



North Devon Council

Report Date: 7th February 2022

Topic: 10 Year Capital Strategy 2022 to 2032

Report by: Director of Resources and Deputy Chief Executive

1 Introduction

The Capital Strategy is a high level review of the corporate priorities, capital investment ambition, available resources, affordability and risk management in the context of ensuring the long term financial sustainability of this authority.

2 Recommendations

The Committee is asked to recommend to full Council that:

- 2.1 The Capital Strategy 2022/23 to 2031/32 be approved.

3 Reasons for Recommendations

- 3.1 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146) requires the Council to have regard to the Treasury Management Code.
- 3.1 To meet the requirements of the Prudential Code 2017, ensuring the Committee has assurance on the long term financial standing of the Council and risks associated with the capital strategy
- 3.2 To ensure that future capital investments are affordable and targeted to the Council's priorities.

4 Capital Strategy

4.1 Background

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes stating that from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

This capital strategy document covers the ten year period from 2022/23 to 2031/32 and will be reviewed annually by Full Council prior to each financial year.

4.2. Corporate Priorities

The Corporate Plan sets out our medium-term ambitions over the next four years, covering the four main areas as summarised below:

- 1. Achieving financial security**
- 2. Become focused on delivering the best for our citizens**
- 3. Our environment is cherished and protected**
- 4. We plan for North Devon's future**

For further information please see the Council's full Corporate Plan.

4.3 Capital Governance

The Council has a well-established capital project appraisal process. All capital projects require a business case, reviewing options, risks and associated costs, whilst formally recording internal consultation, including Legal Services, Finance, HR, ICT, Procurement and the Senior Management Team.

The Project Appraisal Group (PAG) comprises of the; Chief Executive, Business Information Systems Manager, Head of Resources and Accountancy Manager who will then meet to score the proposed project. The scoring will assess each proposal against a series of objective criteria including:

- legal or statutory obligation and risk of death or maiming
- alignment with the corporate priorities
- maintenance of a council asset
- material improvement in the service
- number of people it would benefit
- proportion of external funding or revenue savings

The project scoring determines which projects move forward and get considered by the Strategy and Resources Committee who will then make a recommendation to Full Council to vary the capital programme accordingly.

As part of the Committee reporting process the funding or resource implications will be clearly identified. For example funding from external grants, capital receipts, S106 income, reserves or borrowing. Any additional costs arising from borrowing on approved capital projects will then be built into the budget setting process and Medium Term Financial Strategy (MTFS).



In addition to the original approval of the project, a separate approval will also be sought from the Strategy and Resources committee and then Full Council to release the capital funds three to six months before the project is due to start.

All Capital spend will be undertaken in accordance with our Contract Procedure rules, which provides the following thresholds:

Contract value	Procurement requirement
Below £5,000	No procurement required, although a written quote will be obtained
£5,000 to £39,999	A minimum of three alternative quotes are sought
£40,000 and above	A competitive tendering process is undertaken

The Council has a project management framework based on the PRINCE2 methodology and therefore incorporates industry best practice. The framework consists of four phases; pre-project feasibility, initiation planning, delivery & implementation, and closure & review.

Project Management is all about successfully planning, implementing and managing change. Following the NDC framework allows the Project Manager to apply control throughout the project and manage the variables of time, cost and quality in order to deliver the expected business benefits.

The Council is committed to post project evaluation and sharing lessons learnt to improve future project management

4.4 Capital Strategy Years 2022/23 to 2024/25 (Medium Terms)

This section looks to summarise and bring together the key points of the Council's approved medium term financial strategy, capital programme and the overall treasury position, over the medium term, in order to set the context for Members, prior to looking at the longer term capital strategy.

<u>CAPITAL</u> £'000	2021-22	2022-23	2023-24	2024-25	2025-26
Net Annual Capital Financing Gap	18,065	5,693	3,567	1,057	306
Total Capital Financing Requirement (Borrowing need)	23,362	29,265	32,660	35,355	34,092
Projected Long Term Liabilities (Finance leases)	1,220	2,165	3,038	5,834	5,395
Projected External Borrowing	10,500	22,500	26,000	26,000	26,000
Annual Cost of External Borrowing (MRP & Interest)	536	1,069	1,523	1,667	1,639

**please note that 2025/26 figures are estimates not yet approved.*

<u>REVENUE</u> £'000	2021-22	2022-23	2023-24	2024-25	2025-26
Medium Term Financial Strategy Budget Gap	(89)	0	2,070	2,286	2,595

Revenue

The Council is required to operate a balanced revenue budget, however for 2023/24 current projections show a medium term financial strategy budget gap of £2.07m increasing to £2.59m in 2025/26.

