

NORTH DEVON COUNCIL

REPORT TO: STRATEGY AND RESOURCES
DATE: 3RD FEBRUARY 2020
TOPIC: 10 YEAR CAPITAL STRATEGY 2020 TO 2030
REPORT BY: CHIEF FINANCIAL OFFICER

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 the full Council that:

2.1 The Capital Strategy 2020/21 to 2029/30 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 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

3.3 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 2020/21 to 2029/30 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:

- ✓ **Achieving financial security**
 - *Adopt a commercialisation strategy*
 - *Explore investment opportunities and alternative delivery models*
- ✓ **Become focused on delivering the best for our citizens**
 - *Use technology to improve our services*
 - *Review services to ensure that meet customer expectations*
- ✓ **Our environment is cherished and protected**
 - *Introduce own carbon reduction plan and enhance green spaces*
 - *Encourage energy efficiency and renewable energy initiatives including Council buildings*
- ✓ **We plan for North Devon's future**
 - *Work with Partners to develop a vision for Northern Devon for 2050*
 - *Explore ways to bring forward sites for development within the Local Plan*

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 additional 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 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

4.4 Capital Strategy Years 2020/21 to 2023/24 (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.

CAPITAL £'000	2019-20	2020-21	2021-22	2022-23	2023-24
Net Annual Capital Financing Gap	1,664	3,530	7,963	1,358	1,122
Total Capital Financing Requirement (Borrowing need)	5,866	8,770	16,120	16,569	16,831
Projected External Borrowing	1,250	5,500	13,000	14,500	14,500
Annual Cost of Borrowing (MRP & Interest)	535	700	870	1,305	1,278

**please note that 2023/24 figures are projections not yet approved.*

REVENUE £'000	2019-20	2020-21	2021-22	2022-23	2023-24
Medium Term Financial Strategy Budget Gap	0	0	1,781	2,110	2,678

Revenue

The Council is required to operate a balanced revenue budget, however for 2021/22 current projections show a medium term financial strategy budget gap of £1.78m increasing to £2.68m in 2023/24. This forecast prudently assumes the worse-case scenario of losing £1.02m of core funding/business rates and £1.02m reduction of New Homes Bonus grant until the Government Fair Funding Review is announced in autumn 2020. Whatever the outcome of the funding review the Council will have to review a number of options and have to make decisions for bridging the budget gap such as any financial benefits from a roll out of the 3 weekly black bin collection, the commercial trade waste service and the provision of public conveniences. *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 2020 is £5.87m and for March 2024 is £16.83m. This substantial increase in CFR reflects the £34m capital programme approved from 2019/20 to 2022/23 including the new Leisure Centre. A full list of the approved capital items can be found in Appendix E of the Budget Report 2020/21.

The CFR will in part be funded by external borrowing. Total external borrowing as at March 2020 is projected to remain at £1.25m increasing by a further £13.25m 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 payable on the borrowing (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. The projected annual borrowing cost for 2023/24 is £1.28m. *For further details on the Capital Financing Requirement and Minimum Revenue Provision please refer to the Annual Treasury Management Strategy 2020/21.*

The Council will be receiving an annual Management Fee in relation to the running of the new Leisure Centre of circa £0.38m to help offset an element of the borrowing costs above. *For further details please see the report for the Leisure Provision at Seven Brethren approved by Executive in February 2019.*

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 2024/25 to 2029/30 (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	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
£'000						
Net Vehicle Replacement Cost	1,285	235	1,188	0	0	628
Net ICT Infrastructure Cost	202	180	188	466	203	210

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 Income

The 10 year funding model assumes that £640k of currently unbanked s106 income earmarked for the Leisure Centre project will be received by 2025/26.

