



**South
Derbyshire
District Council**

Capital Strategy 2019/20 – 2022/23

Introduction

The Capital Strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

This Capital Strategy forms a key component of the Council's planning framework and provides a mechanism by which the Council investment and financing plans can be prioritised and delivered over the medium term planning period.

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.

The Strategy defines at the highest level how the capital programme is to be formulated and designed; it identifies the issues and options that influence capital spending and sets out how the resources and capital programme will be managed. As well as detailing the approved capital investment programme over the forthcoming four years, the document also sets out the Council's ambitions over the medium to longer term.

The basic elements of the Strategy therefore include:

- A direct relationship to the Medium Term Financial Plan.
- A framework for the review and management of existing and future assets (Asset Management Plan).
- A framework that prioritises the use of capital resources;
- A consideration of the need to pursue external financing (grants, contributions etc.) which reconcile external funding opportunities with the Council's Corporate Plan.
- A direct relationship with the Treasury Management Strategy and the limitations on activity through the treasury management Prudential Indicators.

This document is intended for use by all stakeholders to show how the Council makes decisions on capital investment:

- To decide on capital investment policy within the overall context of investment need/opportunity and affordability.
- To provide an understanding of the need for capital investment and help stakeholders scrutinise policy and management.
- The strategy sets out South Derbyshire District Council's approach to Capital Investment for the next 4 years, aligned with the Council's Medium Term Financial Plan.

Operating Environment

Asset and Capital decisions need to be made in context of the following directions and influences to the environment in which they are made.

National Context

The Government's referendum held on 23rd June 2016 resulted in the decision for the United Kingdom to leave the European Union. The negotiations on the exit arrangements are ongoing and therefore there is an added uncertainty on the economic situation until the conclusion of these negotiations.

This plan period may see South Derbyshire District Council's revenue budgets being subject to further pressure which could have a direct impact on the Council's ability to self-fund capital investment.

Over recent years, the Government has revised mechanisms to prioritise capital funding with increased business case bids and developments, such as the Better Care Fund combining Disabled Facility Grants (DFG) and Adult Social Care as one fund to be allocated over prioritised projects enabling better use of the available funding.

The Single Local Growth fund is another government scheme developed to bring together local public sector partners. Through Growth Deals, Local Enterprise Partnerships can seek freedoms, flexibilities and influence over resources from the Government and a share of the Local Growth Fund to target their identified growth priorities.

Local Enterprise Partnerships can draw investment for a range of resources to fund priorities identified in the Strategic Economic Plans. Through whichever mechanism they are delivered, direct grants are expected to be a significant source of capital funding for the Council.

South Derbyshire District Council's Position

Previously, resources have been set-aside from Capital Receipts to finance capital projects within the District. Associated schemes were approved and included within the Capital Programme. All of the Projects with approved funding from previous capital receipts have reached completion within the financial year 2018/19.

Going forward, the main focus area of spend will be on council housing investment, private sector housing and the acquisition of vehicles.

Additional capital receipts may be received from sales of land but no prior investment commitments will be made until monies have been received. The Council has an established evaluation framework in place to prioritise capital investment.

The Better Care Fund (BCF) allocation from Derbyshire County Council has increased the funding received for Disabled Facility Grants. The funding is to be allocated to a number of projects delivered through the BCF Assurance Plan.

Council policy is to reinvest all housing receipts (after any pooling payment to Government) from the sale of council houses and land, into the housing stock and in particular, for New Build.

With regards to New Build, the Council has an agreement with the Government to enable it to retain additional receipts generated above a target level of council house sales each year (known as 1-4-1 receipts) to be used on New Build.

The Councils' Vision and priorities

This is set out in the Corporate Plan (2016 to 2021) and is to:

“Make South Derbyshire a better place to live, work and visit.”

To enable this vision to be delivered, the Corporate Plan has set out 4 main priorities:

- People – Keeping residents happy, healthy and safe.
- Place – Creating vibrant communities to meet residents needs
- Progress – Encouraging inward investment and tourism opportunities.
- Outcomes – Work that underpins all of our activities

The Capital Strategy supports the achievement of this vision through investment in the assets the Council owns, through the delivery of key infrastructure to support growth and improvement in services and through improvement to the services and systems that the Council utilises.

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 2019/20, the Council is planning capital expenditure of £2.6m as summarised below:

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

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget
General Fund services	766,908	2,441,646	336,000	336,000	336,000	386,000
Council housing (HRA)	1,323,517	2,869,513	1,888,000	1,935,000	1,983,000	1,692,000
Capital investments	2,066,828	1,467,638	445,000	445,000	445,000	445,000
TOTAL	4,157,253	6,778,797	2,669,000	2,716,000	2,764,000	2,523,000

The capital investment is split between vehicle and asset investment with £315k per year to allow for the replacement of the Council's vehicles over a 7 year period, and £130k for investment/replacement in the Councils' assets.