The Government's Fair Funding Review has been delayed by a further 12 months and could now be implemented in 2023/24 onwards. As a result only a one year financial settlement was announced for 2022/23, which leaves local authorities with much greater uncertainty regarding the longer term funding. This forecast prudently assumes the worse-case scenario of losing circa £2m of core funding/business rates and New Homes Bonus grant.

Whatever the outcome of the funding review the Council will have to become more entrepreneurial in how it delivers services to generate extra income and reduce costs in line with our commercialisation strategy. The Council will also have to review a number of options for bridging the budget gap and any such financial benefits these may produce; these would be subject to further reports being presented to Members. *Please see the Medium Term Financial Strategy for further details.*

Capital

Any capital expenditure that is not immediately paid for through a revenue or capital resource leads to a capital financing need or gap, which will increase the Council's total Capital Financing Requirement (CFR). The CFR is a measure of the Council's underlying need to borrow to finance the total historic outstanding capital programme.

The estimated CFR for March 2022 is circa £23m which increases to its peak in March 2025 at £35m. This is a substantial increase in CFR from £4.5m in March 2021, but reflects the £47m capital programme over the medium term, including the new Leisure Centre, the purchase of Green Lanes Shopping Centre and the Future High Streets programme. A full list of the currently approved capital projects can be found in Appendix E of the Budget Report 2022/23.

The CFR will in part be funded by external borrowing. Total external borrowing as at March 2022 is projected to increase from £0.5m to £10.5m, increasing by a further £15.5m over the next four years to peak at £26m. The medium term strategy is prudently maintaining an under-borrowed position, meaning that as a temporary measure the Council is using its own cash supporting reserves, balances and cash-flows rather than fully funding the CFR with external borrowing. This position will need to be reviewed in line with investment returns and counterparty risks.

Where a capital project increases the CFR or financing gap then a minimum revenue provision (MRP) must be made to reduce the borrowing amount over the life of the asset. The MRP and the interest payable on the borrowing (annual cost of external borrowing) are charged to the revenue account each year and this will therefore impact on the Council's revenue budget and on-going medium term financial plan budget gap. The projected annual borrowing cost for 2022/23 is circa £1m and is over £1.5m for each remaining year of the medium term forecast. *For further details on the Capital Financing Requirement and Minimum Revenue Provision please refer to the Annual Treasury Management Strategy 2022/23.*

The Council will be receiving an annual management fee in relation to the running of the new Leisure Centre to help offset an element of the borrowing costs above. There will also be additional income from Green Lanes Shopping Centre and the Future High Street redevelopments which have been factored into the 2022/23 budget and medium term financial strategy.

In October 2021, the Council entered into a vehicle leasing programme for our fleet renewals. Whilst these finance leases increase the CFR and therefore our borrowing requirement, these types of scheme include a borrowing facility by the lease provider and so the Council is not required to separately borrow for these vehicles. The balance of this borrowing is shown as long term liabilities in the table above.

The table above shows the Council is facing both revenue and capital resource pressures within the medium term forecast and that Members will be faced with challenging decisions to make as part of setting future budgets and delivering capital schemes which are not fully funded.

4.5 Capital Strategy Years 2026/27 to 2031/32 (long Term)

Capital Expenditure

The Council has identified two main areas of capital expenditure within the long term forecast which are necessary to maintain business as normal. Firstly, our vehicle replacement programme, as the works and recycling fleet have specific asset life cycle. Secondly, the on-going maintenance of our ICT infrastructure. The projected costs are shown below:

<u>CAPITAL EXPENDITURE</u>	2026-27	2027-28	2028-29	2029-30	2030-31	2031-32
£'000						
Vehicle Capital Cost	1,029	572	1,300	1,340	1,380	1,420
Net ICT Infrastructure Cost	202	466	203	371	352	210

As mentioned in section 4.4, the vehicle fleet are now leased and that scheme includes the borrowing element from the lease provider.

The forecast also builds in a level of disabled facilities grant for each year, but we have anticipated that this will continue to be fully funded by external grants as at present.

The Council's Property Team are currently in the process of refreshing our Asset Management Plan, which includes carrying out condition surveys of our land and property portfolio. The result of this work will help to formulate a ten-year asset maintenance plan which will then feed into future capital strategy reports. Currently, the Council has a £0.24m revenue repairs fund for planned and response maintenance. This capital strategy assumes that this repairs fund will continue and be allocated to capital works if appropriate.

