report includes these statutory disclosures.

1.3 The legislation does not require the publication of a medium term financial plan (MTFP) although the Chartered Institute of Public Finance and Accountancy (CIPFA) advises that while the statutory requirement is to set an annual budget, a longer term perspective is essential if local authorities are to demonstrate their financial sustainability. CIPFA recognises that while formal publication of the medium term financial plan may only reflect government settlements, it is the responsibility of the leadership of the organisation to have a long-term financial view. A summary of the longer-term scenarios was included in the report to Cabinet on 27th January 2020.

1.4 The Council’s Constitution specifically defines the role of all Members in defining and agreeing the policy and budgetary framework of the Council in accordance with applicable laws providing sufficiency of resources. The budget approval process includes Cabinet Committee meetings, the Scrutiny Committee meeting and Member briefings leading up to the formal Budget meeting and the recommendations set out in this paper. These are the mechanisms by which all Members have the opportunity at today’s Council meeting to define, challenge, amend and ultimately vote on the Council’s budgetary framework for the next year and in which all Members have a voice and a vital role to play.

1.5 The Council launched a budget communication and consultation campaign on 16th October 2019. The consultation closed on 25th November 2019. A separate report on the results of this campaign was published on 6th January 2020 and is included as a background document to this report. The number of responses continues to be relatively low (1,360) and there were fewer responses than last year (1,717). A majority of responses supported Council Tax increases up to or exceeding the referendum limit to sustain services, and another year of an additional 2% adult social care precept. The consultation also sought views on spending priorities on people and place based services, which showed the highest priority being given to older persons social care, public protection, education & youth services, and highways. These priorities are reflected in both revenue and capital budget proposals.

1.6 The draft Budget Book (black combed) was published on 6th January 2020. This publication had been prepared before the Provisional Local Government Finance Settlement was announced on 20th December, or tax base/collection fund estimates from districts had been received. Consequently, it was based on best estimates and included a gap of £1.9m. The draft budget includes provision for £3.5m to invest in high impact priority areas informed by the outcome of consultation on the new Five-Year plan. This original black-combed publication has now been superseded and should no longer be used.

1.7 The details of the provisional settlement, tax base and collection fund estimates, and any other issues which had emerged since the original draft publication were reported to Cabinet on 27th January 2020. All these changes have been included in the republished draft Budget Book (white-combed) for Council approval. The settlement and tax base/collection fund estimates were sufficient to close the revenue budget gap, fund additional pressures related to National Living Wage and National Minimum wage announcements and reduce the need to draw down from reserves as a temporary solution.

1.8 Since Cabinet on 27th January the final tax base and collection fund estimates have been received from all districts. Districts must notify their final estimates by 31st January. The final estimates include a change to the Council Tax collection fund balance and the notification of locally retained Business Rate growth and collection fund balance (previously the draft budget included in the Council's estimates). The notification of the Council's share of the Business Rate tax base has enabled a revision to the calculation of estimated Business Rate Compensation Grant. The impact of final notification is detailed in section 3 of this report. Overall these changes have increased the net revenue budget by £3.715m compared to the amount reported to Cabinet and have been reflected in revised amount proposed to be drawn down from reserves in the republished draft Budget Book (white-combed) which can be found at https://www.kent.gov.uk/__data/assets/pdf_file/0019/104671/Revised-Budget-Book-2020-21.pdf

1.9 The republished draft Budget Book (white-combed) shows an increase in the net revenue budget from £986.4m for 2019-20 to £1,063.7m for 2020-

21. The challenge from rising spending demands and the solution from a combination of savings/income, Council Tax/business rates, and government grant is shown in table 1 below. Fuller details are set out in section 3 of the republished draft Budget Book (white-combed) for Council approval. It should be noted that 2020-21 is the first time in ten years that there has been a net increase in government grant within the settlement.

Table 1 - Budget Equation

| 2019-20 £m | Revenue Budget Equation | 2020-21 £m |
|---|---|---|
| 72.8 | Spending Demands (including replacing one-offs) | 107.0 |
| 28.2 | Government Revenue Support Grant Reductions | |
| 101.0 | Total Challenge | 107.0 |
| | | |
| 19.0 | Government Grant Increases | 37.4 |
| 37.1 | Council Tax & Business Rates | 39.9 |
| 44.9 | Savings, Income and Reserves | 29.7 |
| | | |
| 101.0 | Total Solution | 107.0 |

1.10 The capital programme in the republished draft Budget Book (white-combed) for approval identifies £1,014m investment in infrastructure over the 3 years 2020-21 to 2022-23, this includes £121m of new schemes not included in previous programmes including a significant investment in highways asset management and priority remedial works. Capital investments are funded by a combination of government grants, developer contributions, external funding, capital receipts and borrowing. The plan includes a preliminary figure for the 2019 schools commissioning plan together with assumed basic need grant, but this will be subject to confirmation.

1.11 The Council already has a relatively high level of debt to finance previous capital spending and the aim has been to limit additional borrowing as this has long-term revenue consequences for interest costs and setting aside provision for repayment of debt over the lifetime of the asset. Avoiding over committing future revenue is important in view of the one-year settlement from government. Nonetheless, due to the urgent need for additional capital spending, plans for the associated borrowing to support the programme over the three years 2020-23 have been included. This additional borrowing, over and above that required under the previous capital programme adds £0.5m revenue pressure in 2020-21 rising to over £10m per annum when the new programme has been fully delivered. It should be noted that much of the additional capital spending can be reconsidered if this revenue consequence is unsustainable following the Spending Review anticipated later this year.

1.12 A capital strategy as required under the Prudential Code 2017 is included as appendix 1 to this report. The code requires that the strategy is agreed by the full Council. The Treasury Management Strategy must also be approved. Whilst this can be through another relevant committee, given the significance of the Treasury Management Strategy, it is proposed that full Council approves the Strategy for 2020-21 and an updated Strategy is included as appendix 2 to this report.

1.13 The Council must also agree the annual Minimum Revenue Provision (MRP) Statement. The MRP statement sets out the Council's policy to make prudent provision for borrowing incurred to finance capital assets. The MRP statement is included as appendix 3 to this report.

1.14 The additional flexibility, offered by Government, to be able to use capital receipts from the sale of physical assets to help fund the revenue costs of transformation projects and support the delivery of future savings was originally approved for the three years 2016-17 to 2018-19. KCC's budgets for 2017-18 and 2018-19 included £2.5m of capital receipts in each year to be used in this way. The ability to use receipts has subsequently been extended for a further three years up to 2021-22. KCC is not proposing to use this extension at this stage due to the level of receipts required to fund capital projects, however, the timing of some of the transformation plans means planned spending has been re-phased into 2019-20. Furthermore, it is now proposed not to fully utilise the original £5m included in the 2017-18 and 2018-19 budgets as a transformation reserve has been established to fund such costs meaning the use of receipts can be refocused towards funding capital infrastructure. The individual transformation projects that have been funded through capital receipts flexibility must be reported to full Council. This was first presented to Council in October 2018 and the updated schedule is included as appendix 4 to this report. It is anticipated this will be last time this will be reported providing the rephased amounts are spent as planned.

1.15 The pressure on the High Needs spending continues to be identified as the highest revenue budget risk. The demand for supporting children and young people with Special Educational Needs and Disability (SEND) is rising by more than the High Needs block within the Dedicated Schools Grant (DSG) and approved transfers from the Schools Block. The Government has confirmed that local authorities are not required to repay deficits on the DSG from the General Fund but it remains unclear how such deficits will be treated (other than a requirement to report a recovery plan once any deficit exceeds 1% of total DSG). This issue has been raised with Government by the Council along with many other councils experiencing similar challenges. The action to redress this needs to be three-fold; increased funding in both the short and medium term from government, systematic reform to the current legislative requirements, and local reform to provision and practice.

## 2. National Fiscal and Economic Context

2.1 The national fiscal and economic context is an important consideration for the Council in setting the Budget. This context does not just determine the amount received through central government grants, but also sets out how local government spending fits in within the totality of public spending.

This latter aspect essentially sets the government's expectations of how much local authorities would raise through local taxation.

*Public Spending*

2.2 The Chancellor announced on 4th September 2019 the government's spending plans for 2020-21 (SR2019). SR2019 included additional spending compared to the previous plans. The stated aim of SR2019 was to provide stability and certainty in funding in 2020-21 to enable government departments and devolved administrations to focus on delivering Brexit. The Chancellor has confirmed that a multi-year Spending Review will follow in 2020 although the exact timing of this has not be confirmed.

2.3 SR2019 was originally set within the previous fiscal targets:

- Maintain the structural deficit below 2 per cent of GDP in 2020-21
- Total accumulated debt falling as a percentage of GDP in 2020-21
- Structural deficit to be eliminated and converted to a surplus by the middle of the decade.

2.4 The Chancellor would normally be expected to make his annual Budget statement during the autumn in response to forecasts from the Office for Budget Responsibility (OBR) of performance against the targets. The Budget would have included any tax changes necessary to finance spending plans within the targets. In October the Chancellor postponed the Budget statement scheduled for 6th November 2019. In November he announced the introduction of revised fiscal targets:

- Balance current spending (i.e. excluding capital spending) in three years' time
- Investment limited to 3% of GDP
- Borrowing plans to be reviewed if total debt interest exceeds 6% of tax revenues.

The Chancellor's next Budget is scheduled for 11th March 2020.

2.5 SR2019 for local government was based on a "roll-forward" concept with the continuation of grants within the Ministry of Housing, Communities and Local Government (MHCLG) settlement received in 2019-20. The grants continuing are listed in table 2 below together with the national and KCC amounts included in the Provisional Local Government Finance Settlement announced on 20th December 2020:

Table 2 – List of 2019-20 grants which are continuing in 2020-21

| | 2019-20 | | 2020-21 Provisional | |
|---|---|---|---|---|
| Description of grant or fund | National Amount £'m | KCC Amount £'m | National Amount £'m | KCC Amount £'m |
| Revenue Support Grant[1] | 2,284 | 9.5 | 2,321 | 9.6 |
| Business Rate Top-up[1] | - | 136.2 | - | 138.4 |
| Business Rate Baseline[1] | 12,276 | 48.7 | 12,476 | 49.5 |
| New Homes Bonus Grant | 918 | 6.4 | 907 | 6.4 |
| Social Care Support | 410 | 10.5 | 410 | 10.5 |
| Business Rate Compensation for under indexation of the multiplier | 424 | 6.1 | 500 | 7.5 |
| Business Rate Compensation for other reliefs[2] | 1,373 | 4.9 | | |
| Improved Better Care Fund | 1,837 | 42.4 | 2,077 | 48.5 |
| Winter Pressure Grant | 240 | 6.2 | | |
| New Social Care Grant | | | 1,000 | 23.8 |

2.6 SR2019 included an additional £1bn nationally to support Adult and Children's Social Care pressures. The provisional settlement confirmed that this is allocated according to the adult social care relative needs formula (RNF) with up to 15% adjusted to reflect ability to raise Council Tax through the social care levy. For KCC, this equates to £23.8m share of the £1bn total.

2.7 SR2019 and provisional settlement also confirmed that the Government intends to set the Council Tax referendum threshold for 2020-21 at 2% (this level is subject to final decision by Parliament). In addition, councils with responsibility for adult social care can choose to levy up to a further 2% increase on Council Tax under the social care precept.

2.8 Finally, SR2019 confirmed that the £2bn funding provided to government departments for Brexit will be continued in 2020-21, although at this stage it is not known how much KCC will receive.

2.9 There are no indicative spending plans/local government settlement or Council Tax referendum limits for 2021-22 and beyond, meaning the future funding envelope remains incredibly uncertain. These will not be known until after the outcome of the full Spending Review, which was originally anticipated sometime during 2020 but might be delayed. A further roll-forward for 2021-22 settlement is one of many possibilities.

2.10 Further details are still awaited on whether the new government will proceed with the proposed 75% business rate retention arrangements, and the reforms following the Fair Funding review. These are likely to

[1] Uplifted by 1.63% uplift to business rate multiplier based on September CPI and adjusted to include notional RSG for business rate retention pilot authorities
[2] Notified after the final settlement

have a significant impact on future year's settlements and the Council's MTFP, this uncertainty makes forward financial planning very imprecise.

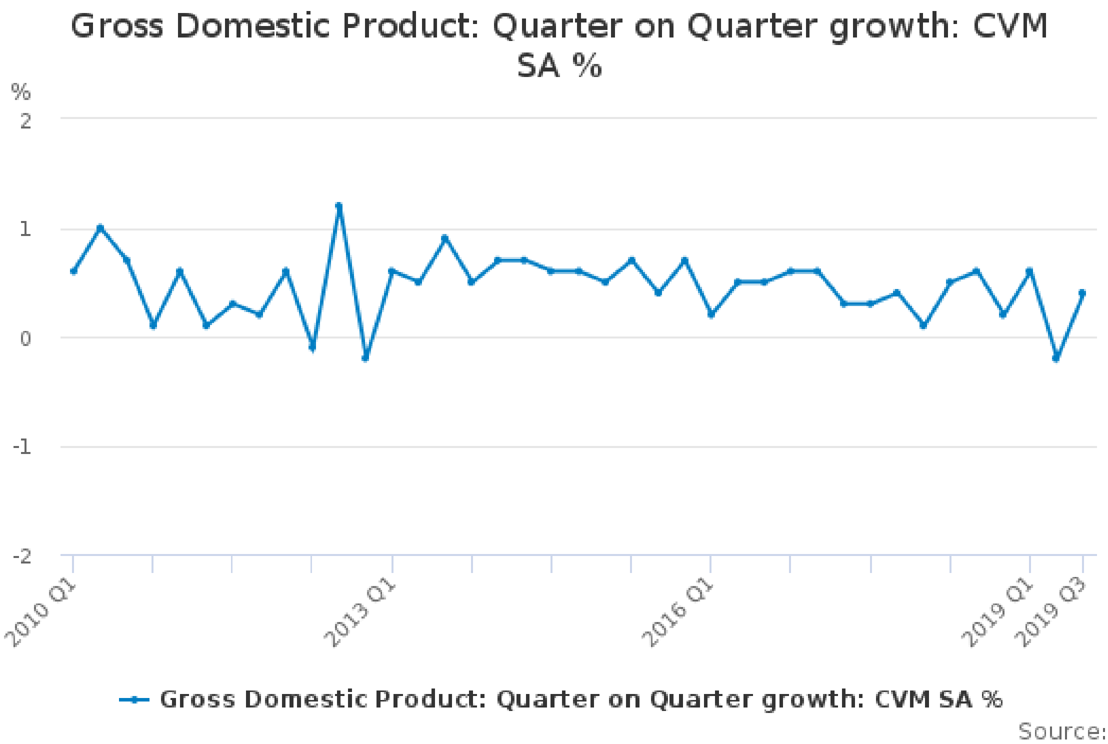
2.11 In view of the uncertainty, a one-year only plan has been published. Section 3 of the draft Budget Book (white-combed) for Council approval provides detail of individual spending pressures and savings. Different scenarios of funding for future years will continue to be modelled so that the potential impact from each scenario is understood.

