**Cabinet**
**1 February 2022**

## 2022/23 Capital Strategy

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

**Reason for Report:** To agree the proposed Capital Strategy for 2022/23.

**RECOMMENDATION(S): Cabinet are asked to recommend to Full Council that the proposed Capital Strategy for 2022/23 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. The Capital Strategy set the boundaries in which the Council's capital and treasury management functions operate.

**Legal Implications:** Authorities are required by regulation to prepare a Capital Strategy for each financial year which needs to be approved by the Full Council prior to the start of the financial year. Authorities must also 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:** There are no direct Equality implications arising from 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 within the body of the report.

### 1. Introduction

1.1. The Capital Strategy 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.

1.3. This strategy brings together the statutory requirements of the Chartered Institute of Public Finance Accountants (CIPFA) and the CIPFA Prudential Code for Capital Finance in Local Authorities. There is also a strong link with the Treasury Management Strategy that provides a framework for the borrowing and lending activity of the Council.

1.4. The Capital Strategy needs to be relevant in the current financial and economic climate and therefore needs a cautious and measured, yet flexible, approach that reflects the fact that:

- Revenue resources have, and will be, cut significantly in each of the forthcoming financial years. The impact on the Revenue Budget arising from the Capital Investment Programme must be affordable and sustainable, and be used to aid the bottom line;
- Capital resources available to the Council are limited, with little direct funding provided from Government and currently limited scope to raise income from Capital Receipts;
- Local Government's range of responsibility is constantly changing along with the role that it plays within the community, leading to an expectation that Society will assist in the delivery of services.

1.5. The Council is required, by regulation, to publish a number of indicators relating to the Capital Investment Programme, Treasury Management and the revenue implications of the programme, known as the Prudential Indicators. This report, along with the Treasury Management Strategy, publishes those indicators, based on the assumption that Cabinet / Council will approve the proposals contained within the Revenue Budget and Capital Programme.

## 2. Strategic Aims

2.1. The key objective of the Capital Strategy is to deliver a Capital Programme that:

- Ensures that the Council has assets that are fit for purpose and enable the delivery of the priorities set out in the Corporate Plan;
- Supports the Council's service specific plans and strategies;
- Facilitates income generation that aids the revenue budget;
- Is affordable, financially prudent and sustainable.

This should not however prevent the authority from:

- Reducing the on-going liability of holding assets by engaging with communities to develop alternative service delivery options including asset transfer;

- Fully utilising resource opportunities available for Capital Investment from outside sources where this does not create ongoing revenue liabilities or commitments that cannot be met.

## 3. Priorities

3.1. The Council's priority areas for investment can be summarised as:

3.1.1. **Asset replacement and/or enhancement**: The services delivered by the Council depend upon a variety of assets such as computers, equipment or vehicles. These need to be updated/upgraded on a regular basis to ensure service delivery is maintained or enhanced. Asset maintenance is a revenue cost; the purchase or enhancement is a capital cost.

3.1.2. **Income Generation:** The Council is looking to identify investments that generate an income to replace the lost grant funding and ease the pressure on the Revenue Budget. Specific projects / investment opportunities will be brought forward for approval by the Cabinet as they are identified.

3.1.3. **Economic Regeneration:** The Council is committed to investing in the District's future through regeneration projects. Any schemes will need to be self-financing so that borrowing costs are covered by either Grant, investment income or capital receipts, so that there is no impact on the Council's revenue budget.

3.1.4. **Invest to save**: The Council is always looking for opportunities to deliver future efficiencies in service provision, known as 'Invest to Save'. This could include investment in technology or processes. The "green" investments are a good example of this, where investment in more efficient heating systems reduces the ongoing cost of energy consumption.

3.1.5. **Health and Wellbeing:** The Council's receives the Disabled Facilities scheme, which pays for essential housing adaptations to help disabled people stay in their own homes. In the current climate, it is also important that the Council plays wider role in the health and wellbeing of its local community.

## 4. Capital Expenditure and Financing

4.1. 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 deemed deminimis and are not capitalised but are instead charged to revenue in-year.

