South Derbyshire District Council

Capital Strategy

2024/25 – 2028/29

Introduction

This capital strategy report 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. It has been written in an accessible style to enhance members' understanding of these sometimes-technical areas.

Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

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 assets. The Council has some limited discretion on what counts as capital expenditure, for example Property assets costing below £10,000 and vehicles below £5,000 are not capitalised and are charged to revenue in year.

In 2024/25, the Council is planning capital expenditure of £9.8m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure (£)

	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget	2028/29 Budget
General Fund services	3,355,210	4,402,138	4,035,387	1,393,000	1,030,000	695,000	685,000
Council housing (HRA)	2,456,166	2,432,186	3,119,676	3,500,000	4,630,000	4,200,000	4,300,000
Capital investments	665,585	340,420	2,650,000	2,424,000	1,850,000	52,500	0
TOTAL	**6,476,961**	**7,174,744**	**9,805,063**	**7,317,000**	**7,510,000**	**4,947,500**	**4,985,000**

The main General Fund capital projects include revitalising Rosliston Forestry Centre (£832K total project funding), which is still an ongoing project from the 2020 capital bidding round. Delays on this project have been due to public consultations, however it is expected that this project will complete in the new financial year.

There are also several new capital projects approved as part of the 2024/25 budget round. These include a new fleet replacement programme (£7.257m), play area refurbishments (£1.283m) and a new events space (£1.7m). Further smaller projects include, cemetery and green space infrastructure replacement (£660k), shop front replacements (£55k), and new air conditioning and lighting at community centres (£35k).

Sources of funding for these projects (as outlined in the table below) include capital contributions, revenue contributions, internal borrowing, and external funding. The Council was awarded £1.108m of levelling up funding to invest in Swadlincote town centre which has been used to compliment the programme of works.

General Fund Services include the funding received from Derbyshire County Council for the delivery of projects through the Better Care Fund and the BCF Assurance Plan.

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. The Council has a programme of funding major improvements under self-financing to its current housing stock.

Governance: In previous years Heads of Service could only bid for capital expenditure when capital funds had been identified as available.

In September 2023, consultations for setting the 2024/25 budget were held with each policy committee for approval. The report outlined key principles to develop budget proposals and stated that capital growth will be considered based on need and innovation.

Under the new approach, Heads of Service bid annually in September 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 bids are then scrutinised by Senior Leadership team, based on a comparison of corporate priorities and financing costs, and makes recommendations to Finance and Management committee as part of the consolidated draft budget in November. The final capital programme is then presented to Finance and Management Committee and to Full Council in February each year.

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 (£)

	2022/23 Actual	**2023/24 Forecast**	**2024/25 Budget**	**2025/26 Budget**	**2026/27 Budget**	**2027/28 Budget**	**2028/29 Budget**
External sources	2,906,199	2,924,000	2,348,000	820,000	400,000	400,000	400,000
Capital resources	532,052	1,244,362	727,828	355,800	536,000	10,625	0
Revenue resources	3,038,710	3,006,382	5,602,235	4,045,728	4,134,000	4,285,000	4,385,000
Internal Borrowing	0	0	1,127,000	2,095,472	2,440,000	251,875	200,000
Debt	0	0	0	0	0	0	0
TOTAL	**6,476,961**	**7,174,744**	**9,805,063**	**7,317,000**	**7,510,000**	**4,947,500**	**4,985,000**

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 the **Minimum Revenue Provision (MRP**). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance.

MRP represents the minimum amount that must be charged to a Council's revenue account each year for financing of capital expenditure, which will have initially been funded by borrowing.
MRP is important for prudent accounting because it allows a Council to put aside an amount of revenue that can be used towards the capital expenditure that was previously financed through either borrowing or credit.

The Council currently uses the Regulatory method to calculate MRP and the Regulatory method is charged at 4% of the Council's underlying need to borrow for capital purposes, i.e. the Capital Financing Requirement (CFR). However, the Council has explored a more prudent approach to the way is calculates it's MRP by using an annuity method. The details have been outlined in the MRP 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 £1.09m during 2024/25. 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 (£'000)

	2022/23 Actual	**2023/24 Forecast**	**2024/25 Budget**	**2025/26 Budget**	**2026/27 Budget**	**2027/28 Budget**	**2028/29 Budget**
General Fund services	6,860	6,822	7,909	9,948	11,682	11,464	11,163
Council housing (HRA)	51,584	41,584	41,584	41,584	42,025	41,971	41,914
Capital Financing Requirement	58,444	48,406	49,493	51,532	53,707	53,435	53,077

The relevant Prudential Indicators for the capital programme are detailed in the Treasury Management Strategy

Asset management: To ensure that capital assets continue to be of long-term use, the Council has a Corporate Asset Management Plan in place. The Corporate Asset Management Plan seeks to align the Council's non-housing property assets to the corporate objectives. The Plan covers the assets under the Corporate Property Section's management and control, and sits alongside the Housing Asset Management Strategy 2016-46, with the latter addressing the management, regeneration and identification of surplus assets held under the Housing Revenue.

