

Capital Strategy Report 2019/20

Introduction

This capital strategy is a new report 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 technical areas.

Capital Expenditure and Financing

Capital expenditure is where the Council spends money on assets, such as property 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/build assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £20k are not capitalised and are charged to revenue in year.

The detail of our approach to capitalisation is shown in our Accounting Policies in the Statement of Accounts that we produce each year.

<https://www.middevon.gov.uk/media/345544/mddc-accounts-2017-18.pdf>

In 2019/20, the Council is planning capital expenditure of £23.711m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2017/18 actual £m	2018/19 forecast £m	2019/20 budget £m	2020/21 budget £m	2021/22 budget £m
General Fund services	4.234	0.978	10.262	12.349	12.009
Council Housing (HRA)	4.227	4.848	8.335	9.310	4.810
*Commercial activities/ non-financial investments	0.062	0.850	5.114	0	0
TOTAL	8.523	6.676	23.711	21.659	16.819

*Commercial activities / non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties etc.

The main capital projects budgeted for in 2019/20 include the following General Fund Schemes: £680k Hydro Mills Electricity Project; £562k Disabled Facilities Adaptations; £5.114m Tiverton Town Hall Development; £2m Waddeton Park (75 Affordable Homes); £5.2m District-wide redevelopment project (£4m 18/19 and

£1.2m 19/20 programmes) and; HRA Schemes: £2.285m for major repairs to Housing Stock; £2m to replace end of life HRA Assets; £2m for Council House building schemes; and £1.5m for the Tiverton Round Hill Site project.

The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately.

Governance: Service managers bid annually to include projects in the Council's capital programme. Bids are collated by Finance who calculate the financing cost (which can be nil if the project is fully externally financed). The relevant PDGs appraise all bids based on a comparison of service priorities against financing costs and makes recommendations to Cabinet. The final capital programme is then presented to Cabinet in February and to Council the same month each year.

➤ For full details of the Council's capital programme see report on this Agenda.

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

Table 2: Capital financing in £ millions

	2017/18 actual £m	2018/19 forecast £m	2019/20 budget £m	2020/21 budget £m	2021/22 budget £m
PWLB Borrowing	0.207		15.556	12.842	10.500
New Homes Bonus	0.979	0.306	0.613	1.577	0.448
Housing Maint Fund	0.278	1.032	2.000	2.000	1.143
Capital Receipts Reserve	2.400	1.456	1.096	1.365	1.064
Other Housing EMRs	2.499	2.324	2.607	2.582	2.582
Capital Grants Unapplied	0.978	0.642	0.951	0.689	0.694
Heritage Enterprise Grant bid			0.600	0.200	0.000
Historic England Grant bid				0.200	0.200
Homes and Communities Agency Grant (HCA)	0.218	0.916		0.000	0.000

Other GF EMRs	0.964		0.288	0.204	0.188
TOTAL	8.523	6.676	23.711	21.659	16.819

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. Planned MRP is as follows:

Table 3: Planned MRP payments £ millions

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
GF - MRP/Revenue	0.354	0.287	0.283	0.422	0.595
HRA - MRP/Revenue	0.977	0.977	0.977	1.030	1.097

- The Council's full minimum revenue provision / loans fund repayments statement is shown in Appendix 1 of the Treasury Management Strategy Statement

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 MRP / loans fund repayments and capital receipts used to replace debt. The CFR is expected to increase by £14.297m during 2019/20. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

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

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
General Fund services	6.311	6.024	13.542	22.620	32.524
Council housing (HRA)	43.166	42.189	43.854	46.166	45.985
Capital investments	0.750	1.610	6.724	6.724	6.724
TOTAL CFR	50.227	49.823	64.120	75.510	85.233

Treasury Management

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

Due to decisions taken in the past, the Council currently has £41.027m borrowing (inc Finance leases) at an average interest rate of c2% and £34m treasury investments at an average rate of 0.9%.

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 the 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%).

Projected levels of the Council's total outstanding debt (which comprises borrowing, and leases are shown below, compared with the capital financing requirement (see above).

Table 5: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Debt (incl. leases)	42.822	41.027	54.738	65.489	73.605
Capital Financing Requirement	50.227	49.823	64.120	75.510	85.233

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 5, the Council expects to comply with this in the medium term.

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

Table 6: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2018/19 limit	2019/20 limit	2020/21 limit	2021/22 limit
Authorised limit – borrowing/lease	59.0	77.0	89.0	98.0
Operational boundary – borrowing/lease	54.0	68.0	80.0	89.0

- Further details on borrowing are in pages 6 to 7 of the Treasury Management Strategy.