General Fund Services is 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.

Following the Government's announcement of the removal of the Debt Cap, the Council currently has no plans to borrow over its original cap of £66.853m and will continue to be prudent.

Governance: The Strategic Director (Corporate Resources) is responsible for ensuring that capital proposals have undergone project appraisal in accordance with guidelines issued. The Strategic Director (Corporate Resources) ensures projects have a plan, progress targets and associated revenue expenditure is prepared for each capital project. In order to obtain approval, the Finance and Management Committee appraise all bids based on a comparison of service priorities against financing costs. The final 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 (£)

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/2023 budget
External sources	766,113	4,072,658	336,000	336,000	336,000	386,000
Own resources	3,391,139	2,706,139	2,333,000	2,380,000	2,428,000	2,137,000
Debt	0	0	0	0	0	0
TOTAL	4,157,253	6,778,797	2,669,000	2,716,000	2,764,000	2,523,000

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)** / 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 authority'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 authority's underlying need to borrow for capital purposes, i.e. the Capital Financing Requirement (CFR).

Table 3: Replacement of debt finance (£)

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/2023 budget
Own resources	3,391,139	2,706,139	2,288,000	2,335,000	2,383,000	2,092,000

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

Under self-financing, the HRA pool operated within a cap over which no actual borrowing was allowed. Previously the prescribed debt cap limit for the Council set by the Government was £66.853m.

In October 2018 the government announced the abolition of the borrowing cap. As a result, local authorities are now able to borrow for housebuilding in accordance with the Prudential Code. The Council has adopted a prudent approach to the announcement and has no current plans to exceed the cap previously prescribed.

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 2018, the Authority had net borrowing (after allowing for investments) of £32.95m arising from its revenue and capital income and expenditure, a decrease on 2017 of £14.5m.

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)

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/2023 budget
General Fund services	5,653	5,316	4,988	4,667	4,409	4,214
Council housing (HRA)	61,584	61,584	61,584	61,584	61,584	51,584
TOTAL CFR	67,237	66,900	66,572	66,251	65,993	55,798

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 an Asset Management Strategy in place. This seeks to align the Council's asset base with its corporate objectives to ensure services are delivered efficiently.

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021/22.

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)

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget
Asset sales	0	-400	0	0	0	0
Land Sales	-1,767	-691	0	0	-500	-500
TOTAL	-1,767	-1091	0	0	-500	-500

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 0.79% on variable rate borrowing. Current Treasury investments total £27.592m at an average rate of 4.54% (long term investment) and 0.23% 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 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%).

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

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

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/2023 budget
General Fund Services	-3,560	-2,864	-1,754	-740	510	2,162
Council housing (HRA)	57,423	57,423	57,423	57,423	47,423	47,423
Capital Financing Requirement	67,237	66,900	66,572	66,251	65,993	55,798

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 £67,237m and is forecast to fall to £55,993m over the next five years.

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

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget
Outstanding borrowing	57,423	57,423	57,423	57,423	47,423	47,423
Liability benchmark	67,237	66,900	66,572	66,251	66,251	55,993

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)

	2018/19 limit	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit – borrowing GF	5,316	4,988	4,667	4,667	4,409
Authorised limit – borrowing HRA	66,853	66,853	66,853	66,853	66,853
Authorised limit – total external debt	72,169	71,841	71,520	71,520	71,262
Operational boundary – borrowing	62,423	62,423	62,423	52,423	52,423
Operational boundary – total external debt	62,423	62,423	62,423	52,423	52,423

Further details on borrowing are in pages 5 to 7 of the Treasury Management Strategy

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)

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/2023 budget
Near-term investments	8,000	5,000	4,000	4,000	2,000	2,000
Longer-term investments	1,000	1,000	2,000	2,000	2,000	2,000
TOTAL	9,000	6,000	6,000	6,000	4,000	4,000

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Strategic Director (Corporate Resources) 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 £31.668m as at 31st March 2018). It has also set aside £929k 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 Financial Services Manager 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 78 to 94 of the 2017/18 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

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/2023 budget
Financing costs £m	1.732	1.788	1.788	1.788	1.788	1.498
Proportion of net revenue stream	15%	15%	15%	15%	15%	11.61%

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 Financial Services Manager is a qualified accountant, the Asset Manager 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 Senior 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.