*Economic Trends*

2.12 We have previously provided information on key economic trends as these continue to have a significant bearing on both future government settlements and the general economic conditions in which the budget is being set. This includes the latest information from Office for National Statistics (ONS) on economic growth, inflation, employment and earnings, and the Bank of England (BoE) forecasts in their quarterly Monetary Policy Reports.

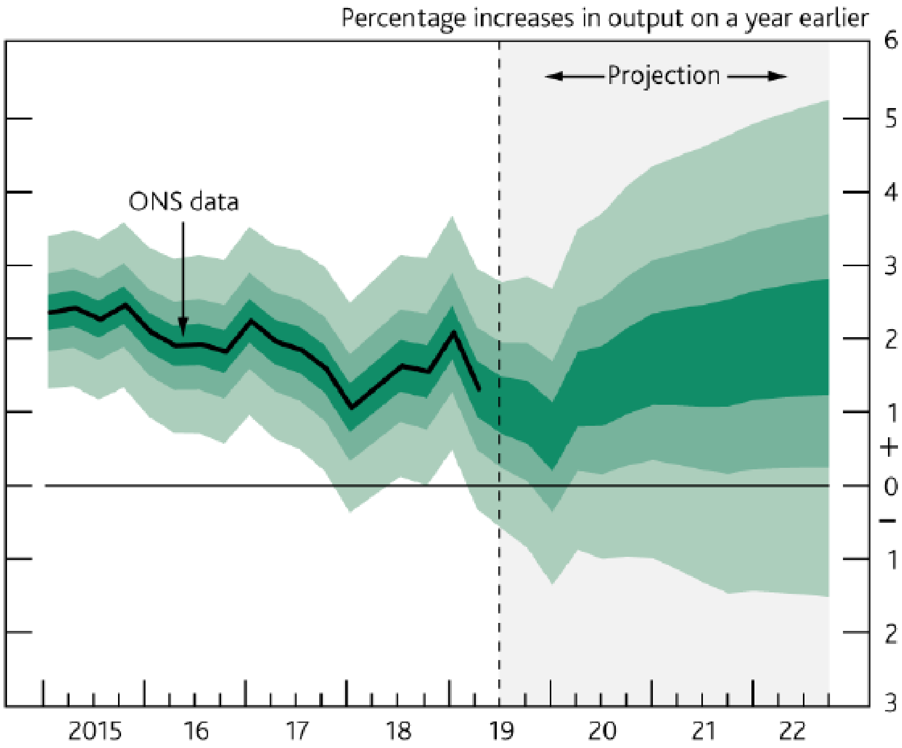
2.13 Chart 1 below shows the latest quarterly growth in Gross Domestic Product (GDP) over the last 10 years up to quarter 3 of 2019. This was released on 20th December 2019. Growth during 2019 has been low with quarter 2 showing negative growth due to ongoing economic uncertainties. Negative growth in consecutive quarters constitutes a recession.

Chart 1



2.14 Chart 2 shows the growth forecast in the BoE Monetary Policy Report November 2019. This is one month in arrears from the latest ONS release (chart 1). The fan chart depicts the probability of various outcomes for GDP growth in the future.

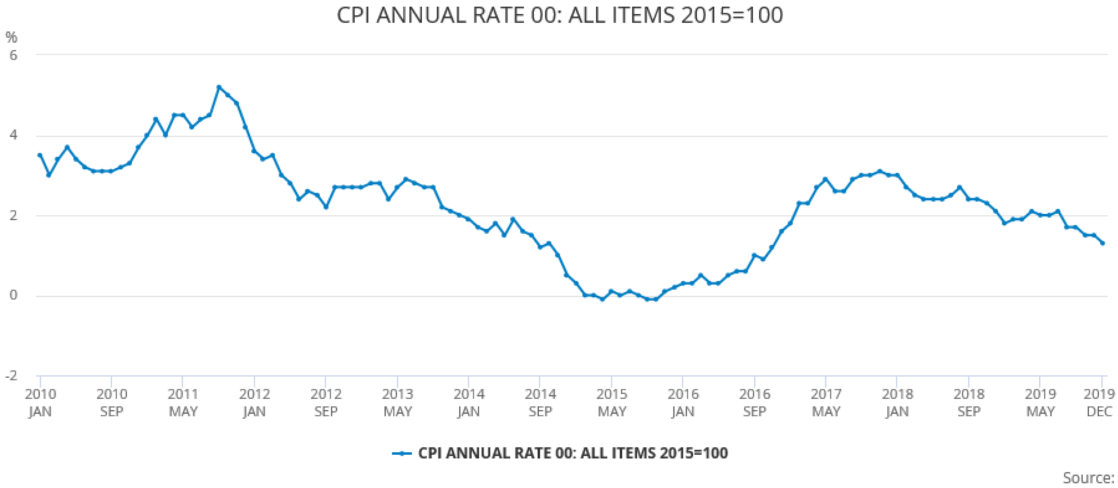
Chart 2 – GDP Growth Forecast

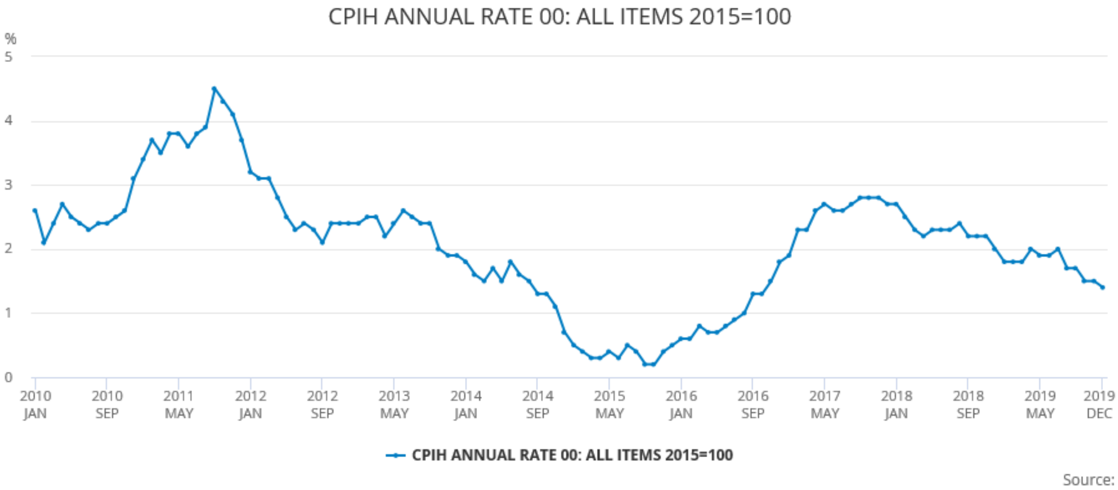



GDP growth has slowed materially reflecting weaker global growth, driven by trade protectionism, and Brexit uncertainty. The Monetary Policy Committee (MPC) projects that GDP growth will pick up during 2020 as Brexit uncertainty falls, supported by easier UK fiscal policy and a modest recovery in global growth.

2.15 Chart 3 shows the annual rate of inflation based on consumer price index (CPI) and CPIH (which includes owner occupier housing costs) up to December 2019. This was released on 15th January 2020. The trend in both CPI measures has been a reducing annual rate of inflation since CPI peaked at 3.1% in November 2017 (with the occasional small monthly increase). CPI has been below the 2% target since July 2019.

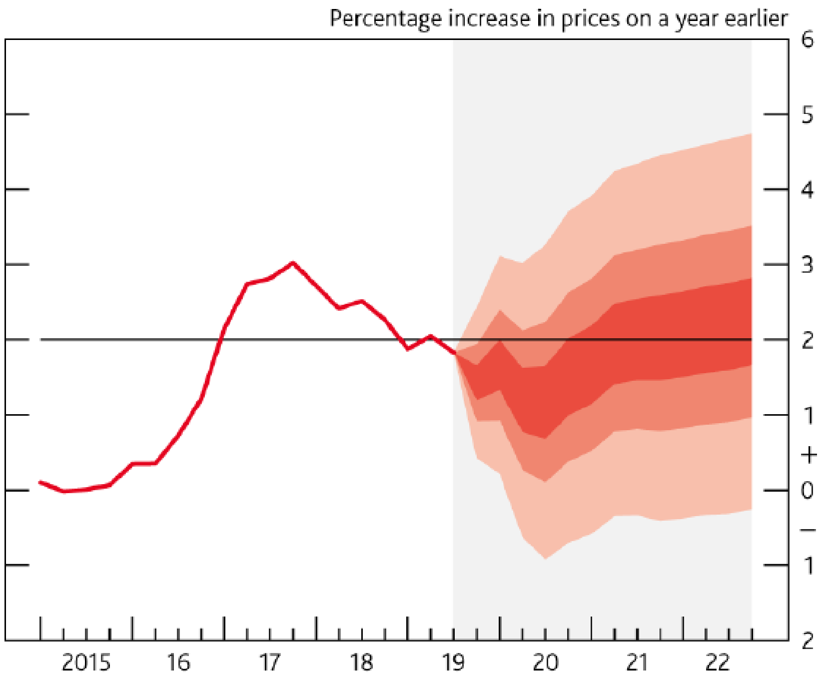
Chart 3




2.16 Chart 4 shows the inflation forecast in the BoE Monetary Policy Report November 2019. This is three months in arrears from the latest ONS release (chart 3). The fan chart depicts the probability of various outcomes for CPI inflation in the future.

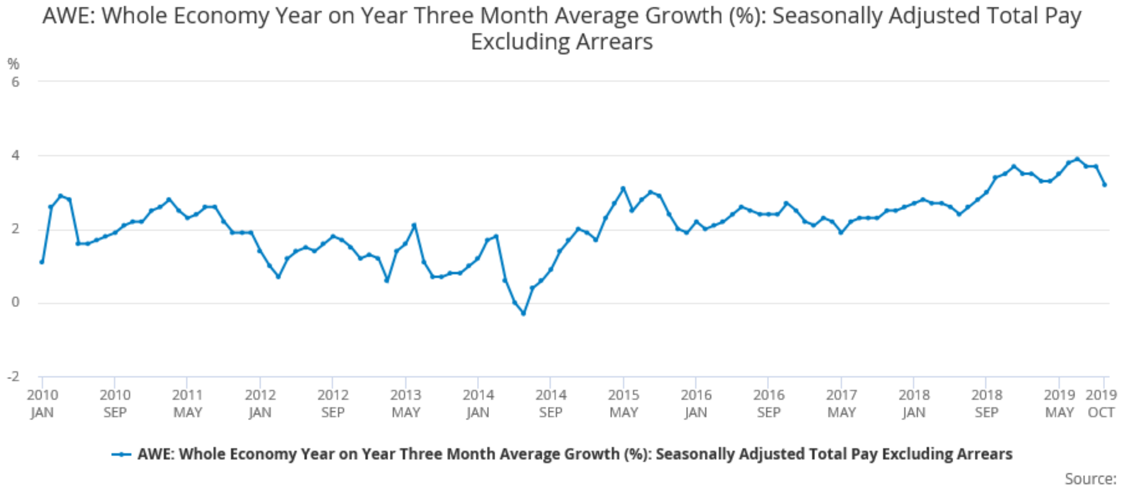
Chart 4 – CPI Inflation Forecast




CPI inflation remained at 1.7% in September and is expected to decline to around 1.25% by the spring, owing to the temporary effect of falls in regulated energy and water prices. The MPC forecasts a margin of excess demand in 2021 and 2022 taking CPI slightly above 2% by the end of the forecast period.

2.17 Chart 5 shows the annual rate of growth in total earnings (regular pay and bonuses but excluding arrears) in the whole economy over the last 10 years up to October 2019. This was released on 17th December 2019. The trend had been for increasing rates of earnings growth in the first half of 2019 although the rate of growth has reduced a little during recent months. Comparison of wage growth in chart 5 and CPI inflation in chart 3 shows that wages have been growing at a faster rate than prices since summer 2018.

Chart 5



## 3. Council Tax and Retained Business Rates

*Council Tax*

3.1 Setting the annual budget is one of the most significant decisions the County Council takes each year. It sets the County Council's share of Council Tax and the overall resource framework in which the Council operates. It also gives delegated authority to manage the budget to Corporate Directors and Directors within the parameters set out in the Council's Constitution and Financial Regulations. Corporate Directors and Directors will be held to account for spending decisions within delegated powers via the budget monitoring and reporting arrangements throughout the year.

3.2 The budget proposes a Council Tax increase up to the maximum permitted within the 2% referendum limit. This would increase the County Council's band C charge (the most common band) from £1,155.04 to £1,178.08 (1.995%). Consultation responses from 58% of respondents supported a Council Tax increase up to or exceeding the referendum limit to protect services and help meet rising demand for council services. A further 10% supported an increase but less than the referendum limit, whereas 32% of responses did not support any increase.

3.3 The budget also proposes to levy an additional 2% Council Tax specifically for adult social care. This would increase the band C charge by a further £23.04 to a total of £1,201.12 for 2020-21. This takes the total increase in the County Council's share of a band C charge to £46.08. Consultation responses from 55% of respondents supported a further increase in the social care levy provided this is spent directly on the care of the most vulnerable adults and older people.

3.4 Appendix A of the republished draft Budget Book (white-combed) for Council approval includes more information about Council Tax including the tax base estimates from districts, the charges for each band, and confirmation of compliance with the Council Tax Referendum Principle regulations. Additional information about Council Tax for residents is also provided via an on-line "Council Tax leaflet".

3.5 The Council must have regard to in-year collection when setting the Council Tax for the next year. This is done by including the notification of the estimated collection fund balance from districts as part of the overall funding needed to balance the net budget requirement. Some districts have provided revised calculations to the amount reported to Cabinet on 27th January and the Council now has a final estimated Council Tax collection fund balance of £3.898m. This final balance has been reflected in the republished draft Budget Book (white-combed) for Council approval and the amount drawn down from reserves has been adjusted accordingly.

*Business Rates*

3.6 The County Council retains 9% of the business rates raised in Kent (districts retain 40%, Fire authority 1%, and the remaining 50% is returned to central government). This includes the retained growth over and above the baseline in the settlement and KCC's share of the business rate pool. The retained shares are determined by districts and these had not been received when the budget was reported to Cabinet on 27th January. The district calculations have now been received and have increased the Council's share from the £4.248m in the draft Budget Book to £6.469m. This is an unprecedented increase and further evaluation to understand the underlying reasons will be undertaken. This revised share of retained growth is reflected in the republished draft Budget Book (white-combed) for Council approval and the amount drawn down from reserves has been adjusted accordingly.

