Cabinet
18 February 2021

Capital Strategy 2021/22

Cabinet Member: Councillor Andrew Moore, Cabinet Member for Finance
Responsible Officer: Deputy Chief Executive (S151), Andrew Jarrett

Reason for Report: To agree the proposed Capital Strategy for 2021/22.

RECOMMENDATION(S) that Cabinet recommend to Council that:
The proposed Capital Strategy for 2021/22 is approved.

Relationship to the Corporate Plan: A strategic approach to Asset Management supports our Corporate Plan priorities of business retention; growth and development. Maximising our return from all associated treasury activities enables the Council to support current levels of spending in accordance with our Corporate Plan.

Financial Implications: Good financial management and administration underpins the entire strategy.

Legal Implications: Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

Risk Assessment: The S151 Officer is responsible for the administration of the financial affairs of the Council. A co-ordinated approach to Asset Management and Financial Planning will help mitigate the risks associated with holding and utilising assets. Financial risk is mitigated by sound Treasury Management practices and defined limits.

Equality Impact Assessment: No equality issues identified for this report.

Impact on Climate Change: The Council has committed to a net zero carbon policy by 2030. Elements of the capital programme contribute to the achievement of this objective as highlighted below.

1.0 Overview

1.1 The capital strategy for 2021/22, gives 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.

1.2 The strategy is designed to be a user-friendly document which can direct stakeholders to the relevant documents relating to Treasury decisions; Asset Management and the Capital Programme for the coming years. It provides a link between these activities and reiterates the need for these to be co-ordinated to support the objectives of the Corporate Plan.

2.0 **Introduction**

2.1 The capital strategy was first published in 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. The aim of the strategy is to ensure that elected Members fully understand the overall policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

3.0 Capital Expenditure and Financing

3.1 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.

3.2 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/351593/annual-accounts-2019-20.pdf

3.3 In 2021/22, the Council is planning capital expenditure of £35.054m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2019/20 Actual £m	**2020/21 Forecast £m**	**2021/22 Adjusted capital programme* £m**	**2022/23 Adjusted capital programme* £m**	**2023/24 Adjusted capital programme* £m**
Non-HRA	2.046	2.299	7.527	14.047	13.727
HRA	4.006	2.552	11.648	15.498	7.485
Commercial activities/ non-financial investments **	6.146	2.942	15.879	15.969	12.926
Total	**12.198**	**7.793**	**35.054**	**45.514**	**34.138**

**The "Adjusted capital programme" includes the capital programme plus estimated slippage from previous years.*

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

3.4 The main projects in the capital programme in 2021/22 include the following General Fund Schemes: £2.684m Cullompton Town Centre Relief Road (HIF Funded); £2.175m Crediton NHS hub building; various 3 Rivers Developments Limited projects (£6.153m) largely subject to approval of the 3RDL business plan which will be presented to Cabinet 18 February; 3RDLs Riverside Development £2.976m; £4.575m Post Hill (75 Affordable Homes); and HRA Schemes: £3.168m for major repairs to Housing Stock and £2.0m for Council House building schemes.

3.5 The Council has committed to a policy of achieving net zero carbon emissions by 2030. Employment of a Climate Change Co-ordinator is facilitated in the revenue budget to progress projects and opportunities to achieve this objective. Further, the capital programme includes £1.050m of expenditure on schemes directly linked to combating climate change. £250k has been allocated within the HRA to improve housing stock energy efficiency. There is also the hydro mills electricity generation project at Tiverton Weir costing £800k. Providing green electricity for use at the Council's Phoenix House offices; this project will also generate budget savings along with feed in tariff revenue.

3.6 Further, the Council welcomes recent confirmation of £311k grant funding from BEIS to support decarbonisation projects.

3.7 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.

3.8 **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 04/02/21 Cabinet Agenda.

3.9 All capital expenditure must be financed, whether 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

	2019/20 Actual £m	2020/21 Forecast £m	2021/22 Adjusted capital programme * £m	2022/23 Adjusted capital programme * £m	2023/24 Adjusted capital programme * £m
PWLB Borrowing/Internal Borrowing	6.251	2.992	24.455	26.716	21.461
New Homes Bonus	0.194	1.033	1.441	0.863	0.179
Housing Maint Fund	0.746	0.158	1.109	2.536	1.128
Capital Receipts Reserve	0.463	0.395	2.408	1.755	1.638
Other Housing EMRs	2.097	1.793	3.663	2.590	2.585
Capital Grants Unapplied	0.981	0.447	0.799	0.581	0.666
Housing Infrastructure Fund (HIF)	0.132	0.538	0.825	10.315	6.390
Homes and Communities Agency Grant (HCA)	0.734				
Other GF EMRs	0.600	0.437	0.354	0.158	0.091
TOTAL	**12.198**	**7.793**	**35.054**	**45.514**	**34.138**

**The "Adjusted capital programme" includes the capital programme plus estimated slippage from previous years.*

3.10 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. Planned MRP is as follows:

Table 3: Planned MRP payments - £ millions

	2019/20 Actual £m	2020/21 Budget £m	2021/22 Budget £m	2022/23 Budget £m	2023/24 Budget £m
GF – MRP/ Revenue	0.419	0.746	0.781	0.795	0.819
HRA –	0.954	0.963	0.974	0.974	1.004

MRP/Revenue					

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

3.11 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 MRP / loans fund repayments and capital receipts used to replace debt. The CFR is expected to increase by £21.957m during 2021/22. 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

	31/03/2020 actual £m	**31/03/2021 forecast £m**	**31/03/2022 budget £m**	**31/03/2023 budget £m**	**31/03/2024 budget £m**
General Fund services	7.277	9.414	11.874	13.149	18.887
Council housing (HRA)	40.431	39.607	43.406	51.202	52.398
Commercial activities/non-financial investments	8.404	9.564	25.263	39.959	38.301
TOTAL CFR	**56.114**	**58.586**	**80.543**	**104.310**	**109.586**

NB. Of the £22m increase, £9.129m relates to projects undertaken by 3RDL. There is an additional £2.175m relating to the Crediton NHS hub and £4.575m relating to the development of 75 affordable homes at Post Hill.