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

The Council’s policy on treasury investments is to prioritise security and liquidity over yield, to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with 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, shares and property, 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 7: Treasury management investments in £millions

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Near-term investments	21.0	18.5	20.0	20.0	20.0
Longer-term investments	5.0	5.0	5.0	5.0	5.0
TOTAL	26.0	23.5	25.0	25.0	25.0

- Further details on treasury investments are in the treasury management strategy.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Deputy Chief Executive (S151) and staff, who must act in line with the treasury management strategy approved by Full Council annually. Reports on treasury management activity are presented to Cabinet three times per year.

Investments for Economic Development Purposes

The Council makes investments to assist local public services, including making loans to other public sector bodies and the Council's subsidiary to promote economic development and provide an income stream. 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 profit after all costs, after conducting all appropriate due diligence.

Governance: Decisions on investments of this type are made by the relevant service manager in consultation with the Deputy Chief Executive (S151) and must meet the criteria and limits laid down in the Treasury Management Strategy Statement (TMSS). Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

Commercial Activities

With Central Government financial support for local public services declining, the Council invests in Commercial Property for financial gain and for Economic Development purposes. It lends to its subsidiary 3 Rivers Ltd to develop land and commercial income generating projects. We charge interest on loans to 3 Rivers at a commercial rate.

With economic development being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include the timing of debt repayments; development market values; development costs and profitability of the subsidiary. These risks are managed by due diligence of business cases. Although there is no cap to the level of lending between the Authority and the subsidiary, advance approval of the level of lending is required from Cabinet before the start of each financial year, with reference to the company's Annual Report.

Governance: Decisions on commercial investments are made by the Deputy Chief Executive (S151) in conjunction with the Leadership Team members, in line with the criteria and limits approved by Council in the Treasury Management Strategy Statement. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved alongside the capital programme.

The Council also has commercial activities in retail properties, which expose it to normal commercial risks. The over-arching ethos behind these activities is economic regeneration and retention of premises within the town centre rather than the income stream.

Asset Management

In order to ensure we are allocating our resources in the most effective way, we maintain an Asset Management Plan. The Asset Management Plan (AMP) sets out the Council's approach to the Strategic Management of its land and building assets. It has been developed in consultation with the Senior Officers and members of the Council that form the Capital Strategy Asset Management Group (CSAG). The AMP seeks to ensure that assets are used in the most effective and efficient way to support the delivery of the Corporate Plan. The AMP can be found here. <https://www.middevon.gov.uk/media/343202/20160707amp-2016-2020-cabinet-2.pdf>

The AMP enables us to consider the best use of our assets by identifying those that require investment in planned maintenance; those that we should consider disposal of; those that could generate additional income from leasing out etc. These considerations will then inform our capital programme and funding decisions.

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. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021/22. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £0.361m of capital receipts in the coming financial year as follows:

Table 8: Capital receipts in £ millions

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
Asset sales	3.491	1.876	0.361	0.361	0.361
Loans repaid	0	0	0	0	0
TOTAL	3.491	1.876	0.361	0.361	0.361

- Further details of planned asset disposals are in the attached capital programme.

Liabilities

In addition to debt of £41.027m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £60.009m 2017/18).

Governance: The risk of liabilities crystallising and requiring payment is monitored by Finance and Legal. Any new material liabilities would be reported to Full Council for approval/notification as appropriate.

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and Minimum Revenue Provision (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: Proportion of financing costs to net revenue stream

General Fund	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
Financing costs (£m)	0.153	0.075	0.157	0.661	1.014
Proportion of net revenue stream	2%	0.85%	1.76%	7.15%	10.67%

- Further details on the revenue implications of capital expenditure are found in the attached Revenue Budget report.

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 Deputy Chief Executive (S151) is satisfied that the proposed capital programme is prudent, affordable and sustainable because the Council has adequate means of financing and repaying any required borrowing.

Knowledge and Skills

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Deputy Chief Executive (S151) is a qualified accountant with 15 years' of experience and the Group Manager for Corporate Property and Commercial Assets is experienced across the full range of Property responsibilities. The Council employs eight finance staff who hold one or more of the following qualifications CIPFA, CIMA, ACCA and AAT.

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 Link Asset Services as treasury management advisers and Ichabod Industries as technical advisers on accountancy matters. 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.