3.7 As with Council Tax the notification of the Council's share of estimated Business Rates collection fund balances also needs to be included in the budget requirement. This notification had also not been received in time for the Cabinet report on 27th January (an estimate based on the final 2018-19 outturn was included). Notification of our estimated share of £2.563m has now been received and is £0.863m more than the £1.7m previously assumed. This collection fund balance includes the residual impact of the 2018-19 100% retention pilot which will not be repeated. The final balance is reflected this in the republished draft Budget Book (white-combed) for Council approval and the amount drawn down from reserves has been adjusted accordingly.

3.8 Government grant to compensate for reductions in business rate yields as a result of national decisions to limit the impact of the tax on individual businesses has also been received. This includes the lower indexation to business rates either through the cap in 2016-17 or the lower indexation based on CPI from April 2018; the doubling of small business rate relief from April 2017; and various reliefs given to particular business activities e.g. smaller high street shops/pubs/restaurants, local newspaper offices, etc. The final grant notification will not be received until later in the year but following the tax base notification the estimate has been revised from £11.4m included in the Cabinet report (already £1.4m more than the estimate in the black-combed draft budget) to £12.662m.

3.9 A summary of the Council Tax base/collection fund and business rate growth/collection fund changes is shown in table 3 below.

Table 3 – Final Council Tax and Business Rate Notifications

| Black Combed 6th Jan | | Cabinet 27th Jan | White Combed 4th Feb | Change |
|---|---|---|---|---|
| £747.181m | Council Tax Precept | £749.443m | £749.443m | - |
| £2.500m | Council Tax Collection Fund | £4.530m | £3.898m | -£0.632m |
| £53.751m | Retained Business Rates | £53.716m | £55.938m | +£2.222m |
| £1.700m | Business Rate Collection Fund | £1.700m | £2.563m | +£0.863m |
| £10.000m | Business Rate Compensation Grant | £11.400m | £12.662m | +£1.262m |
| £815.132m | Total | £820.789m | £824.504m | +£3.715m |

## 4. Capital Budget Strategy and Proposals

4.1 Capital expenditure is spent on the purchase or enhancement of physical assets where the benefit will last longer than the year in which it is incurred e.g. school buildings, roads, economic development schemes, IT systems, etc. It includes the cost of purchasing land, construction costs, professional fees, plant and equipment and grants to third parties. Capital spending plans are determined according to the Council's statutory responsibilities and local priorities as set out in the MTFP, with the ultimate aim of delivering the vision set out in the Strategic Statement.

4.2 Capital spending has to be affordable as the cost of interest on borrowing and setting aside sufficient provision to cover the initial investment funded by loans over the lifetime of the asset, are borne as revenue spending each year over a very long period. A review of the options available is to be undertaken during 2020-21 to determine the optimum approach for assessing and ensuring affordability. This affordability would also apply to invest to save schemes which need to have a reasonable payback.

4.3 Section 1 of the draft Budget Book (white-combed) sets out a summary of the proposed 2020-23 programme and associated financing requirements. The summary provides a high-level overview for the whole council. The individual directorate pages in section 2 provides more detail of rolling programmes and individual projects.

4.4 A significant proportion of the capital programme is funded by grants from government departments, particularly Department for Education (DfE) and Department for Transport (DfT). In many cases future year's grant allocation notifications have not been received and the capital programme is therefore based on estimates. Some schemes also require external funding e.g. Heritage Lottery Fund (HLF) which may not yet have been secured. Schemes that include significant elements of unsecured funding are shown in *italics* in the capital programme and will only go ahead if the funding is secured.

4.5 The capital programme has been developed to show a longer term 10-year horizon. Inevitably extending planning horizons introduces additional uncertainty and the programme shows the detail of planned spending in each of the first 3 years (2020-23) and a cumulative estimate for years 4 to 10. The later years of the 10 year capital strategy will be further developed during 2020-21. Any revised spending profiles will be reported as revised cash limits through the finance monitoring reports to Cabinet.

4.6 The capital strategy in appendix 1 of this report provides a high level overview of the linkages between capital spending, financing and the Council's treasury management. The strategy identifies how financial risks associated with capital investments are managed and the implications for future financial sustainability.

4.7 Sitting alongside the capital strategy are the separate Treasury Management Strategy (appendix 2), Investment Strategy (appendix 5), and Capital Programme Strategy (appendix 6). The capital strategy includes the prudential indicators which must be approved by full Council.

## 5. Revenue Budget Strategy and Proposals

5.1 This section of the report provides further background to the construction of the 2020-21 revenue budget proposals. Revenue expenditure is what is spent on the provision of day to day services provided by the Council e.g. care for the elderly and vulnerable adults, supporting children in care, libraries, maintaining the road network, etc. It includes the cost of salaries for staff, contracts for services procured by the council, the costs of financing borrowing to support the capital programme, and other goods and services used by the council. Revenue spending must have regard to the Council's statutory responsibilities and local priorities set out in the Strategic Statement/Five-Year plan and MTFP.

5.2 Revenue spending is funded by a combination of Council Tax, locally retained Business Rates and un-ring-fenced grants from the Ministry of Housing Communities and Local Government (MHCLG) included in the local government finance settlement. Grants from other government departments are ring-fenced to specific areas of spending and are shown as income to offset the related spending.

5.3 The original draft Budget Book (black-combed) calculations, published on 6th January 2020, were based on the estimated impact of the local government finance settlement and KCC estimates for Council Tax base, local share of Business Rates and collection fund balances. The changes as a result of the provisional settlement (announced on 20th December) and provisional Council Tax base and collection fund balances from districts were reported to Cabinet on 27th January 2020. There have been some further changes as a result of the final Council Tax base and collection fund, and Business Rates tax base/collection fund balance, as outlined in section 2 of this report. These have been reflected in the republished draft Budget Book (white-combed) for Council approval and the amount drawn down from reserves has been adjusted accordingly.

5.4 Section 3 of the draft Budget Book (white-combed) sets out the principal components of the changes in revenue spending between 2019-20 and 2020-21 by directorate. Section 4 of the draft Budget Book (white-combed) provides a high-level summary of planned revenue spending and income by directorate, and high-level analysis of funding from Council Tax, Business Rates and un-ring-fenced grants. More detail of individual directorates is shown in section 5 providing an outline of directorate objectives and resources together with spending and income plans for key services. The main elements of the year on year changes in revenue spending is outlined in the following paragraphs.

5.5 The revenue budget strategy continues to be based on an equation which identifies the challenge from increasing spending demands (including replacing the use of one-off savings to support the current year's budget e.g. draw down of corporate and directorate reserves, one off income dividends, etc.) and the solution from changes in Council Tax, locally retained Business Rates growth, other grant increases/changes in the provisional settlement, and savings (including further use of reserves). This equation is a little simpler now that there is no longer any need to factor in reductions in central government grant and this has been an emerging picture throughout the year as forecasts have become more refined.

5.6 Table 4 shows the emerging picture from the 2020-21 estimates in the 2019-22 MTFP presented to Council in February 2019, the autumn budget consultation, original draft Budget Book (black-combed) published on 6th January 2020, the update to Cabinet on 27th January 2020, and the republished draft Budget Book (white-combed) for Council approval presented in this report.

Table 4 – Evolution of Revenue Budget

| | 2019-20 MTFP | Budget Consult | Black Combed 6th Jan | Cabinet 27th Jan | White Combed 4th Feb |
|---|---|---|---|---|---|
| Spending Demands (incl. replacing one-offs) | £64.0m | £101.2m | £104.2m | £107.1m | £107.0m |
| | | | | | |
| Government Grant Increases | -£12.8m | £32.5m | £34.8m | £36.1m | £37.4m |
| Council Tax & Business Rates | £11.8m | £33.4m | £33.2m | £37.5m | £39.9m |
| Savings, Income & Reserves | £4.9m | £13.7m | £34.3m | £33.5m | £29.7m |
| Total Solution | £3.9m | £79.6m | £102.3m | £107.1m | £107.0m |
| | | | | | |
| Gap | £60.1m | £21.6m | £1.9m | - | - |

5.7 Any further material changes since this report was produced will be reflected in the Council motion at the meeting. This could include the final Local Government Finance settlement which is due to be agreed before parliament recess begins on 14th February.

5.8 The remainder of this section explores each element of the revenue budget equation to support the detailed one-year revenue plan (published as section 3 of the draft Budget Book)

***Spending Demands***

5.9 In the draft Budget Book the spending demands have been split between the following categories:

- Net Budget Realignment
- Replacement of One-Offs
- Loss of Specific Grant Income
- Pay and Prices
- Demand and Demography
- Government and Legislative
- Service Strategies and Improvement

5.10 The net budget realignment reflects the "right-sizing" of budgets for known variances in either cost and/or demand which have arisen during the current year. Realignment can either increase or reduce budgets. Without this realignment the budget would not stand up to the robustness test required under the section 25 assurance referred to in paragraph 1.2 as the budget would have been set knowing that it did not reflect current year performance. The proposed budget realignment includes a £2m provision held unallocated to cover any other issues that are reported in monitoring throughout the remainder of the 2019-20 financial year. Allocations from this provision (and other unallocated amounts in the proposed budget) will be subject to the governance arrangements set out in section 6 of this report. The approach to realigning budgets will be reviewed as part of the Council's move to an outcome-based budgeting approach from 2021-22.

5.11 The 2019-20 budget included one-off solutions to support the core spending which need to be replaced in future years' budgets. Some of these related to use of corporate reserves within financing items and some within directorate budgets. The one-offs and their replacements are shown in table 5. The smoothing of the Improved Better Care Fund (iBCF) relates to the additional funding announced in the 2017-18 settlement (front-loaded) which was agreed to be spread more evenly over three years. Not all the smoothing of iBCF needs to be replaced as some activities were time limited.

Table 5 – One-offs in 2019-20

| | 2019-20 | 2020-21 | Later Years |
|---|---|---|---|
| Financing Items | | | |
| Drawdown from Corporate Reserves | -£7.852m | £7.852m | |
| Business Rate Levy Account surplus | -£2.836m | £2.836m | |
| Increased drawdown from Kings Hill (two years) | -£2.000m | £1.000m | £1.000m |
| Sub Total | -£12.688m | £11.688m | £1.000m |
| | | | |
| Directorate | | | |
| Adult Social Care to smooth phasing of iBCF | -£8.730m | £6.530m | |
| Adult Social Care directorate reserves | -£2.896m | £2.896m | |
| Sub Total | -£11.626m | £9.426m | |

5.12 The loss of income from reductions in specific grants is shown as a pressure. The compensating action to reduce spending (or use of reserves) is shown as a saving.

*Pay and Reward*

5.13 The draft budget includes an additional £7.4m contribution towards the pay and reward package for Kent Scheme staff. This contribution is intended to be sufficient for the total pay and reward package for the majority of staffs' performance reward being approx. 3.6% (including the net saving on pay from new staff appointed lower in the pay range than staff they replace). This would enable the increases in Kent Scheme staff pay for 2020-21 to keep pace with the September average earnings increase published by the Office for National Statistics (ONS).

5.14 The final reward percentages will depend on the number of staff and their current salaries assessed at each TCP level to ensure the cost is contained within the overall allocation. The top and bottom of each pay range are uplifted under a separate process (usually by at least ½ of the successful %). This ensures that pay scales are kept up to date whilst at the same time allowing staff to progress through the range to reach the top (which is considered as the “market rate” for staff fully competent in the role). Decisions on the final proposed distribution of the pay and reward allocation, and uplift to pay ranges, will be agreed by the Cabinet Member for Communications, Engagement & People after consultation with the Leader and Cabinet, under powers delegated by the Council.

5.15 The reward payment either increases an individual’s salary via progression through the pay range or is a non-consolidated lump sum payment for staff on the top of the grade (in reality this is a combination of both for staff at the top following the annual uplift to ranges). These arrangements differ from other public sector pay schemes including the National Joint Council (NJC) scheme used by most local authorities. Under the Kent arrangements there is no separate “cost-of living” award and incremental progression.

5.16 In 2019-20 the County Council agreed to implement a minimum salary for Kent Scheme staff equivalent to the Living Wage Foundation’s “Real Living Wage”. This resulted in a single pay point for staff in KR2 equivalent to £9 per hour. The County Council did not formally adopt Foundation Living Wage employer status. For 2020 further reforms to the Kent Scheme are proposed which would see the minimum pay increase to £9.35 per hour. This is more than the £9.30 recommendation from the Living Wage Foundation for outside London. This higher increase would result in a higher pay rewards for the lowest paid staff (3.9%) compared to other staff (approx. 3.6%), reflecting the Council’s ongoing commitment to improve the pay for our lowest paid staff and would ensure all of a successful pay reward for these staff is paid in salary (with no non-consolidated lump sum).

5.17 The proposed increase in the minimum pay will combine KR2 and KR3 into a new single pay point. A gap of 0.5% between this point and bottom of KR4 will need to be maintained, and the top of KR4 will need to be £1,200 more than the new KR2/3 to ensure staff at the top of the higher range are paid £100 per month more than the minimum pay (there is 0.5% gap and minimum £1,200 difference between the tops of all adjacent pay ranges). The Council will look to make further reforms to Kent Scheme pay ranges in future years once there is the added certainty of multi-year financial settlements.

*Price Inflation*

5.18 The republished draft budget includes provision for specific contractual price increases. In the main, these are index-linked and summarised on page 19 in section 3 of the draft Budget Book (white combed). These have remained largely unchanged in the republished draft Budget Book (white-combed) for Council approval other than increasing the amounts for adults and children’s social care prices to reflect the recent announcements on National Living Wage (NLW) and National Minimum Wage (NMW).

5.19 The budget includes provision for non-specific increases in negotiated contracts. This calculation includes a proportion of the NLW and NMW for under 25s which the Council is passing on to contractors as price increases. The amount is based on the assumed proportion of prices which relate to workers eligible for the confirmed increases e.g. NLW increasing from £8.21 per hour to £8.72 (6.2%), and an appropriate increase for the proportion relating to staff above NLW/NMW, and general inflation on the non-staffing element. The impact of these announcements was reported to Cabinet on 27th January 2020 and has increased social care prices by £2.7m to ensure care providers are funded to be able to meet the new minimum statutory amounts but also to maintain some differential (albeit reduced) between minimum and higher paid employees.

5.20 The Public Health prices include £4.1m for the estimated impact on services commissioned from the National Health Service (NHS) due to the Agenda for Change pay and pension increases. The impact in 2019-20 was managed within the health sector with additional funding provided directly to NHS providers. In 2020-21, this funding is envisaged to transfer to Local Authorities (as Commissioners), or at least to be paid for by the NHS directly as in previous years. As yet there has been no confirmation of the 2020-21 Public Health grant. The budget is based on a worst-case scenario with additional costs passed on through commissioned prices with no additional funding. If such increases have to be absorbed from within the ring-fenced Public Health grant and reserves this will present a significant in year challenge for Public Health. The Council is continuing to lobby for sufficient funding to cover the NHS related costs.