4.2. The detail of our approach to capitalisation is shown in our Accounting Policies in the Statement of Accounts that we produce each year. The latest approved Accounts are for the year 2020/21 and can be found here:

https://www.middevon.gov.uk/your-council/finance/annual-accounts/

4.3. 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.

4.4. In 2022/23, the Council is planning new capital expenditure of £34,303k as well as £23,239k of expenditure approved in prior years that has slipped in timescale, as detailed within the Capital Programme included elsewhere on the meeting agenda. It can be summarised as follows:

*Table 1: Prudential Indicator: Estimates of Capital Expenditure*

| **Estimates of Capital Expenditure** | **2020/21 Actual Capital Spend £K** | **2021/22 Forecast Capital Spend £K** | **2022/23 Proposed Capital Spend £K** |
|---|---|---|---|
| General Fund Projects | 3,099 | 7,353 | 19,166 |
| HRA Projects | 2,637 | 5,469 | 18,378 |
| Loans To Subsidiary Company | 1,318 | 5,761 | 19,998 |
| **TOTAL** | **7,054** | **18,583** | **57,542** |

4.5. The main projects in the Capital Programme in 2022/23 include the following:

4.5.1. General Fund Schemes:

- £13,054k investment in Infrastructure projects in Tiverton and Cullompton. Funding is actively being sought to enable the Tiverton project to be delivered;
- £3,534k investment in Housing Developments through 3 Rivers, in line with their Business Plan approved by Cabinet in November;
- £577k investment in essential housing adaptations to help disabled people stay in their own homes funded through the Disabled Facilities Grant;
- £420k further investment in the hydro mills electricity generation project at Tiverton Weir that will provide green electricity at the Council's Phoenix House offices (note £800k will slip from 2021/22).

4.5.2. HRA Schemes[1]:

- £2,465k investment to enhance the quality of our existing housing stock are undertaken each year through the planned maintenance scheme;
- £8,514k investment in Housing Developments to deliver new housing within the district in the main through highly efficient (zero carbon) modular buildings. A prudent assumption has been included for the utilisation of 1-4-1 receipts or for additional grant funding to be made available from Homes England.

4.6. 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).

4.7. Borrowing may be internal or external:

4.7.1. **Internal borrowing** uses the cash balances of the Council. Currently, these balances yield small returns on the market and is therefore cheaper than the interest rate payable on an external loan and so is maximised as far as possible. This has been a significant funding source in recent years.

4.7.2. **External borrowing** is via loans. Within Local Government the main provider for long term borrowing has traditionally been the Public Works Loan Board [PWLB]. However, the Council also uses other organisations, such as other Local Authorities for shorter term requirements.

4.8. An increasing number of assets are leased, such as the new vehicles within our fleet. These are normally taken through Finance Leases where the asset remains owned by the finance company, but the Council rents them.

4.9. The planned financing of the above expenditure is as follows:

[1] 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.

*Table 2: Capital financing*

| Capital Financing | 2020/21 Actual Capital Spend £K | 2021/22 Forecast Capital Spend £K | 2022/23 Proposed Capital Spend (Incl Projected Slippage from 2021/22) £K |
|---|---|---|---|
| PWLB / Internal Borrowing | 2,287 | 11,251 | 32,642 |
| New Homes Bonus | 874 | 246 | 1,414 |
| Housing Maintenance Fund | 225 | 922 | 316 |
| Capital Receipts Reserve | 376 | 1,941 | 1,922 |
| Other Housing EMRs | 2,073 | 2,615 | 3,564 |
| Capital Grants | 471 | 400 | 920 |
| Housing Infrastructure Fund (HIF) | 446 | 917 | 6,465 |
| Levelling Up or Similar * | | | 6,436 |
| Homes England Grant | 0 | 0 | 3,031 |
| Other GF EMRs | 193 | 241 | 832 |
| S106 | 109 | 50 | 0 |
| **TOTAL** | **7,054** | **18,583** | **57,542** |

*Bid failed – now seeking alternative funding to make Cullompton HIF viable

4.10. 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.