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 "flexibly" on service transformation projects until 2025/26.

Capital grants, loans and investments also generate capital receipts. The Council's known capital receipts in the coming financial years are as follows:

Table 5: General Capital receipts (£'000)

	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget	2028/29 Budget
Asset sales	589	806	612	612	612	612	612
Land Sales	196	0	0	0	0	0	0
TOTAL	**785**	**806**	**612**	**612**	**612**	**612**	**612**

Land sales have been achieved through collaboration with adjacent landowners. The deal secured ransom values from third parties and achieved optimum value through the joint master planning of large sites which are attractive to major housebuilders. The last of the planned receipts was paid in 22/23. Asset sales will be achieved through the predicted right to buy receipts.

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 Current Account.

The Council is currently cash rich in the short-term as revenue income is received before it is spent, but potentially 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 £47.512m borrowing at an average interest rate of 3.19% on fixed term borrowing. Treasury investments total £79m at an average rate of 3.81% (long term investment) and 5.10% in short term investments.

Borrowing strategy: The Council's main objectives of 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 and long-term fixed rate loans where the future cost is known but higher.

The Council does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board.

Projected levels of the Council's total outstanding debt are shown below, compared with the capital financing requirement.

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement (£'000)

	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget	2027/28 Budget
Council housing (HRA)	47,423	37,423	37,423	37,423	27,423	27,423	27,423

Capital Financing Requirement (HRA)	51,584	41,584	41,584	41,584	42,025	41,971	41,914

Statutory guidance is that 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.

Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £10m at each year-end. This benchmark is currently -£8.03m and is forecast to drop to £11.3m over the next three years.

Table 7: Borrowing and the Liability Benchmark in (£'000)

	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget	2028/29 Budget
Forecast borrowing	47,423	37,423	37,423	37,423	27,423	27,423	27,423
Liability Benchmark	-7,994	-2,784	4,120	11,346	18,559	24,335	28,758

The table shows that the Council expects to remain borrowed below its liability benchmark in the medium term. This is because cash inflows to date have been above the assumptions made when the loans were borrowed and there has been no requirement for additional sums.

However, as balance sheet resources are utilised to cover expenditure and the liability benchmark increases, there maybe a need to borrow in the longer 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. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 8: Prudential Indicators: Authorised limit and operational boundary for external debt (£'000)

	2022/23 limit	2023/24 limit	2024/25 limit	2025/26 limit	2026/27 limit	2027/28 limit	2028/29 limit
Authorised limit – borrowing GF	6,860	6,822	7,909	9,948	11,682	11,464	11,163
Authorised limit – borrowing HRA	51,584	41,584	41,584	41,584	42,025	41,971	41,914
Authorised limit – total external debt	58,444	48,406	49,493	51,532	53,707	53,435	53,077

Operational boundary – borrowing	52,423	42,423	42,423	42,423	32,423	32,423	32,423
Operational boundary – total external debt	52,423	42,423	42,423	42,423	32,423	32,423	32,423

Further details on borrowing are detailed in the Treasury Management Strategy

Treasury Investment strategy: Treasury investments arise from receiving cash before it is expended. 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, i.e., 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 with the CCLA Property Fund 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 9: Treasury management investments (£'000)

	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget	2028/29 Budget
Near-term investments	61,845	46,207	39,303	32,077	14,864	9,388	5,165
Longer-term investments	3,572	4,000	4,000	4,000	4,000	4,000	4,000
TOTAL	**65,417**	**50,207**	**43,303**	**36,077**	**18,864**	**13,388**	**9,165**

Forecast totals represents the difference between the liability benchmark and borrowing in table 7 plus the minimum investment balance built into the liability benchmark.