Capital Funding and Affordability

The following table is based on the capital information identified in the previous section:

<u>CAPITAL</u>	2026-27	2027-28	2028-29	2029-30	2030-31	2031-32
£'000						
Total Capital Financing Requirement (Borrowing need)	33,246	32,164	31,396	30,721	30,036	29,176
Projected Long Term Liabilities (Finance leases)	5,536	5,081	5,282	5,361	5,465	5,574
Projected External Borrowing	25,500	24,000	24,000	22,000	22,000	20,000
Annual Cost of External Borrowing (MRP & Interest)	1,690	1,568	1,648	1,564	1,580	1,581

REVENUE	2026-27	2027-28	2028-29	2029-30	2030-31	2031-32
£'000						
Medium Term Financial Strategy Budget Gap	3,220	3,141	*3,220	*3,136	*3,153	*3,154

**For this purpose it assumes no other revenue changes apart from the cost of borrowing for capital*

The capital table above shows that the CFR is generally on a downward trend from £33.2m in 2026/27 to £29.2m by 2031/32. External borrowing over the longer term remains at a high level, reducing from £25.5m to £20m over the same period, again assuming the under-borrowed position remains prudent and sustainable.

As a result of the high borrowing, the annual borrowing cost will continue to put pressure on the Council's revenue budget each year. The projected cost of external borrowing is £1.69m in 2026/27 reducing to £1.58m in 2031/32. In the revenue table above, the forecast medium term financial strategy budget gap has been extended beyond 2027/28, just to reflect the additional external borrowing costs before any other revenue changes are considered. On this basis, the revenue budget gap for the long term remains above £3.1m.

The strategy shows that the business as normal capital schemes such as our vehicles and ICT may present affordability challenges that Members will need to consider as further schemes come forward for investment.

The graph below illustrates the current ten year capital strategy:



4.6 Aspirations Capital Projects

Whilst the medium and long term capital strategy above clearly sets out the financial context under which future capital expenditure decisions should be considered, it would not prevent the Council pursuing aspirational projects such as the proposed the review of Seven Brethren, Barnstaple.

However, for the reasons already stated, any such projects would have to have no or limited impact on the revenue budget gap. Any additional borrowing costs would have to be offset by additional income such as a management fee, rental income or additional capital receipts would need to be identified and earmarked over and above the capital receipts required for normal service investments like fleet replacements.

4.7 Non-Treasury Investments

The Council will not borrow primarily for financial return and furthermore recent changes to the PWLB lending terms mean that they will no longer lend to local authorities that have plans to buy commercial assets primarily for yield within their capital programme. Given the level the external borrowing required over the ten year period and that PWLB would currently be the best option for the Council to borrow these funds, careful consideration would need to be given before any commercial investments decisions were made.

It is more likely, that the Council would consider service investments within the Council boundary, where the main purpose of the scheme is regeneration.

For further details of the non-treasury investment categories and authorised limits, please refer to Appendix B of the Treasury Management Strategy Statement 2022/23.

4.8 Commercialisation

The long term outlook for the Council's financial standing strongly supports the need for the Council to become more efficient and commercially minded across all areas of the organisation to generate additional income for the revenue budget.

The Commercialisation Strategy sets out the parameters and options for income generation and net revenue gains.

4.9 Environmental, Social & Governance (ESG Investments)

The revised CIPFA codes published in December 2021, places a requirement to address ESG issues within the capital strategy on or before April 2023.

These issues are being considered with our Treasury Advisors, Link Group and Members will be updated on any changes to our investment approach



4.10 Risks with the Capital Strategy

The risks with any long term strategy is the unknown or unexpected events which will require large scale capital investments; as we have seen in the past such as storm repairs to Ilfracombe Harbour. Whilst the treasury management strategy has sufficient headroom within its borrowing limits to deal with such situations, the impact of the borrowing cost on the revenue budget are much harder to protect against.

There could also be service or legislation changes which the Council will have to adapt to in order to maintain efficient and effective service provision.

Whilst our long term budget projections have factored inflation into the estimates, economic and trading conditions can impact on future prices.

The Budget Report 2022/23 provides further details on potential risks facing the Council.

5 Resource Implications

5.1 As detailed in the report.

6 Equalities Assessment

6.1 There are not any equalities implications anticipated as a result of this report, as the purpose of this report is to present the Council's financial position only.

7 Environmental Assessment

7.1 There are not any environmental implications anticipated as a result of this report, as the purpose of this report is to present the Council's financial position only

8 Corporate Priorities

8.1 The 10 year capital programme sets the financial long term context for delivering the corporate priorities and approving capital projects against those priorities.

9 Constitutional context

9.1 Part 4 Financial Procedure Rules (Article 13.8) / Article 4.4

9.2 Delegated power



10 Statement Of Confidentiality

10.1 This report contains no confidential or exempt information under the provisions of Schedule 12A of 1972 Act.

11 Statement Of Internal Advice

11.1 The author (below) confirms that advice has been taken from all appropriate Councillors and Officers.

Jon Triggs, Director of Resources and Deputy Chief Executive