4.11. The Council's full Minimum Revenue Provision / loans fund repayments statement is shown in Appendix 1 of the Treasury Management Strategy Statement. This strategy is also included elsewhere on the meeting agenda. Planned MRP is as follows:

*Table 3: Planned MRP payments*

| ***Planned MRP Payments*** | 2020/21 Actual £K | 2021/22 Forecast £K | 2022/23 Proposed Budget £K |
|---|---|---|---|
| *General Fund* | 703 | 742 | 687 |
| *HRA* | 958 | 964 | 981 |
| ***Total*** | **1,661** | **1,706** | **1,668** |

4.12. 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 £19,251k during 2022/23. Within this increase, £7,912k relates to projects undertaken by 3 Rivers Developments Ltd. There is an additional £5,417k relating to the development of 75 affordable homes at Post Hill and £4,249k relating to other HRA projects. 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*

| Estimates of Capital Financing Requirement | 2020/21 Actual £K | 2021/22 Forecast £K | 2022/23 Proposed Budget £K |
|---|---|---|---|
| **General Fund Services** | 9,336 | 13,337 | 15,853 |
| **Council Housing (HRA)** | 39,550 | 39,606 | 48,429 |
| **Loans To Subsidiary Company*** | 8,959 | 13,533 | 21,445 |
| Total CFR | **57,846** | **66,476** | **85,727** |

** Loans To Subsidiary Company investments relate to capital expenditure on housing developments and investment properties.*

4.13. At present, the Council does not charge MRP on it loans to 3 Rivers. This is because it funds assets that are under construction – to which MRP does not apply. Once the assets are complete and MRP would normally become chargeable, they are sold by 3 Rivers and the loan is repaid. However, CIPFA is out to consultation at this time to enforce MRP to be applicable on loans to third parties, despite the regulations around "assets under construction". If formally implemented, this will apply from 2023/24.

## 5. Treasury Management

5.1. Treasury Management is concerned with keeping sufficient, but not excessive cash, available to meet the Council's spending needs, while managing the risks involved. To avoid excessive credit balances or overdrafts in the bank current account, surplus cash is invested until required while a shortage of cash will be met by borrowing. 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.

5.2. Due to decisions taken in the past, at 31 March 2022 the Council is forecast to have £35,234k of borrowing (excluding finance leases) at an average interest rate of 2.91% and £27,000k treasury investments earning interest at an average rate of 0.30%.

5.3. **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 0.50%) and long-term fixed rate loans where the future cost is known but higher (currently 1.74% to 2.46%[2]).

5.4. 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).

[2] As at the time of drafting this report – 14 January 2022

*Table 5: Prudential Indicator: Gross Debt and the Capital Financing Requirement*

| Gross Debt and the Capital Financing Requirement | 2020/21 Actual £K | 2021/22 Forecast £K | 2022/23 Proposed Budget £K |
|---|---|---|---|
| Debt (Incl. Leases) | 39,541 | 37,404 | 46,668 |
| Capital Financing Requirement | 57,846 | 66,476 | 85,727 |

*5.5.* 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 2022/23.

5.6. **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. Further details on borrowing are included with the Treasury Management Strategy, which is also included elsewhere on the meeting agenda.

*Table 6: Prudential Indicators: Authorised Limit and Operational Boundary for external debt*

| Authorised Limit and Operational Boundary For External Debt | 2020/21 Limit £K | 2021/22 Limit £K | 2022/23 Limit £K |
|---|---|---|---|
| Authorised Limit | 69,000 | 77,000 | 96,000 |
| Operational Boundary | 60,000 | 68,000 | 87,000 |

5.7. **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.

5.8. 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. Further details on treasury investments is included within the Treasury Management Strategy, but can be summarised as follows[3]:

[3] As at the 31 March of the appropriate year

*Table 7: Treasury Management investments*

| Treasury Management Investments | 2020/21 Actual £K | 2021/22 Forecast £K | 2022/23 Proposed Budget £K |
|---|---|---|---|
| Near-Term Investments | 17,500 | 26,000 | 16,000 |
| Longer-Term Investments | 5,000 | 5,000 | 5,000 |
| **TOTAL** | **22,500** | **31,000** | **21,000** |

5.9. **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.