5.21 Budget holders will be expected to negotiate prices within the inflation parameters outlined in paragraphs 5.18 to 5.20. The budget does not include any provision for general inflation on goods and services procured by the council, budget holders will be expected to cover the impact of any such inflation within their overall budget.

*Demand and Demography*

5.22 The draft budget includes the forecast impact of population changes and estimated additional demand arising during the forthcoming year. These continue to represent a significant cost pressure, particularly within adult social care services. The forecasts not only reflect changes in client numbers/service users but also non-inflationary changes in package costs. For the 2020-21 budget a more detailed breakdown of forecasts has been provided by client groups, and the forecasts have been split between changes in the number of clients/client weeks; changes in unit cost associated with other non-inflationary factors; impact of changing client numbers and settings on income; and other changes.

5.23 Rising demand within children's services is continuing, including the numbers receiving disabled children's services, increasing complexity in specialist children's services (impacting on both care costs and casework for social workers), and support for children with special educational needs and disabilities (SEND) arising from significant growth in the number of Education, Health and Care Plan (EHCP) assessments. The majority of SEND pressures are within the High Heeds Block of Dedicated Schools Grant (DSG) but the Council does have to fund home to school transport costs within the general fund.

5.24 A number of other services have identified demand and demography cost pressures such as waste recycling and disposal linked to increased household numbers.

*Service Strategies and Improvements*

5.25 The 2020-21 draft budget includes significant additional spending on service improvements. This includes the impact of external recommendations e.g. joint Written Statement of Action on SEND following inspections from OfSTED and Care Quality Commission; impact of market forces on tendered services e.g. highways term maintenance contract, total facilities management, social care residential contracts; and local priorities e.g. additional debt costs to finance the capital programme, a growth allocation to invest in strategic priorities identified from the feedback from the consultation on the new Five-Year Plan. A summary of the key service strategies and improvements is set out in table 6 below.

Table 6 – Service Strategy and Improvements proposed in 2020-21 Revenue Budget

| | |
|---|---|
| Implementation of joint Written Statement of Action on SEND | £2.368m |
| Growth Fund for Five -Year Plan strategic priorities | £3.500m |
| Climate Change initial contribution to reserve | £1.000m |
| Young Care Leavers Council Tax exemption | £0.600m |
| Response to time limited debate on supporting disabled people with travelling to work | £0.200m |
| Public Health investment in drug related referrals and sexual health services | £0.600m |
| Highways Term Maintenance Contract one-off costs and retender | £2.222m |
| Total Facilities Management retender | £0.756m |
| Social Care Residential Care retender | £4.392m |
| Financing Capital Programme | £2.962m |
| Oakwood House redevelopment | £0.550m |

5.26 A summary of all the additional spending proposals is set out in section 3 of the republished draft Budget Book (white combed) for Council approval (pages 17 to 22).

***Savings and Income***

5.27 The savings and income proposals in the draft budget are set out in section 3 of the republished draft Budget Book (white-combed) for council approval (pages 23 to 26). In total £29.7m of savings and income are needed to balance the 2020-21 budget. This is significantly less than the level of savings which have been needed to be found over the last ten years as a result of the improved settlement. 37% of the total additional spending is funded from Council Tax (tax base and proposed increased charges) and Business Rate increases, 35% from additional government funding (albeit some of this is not new money as it represents the transfer of ring-fenced Winter Pressures Grant into un-ring-fenced iBCF), and 28% from savings/income and reserves.

5.28 £6.9m of the savings derive from the full year effect of savings in the 2019-20 budget; £3.9m from the continuation of existing charging policies; and £5.9m from financing and minor savings under £200k. The remaining £13.0m are new proposals in section 3 of the draft Budget Book (white-combed).

5.29 £9.1m of the savings are being found from reserves. £8.4m of this is from directorate reserves; Adult Social Care provision should the winter monies not be repeated (not now needed as winter monies have been built into iBCF) and other uncommitted reserve provisions, and Public Health (see 4.19 above). £0.7m are from corporate reserves.

5.30 Detailed consultation and equality impact assessments of specific proposals within each directorate will be undertaken, where necessary, once the budget has been approved and prior to implementation. Approval of the budget includes granting delegated power to Cabinet Members to make changes to the proposals in response to detailed consultation and equality impact assessments. Any such changes will be reflected in the monthly monitoring reports to Cabinet.

***Use of Reserves and Debt Repayment***

5.31 The Council's usable revenue reserves in 2013-14 were £196m (excluding schools, usable capital receipts and unapplied capital grants). 2013-14 was the first year of the current Business Rates retention funding arrangements for local government and thus a reasonable starting point for noting the Council's reserves levels. Total reserves at end of 2018-19 were £223.5m (£186.4m earmarked and £37.1m general).

5.32 The reserves at the end of 2018-19 were higher than expected as a result of better than anticipated receipts from the business rate retention pilot, rollforwards from 2018-19 underspend, re-phasing of transformation and other projects, and late grant distributions from central government. Many of these would be drawn in 2019-20 (as well as drawdown to support the budget) and usable revenue reserves are forecast to be at a similar level at the end of 2019-20 (£183.1m earmarked and £37.1m general).

5.33 Over the six-year period 2013-14 to 2018-19 KCC's overall usable reserves have been fairly stable. This is after £78.7m drawdown to support the revenue budget, and planned use/contributions to reserves. Table 7 shows the annual changes over this period.

Table 7 – Changes in Reserves

| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
|---|---|---|---|---|---|---|
| General Reserves | £31.7m | £34.7m | £36.4m | £36.7m | £36.9m | £37.1m |
| Earmarked Reserves | £157.9m | £166.2m | £163.3m | £157.3m | £155.1m | £179.5m |
| Trading Account Surpluses | £3.5m | £2.9m | £0.6m | - | £0.2m | £0.9m |
| Public Health Reserves | £2.9m | £2.1m | £2.0m | £3.8m | £3.6m | £6.0m |
| Total Usable Revenue Reserves | £196.0m | £205.9m | £202.3m | £197.8m | £195.8m | £223.5m |
| | | | | | | |
| Breakdown of General Reserves | | | | | | |
| Commercial Services | - | - | -£0.8m | -£0.5m | -£0.3m | -£0.1m |
| KCC | £31.7m | £34.7m | £37.2m | £37.2m | £37.2m | £37.2m |
| | | | | | | |
| Breakdown of Earmarked | | | | | | |
| Directorate | £61.3m | £57.8m | £51.3m | £48.7m | £41.8m | £47.7m |
| Corporate | £89.5m | £100.6m | £102.8m | £100.4m | £105.1m | £123.6m |
| Trading Bodies | £7.1m | £7.8m | £9.2m | £8.2m | £8.2m | £8.2m |

5.34 As already identified the proposed 2020-21 budget proposes a drawdown of £9.1m from corporate and directorate reserves and there are some changes to planned contributions e.g. one-year holiday on the contribution to the Transformation Reserve. Overall, a net £10.3m reduction in reserves over the course of 2020-21 is anticipated (after taking account of drawdown and planned use/contributions) reducing the forecast level of usable revenue reserves to around £210m by 31st March 2021.

5.35 As with other aspects of the budget the plans to use reserves will need to be adapted to changing circumstances throughout the year. In recent years this has generally meant that the council has not had to use as much from reserves as planned or been able to build up additional reserves. Either can arise from re-phased spending from earmarked reserves or managing in-year underspends. In comparison with other counties, KCC has relied less on reserves to support budgets than the average county in recent years but still has a smaller proportion of the net revenue budget in reserve than other counties. The Council's relative reserves and debt compared to other counties are shown in the Assessment of Levels of Reserves (Appendix B) of the republished draft Budget Book (white-combed) for Council approval.

5.36 The criteria for use of our earmarked reserves are maintained by the Finance Division. These are reviewed each year, but few changes generally come from those reviews. A more comprehensive review of reserves is planned during 2020-21 to include the balance between corporate and directorate reserves, scope to reduce the number of reserves, and the purposes for which reserves are held. The criteria for use of reserves and the balances is ultimately a decision for the Council's Section 151 Officer after consultation with Cabinet and the Corporate Management Team.

5.37 The draft budget proposals also include a reduction in the amount to be set aside for future debt repayments. This reduction is simply a recalculation of the Minimum Revenue Provision (MRP) to cover capital financing requirements based on an updated asset schedule. It does not represent a change to the Council's MRP statement as set out in appendix 3 of this report.

## 6. Unallocated Spending and Savings

6.1 There are an increased number of spending pressures and savings which need to be held unallocated at the time the budget is approved. These have been held centrally within Financing Items budget. This is not uncommon and has happened in previous years. The allocation of these sums has previously been approved by the Section 151 Officer (after consultation with Cabinet Member for Finance, Corporate & Traded Services and Group Leaders) under powers delegated as part of the budget approval. However, due to the expansion of the reasons for holding amounts centrally unallocated this needs a more varied approach to the governance of approvals for allocations. An analysis of all the additional amounts unallocated in excess of £1m is set out in table 7 together with the proposed governance for decision making (amounts under £1m will be subject to virement procedures set out in Financial Regulations).

Table 7 – Changes in Unallocated Allocations

| Budget Heading | Amount | Route for Decision Making |
|---|---|---|
| Pay & Reward | £7.800m | Cabinet Member decision regarding 2020-21 Performance Rewards as per paragraph 5.14 |
| Care and Support in Home Price Uplift | £2.193m | Delegated Section 151 powers in line with previous procedures (including consultation) and following evaluation of tenders |
| Residential Care Price Uplift | £3.104m | Delegated Section 151 powers in line with previous procedures (including consultation) and following evaluation of tenders |
| Emerging Pressures | £2.000m | Delegated Section 151 powers in line with previous procedures (including consultation) |
| Strategic Statement Priorities | £3.500m | Cabinet decision following the full Council endorsement of the new Five-Year plan objectives after consultation has completed. |

## 7. Robustness of Estimates and Adequacy of Reserves

7.1 As required by the Local Government Act 2003, the Section 151 officer (for Kent this is the Corporate Director of Finance) must formally give opinion as to the robustness of the budget estimates and the level of reserves held by the Council.

7.2 The estimates have been produced from a comprehensive budget process with Cabinet Members, Corporate Directors and Directors resulting in agreement on the level of service delivery within the identified financial resources. In addition, appendix C of the republished draft Budget Book (white-combed) sets out the main budget risks, alongside the proposed management action for dealing with these.

7.3 The republished draft Budget Book also clearly sets out the recommended strategy for ensuring adequate reserves (Appendix B – Assessment of Level of Reserves). This has been set in consideration of key factors, such as the Council's continued excellent record on budgetary control, the internal financial control framework, and the strong approach to risk management. The planned draw-down from reserves in 2020-21 is now £9.1m rather than £12.9m identified in the Cabinet report as a result of the notification of final estimated Council Tax and Business Rates tax base and collection funds.

7.4 The forecast overall level of reserves at the end of 2020-21 is around £210m. This is £10.3m less than the forecast for 2019-20 arising from a combination of draw-down, use of Kings Hill reserves to support revenue and repayment of previous loans from reserves. The level of general reserves is in line with best practice as recommended by CIPFA and the Audit Commission.

7.5 To conclude, the Section 151 officer can formally report that the budget estimates are robust and the level of reserves adequate, as required by the Local Government Act 2003. The proposed budget has been formulated following a robust process of internal challenge with Cabinet Members and Corporate Directors, public consultation and scrutiny by Members of all political groups.

7.6 There are no immediate concerns about the financial sustainability of the Council, although given the pressures on local government funding, the increasing demands, and the uncertain outcomes from the major national funding reviews (Spending Review, Business Rate Retention, Social Care and Fair Funding), the sustainability of the Council's finances needs to be kept under close review.

## 8. Recommendations

**Recommendations**:

The County Council is asked to agree:

(a) The net revenue budget requirement of £1,063.654m for 2020-21.

(b) The 10 year Capital programme and investment proposals of £1,014.339m over three years from 2020-21 to 2022-23 together with the necessary funding and subject to approval to spend arrangements.

(c) The Capital Strategy as set out in appendix 1 of this report including the Prudential Indicators.

(d) The Minimum Revenue Provision (MRP) Statement as set out in appendix 3 of this report.

(e) The directorate capital programmes as set out in sections 1 & 2 of the draft Budget Book (white-combed) for Council approval published on 5th February.

(f) The directorate revenue budget proposals as set out sections 3, 4 and 5 of the draft Budget Book (white-combed) for Council approval published on 5th February.

(g) To delegate responsibility to Cabinet Members and Corporate Directors to manage the budget within the parameters set out in the Constitution and Financial Regulations.
(h) To increase Council Tax band rates up to the maximum permitted without a referendum as set out in table 2 in appendix A of the draft Budget Book (white-combed) for Council approval published on 5th February.
(i) To levy the additional 2% social care precept (raising an additional £14,375,896 and taking the total social care precept to £65,789,689 out of precept set out in (j) below).
(j) The total Council Tax requirement of £749,443,400 to be raised through precepts on districts as set out in table 1 in appendix A of the draft Budget Book (white-combed) for Council approval published on 5th February.
(k) The Treasury Management Strategy as set out in appendix 2 of this report.
(l) The reforms to the lowest Kent Scheme pay ranges (KR2 and KR3) to a single point paying £9.35 per hour.
(m) The governance process for the allocation of unallocated amounts within the approved budget set out in paragraph 6.1 of this report.

