



**South
Derbyshire
District Council**

Capital Strategy 2020/21 – 2024/25

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 Authority 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.

The principal aim is to deliver an affordable programme of capital investment consistent with the Council's financial strategy and that contributes to the achievement of the Council's priorities and objectives as set out in the Medium-Term Financial Plan.

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 Authority 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 2021/22, the Council is planning capital expenditure of £6.3m as summarised below:

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

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
General Fund services	735,128	4,042,582	3,071,896	683,072	740,420	1,484,814
Council housing (HRA)	3,230,092	5,042,905	2,719,673	2,470,000	2,182,186	2,477,000
Capital investments		1,808,159	548,527	508,473	186,000	85,000
TOTAL	3,965,220	10,893,646	6,340,096	3,661,545	3,108,606	4,046,814

The main General Fund capital projects include revitalising Rosliston Forestry Centre (£808K), Oversetts Road Football Facility (£1.188m) and the renovation of Melbourne Assembly rooms (£260K), there are also several small projects that have been approved, totalling 14 new capital projects for inclusion in the capital programme.

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 and includes the building of 21 new homes over the next two financial years. The Council has a programme of funding major improvements under self-financing to its current housing stock.

Governance: Heads of Service submit bid's when capital funds are identified as available, to include projects in the Council's capital programme. Bids are collated and scored the financing cost is calculated (which can be nil if the project is fully externally financed). The bids are appraised in accordance with the approved Capital Evaluation Framework. All bids are based on a comparison of service priorities against financing costs and makes recommendations to Finance and Management Committee. The final capital forecast is then presented to Finance and Management Committee in February each year. The capital programme is monitored quarterly and reported to members at the Finance and Management Committee.

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 (£)

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
External sources	824,203	3,080,850	1,728,440	423,072	400,000	400,000
Capital resources	1,151,515	3,757,300	1,202,425	521,473	149,186	624,814
Revenue resources	1,989,502	4,055,496	3,409,231	2,717,000	2,559,420	3,022,000
Debt	0	0	0	0	0	0
TOTAL	3,965,220	10,893,646	6,340,096	3,661,545	3,108,606	4,046,814

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)** / loans fund repayments. 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 an 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 an authority 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 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).

Table 3: Replacement of debt finance (£)

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
Capital resources	1,151,515	3,757,300	1,202,425	521,473	149,186	624,814
Revenue resources	1,989,502	4,055,496	3,409,231	2,717,000	2,559,420	3,022,000
Total	3,141,017	7,812,796	4,611,656	3,238,473	2,708,606	3,646,814

The General Fund does not currently have any actual debt outstanding and its underlying borrowing requirement is financed from reserves and balances.

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. On 31st March 2020, the Authority had net borrowing (after allowing for investments) of £7.69m arising from its revenue and capital income and expenditure, a decrease on 2019 of £4.22m.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). Actual CFR versus budgeted CFR is summarised below.

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement (£'000)

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
General Fund services	4,988	4,667	4,409	4,214	4,026	3,871
Council housing (HRA)	61,584	61,584	51,584	51,584	41,584	41,584
TOTAL CFR	66,572	66,251	55,993	55,798	45,610	45,455

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 on service transformation projects until 2022/23.

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)

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
Asset sales	752	727	724	720	615	612
Land Sales	1,497	792	705	0	0	0
TOTAL	2,249	1,519	1,429	720	615	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 is due in 21/22. 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 £57.541m borrowing at an average interest rate of 3.19% on fixed term borrowing and 0.88% on variable rate borrowing. Current Treasury investments total £71m at an average rate of 5.20% (long term investment) and 0.19% in short term investments.

Borrowing strategy: The Council’s main objectives if 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 0.10%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5 to 2.5%).

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)

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
General Fund Services	4,988	4,667	4,409	4,214	4,026	3,871
Council housing (HRA)	61,584	61,584	51,584	51,584	41,584	41,584
Capital Financing Requirement	66,572	66,251	55,993	55,798	45,610	45,455

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 £57,423m at each year-end. This benchmark is currently £66,572m and is forecast to fall to £45,455m over the next five years.

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

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
Outstanding borrowing	57,423	57,423	47,423	47,423	37,423	37,423
Liability benchmark	66,572	66,251	55,993	55,798	45,610	45,455

The table shows that the Council expects to remain below its liability benchmark. 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. The Council has adopted a prudent approach to its finances and its borrowing requirements.

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)

	2020/21 limit	2021/22 limit	2022/23 limit	2023/24 limit	2024/25 limit
Authorised limit – borrowing GF	4,667	4,409	4,214	4,026	3,871
Authorised limit – borrowing HRA	61,584	51,584	51,584	41,584	41,584
Authorised limit – total external debt	66,251	55,993	55,798	45,610	45,455

Operational boundary – borrowing	62,423	52,423	42,423	42,423	42,423
Operational boundary – total external debt	62,423	52,423	42,423	42,423	42,423

Further details on borrowing are in pages 5 to 7 of 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)

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
Near-term investments	43,350	52,700	25,000	20,000	10,000	5,000
Longer-term investments	4,000	4,000	4,000	4,000	4,000	4,000
TOTAL	47,350	56,700	29,000	24,000	14,000	9,000

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. 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 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.

Commercial Activities

Central Government financial support for local public services has been declining year on year. In response to this, many authorities are increasing their investment 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.

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

The Council has a small portfolio of commercial properties which are held to earn rentals and/or for capital appreciation.

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.

Liabilities

In addition to debt of £57.423m detailed previously, the Council is committed to making future payments to cover its pension fund deficit (valued at £27,605m as at 31st March 2020). It has also set aside £786k 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 discretionary liabilities are taken by Service Managers in consultation with the Financial Services Manager and the Strategic Director (Corporate Resources). 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 73 to 88 of the 2019/20 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.

Table 10: Prudential Indicator: Proportion of financing costs to net revenue stream

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
Financing costs £m	1,595,000	1,713,000	1,738,000	1,738,000	1,738,000	1,738,000
Proportion of net revenue stream	13.49%	14.08%	14.03%	13.82%	13.54%	13.23%

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 Authority 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.