4.0 Treasury Management

4.1 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.

4.2 Due to decisions taken in the past, at 31/03/21 the Council is forecast to have £39.636m borrowing (inc finance leases) at an average interest rate of 2% and £23m treasury investments at an average rate of 0.05%.

4.3 **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 0.15%) and long-term fixed rate loans where the future cost is known but higher (currently 0.81 to 1.51%).

4.4 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

	31/03/2020 actual £m	**31/03/2021 forecast £m**	**31/03/2022 budget £m**	**31/03/2023 budget £m**	**31/03/2024 budget £m**
Debt (incl. leases)	39.916	39.636	48.638	72.314	80.056
Capital Financing Requirement	**56.114**	**58.586**	**80.543**	**104.310**	**109.586**

4.5 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.

4.6 **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

	2020/21 limit £m	**2021/22 limit £m**	**2022/23 limit £m**	**2023/24 limit £m**
Authorised limit – borrowing/lease	69.0	91.0	115.0	119.0
Operational boundary – borrowing/lease	60.0	82.0	106.0	110.0

- Further details on borrowing are in pages 7 to 10 of the Treasury Management Strategy.

4.7 **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.

4.8 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

	31/03/2020 actual £m	31/03/2021 forecast £m	31/03/2022 budget £m	31/03/2023 budget £m	31/03/2024 budget £m
Near-term investments	20.0	18.0	8.0	8.0	8.0
Longer-term investments	5.0	5.0	5.0	5.0	5.0
TOTAL	**25.0**	**23.0**	**13.0**	**13.0**	**13.0**

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

4.9 **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.

5.0 Investments for Economic Development Purposes

5.1 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 is still planned for such investments to generate a profit after all costs, and after conducting all appropriate due diligence.

5.2 In 2019/20 the Council approved a loan to fund a GP Surgery/NHS Hub in Crediton which is expected to be facilitated in 2021/22. Not only will this provide the Council with a return on its loan, it will also provide an important, modern NHS Hub in Crediton, replacing two existing GP Surgeries and offering further NHS services to the public.

5.3 **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.

6.0 Commercial Activities

6.1 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 RDL to develop land and commercial income generating projects. We charge interest on loans to 3 RDL at a commercial rate.

6.2 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 on 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 Business Plan.

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

6.4 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.

7.0 Asset Management

7.1 In order to ensure we are allocating our resources in the most effective way, we maintain an Asset Management Plan (AMP). The 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 who 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.

7.2 The AMP is under routine review and an updated version will be forwarded to Cabinet for consideration on 4 March. In the meantime, the current version can be found here:

https://www.middevon.gov.uk/media/343202/20160707amp-2016-2020-cabinet-2.pdf

7.3 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.

7.4 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 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 expects to receive £0.900m of capital receipts (net of Pooling) in the coming financial year as follows:

Table 8: Capital receipts in £ millions

	2019/20 actual £m	**2020/21 forecast £m**	**2021/22 budget £m**	**2022/23 budget £m**	**2023/24 budget £m**
Asset sales	2.038	0.750	0.900	0.900	0.900
Loans repaid	0	0	0	0	0
TOTAL	**2.038**	**0.750**	**0.900**	**0.900**	**0.900**

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

8.0 Liabilities

8.1 In addition to debt of £39.636m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £58.765m 2019/20).

8.2 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.

9.0 Revenue Budget Implications

9.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans 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

%	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Non-HRA	-0.13%	2.65%	8.41%	7.46%	8.40%
HRA	15.54%	15.01%	15.10%	14.49%	14.12%

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

9.2 **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.

10.0 Knowledge and Skills

10.1 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 17 years' of experience and the Group Manager for Corporate Property and Commercial Assets is experienced across the full range of Property responsibilities. In addition, the Council employs ten finance staff who hold one or more of the following qualifications CIPFA, ACA, CIMA, ACCA and AAT.

10.2 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.

11.0 Conclusion

11.1 The capital programme for 2021/22 is £17.705m. This is adjusted for slippage carried forward from previous years such that approved capital expenditure in the year is expected to be £35.054m. Slippage occurs due to the size and complexity of capital projects and it can be expected that some projects will similarly slip into future years. Of course, the inactivity caused by Covid precautions has compounded these delays in the current year.

11.2 The capital programme embraces a broad range of expenditure including operational assets which will be used for more than one year; assets owned by other bodies, and loans and grants to other bodies enabling them to buy/build assets.

11.3 Funding for this programme may include borrowing although this is a temporary form of finance as debts must be repaid and so replaced by other means of financing, usually from revenue in the form of the MRP. Borrowing strategy is determined by the need to keep costs low and certain whilst allowing flexibility should plans change.

11.4 The TMSS details the approach that the Council will take to ensuring it has sufficient cash available to meet the Council's spending needs. Surplus cash may be invested although revenue cash surpluses are also offset against capital cash shortfalls to reduce overall borrowing.

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Circulation of the Report: Leadership Team and Cabinet Member for Finance