In addition:
(n) To note that the Cabinet Member for Communications, Engagement & People after consultation with the Leader and Cabinet, will determine the TCP reward thresholds for staff assessed as successful, excellent, and outstanding, and the uplift to the Kent Ranges in accordance with the 0.5%/£1,200 principles.
(o) To delegate authority to the Corporate Director of Finance (after consultation with the Leader, Cabinet Member for Finance, Corporate & Traded Services and the political Group Leaders) to resolve any minor technical issues for the final budget publication which do not materially alter the approved budget or change the net budget requirement. This includes approving the distribution of unallocated amounts within the approved budget set out in paragraph 6.1.
(p) Changes made in (o) above to be reflected in the final version of the Budget Book (blue combed) due to be published in March.
(q) To note the proposed review of reserves to be conducted by the Council's Section 151 Officer after consultation with Cabinet and Corporate Management Team set out in paragraph 5.36.
(r) To note the Section 151 Officer's opinion on the robustness of the budget estimates and the level of reserves held by the Council.
(s) To note the uncertain financial outlook for later years in the absence of a multi-year settlement from government
(t) To note the development of an outcome-based budgeting approach from 2021-22 onwards
(u) To note reviews to the realignment of base budgets and treatment of unallocated amounts in future year's budgets

## 9. List of Appendices

Appendix 1 – Capital Strategy

Appendix 2 – Treasury Management Strategy

Appendix 3 – Minimum Revenue Provision Statement

Appendix 4 – Flexible Use of Capital Receipts

Appendix 5 – Investment Strategy

Appendix 6 – Capital Programme Strategy

## 10. Background Documents

10.1 KCC's Budget webpage
https://www.kent.gov.uk/about-the-council/finance-and-budget

10.2 KCC's Corporate Risk Register and Risk Management Policy & Strategy
https://democracy.kent.gov.uk/documents/s88701/Item%2009%20Review%20of%20KCCs%20Risk%20Management%20Policy%20and%20Strategy.pdf
https://democracy.kent.gov.uk/documents/s88720/Item%2009%20Appendix.pdf
https://democracy.kent.gov.uk/documents/s88699/Item%2008%20Corporate%20Risk%20Register.pdfhttps://democracy.kent.gov.uk/documents/s88707/Item%2008%20Appendix.pdf

10.3 KCC's approved 2019-20 Budget and Medium Term Financial Plan
https://www.kent.gov.uk/__data/assets/pdf_file/0006/93390/Budget-Book-2019-20.pdf

10.4 KCC Budget Consultation launched 16th October 2019
https://kccconsultations.inconsult.uk/gf2.ti/f/1073826/57416805.1/PDF/-/2020_21_Budget_Consultation__FINAL.pdf

10.5 KCC report on 2019 Budget Consultation
https://kccconsultations.inconsult.uk/gf2.ti/f/1073826/61281381.1/PDF/-/Budget_Campaign_Consultation_2020_21_final_report_v.final.pdf

10.6 Provisional Local Government Finance Settlement 20th December 2019
https://www.gov.uk/government/collections/provisional-local-government-finance-settlement-england-2020-to-2021

10.7 KCC Draft Budget Book 5th February 2020

10.8 Response to Provisional Local Government Finance Settlement

10.9 Budget reports to Cabinet Committees in January
Policy & Resources
Growth, Economic Development and Communities
Environment and Transport
Adult Social Care
Children’s, Young People and Education
Health Reform and Public Health

10.10 Minutes of Scrutiny Committee 24th January 2020

10.11 Cabinet 27th January 2019

**10. Contact details**

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# Capital Strategy

**Introduction**

1.1 This capital strategy was a new requirement for 2019-20, giving a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes highly technical areas. To complement this new presentation, the fuller Capital Programme Strategy has been published separately in Appendix 6 of the County Council report.

**Capital Expenditure and Financing**

1.2 Capital expenditure is where the Council spends money on assets, such as property, highways assets or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are deemed *de-minimis* and not capitalised and are charged to revenue in year.

1.3 Details of the Council's policy on capitalisation are included in the Council's annual Statement of Accounts, the relevant extract is set out below:

"Assets that have physical substance and are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and that are expected to be used during more than one financial year are classified as Property, Plant and Equipment.

1.4 All expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment above our *de-minimis* of £10k (£2k in schools) is capitalised on an accruals basis. In this context, enhancement means work that has substantially increased the value or use of the assets. Work that has not been completed by the end of the year is carried forward as "assets under construction".

1.5 In 2020-21, the Council is planning capital expenditure of £471.9m as shown in the following table:

*Table 1: Prudential Indicator 1: Estimates of Capital Expenditure in £millions*

| | **2018-19 Actuals** | **2019-20 Forecast** | **2020-21 budget** | **2021-22 budget** | **2022-23 budget** |
|---|---|---|---|---|---|
| General Fund services | 200.5 | 253.7 | 429.9 | 310.6 | 197.8 |
| Capital investments | 0.1 | 37.0 | 42.0 | 34.0 | 0.0 |
| **TOTAL** | 200.6 | 290.7 | 471.9 | 344.6 | 197.8 |

1.6 The main General Fund capital projects include investments in additional school places to increase capacity (£168m), highways, structures & waste enhancement (£82m), highways and other transport improvements (£76m), modernisation and improved utilisation of council premises (£31m), other school projects (£31m), economic development initiatives (£26m), community projects (£10m) and adults projects (£5m).

1.7 The Council has up to £42m available in 2020-21 for acquisition of strategic properties.

1.8 **Governance**: Service managers bid to include projects in the Council's capital programme. Bids are collated by the Capital Team in Corporate Finance who review the bids and calculate the financing cost (which can be nil if the project is fully externally financed). The Infrastructure Commissioning Board (ICB) appraised all the bids for the 2020-23 capital programme against the Capital Strategy Drivers and made recommendations for inclusion in the final capital programme. Going forward there will be a revised governance process which will undertake this function. The final capital programme is then presented to Cabinet in January and to County Council in February each year for approval.

- Full details of the Council's capital programme are set out in Sections 1 and 2 of the draft Budget Book (white combed) for Council approval.

1.9 All capital expenditure must be financed, either from external sources (government grants, developer contributions and other external funding), the Council's own resources (revenue, reserves and capital receipts from sale of assets) or borrowing. The planned financing of the above expenditure is as follows:

*Table 2: Capital financing in £millions*

| | **2018-19 actual** | **2019-20 forecast** | **2020-21 budget** | **2021-22 budget** | **2022-23 budget** |
|---|---|---|---|---|---|
| External sources* | 153.9 | 178.9 | 248.0 | 238.3 | 134.9 |
| Own resources | 24.7 | 36.2 | 30.7 | 11.6 | 10.9 |
| Borrowing | 22.0 | 75.6 | 193.2 | 94.7 | 52.0 |
| **TOTAL** | **200.6** | **290.7** | **471.9** | **344.6** | **197.8** |

*External sources include funding from loan repayments. The Council operates a number of revolving loan schemes, the majority of which are funded from external sources. However, this will also include an element of funding that was originally from the Council's own resources but cannot now be separately identified.

1.10 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Borrowing is a combination of external loans and internal borrowing (from cash reserves). Debt is usually only repaid when a loan matures. Occasionally the Council can refinance debt with replacement borrowing at a lower rate of interest, this is rare as there are usually excessive penalties to repay loans earlier than their normal maturity. Planned MRP debt during the medium-term planning period is as follows:

*Table 3: Replacement of debt finance (MRP) in £millions*

| | 2018-19 actual | 2019-20 forecast | 2020-21 budget | 2021-22 budget | 2022-23 budget |
|---|---|---|---|---|---|
| MRP | 60.0 | 59.3 | 60.2 | 64.8 | 64.6 |

- The Council's full minimum revenue provision statement is at Appendix 3.

1.11 The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with repayments from MRP and capital receipts used to replace debt. The CFR is expected to increase by £133.0m during 2020-21. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

*Table 4: Prudential Indicator 2: Estimates of Capital Financing Requirement £millions*

| | 31.3.2019 actual | 31.3.2020 forecast | 31.3.2021 budget | 31.3.2022 budget | 31.3.2023 budget |
|---|---|---|---|---|---|
| TOTAL CFR | 1,284.5 | 1,300.8 | 1,433.8 | 1,463.8 | 1,451.2 |

*The in-year movement in the total row equals borrowing from table 2 less MRP from table 3*

1.12 **Asset management:** To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place. This sets the framework for managing the property portfolio effectively over the next 3 to 5 years. It will guide future strategic property decisions to make sure the property portfolio is managed sustainably and efficiently so that it can adapt to remain fit for the future and support frontline delivery. Property assets are an important part of supporting and enabling the Council to transform the way public services are delivered with partners and it is therefore essential that an innovative and forward-thinking strategy is in place.

- The Council's asset management strategy can be read here: https://www.kent.gov.uk/about-the-council/strategies-and-policies/corporate-policies/asset-management-strategy

1.13 **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.

1.14 Repayments to the Council of capital grants, loans to third parties and investments also generate capital receipts. The timing of when capital receipts are banked and applied to fund the capital programme will not necessarily match, and where necessary, timing differences will be managed through short term internal borrowing from cash balances. The following table shows when the Council plans to apply capital receipts and loan repayments in the coming financial years:

*Table 5: Capital receipts to be applied in £millions*

| | Prior Years | 2020-21 budget | 2021-22 budget | 2022-23 budget |
|---|---|---|---|---|
| Application of asset sales | 37.7 | 20.1 | 2.1 | 1.4 |
| Loan repayments | 31.6 | 13.9 | 14.6 | 12.7 |

- The Council's Flexible Use of Capital Receipts Policy is at Appendix 4.

**Treasury Management**

1.15 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.

1.16 As at 31 December 2019 the Council had £898m external borrowing, at an average interest rate of 4.51% and £382m treasury investments at an average rate of 2.71%.

1.17 **Borrowing strategy:** The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%).

1.18 Projected levels of the Council's total outstanding debt comprising external borrowing and other long-term liabilities identified in the balance sheet (including PFI liabilities, leases, etc) are shown below, compared with the capital financing requirement (see above) and the resulting balance funded from internal borrowing (cash balances).

*Table 6: Prudential Indicator 3: Gross Debt and the Capital Financing Requirement in £millions*

| | 31.3.2019 actual | 31.3.2020 forecast | 31.3.2021 budget | 31.3.2022 budget | 31.3.2023 budget |
|---|---|---|---|---|---|
| Other Long-term Liabilities | 254.9 | 254.9 | 254.9 | 254.9 | 254.9 |
| External Borrowing | 906.2 | 884.0 | 944.0 | 915.0 | 891.6 |
| Total Debt | 1,161.1 | 1,138.9 | 1,198.9 | 1,169.9 | 1,146.5 |
| Capital Financing Requirement | 1,284.5 | 1,300.8 | 1,433.8 | 1,463.8 | 1,451.2 |
| Internal Borrowing (cash balances) | 123.4 | 161.9 | 234.9 | 293.9 | 304.7 |

1.19 Statutory guidance is that total debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Council expects to comply with this in the medium term.

1.20 **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. Both limits are set with reference to the Council’s plans for capital expenditure and financing. The authorised limit provides headroom over and above the operational boundary sufficient for unusual cash movements.

*Table 7: Prudential Indicator 4: Authorised limit and operational boundary for external debt in £millions*

| | **2019-20 limit** | **2020-21 limit** | **2021-22 limit** | **2022-23 limit** |
|---|---|---|---|---|
| Authorised limit – borrowing | 1,013 | 1,020 | 992 | 959 |
| Authorised limit – PFI and leases | 263 | 246 | 246 | 246 |
| Authorised limit – total external debt | 1,276 | 1,266 | 1,238 | 1,205 |
| Operational boundary – borrowing | 988 | 995 | 964 | 935 |
| Operational boundary – PFI and leases | 263 | 246 | 246 | 246 |
| Operational boundary – total external debt | 1,251 | 1,241 | 1,210 | 1,181 |

It is likely that the lease liability figure on the balance sheet will increase as a result of IFRS16. If this results in the expectation that the Council will exceed the authorised limit during 2020-21, then a revised limit will be brought back to County Council for approval.

- Further details on borrowing are in the Treasury Management Strategy – see Appendix 2.

1.21 **Treasury 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.

1.22 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, in particular in Money Market Funds, with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, equity and property funds, 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.

*Table 8: Treasury management investments in £millions*

| | 31.3.2019 actual | 31.3.2020 forecast | 31.3.2021 budget | 31.3.2022 budget | 31.3.2023 budget |
|---|---|---|---|---|---|
| Near-term investments | 217 | 179 | 100 | 100 | 100 |
| Longer-term investments | 261 | 268 | 300 | 300 | 300 |
| **TOTAL** | **478** | **447** | **400** | **400** | **400** |

- Further details on treasury investments are in the Treasury Management Strategy at Appendix 2.

1.23 **Risk management:** The effective management and control of risk are prime objectives of the Council's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

1.24 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Corporate Director of Finance and staff, who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity are presented to Governance and Audit Committee with half-yearly and annual reports going to County Council. The Treasury Management Advisory Group (TMAG) is responsible for scrutinising treasury management decisions.

## Investments for Service Purposes

1.25 The Council makes investments to assist local public services, including making loans to or buying shares in other organisations (service investments). In light of the public service objective, the Council is willing to take more risk than with treasury investments, however it still plans for such investments to generate a surplus after all costs.

1.26 **Governance:** Decisions on service investments are made by the relevant service manager after consultation with and approval of the Corporate Director of Finance and must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

- Further details on service investments are in the Investment Strategy at Appendix 5.

## Commercial Activities

1.27 With central government financial support for local public services declining, the Council has strategically invested in commercial property purely or mainly for financial gain. The capital programme for Strategic and Corporate Services has included provision for Property Investment and Acquisition Funds (PIF1 and PIF2) for a number of years. PIF1 was funded from capital receipts, PIF2 is funded by internal borrowing (cash balances). The objectives of PIF are threefold: to create a pipeline of capital assets for future disposal to support the capital programme; to deliver a return to the Council through income from the assets and/or capital growth; to support regeneration of the Kent economy.

1.28 This strategy also makes provision for the acquisition of strategic assets, where business cases will be subject to approval by external review to ensure that these generate an income stream and will not create a financial burden on the County Council. That is, income streams must cover the total debt costs, including the minimum revenue provision over the medium term, and the short term consequences will have to be reflected in the medium term revenue budget. The external advisors will be appointed by the S151 Officer.

1.29 The approval process and tests that need to be satisfied for the business case to proceed are as follows:

a) That the rate of return meets the set criteria
b) That all revenue costs are identified including debt costs and are covered by the income stream
c) Signed approval of business case by external company review
d) Sign off by S151 Officer
e) Sign off by Head of Paid Service
f) Sign off by Monitoring Officer
g) Approval through the appropriate formal governance route

1.30 As and when these business cases are agreed, they will be added to the capital programme.

1.31 With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include void periods when properties are empty and reductions in market value. These risks are managed by a rigorous appraisal process prior to any acquisition decision. Total commercial investments as at 31st March 2019 were valued at £9.2m with the largest being the former Royal Mail site in Maidstone and Eurogate Business Park in Ashford.

1.32 **Governance:** Decisions on commercial investments and disposals are made by the Director of Infrastructure in accordance with the Councils constitution, and more relevantly the Property Management Protocol, and following consultation with and approval of the Corporate Director of Finance. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

- Further details on commercial investments and limits on their use are included in the investment strategy – Appendix 5

- The Council also has commercial activities in a number of trading companies, details of which are included in the investment strategy – Appendix 5.

## Liabilities

1.33 In addition to debt of £883.4m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £1,333.8m). It has also set aside £37.1m in general reserves to cover unforeseen risks as identified in the Assessment of Reserves – Appendix B to the draft Budget Book (white combed) for Council approval. The Council has identified a number of budget risks but has not put aside any money because the Council has sufficient reserves to cover these eventualities should they arise. These risks are identified in a separate risk register published as Appendix C to the draft Budget Book (white combed) for Council approval.

1.34 **Governance:** Decisions on incurring new discretional liabilities are taken by service managers after consultation with and approval of the Corporate Director of Finance. The risk of liabilities crystallising and requiring payment is monitored by Corporate Finance and included in monitoring reports.

