

NORTH DEVON COUNCIL

REPORT TO: EXECUTIVE
DATE: 4TH FEBRUARY 2019
TOPIC: 10 YEAR CAPITAL STRATEGY 2019 TO 2029
REPORT BY: CHIEF FINANCIAL OFFICER

1. INTRODUCTION

This report has been prepared in compliance with CIPFA’s Code of Practice and covers the following:

- Capital Strategy 2019/20 to 2028/29

2. RECOMMENDATIONS

The Executive is asked to recommend to the full Council that:

- 2.1 The Capital Strategy 2019/20 to 2028/29 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.
- 3.2 To ensure Executive has assurance on the financial standing of the Council and risks associated with the capital strategy
- 3.3 To ensure Executive have plans in place to deliver the long-term financial strategy of the Council
- 3.4 To ensure that future capital investments are available and targeted to the Council’s priorities.

4. CONSTITUTIONAL CONTEXT

Article and paragraph	Referred or delegated power?	A key decision?	In the Forward Plan?
Article 4.4	Referred	No	Yes

5. CAPITAL STRATEGY

5.1 Introduction

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 2019/20 to 2028/29 and will be reviewed annually by Full Council prior to each financial year.

5.2 Corporate Priorities

The Council currently has two overarching priorities which are:

Organisational Transformation

- ✓ to develop a robust and flexible organisation
- ✓ determine our own future/destiny
- ✓ maintain or improve our services by flexing council structures and activities delivering resilience in the short to medium term

Growing North Devon

- ✓ to create and protect a resilient North Devon
- ✓ promote Barnstaple and its uniqueness as the sub-regional centre for growth but consider all opportunities
- ✓ use the increase in the local tax base from predicted housing and/or businesses to deliver resilience
- ✓ support and develop low carbon opportunities including the tidal demonstration zone

5.3 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; Business Information Systems Manager, Head of Corporate and Community Services, 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
- 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 Executive 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 additional to the original approval of the project, a separate approval will also be sought from Executive 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 the relevant EU threshold	A competitive tendering process is undertaken
Above the relevant EU threshold	A competitive tendering process is undertaken in accordance with the requirements of the Public Contracts Regulations 2015

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

5.4 Capital Strategy Years 2019/20 to 2022/23 (Medium Term)

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>	2018-19 £'000	2019-20 £'000	2020-21 £'000	2021-22 £'000	2022-23 £'000
Net Annual Capital Financing Gap	914	1,569	25	531	1,312
Total Capital Financing Requirement (Borrowing need)	5,419	6,440	5,786	5,700	6,318
Projected External Borrowing	1,250	2,500	2,500	3,000	3,500
Annual Cost of Borrowing (MRP & Interest)	530	590	730	690	790

**please note that 2022/23 figures are projections not yet approved.*

<u>REVENUE</u>	2018-19 £'000	2019-20 £'000	2020-21 £'000	2021-22 £'000	2022-23 £'000
Medium Term Financial Strategy Budget Gap	0	0	401	470	666

Revenue

The Council is required to operate a balanced revenue budget, however for 2020/21 current projections show a medium term financial strategy budget gap of £401,000 increasing to £666,000 in 2022/23. The Council will review a number of options and have to make decisions for bridging this gap such as any financial benefits from a roll

out of the 3 weekly black bin collection. *Please see the Medium Term Financial Strategy for further details.*

Capital

A full list of the approved capital programme items can be found in Appendix 5 of the Budget Report 2019/20. 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 2019 is £5,419,000 and for March 2023 is £6,318,000.

The CFR will in part be funded by external borrowing. Total external borrowing as at March 2019 is projected to be £1,250,000 increasing by a further £2,250,000 over the next four years. 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 (annual cost of 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. *For further details on the Capital Financing Requirement and Minimum Revenue Provision please refer to the Annual Treasury Management Strategy 2019/20.*

The table above clearly show 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.

5.5 Capital Strategy Years 2023/24 to 2028/29 (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 an eight year life cycle. Secondly, the on-going maintenance of our ICT infrastructure. The projected costs are shown below:

CAPITAL EXPENDITURE	2023-24 £'000	2024-25 £'000	2025-26 £'000	2026-27 £'000	2027-28 £'000	2028-29 £'000
Net Vehicle Replacement Cost	1,010	1,160	235	1,265	0	0
Net ICT Infrastructure Cost	98	185	159	163	438	171

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 £240,000 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 expenditure identified in the previous section:

CAPITAL	2023-24 £'000	2024-25 £'000	2025-26 £'000	2026-27 £'000	2027-28 £'000	2028-29 £'000
Net Annual Capital Financing Gap	1,108	1,345	394	1,428	438	171
Total Capital Financing Requirement (Borrowing need)	6,789	7,348	6,883	7,422	6,864	5,993
Projected External Borrowing	4,000	4,500	4,500	4,750	4,000	3,250
Annual Cost of Borrowing (MRP & Interest)	750	910	980	1,030	1,120	1,140

REVENUE	2023-24 £'000	2024-25 £'000	2025-26 £'000	2026-27 £'000	2027-28 £'000	2028-29 £'000
Medium Term Financial Strategy Budget Gap	626	786	856	906	996	1,016

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

The capital table above shows that the CFR peaks in 2026/27 at £7,422,000 with external borrowing in that year predicted to be £4,750,000, again assuming the under-borrowed position remains prudent and sustainable.

With the continued non-funded capital expenditure in each of the years 23/24 to 28/29 there is a dramatic rise in the associated cost of borrowing which would reach £1,140,000 in 2028/29. This borrowing cost would impact on the revenue budget each year and to illustrate this the forecast medium term financial strategy budget gap has been extended just to reflect the additional borrowing costs before any other revenue changes are considered. On this basis, the revenue budget gap for 2028/29 would increase to £1,016,000.

The strategy shows that the business as normal capital schemes such as our vehicles and ICT may present affordability challenges and Members will need to give further consideration to our property portfolio in terms of acquisitions and disposals, the review of Seven Brethren redevelopment and the wider car parks strategy.

Any future Capital Receipts need to be prioritised and prudently earmarked to ensure that our normal business investment can continue, so that service levels can be maintained and that the authority can bridge the funding gap identified in the revenue table above, allowing a balanced budget to be set for future years.

The graph below illustrates the current ten year capital strategy:



Aspirational 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 new Leisure Centre for North Devon.

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; 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.

Non treasury Investments

The Council can within the existing treasury management practices consider small scale investments in other financial assets and property primarily for financial return. Such activities include investment property portfolios.

Whilst the Council has a low risk, immaterial approach to non-treasury (commercial) investments it will consider opportunities that arise within the time frame of the capital strategy, such as light industrial investment within the Council boundary i.e. Seven Brethren.

For further details of the investment categories and authorised limits, please refer to Appendix 2 of the Treasury Management Strategy Statement 2019/20

5.6 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 2019/20 provides further details on potential risks facing the Council.

6 RESOURCE IMPLICATIONS

As detailed in the report.

7 EQUALITY and HUMAN RIGHTS

An EINA has not been completed as the purpose of this report is to present the Council's financial position only.

8 STATEMENT OF INTERNAL ADVICE

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

9 STATEMENT OF CONFIDENTIALITY

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

10 BACKGROUND PAPERS

The background papers are available for inspection and will be kept by the author of the report.

Executive Member: Councillor R Edgell and Councillor G Lane

Author: Jon Triggs, Head of Resources

Date: 22nd January 2019

Reference: T:\Technical\Adam\Capital Strategy\Capital Strategy 19-20.doc