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.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Strategic Director (Corporate Resources), Head of Finance and staff, who must act in line with the Treasury Management Strategy approved by the Finance and Management Committee. Quarterly reports on treasury management activity are presented to the Finance and Management Committee. The Council's Audit Sub-Committee is responsible for scrutinising the Treasury Management Framework in response to Auditor's reports.

The Councils borrowing and investment strategies are detailed in the Treasury Management Strategy

Investments for Service Purposes

The Council makes investments to assist local public services including making grants and loans to local service providers, local small businesses to promote economic growth and the Council's partnerships that provide services.

Risk Management: 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 break-even/generate a profit after all costs.

Governance: Decisions on service investments are made by the relevant service manager in consultation with the Strategic Director (Corporate Resources) and must meet the criteria and limits laid down in the Non-Treasury Investment Strategy which is to be updated. Any loans and shares entered into are capital expenditure and purchases will therefore also be approved as part of the capital programme. The Strategic Director (Corporate Resources) is responsible for ensuring that adequate due diligence is carried out before investment is made.

The Council has no plans to make any material investment in services in the medium term.

Commercial Activities

With central government financial support for local public services declining, the Council previously invested in commercial property purely or mainly for financial gain with financial return being the main objective. In these cases, higher risks are accepted on commercial investment than with treasury investments.

Risk management: With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments.

Governance: Decisions on commercial investments are made by the Strategic Director (Corporate Resources) in line with the criteria and limits approved by Finance and Management Committee in the Treasury Management Strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

The Council has a small portfolio of commercial properties which are held to earn rentals and/or for capital appreciation. The following table shows the proportion of income from commercial properties to the net revenue of the Council. The estimated decline in income is due to the uncertainty around the letting of bespoke factory premises.

The Council currently has no plans over the medium term to invest in any new commercial activities and follows its non-treasury investment strategy for lower risk returns on surplus funds.

Table 10: Prudential indicator: Net income from commercial and service investments to net revenue stream.

	2022/23 Actual	**2023/24 Forecast**	**2024/25 Budget**	**2025/26 Budget**	**2026/27 Budget**	**2027/28 Budget**	**2028/29 Budget**

Net Income from Commercial and Service Investments to net revenue stream	729,199	738,029	701,997	704,937	707,966	711,085	714,297
Proportion of net revenue stream	2.35%	2.53%	2.26%	2.31%	2.30%	2.29%	2.27%

Liabilities

In addition to debt of £47.423m detailed previously, the Council is committed to making future payments to cover its pension fund deficit. It has also set aside £0.649m to cover risks of appeals against planning and NNDR decisions. No contingent liabilities are currently in place at the Council.

Governance: Decisions on incurring new discretional liabilities are taken by Service Mangers in consultation with the Strategic Director (Corporate Resources) and Head of Finance. The risk of liabilities crystallising and requiring payment is monitored by the Head of Finance and reported quarterly to Finance and Management Committee. New liabilities exceeding the materiality threshold are reported to Full Council for approval/notification as appropriate.

Further details on liabilities and guarantees are on pages 60 and 71 to 76 of the draft 2022/23 Statement of Accounts

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP/ loan fund repayments 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. The table below illustrates the cost of the HRA debt to rental income.

Table 11: Prudential Indicator: Proportion of financing costs to net revenue stream.

	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget	2028/29 Budget
Financing costs £m	1,505	1,505	802	802	802	501	501
Proportion of net revenue stream	12.15%	11.69%	5.74%	5.83%	5.69%	3.47%	3.39%

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 far into the future. The Strategic Director (Corporate Resources) is satisfied that the proposed capital programme is prudent, affordable, and sustainable due to the fact that all business cases and plans for expenditure have been submitted and formally approved following strict governance arrangements before funding is made available.

Investments will be measured using appropriate project appraisals such as NPV (net present value) and direct annual revenue effects will also be considered when assessing affordability. A robust system is in place to ensure that due regard is paid to the Code of Practice on a Prudential Approach to Local Council Commitments in preparing the Capital Programme.

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 Head of Finance is a qualified accountant, the Head of Corporate Property is a qualified Chartered Surveyor, and the Committee are advised by the Section 151 Officer (Chief Finance) Officer who is the Strategic Director (Corporate Resources).

The day-to-day operational responsibility of the Capital Programme is undertaken by the Chief Accountant in the Financial Services Unit at the Council. The Council pays for junior staff to study towards relevant professional qualifications including AAT, CIPFA, ACCA and CIMA for continued professional development and business continuity.

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. This approach is considered to be more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.