## Revenue Budget Implications

1.35 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

*Table 9: Prudential Indicator 5: Proportion of financing costs to net revenue stream*

| | 2018-19 actual | 2019-20 forecast | 2020-21 budget | 2021-22 budget | 2022-23 budget |
|---|---|---|---|---|---|
| Proportion of net revenue stream | 11.8% | 10.9% | 10.3% | 10.9% | 10.7% |

1.36 In light of the one year revenue spending round for 2020, the future year net revenue budgets are likely to change significantly, which will impact on future year's indicators.

1.37 **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Corporate Director of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable because of the rigour which has been applied to the appraisal of schemes and the application of an affordable future borrowing strategy based on an absolute fiscal limit that the costs of borrowing cannot exceed 15% of the annual revenue budget.

**Knowledge and Skills**

1.38 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Corporate Director of Finance is a Fellow of the Association of Chartered Certified Accountants (FCCA) with 20 years' post-qualification experience, and the Council's finance team at the last review included 43 qualified accountants who are members of professional accountancy bodies including ACCA, CIMA, CIPFA and ICAEW. In addition, KCC Finance are an approved employer with professional accreditations from ACCA and CIPFA.

1.39 Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers, Amey/Kier/Skanska as property consultants/facilities management contractors. The Council will use the services of other specialists and consultants as necessary. This approach is more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

1.40 The Council's policy on the use of external advisers is that where a contract for a consultant is estimated to cost £50,000 or more; details of the proposed award must be forwarded to the relevant Cabinet Member prior to the appropriate officer making the award.

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# Treasury Management Strategy

## Introduction

1. Treasury management is the management of Kent County Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the liquidity of invested funds, maturity of debt and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

2. The Council has adopted CIPFA's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) as described in Section 5 of the Code and treasury risk management at the Council is conducted within the framework of the CIPFA Code.

3. The Code requires the Council to approve a treasury management strategy before the start of each financial year and this report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

4. Investments held for service purposes or for commercial profit are considered in the separate Appendix 5 - Investment Strategy.

## Governance

5. The Corporate Director of Finance is responsible for the Council's treasury management operations and day to day responsibility is delegated to the Head of Finance (Policy, Planning & Strategy) / Head of Finance (Operations) and Treasury and Investments Manager. The detailed responsibilities are set out in the Council's Treasury Management Practices.

6. The Treasury Management Advisory Group (TMAG) has been established to work with Officers on treasury management. The agreed terms of reference are "The Treasury Management Advisory Group will be responsible for advising the Cabinet and Corporate Director of Finance on treasury management policy within KCC's overarching Treasury Management Strategy". TMAG meets the requirement in the CIPFA Code for a member body focussing specifically on treasury management. TMAG meets half yearly and members of the group receive detailed information on a monthly basis.

7. Council will agree the Treasury Management Strategy and receives annual and half yearly reports on treasury management activity. Governance and Audit Committee receives annual and half-yearly reports and makes recommendations to County Council. It also receives quarterly updates.

## External Context

### Economic background

8. The UK's progress in negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2020-21. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

9. GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping yearly GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

10. UK Consumer Price Inflation in December 2019 was 1.3% year-on-year, continuing to fall from highs of 2.1% in July and April 2019, as part of a trend which has seen the rate of inflation decline since autumn 2017, below the Bank of England (BoE) target of 2%. Labour market data continues to be positive. The International Labour Organisation (ILO) unemployment rate continues to hold at historic lows at 3.8%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses was 3.4% in November 2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages increased by 1.8% in the three months to November 2019 (and wages have only been rising by more than inflation since early 2018) and only likely to have a moderate impact on household spending.

11. Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the BoE target of 2%. The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee (MPC). Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

12. The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP growth has started to fall (to 2.1%).

13. The fallout from the US-China trade war continues and risks contributing to a slowdown in global economic activity in 2019. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change

quickly. Slow growth in Europe, combined with changes in leadership at the European Central Bank (ECB) and International Monetary Fund (IMF) has led to a change of stance in 2019. Quantitative easing has continued and been extended.

**Credit outlook**

14. The recent Bank of England stress tests assessed all seven UK banking groups. The tests scenarios include deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis, combined with large falls in asset prices and a separate stress of misconduct costs. All seven banks passed the test on both a CET1 ratio and a leverage ratio basis. Major banks have steadily increased their capital for many years now.

15. In 2020 the Bank of England plan to add Virgin Money/Clydesdale to the testing group and separate tests will be included of ringfenced banks.

16. Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

17. Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020-21 and a cautious approach to bank deposits remains advisable.

**Interest rate forecast**

18. The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. Substantial risks to this forecast remain, arising primarily from the government's policy around Brexit and the transitionary period. Arlingclose judges that the risks are significantly weighted to the downside.

19. Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.10% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

20. For the purpose of setting the budget, it has been assumed that new internally managed treasury investments will be made at an average rate of 0.70% and that new long-term loans will be borrowed at an average rate of 2.5%.

## Local Context

21. At 31 December 2019 the Council held £898m of external borrowing and £382m of treasury investments. This is set out in further detail in Annexe A.

22. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to

maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

23. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years and the Council expects to comply with this recommendation.

## Borrowing Strategy

24. On 31 December 2019, the Council's £898m external debt included £31.4m attributable to Medway Council, as part of its strategy for funding previous years' capital programmes. This represents a decrease of £9m on 31 March 2019 and reflects the Council's strategy of maintaining borrowing below their underlying levels.

25. The Council may borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £1,020m.

### Objective

26. The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

### Strategy

27. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability or sustainability of the debt portfolio.

28. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Using cash available on the Council's balance sheet is also known as internal borrowing and at the end of March 2019 the Council had supplemented external debt with £123m of internal borrowing. Internal borrowing is not cost free as it is at the expense of investment returns and does not remove the need for Minimum Revenue Provision (MRP) to be made.

29. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. The Council will use the services of its treasury advisor to develop this 'cost of carry' and breakeven analysis and based on the results the Council will determine whether to borrow additional sums at long-term fixed rates in 2020-21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

30. The Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board (PWLB) but the government increased PWLB rates by 1% in October 2019 making it now a relatively expensive option. The Council will now

look to borrow any long-term loans from other sources including banks, pension funds and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

31. Alternatively, the Council may arrange forward starting loans during 2020-21, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

32. In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.

33. **Prudential Indicators:** The Council's capital strategy prudential indicator 3 indicates that the Council will increase its external borrowing in 2020-21 but it retains the flexibility to consider borrowing either long term or short term as well as using its cash balances.

34. **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:
    - Public Works Loan Board (PWLB) and any successor body
    - any institution approved for investments (see below)
    - any other bank or building society authorised to operate in the UK
    - any other UK public sector body
    - UK public and private sector pension funds (except the Kent County Council Superannuation Fund)
    - capital market bond investors
    - UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
    - UK Government backed funding initiatives

35. **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
    - leasing
    - hire purchase
    - Private Finance Initiative
    - sale and leaseback

36. **LOBO (Lender's Option Borrower's Option) loans:** The Council holds £90m of LOBO loans (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the e Council has the option to either accept the new rate or to repay the loan at no additional cost. LOBOs totalling £40m have option dates during 2020-21, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if the opportunity arises.

37. **Short-term and variable rate loans**: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

38. **Debt rescheduling:** The PWLB allows councils to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk in the current interest rate environment

## Investment Strategy

39. The Council holds significant cash balances, representing income received in advance of expenditure plus balances and reserves held. Since the beginning of April 2019 the Council's cash balance has ranged between £333m and £537m. The average balance is expected to reduce in 2020-21 reflecting the Council's policy of using cash balances to repay maturing loans and internally funding capital expenditure.

40. **Objectives:** The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults, the liquidity of investments and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

41. **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments the Council has continued its strategy of investing in pooled investment funds during 2019-20 adding a further £30m to its existing pooled fund portfolio. It will consider investing more in these higher yielding asset classes during 2020-21 which invest in a diversified range of assets primarily focussed on an income return rather than capital growth. It will however continue to invest in money market funds and Government including local authority deposits to meet its liquidity requirements.

42. **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

### Approved Investment Counterparties

43. The Council may invest its surplus funds with any of the counterparty types listed below:

44. **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

45. **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investments with banks rated below the agreed minimum rating of A- are restricted to overnight deposits with the Council’s current banking services provider.

46. **Money Market Funds:** Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts.

47. **Cash plus / Short Bond Funds:** Pooled investment funds whose value change with market prices and have a notice period, will be used as alternatives to unsecured bank deposits for longer investment periods.

48. **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank’s assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

49. **Corporates:** Bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.

50. **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing. As providers of public services, they retain the likelihood of receiving government support if needed.

51. **Loans:** Loans to entities set up on an arms-length basis from the Council, and other suitable opportunities, on which the Council will take advice from Arlingclose on the appropriate structure of the loans and applicable rate of interest. Included are interest bearing loans to developers under the No Use Empty Development Programme.

52. **Pooled investment funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks,

coupled with the services of a professional fund manager in return for a fee. Pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

53. Pooled funds offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

54. **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

55. **Operational bank accounts:** The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £50,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

**Credit ratings**

56. Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
    - no new investments will be made,
    - any existing investments that can be recalled or sold at no cost will be, and
    - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

57. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that entity until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

**Other information on the security of investments**

58. The Council understands that credit ratings are good but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the entities in which it invests, including credit default swap

prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from Arlingclose, the Council's treasury management adviser. No investments will be made with an entity if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

59. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills, for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

**Investment limits**

60. The Council may invest its surplus funds with any of the counterparty types listed above subject to the cash limits per counterparty and the durations shown in the table below.

61. The Council's cash reserves available to cover investment losses are forecast to be £429m on 31 March 2020. In order that no more than 10% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one counterparty (other than the UK Government and the CCLA LAMIT property fund) will be £25m.

<u>Approved Investment Counterparties and limits</u>

| | Minimum Credit rating | Maximum Cash Limit | | Maximum Duration |
|---|---|---|---|---|
| | | Individual | Total | |
| **Government** | | | | |
| - UK Government | | unlimited | | 50 years |
| - UK Local Authorities | | £25m | | 10 years |
| - Supranational banks | AAA | £20m | £30m | 25 years |
| - Non-UK Government | AA+ | £20m | £30m | 25 years |
| UK banks and building societies – unsecured | A- | £15m | | 13 months |
| Council's banking services provider | | £20m | | Overnight |
| Overseas banks - unsecured | Country limit AA+, | £20m | £30m country | 13 months |

| | Minimum Credit rating | Maximum Cash Limit | | Maximum Duration |
|---|---|---|---|---|
| | Individual limit A- | | limit | |
| Short-term Money Market Funds | A+ | £20m per fund or 0.5% of the fund size if lower | | |
| Cashplus / short bond funds | | £20m per fund | | |
| **Banks secured** | | | | |
| - Covered bonds | AAA | £20m | £100m | 5 years |
| - Reverse repurchase agreements | collateral of AA or better | £20m each | | 5 years |
| Corporates (non- financials) | A | £2m per issuer | £20m | 2 years |
| Registered Providers | | £10m | £40m | 5 years |
| Loans | | | £20m | |
| **Pooled funds and real estate investment trusts** | | | £250m | |
| - Absolute Return funds | | £25m per fund | | |
| - Multi Asset Income funds | | £25m per fund | | |
| - Property funds | | £75m or 5% of total fund value if greater | | |
| - Bond funds | | £25m per fund | | |
| - Equity Income Funds | | £25m per fund | | |
| - Real Estate Investment Trusts | | £25m per fund | | |

62. **Liquidity management:** The Council forecasts its cash flow requirements to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

## Treasury Management Indicators

63. The Council measures and manages its exposures to treasury management risks using the following indicators.

64. **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its internally managed investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of ach investment. Unrated investments are assigned a score based on their perceived risk.

| Credit risk indicator | Target |
|---|---|
| Portfolio average credit rating | AA |

65. **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

| Liquidity risk indicator | Target |
|---|---|
| Total cash available within 3 months | £100m |

66. **Interest rate exposures**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

| Interest rate risk indicator | Limit |
|---|---|
| Upper limit on one-year revenue impact of a 1% rise in interest rates | £10m |
| Upper limit on one-year revenue impact of a 1% fall in interest rates | £10m |

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

67. **Maturity structure of borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

| Refinancing rate risk indicator | Upper limit | Lower limit |
|---|---|---|
| Under 12 months | 100% | 0% |
| 12 months and within 5 years | 50% | 0% |
| 5 years and within 10 years | 50% | 0% |
| 10 years and within 20 years | 50% | 0% |
| 20 years and within 40 years | 50% | 0% |
| 40 years and longer | 50% | 0% |

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

68. **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

| Price risk indicator | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|
| Limit on principal invested beyond year end | £300m | £300m | £300m |

## Related Matters

69. The CIPFA Code requires the Council to include the following in its treasury management strategy.

70. **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

71. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

72. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

73. In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

74. **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Corporate Director of Finance believes this to be the most appropriate status.

## Financial Implications

75. The budget for investment income in 2020-21 is £9.6m, based on an average investment portfolio of £440m at an interest rate of 2.18%. The budget for debt interest paid in 2020-21 is £42.8m, based on an average debt portfolio of £935m at an average interest rate of 4.58%. If actual levels of investments and borrowing, or actual interest rates, differ from forecast, performance against budget will be correspondingly different.

## Other Options Considered

76. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Corporate Director of Finance, having consulted the Deputy Leader and Cabinet Member for Finance, Traded and Corporate Services, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

| Alternative | Impact on income and expenditure | Impact on risk management |
|---|---|---|
| Invest in a narrower range of counterparties and/or for shorter times | Interest income will be lower | Lower chance of losses from credit related defaults, but any such losses may be greater |
| Invest in a wider range of counterparties and/or for longer times | Interest income will be higher | Increased risk of losses from credit related defaults, but any such losses may be smaller |
| Borrow additional sums at long-term fixed interest rates | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain |
| Borrow short-term or variable loans instead of long-term fixed rates | Debt interest costs will initially be lower | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain |
| Reduce level of borrowing | Saving on debt interest is likely to exceed lost investment income | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain |

## Annexe A – Existing Investment & Debt Portfolio Position

| | 31-Dec-19 Actual Portfolio £m | 31-Dec-19 Average Rate % |
|---|---|---|
| **External borrowing** | | |
| Public Works Loan Board | 475.6 | 4.96 |
| LOBO loans from banks | 90.0 | 4.15 |
| Banks and other lenders (Fixed term) | 321.9 | 4.08 |
| Local Authorities | 10.0 | 0.75 |
| **Total external borrowing** | **897.5** | **4.51** |
| **Treasury investments** | | |
| Covered bonds (secured) | 87.9 | 1.13 |
| Government (incl. local authorities) | 65.4 | 0.90 |
| Money Market Funds | 45.0 | 0.73 |
| Equity | 2.1 | |
| **Total internally managed investments** | **200.4** | **0.98** |
| Pooled investments funds | | |
| - Property | 59.2 | 3.57 |
| - Multi Asset | 62.3 | 2.76 |
| - Absolute Return | 5.0 | 1.81 |
| - Equity UK | 33.1 | 6.85 |
| - Equity Global | 21.8 | 3.24 |
| **Total externally managed investments** | **181.4** | **4.63** |
| **Total treasury investments** | **381.8** | **2.71** |
| **Net debt** | **515.7** | |

# Annual Minimum Revenue Provision (MRP) Statement

Councils are asked to submit a statement on their policy of making Minimum Revenue Provision (MRP) under the guidance issued by the Secretary of State for the Ministry of Housing, Communities and Local Government, under section 21(1A) of the *Local Government Act 2003* to full Council or similar. Any revision to the original statement must also be issued.