## 6. Investments for Economic Development Purposes

6.1. 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 a requirement for such investments to generate a profit after all costs, and after conducting all appropriate due diligence.

6.2. For example, during 2021/22, the Council facilitated a loan to fund a GP Surgery/NHS Hub in Crediton. 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.

6.3. **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.

## 7. Commercial Activities

7.1. With Central Government financial support for local public services declining and the tightening of regulations within the Prudential Code that prohibits the Council from investing primarily for financial return, the options for the Council to invest in Commercial and for Economic Development purposes is limited. However, it is able to lend to its subsidiary 3 Rivers Developments Ltd to develop land and commercial income generating projects and charge interest on loans at a commercial rate.

7.2. 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.

7.3. **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 (TMSS). Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved alongside the capital programme.

7.4. 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.

## 8. Asset Management

8.1. In order to ensure we are allocating our resources in the most effective way, we maintain an Asset Management Plan (AMP). It outlines where capital investment can assist the Council achieve its goals or where investment and use of resources plays a contributing role to shared priorities. Therefore the AMP helps set 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.

8.2. The latest version of the AMP was considered and approved by Cabinet on 4 March 2021. It can be found here:

https://democracy.middevon.gov.uk/ieListDocuments.aspx?CId=133&MId=1265&Ver=4

8.3. The AMP enables the Council 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 the Capital Programme and funding decisions.

8.4. **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. During the 2021/22 Finance Settlement, Government announced a 3-year extension from 2022-23 onwards of the existing flexibility for councils to use capital receipts to fund transformation projects that produce long-term savings or reduce the costs of service delivery. Repayments of Capital Grants, loans and investments also generate Capital Receipts. The Council expects to receive £1,027k of Capital Receipts (net of Pooling) in the coming financial year as follows:

*Table 8: Capital Receipts*

| **Capital Receipts** | **2020/21 Actual £K** | **2021/22 Forecast £K** | **2022/23 Proposed Budget £K** |
|---|---|---|---|
| Asset Sales | 730 | 2,146 | 1,027 |
| Loans Repaid | 0 | 0 | 0 |
| **TOTAL** | **730** | **2,146** | **1,027** |

## 9. Liabilities

9.1. In addition to debt of £46,668k in 2022/23 detailed in Table 5 above, the Council is committed to making future payments to cover its pension fund deficit (valued at £75,401k in 2020/21).

9.2. **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.

## 10. Revenue Budget Implications

10.1. 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 Capital 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*

| **Proportion Of Financing Costs To Net Revenue Stream** | **2020/21 Actual £K** | **2021/22 Forecast £K** | **2022/23 Proposed Budget £K** |
|---|---|---|---|
| NON-HRA | 0.79% | 2.18% | 0.98% |
| HRA | 15.07% | 15.15% | 14.90% |

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

10.2. **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the Revenue Budget implications of capital 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.

## 11. Knowledge and Skills

11.1. 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 Corporate Manager for Property, Leisure & Climate Change 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.

11.2. To support those staff, 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.

## 12. Conclusion

12.1. The Capital Programme for 2022/23 is £34,303k. This will be adjusted for slippage carried forward from previous years that will be approved with the outturn report; the slippage for 2021/22 is currently forecast to be £23,239k. 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-19 precautions has compounded these delays over the past couple of years.

12.2. The Capital Programme encompasses 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.

12.3. Funding for this programme may include significant borrowing. The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken, and the type of borrowing should allow the Council transparency and control over its debt.

12.4. The Treasury Management Strategy Statement details the approach that the Council will take to ensuring it has sufficient cash available to meet the Council's spending needs. Reports on treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close, will be taken to Full Council via the Cabinet.

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| **Circulation of the Report:** | Leadership Team, Cabinet |
| **Background Papers:** | October, November & January Cabinet & PDG's (MTFP, Budget Draft and Budget Update reports) |