MRP represents the minimum amount that must be charged to an authority's revenue account each year for financing of capital expenditure, which will have initially been funded by borrowing.

In 2008 the Department for Communities and Local Government (DCLG) issued new guidance on the Minimum Revenue Provision. This guidance provided four ready-made options which would be most relevant for the majority of authorities but stated that other approaches are not meant to be ruled out, provided that they are **fully consistent with the statutory duty to make prudent revenue provision**. The options that we have implemented since this new guidance came into operation are:

- 4% of our capital finance requirement before the change in regulations.

- The asset life method in subsequent years. This method provides authorities with the option of applying MRP over the life of the asset once it is in operation, so for assets that are not yet operational and still under construction we effectively have an "MRP holiday".

The total of these two methods has provided the annual MRP figure since the regulations changed up until 1 April 2014. However, what this did not do was align the MRP with the repayment of debt and other long term liabilities. Since 1 April 2014 we have continued with the existing calculations but then considered whether an adjustment is required to reflect the timing of internal and external debt repayment and other long term liabilities. We will continue with this approach which is more prudent, given the challenges that the Council continues to face.

Any adjustment made will be reflected in later years to ensure the overall repayment of our liabilities is covered at the appropriate point in time. This will depend on the position of the balance sheet each year and will be a new calculation each year but using the same principles.

This method retains the guidance calculations but allows for a more prudent approach, ensuring that adequate provision is made to ensure debt is repaid.

Each year an updated MRP statement will be presented.

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# Flexible Use of Capital Receipts Policy

1.1 The Spending Review 2015 allowed local authorities additional flexibility for the period 2016-17 to 2018-19 to use capital receipts from the sale of their own assets (excluding Right to Buy receipts) to help fund the revenue costs of transformation projects and support the delivery of future savings. This represented a significant departure from the previous requirements which restricted the use of receipts from asset sales to funding new capital investments.

1.2 In December 2017, alongside the provisional local government finance settlement, this flexibility was extended for a further three financial years to 2021-22. This means that local authorities can treat as capital expenditure until 31 March 2022, expenditure which is designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that reduces costs or demand for services in future years for any of the public sector delivery partners, as long as it is funded from capital receipts which have been received during the period of this flexibility, 2016-17 to 2021-22.

1.3 Under the terms of this flexibility, local authorities are required to disclose the individual projects that are funded or part funded through capital receipts flexibility to full Council. We reported the actual use of receipts in 2017-18 and planned use in 2018-19 and 2019-20 in appendix 3 to the County Council budget report last year. This has been updated in this appendix to reflect the latest position.

1.4 KCC's 2017-18 budget and 2017-20 MTFP included the planned use of £5m of capital receipts to fund transformation projects over two years. We are required to report to full Council how such receipts are applied and the anticipated savings. Table 1 below shows the receipts which were applied in 2017-18 and 2018-19 and those approved for 2019-20.

Table 1: Use of Capital Receipts for Transformation

| | project cost | | | planned savings (incremental change) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| PROJECT | 2017-18 | 2018-19 | 2019-20 | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| Adults phase 3 transformation * | 1,989.7 | 326.0 | 68.5 | -2,700.0 | -2,722.6 | -2,700.0 | -3,700.0 | | | |
| 0-25 phase 2 transformation * | 386.6 | | | | | -1,250.0 | -1,250.0 | | | |
| Kent Scientific Services - development of toxicology service (increase laboratory space & purchase of specialist instruments) | 181.2 | 18.8 | | | | -14.0 | -15.0 | | -16.0 | |
| LED Street lighting - upgade of luminaires | | | 750.0 | | | -90.0 | | | | |
| Community Learning Service - temporary relocation to Tonbridge site during the development of Tunbridge Wells Cultural Hub | | 0.6 | 199.4 | | | | -15.0 | -21.0 | -3.0 | -2.0 |
| Kent Scientific Services - increase capacity in order to meet demand and secure new income from working with Port Health Authorities exercising control at our borders in testing meat and meat products for levels of veterinary medicines at the point that they enter the food chain | | 16.1 | 10.9 | | | | -25.0 | -22.0 | | |
| Creation of a Charitable Incorporated Organisation for the Area of Outstanding Natural Beauty (AONB) with the prime purpose of raising external funding to support KCC's adopted policies for the AONB and other KCC services | | 5.0 | 9.7 | | -10.0 | -5.0 | -5.0 | | | |
| | | | | | | | | | | |
| | **2,557.5** | **366.5** | **1,038.5** | **-2,700.0** | **-2,732.6** | **-4,059.0** | **-5,010.0** | **-43.0** | **-19.0** | **-2.0** |
| | | **3,962.5** | | | | | | | | |

* This only represents the costs that are funded by capital receipts and not the full cost of the project, however the savings represent the full planned savings

1.5 Table 1 shows project costs of £3.963m. It is proposed that the £1.037m remainder of the £5m capital receipt flexibility for transformation projects is not taken up given the ambitious capital receipts targets needed to fund the capital programme, and that we have a revenue transformation reserve which is adequate to fund existing transformation commitments. This is therefore the final update to County Council on the flexible use of capital receipts for transformation.

Appendix 5

# Investment Strategy

**Introduction**

1.1 This investment strategy meets the statutory guidance issued by the government in January 2018 (Statutory Guidance on Local Government Investments 3rd Edition).

1.2 The Authority invests its money for three broad purposes:
- Because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments),
- To support local public services by lending to or buying shares in other organisations (service investments), and
- To earn investment income (known as commercial investments where this is the main purpose).

1.3 The Investment Strategy focusses on the second and third of these categories. Treasury management investments are covered separately in the Treasury Management Strategy - see Appendix 2.

**Service Investments: Loans**

1.4 As at 31.03.19 the Council had the following amounts outstanding in relation to loans distributed by its own funding:

| Loans in relation to: | Investment Value £ |
|---|---|
| Kent Empty Property Initiative - No Use Empty | 9.0m |
| Marsh Millions | 0.2m |
| Kent PFI Company 1 Ltd | 2.5m |
| Marlowe Theatre | 2.0m |
| Invicta Law | 1.8m |
| **Total service investments - loans** | **15.5m** |

Kent Empty Property Initiative - No Use Empty

1.5 The Council runs a "No Use Empty" initiative, which was set up in 2005 with the aim of returning long term empty properties back into use. This operates as a revolving loan fund and is open to those who currently own or have acquired a long-term empty property which needs financial assistance to bring the property back into use for rental or sale. As at 31 March 2019 the debt due to KCC under the scheme totalled £9.0m. The scheme has been running since 2005 and since then has awarded £33.6m in loans, of which only £143k has been written off as a bad debt. This represents a mere 0.4% of the total loans awarded. The extremely low value of bad debts is aided by the scheme operating a robust application and assessment process, which includes ID checks and proof of additional funds. The applicant must provide at their cost an independent valuation undertaken by a Chartered Surveyor (RICS) to establish current and future values. This is also used within the assessment process as any loan awarded is secured as a charge and registered with Land Registry or Companies House if applicable. Loans are typically offered over 2 or 3 years.

Marsh Millions

1.6 KCC contributed to the Marsh Millions loan scheme. This was set up to aid small businesses in the Romney Marsh area. As at 31.03.19 the balance outstanding to KCC was £0.2m.

Kent PFI Company 1 Ltd

1.7 In 2013-14 KCC purchased loan notes in Kent PFI Company 1 Ltd, which is the holding company to the contractor who runs six schools for KCC under a Private Finance Initiative (PFI) arrangement. As at 31.03.19 the balance outstanding to KCC was £2.5m.

Marlowe Loan

1.8 In 2010-11 KCC loaned £2m to aid the refurbishment of the Marlowe Theatre in Canterbury. Repayments are due to commence in 2020-21.

Invicta Law Ltd

1.9 Invicta Law Ltd is a law firm, wholly owned by KCC. It commenced trading on 1 June 2017. KCC provided a £1.8m working capital loan to aid the start up of this company.

Others

1.10 During 2019-20, two additional loan agreements were drafted, one with EDSECo, trading as The Education People, for £2.2m to aid the start-up of the company and one for Kent Holdco Ltd for £0.5m.

**Service Investments: Shares**

1.11 As at 31.03.19 the Council had the following equity investments:

| **Company** | **Investment Value £** |
|---|---:|
| GEN2 Property Ltd | 1 |
| Kent County Trading Ltd (Commercial Services) | 4.0m |
| Invicta Law Ltd | 2.0m |
| Kent PFI Company 1 Ltd | 1.9m |
| Cantium Business Solutions | 1.9m |
| **Total service investments - shares** | **9.8m** |

1.12 The Council considers each investment on a case by case basis and uses a number of criteria to obtain a risk/benefit analysis for the Council. Overall the value of loans outstanding and equity investments as at 31.03.19 are immaterial in relation to the Council's balance sheet as a whole. The service benefits derived from these investments are deemed to outweigh the risks. The Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue payments.

1.13 During 2019-20 Kent Holdco Ltd was established and the shares that the Council held in Gen2, Cantium Business Solutions and Kent County Trading were all transferred to Kent Holdco Ltd. Any future dividends will come through Kent Holdco Ltd.

**Commercial Investments: Property**

1.14 The Council operates a Property Investment Fund (PIF) which is currently capped at £17m. This was established in 2015-16 the purpose of which is threefold:

- To create a pipeline of capital assets for future disposals to support the capital programme,
- To deliver a return to the Council either through income generation and /or capital growth,
- To support the regeneration and economy in Kent.

1.15 Within the capital programme there is also up to £100m which is set aside for acquisition of strategic assets, which will create an income stream and cover the associated debt costs. Opportunities are considered on a case by case basis with a rigorous investment appraisal process prior to requesting a decision to invest or acquire. Decisions to invest or acquire are made in accordance with the Council's constitution, in particular the Property Management Protocol, and after consultation with the Corporate Director of Finance.

1.16 The following table provides details of the individual properties that meet the definition of investment (as per the Statutory Guidance on Local Government Investments), that were owned by KCC as at 31 March 2019:

| **Property** | **Purchase cost (including fees)** | **Value in accounts as at 31.03.19** |
|---|---:|---:|
| | £m | £m |
| Sheehan House | 0.723 | 1.140 |
| Royal Mail Site | 3.309 | 3.413 |
| Eurogate | 2.275 | 4.621 |
| **Total commercial investments - property** | **6.307** | **9.174** |

1.17 The Royal Mail site is being held for future regeneration purposes. For this reason, the value in the accounts is based on existing use value, rather than fair value, in accordance with CIPFA guidance.

1.18 Towards the end of 2019-20, the Council purchased 2 office buildings at Kings Hill, totalling £23m, which is forecast to provide an income stream over the short to medium term.

1.19 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs, which the table above shows is the case for all such properties.
A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2019-20 year-end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments including any revenue consequences.

1.20 The total value of property investments is immaterial compared to the total asset value on the Council's balance sheet. The Council is not specifically relying on the sale of these assets to fund future expenditure, therefore the risk relating to fluctuations in the property market is minimal.

**Investment Indicators**

1.21 The Council has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions:

1) Total Risk Exposure: the first indicator shows the Council's total exposure to potential investment losses.

| **Total investment exposure** | **31.03.19 Actual £** |
|---|---|
| Service investments: Loans | 15.5m |
| Service investments: Shares | 9.8m |
| Commercial investments: Property | 9.174m |

2) Rate of return received: this indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred. It should be noted that it is not always the Council's aim to achieve the highest rate of return on investments, for example, some loans are given at a rate below market value in order to encourage take up, for regeneration or other service delivery reasons. These are

correctly treated and accounted for as soft loans in the Statement of Accounts.

| **Investments net rate of return** | **2018-19** |
|---|---|
| Service investments: Loans* | 12.0% |
| Service investments: Shares**: | |
| - Kent County Trading Ltd | 0.0% |
| - Kent PFI Co 1 Ltd | 5.8% |
| - Invicta Law | 0.0% |
| - Cantium Business Solutions | 17.9% |
| Commercial investments: Property: | |
| - Eurogate | 12.0% |
| - Royal Mail Site*** | See note below |

*only includes Kent PFI Company 1 Ltd as loans on Empty Property Initiative and Marsh Millions are at 0%, and repayments are not yet due on the loans to the Marlowe Theatre and Invicta Law.

**Rate of return excludes Gen2 as the £1 shareholding is immaterial.

***Royal Mail Site – The short-term strategy was implemented during 2017-18 and continues to generate income to mitigate the site holding costs. It is anticipated that a small surplus will be generated from 2019-20 onwards. The main purpose of this site is for future regeneration rather than rental income.

It is not possible to accurately forecast dividends or asset values for the current or future years, so these have not been included.

3) Other investment indicators:

As the Council's overall investment exposure in relation to service investments – loans, service investments – shares and commercial investments – property, is immaterial, it is not considered necessary to publish any additional investment indicators at this time, but this will be reviewed annually.

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# Capital Programme Strategy

**Introduction**

1.1 The Capital Programme has invested on average £200m per annum over the last three years. The most significant areas of capital investment have been, and continue to be, in schools and highways. In order to provide more stability to services in light of the one-year spending plans from Government, the capital programme now looks at a ten-year planning window, with greater detail in years 1-3.

## Capital Strategy Principles

1.2 The Capital Strategy sets out the strategic direction for KCC's capital management and investment plans and is an integral part of our medium to long term financial and service planning and budget setting process. It sets out the principles for prioritising our capital investment and incorporates requirements from the prudential system. Prudential Indicators which are required under the 2017 Prudential Code are included within the Capital Strategy (see Appendix 1).

1.3 The core principles of the Council's Capital Strategy are as follows:

The Capital Strategy will:

- Be based on delivering the Council's strategic priorities,
- Set out and deliver its statutory responsibilities on a risk-based approach,
- Ensure the capital programme is long term (10 years), deliverable, realistic and affordable,
- Exclude property investments where loans are provided to third parties, such as No Use Empty – these will be considered as part of the Treasury Management Strategy,
- View borrowing as a last resort – affordability across the medium to long term will be key.

1.4 The development of the capital strategy is underpinned by a number of actions that will be undertaken during the year:

- An evaluation matrix based on the priorities agreed by Members will be developed,
- The evaluation matrix will be used to evaluate bids and make recommendations to the Corporate Management Team and Corporate Board,
- A rolling 10-year capital programme will be developed and updated annually,
- The planning and delivery timescales of all capital projects will be reviewed and revised to minimise slippage,

- The monitoring and reporting requirements will be reviewed and revised to provide a council wide position,
- Set up an earmarked fund for feasibilities to ensure more robust estimates and achieve more realistic planning and delivery,
- Set up an earmarked fund for ICT linked to the Technology Strategy and Technology Strategy Board.

**The Council's Strategic Outcomes**

1.5 The Council's strategic outcomes are set out in the *"Increasing Opportunities, Improving Outcomes"* Strategic Statement (2015-2020) and comprise:

a. Children and young people in Kent get the best start in life.
b. Kent communities feel the benefits of economic growth by being in-work, healthy and enjoying a good quality of life.
c. Older and vulnerable residents are safe and supported with choices to live independently.

1.6 As work on the new five-year strategic statement develops for 2020-2025, the capital strategy will be refreshed annually to incorporate this, and the capital programme will continue to be aligned with the 3-year rolling Strategic Delivery Plan.

1.7 Capital investment should also evidence how it will support the priorities and principles set out in significant strategies. The following are examples of the Council's key strategies:

- Kent and Medway Growth and Infrastructure Framework – this sets out the future strategic infrastructure requirements for the county
- Local Transport Plan 4 – this plan sets out strategic transport priorities
- Commissioning Plan for Education Provision – this sets out changes to existing schools and commissioning of new schools
- Kent Environment Strategy – this sets out priorities to support economic growth whilst protecting and enhancing Kent's environment
- ICT Strategy – this sets out how innovation in technology will support the delivery of the Council's strategic priorities outcomes
- Asset Management Strategy – this sets the framework for managing the Council's property portfolio effectively

**Affordability**

1.8 Capital plays an important role in delivering long term priorities as it can be targeted in creative and innovative ways. However, capital is not unlimited or "free money" – capital funding decisions can have significant revenue implications. Every £10m of prudential borrowing costs approximately £0.7m per annum in revenue financing costs (including repayment of the principal) for 25 years, assuming an asset life of 25 years. For Information Technology projects the revenue costs are much higher per annum as the life is shorter. This is in addition to any ongoing maintenance and running costs associated with the investment. The more revenue that is tied up to repay borrowing, the less is available for service provision, and this is considered alongside revenue pressures.

1.9 In assessing affordability, indicators set by the Prudential Code and the Council's own internal set of fiscal indicators need to be considered. The fiscal indicator "net debt costs should not exceed 15% of net revenue spending" is key to capital investment decisions, and should be seen as a ceiling. This indicator was calculated in times of austerity to allow capital investment to continue to avoid significant increases to backlogs in terms of maintenance of highways and structures and of the office estate. As the period of fiscal restraint lengthened the aim was to stay well within this limit. In recent years this indicator has been reducing as a positive result of prudent spending.

1.10 Projects must come forward with alternative options for delivering outcomes, and with a variety of funding options. All projects must be supported by a business case, using the agreed template which captures this information. The business case must also show realistic phasing of the proposed project, with project plans to support this. If a project slips, funding assigned to that project could have been attributed to other worthy projects that were ready to proceed. As stated above, a critical element of the business case is to identify revenue costs and revenue savings as these will be integral to the budget setting process.

**Statutory Requirements**

1.11 The Council will ensure that appropriate capital funding is allocated on a risk based approach, to meet immediate statutory requirements, such as basic need, health and safety, disability discrimination act (DDA) and other legal requirements. Increasingly, it is anticipated that satisfying statutory requirements and avoidance of legal challenges will need to play a more prominent role in capital investment decisions. Nonetheless, whilst there may be a statutory requirement, capital bids will still need to explore alternative options to satisfy the affordability requirement. Capital spend may not always be necessary to achieve the minimum or required outcomes. Funding for capital projects will be applied in the most logical and efficient way, for example, to use specific grants for their intended purpose or time limited funding first, and where grant is not sufficient other sources of external funding will be explored, before using the Council's resources.

**Invest/Spend to save bids**

1.12 Invest/spend to save bids are encouraged as these will be integral to achieving additional savings/income which is increasingly important to ease the pressure on the revenue budget, although not at the expense of meeting the Council's statutory obligations and strategic priorities. Any bids under this category will be rigorously reviewed and challenged to ensure all relevant costs including any costs of borrowing or other revenue impacts have been adequately accounted for and the identified savings are realistically achievable within a reasonable period.

### Enhancement of Existing Estate and Roads

1.13 Maintenance of the estate and highway roads and structures network is coming under increasing pressure following years of reactive works. The development of a longer-term capital planning period will help provide the service with future funding stability and the ability to highlight forthcoming pressures for early consideration by Members. The level of investment in this area will ensure our statutory responsibilities are met, again using a risk-based approach.

## Funding

1.14 There are a variety of different sources of capital funding, each having different implications and risks attached.

### Borrowing

1.15 The Council currently has external borrowing of just under £900m and a further circa £163m of internal debt (including Private Finance Initiative and leases). This results in a Capital Financing Requirement (CFR) of £1.3bn in 2019-20. The Council's fiscal rule is that net debt costs must not exceed 15% of the net revenue budget. The level of borrowing to fund the capital programme must take into account the revenue implications, i.e. for every £10m of borrowing our annual revenue borrowing costs are around £0.7m for 25 years, when considering borrowing the Prudential Code must be taken into account. In line with the Code, borrowing is not undertaken in advance of need. The longer term capital programme planning period will assist in more effective management of borrowing levels over the longer term.

### Grants

1.16 The challenging financial environment means that national government grants are reducing or changing in nature and becoming more heavily prescribed. These prescriptions reduce the freedom to decide where and how to spend grants– they are largely tied to particular areas such as education or highways. An increasing number of funding schemes directly relate to housing and economic growth such as Local Growth Funding (LGF) from Local Enterprise Partnerships (LEPs). This funding is specific to individual projects and has to be closely monitored. The Council's aim is to use other, less specific grants for their intended purpose in a way that meets statutory obligations. Therefore where the grant is not sufficient, other sources of external funding such as Central Government grants and s106/Community Infrastructure Levy (CIL) will be explored first, before using the Council's resources such as capital receipts and borrowing.

**Developer Contributions: Community Infrastructure Levy (CIL)/S106**

1.17 Developer contributions continue to be a challenging issue and need careful consideration when they are put forward to fund major projects. The nature of s106 agreements means that once the total funding figure has been secured with a s106 contract, the funding is received by the County Council in staged payments as the development is built out, with the full funding potentially not received until the development has been fully completed. Depending on size, a development can take several years to be fully completed. Developer contributions will be built into the programme at the point they are secured within s106 agreements, but it must also be recognised that at this point there are still risks around housing development and realisation of the funding. Careful monitoring of expenditure against this funding is critical.

1.18 Any forward funding arrangements of developer contributions must be approved to ensure appropriate debt costs of forward funding are built into the repayments. The repayment schedule must be formalised by being built into the s106 agreement.

1.19 The Government intends to largely replace the use of s106 agreements with the Community Infrastructure Levy (CIL), a flat rate tariff charge. CIL rates are set by districts as the Charging Authorities, they are also responsible for collection and spend of the levy. To date only four districts in the county have adopted CIL, others are at varying stages of introducing CIL although some may choose not to. The share of CIL funding which the Council will receive in the future is unknown and cannot currently be forecast as unlike s106 agreements the money raised through CIL is administered by the district council and KCC does not automatically receive a share.

1.20 The latest regulations on developer contributions have removed the “pooling restriction” which prevented local authorities using more than five section 106 obligations to fund a single infrastructure project. This is a positive move as it will help to unlock funds. However, the monitoring requirements have increased significantly, and revised arrangements will need to be put in place to ensure compliance with the new regulations.

**Capital Receipts**

1.21 The Council has had a rigorous disposal programme over the past few years which has helped to minimise the level of borrowing. Going forward the same level of receipts will not be achievable as the majority of surplus assets have already been sold. Increasingly capital receipts will need to be generated from underutilised assets rather than surplus assets. In some cases this may require additional capital investment to develop these assets which would need to be included and approved on an individual scheme basis as part of refreshing future capital programmes. The Council’s Infrastructure division will continue to work with service directorates and public sector partners to explore options to release property and maximise capital receipts, with a view to creating a sustainable pipeline of funds in the future, through the following initiatives:

- Asset Utilisation Strategy

  In a similar way to New Ways of Working, the Asset Utilisation strategy is aimed at increased utilisation of operational assets in order to generate surplus assets/capital receipts. This is being achieved through a number of initiatives including more efficient and effective ways of working, exploring alternative, more flexible uses of assets and increasing overall utilisation. This programme is dependent on decisions about future local service delivery.

- Kent Estates Partnership (One Public Estate)

  The Council is an active partner in the One Public Estate “Kent Estates Partnership”; other partners include District Councils, and the NHS. The One Public Estate Programme aims to improve the occupational efficiency of buildings and identify surplus assets for disposal which result in economic or regenerative benefits. Funding is available from Central Government through a bidding process which can be used to improve the viability of marginal projects, masterplan and extend scope to include other partners etc. Within its Asset Utilisation and Disposal work streams, the Council now considers opportunities to collaborate within the Kent Estate Partnership as part of its initial appraisal of options and in the event that it identifies financial or operational synergy, explores further the merits of including them within the One Public estate work stream.

- Transformational Reviews

  As the Council transforms to become a commissioning authority, the requirement for publicly owned assets reduces, generating more surplus assets.

- Property Investment Fund

  The Property Investment Fund (comprising PIF I and PIF II), which is part of our current capital programme, aims to achieve a net revenue income and/or to maximise the capital return from various investment opportunities. These may include (but are not limited to) commercial investments, properties/sites where there is potential to add value (e.g. through gaining planning permission prior to disposal) and surplus properties available from public sector partners.
  The Property Investment Fund is currently capped, and any surplus capital generated on the sale of each investment (i.e. after initial acquisition and development costs) is released back to the Council. If the Fund were to reinvest all of its returns, there would be potential to generate more capital and revenue receipts over the longer term. This would also create the opportunity to invest in development opportunities where the returns are higher, although the risks are also increased.

- Strategic Acquisitions

  This strategy also makes provision for the acquisition of strategic assets, where business cases will be subject to approval by external review to ensure that these generate an income stream and will not create a financial burden on the County Council. That is, income streams must cover the total debt costs, including the minimum revenue provision over the medium term, and the short term consequences will have to be reflected in the medium term revenue budget. The external advisors will be appointed by the S151 Officer.

  The approval process and tests that need to be satisfied for the business case to proceed are as follows:

  a) That the rate of return meets the set criteria
  b) That all revenue costs are identified including debt costs and are covered by the income stream
  c) Signed approval of business case by external company review
  d) Sign off by S151 Officer
  e) Sign off by Head of Paid Service
  f) Sign off by Monitoring Officer
  g) Approval through the appropriate formal governance route

  As and when these business cases are agreed, they will be added to the capital programme.

  With financial return being the main objective, the Council accepts higher risk on commercial investment. The principal risk exposures include void periods when properties are empty and falls in capital values. These risks are managed by a rigorous appraisal process prior to any acquisition decision.

- Disposal Strategy

  As part of its disposal strategy the Council has identified that there may be opportunities to further maximise the capital return from its assets through participating in development activity, either directly or through partnering arrangements with third parties. This may include the establishment of joint venture(s) and other company structures.

**Other potential funding sources to be further explored:**

**Business Rates Growth Pool**

1.22 The business rate growth pool which was developed with districts continues to be a success. In 2019-20 the pool enabled an estimated additional £10m to be retained by pool members to support local services and the financial sustainability of individual authorities. 30% of the pool resources were identified to be spent on jointly agreed projects between districts and the County Council to promote future business growth. There is potential for this element of the pool, in agreement with the relevant district, to fund capital projects that support the agreed objectives.

**Public Partnerships**

1.23 The Council has been developing various strategic relationships with other public sector bodies (primarily the NHS through the Sustainability and Transformation Partnership) which have the potential to generate an enhanced capital receipt for the Council, to reduce the Council's requirement for capital and/or to generate income to fund prudential borrowing. The opportunities are varied, but could include the following:

- Enhancing capital gains by utilising the Council's superior covenant strength (with the Council retaining the additional capital receipt).
- Utilising the Council's property experience to enhance the value of surplus land prior to disposal/letting or to dispose of 'less desirable' sites at a profit.
- Linking adjacent land holdings to improve the overall value of the sites.
- Accessing cheaper borrowing (than would otherwise be available) to fund partner's capital projects.
- Entering into joint development projects with the benefit of spreading the risks/costs in order to generating greater gains.
- Funding partners' invest to save projects (and taking a share of the gains).
- Developing joint service initiatives that generate savings (including a reduced requirement for space).
- Removing duplication in services and/or solving joint problems again to generate savings (including a reduced requirement for space).

**Privately Funded Initiatives**

1.24 There are a number of ways in which the Council can work with the private sector to leverage private sector capital funding. The majority of opportunities will involve the Council (or its partners) committing to long term revenue payments in return for the provision of capital assets. This is likely to be more expensive than funding the provision of the asset through prudential borrowing, however this is an important funding source where capital available to the Council is restricted.

1.25 Other opportunities include:

- Using Council funding to subsidise private sector investment. For example, it might be possible to subsidise a project that would otherwise be unattractive to the private sector because the returns are too low. A capital injection from the Council may make the rest of the investment attractive to the private sector. The Council may be able to recover its capital injection over the longer term.

- Partner with the private sector to fund capital projects, potentially on behalf of other public sector bodies, e.g. a hospital. The Council's contribution to the partnership would be low cost borrowing (in return for guaranteed repayments). The Council would expect to share in any returns (commensurate with their contribution).

- PFIs and similar variants. Whilst traditional PFIs (subsidised by PFI credits i.e. revenue funding) are no longer available, there are a number of other similar initiatives, such as Social Impact bonds, that are available to Councils.

1.26 Any such initiatives will need to be considered on their own merits, and the relative value to the Council. This will need to include an assessment of risk to the Council, particularly where the opportunity is over the long term, and of any other impacts on the Council, such as on the partial exemption calculation for VAT.

**Other Sources**

1.27 Where relevant, consideration should be given to other forms of funding that are not traditionally used by Local Authorities, such as variants on crowd funding, levies (such as tolls on roads), bond issues.

## Governance Arrangements

1.28 The governance arrangements for the capital programme are as set out in the Council's constitution.

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