Capital Funding and Affordability

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

<u>CAPITAL</u>	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
£'000						
Net Annual Capital Financing Gap	1,487	(225)	1,376	466	203	838
Total Capital Financing Requirement (Borrowing need)	17,338	16,034	16,349	15,638	14,734	14,464
Projected External Borrowing	14,500	14,500	14,000	14,000	13,000	12,000
Annual Cost of Borrowing (MRP & Interest)	1,388	1,492	1,483	1,588	1,507	1,480

<u>REVENUE</u>	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
£'000						
Medium Term Financial Strategy Budget Gap	2,788	2,892	2,882	2,987	2,906	2,879

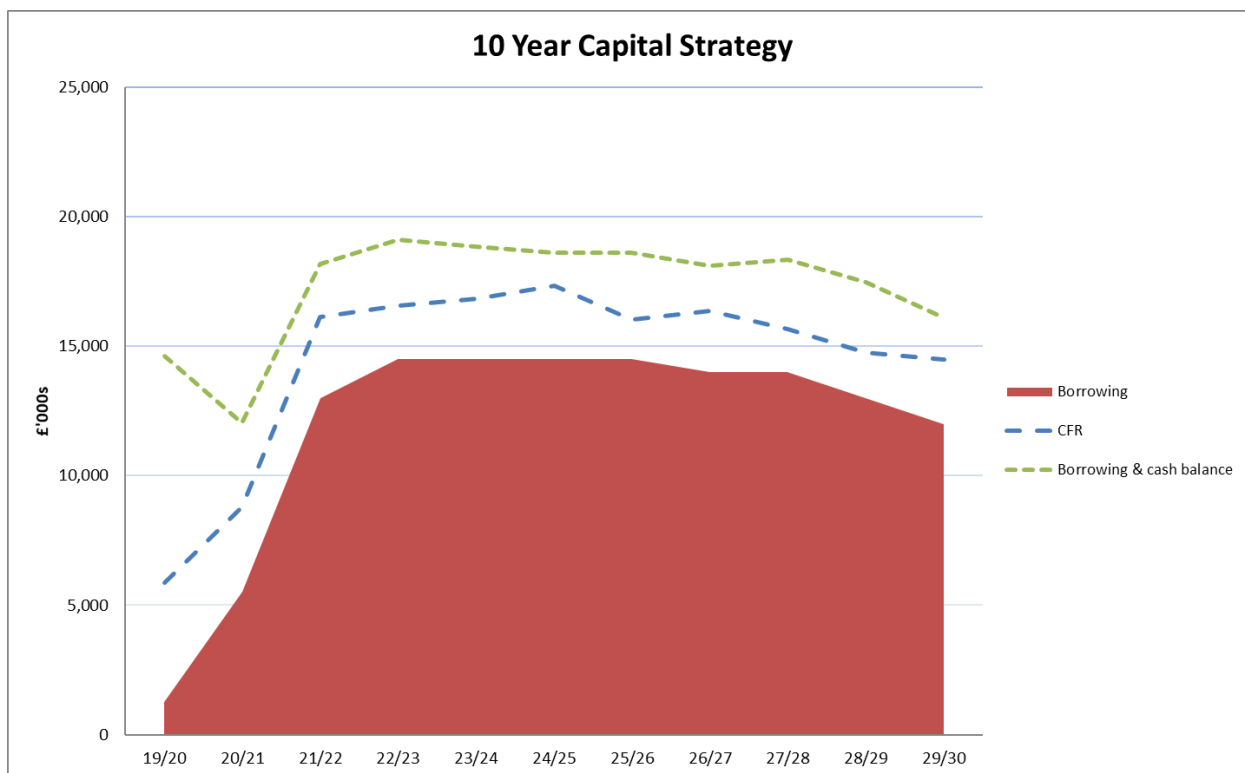
**For this purpose it assumes no other revenue changes apart from the cost of borrowing from capital*

The capital table above shows that the CFR peaks in 2024/24 at £17.3m before gradually reducing to £14.5m by 2029/30. External borrowing over the longer term remains at a high level, £12m and above, again assuming the under-borrowed position remains prudent and sustainable.

The cost of borrowing continues to increase to £1.59m in 2027/28. This borrowing cost will 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 2027/28 is forecast to increase to £2.99m.

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.

The graph below illustrates the current ten year capital strategy:



4.6 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 Watersport Centre, Ilfracombe and 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 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 B of the Treasury Management Strategy Statement 2020/21

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.

In line with our corporate priorities, a new Commercialisation Strategy will shortly be presented for adopted by Members, planned for April 2020. This will set out the parameters and options for income generation and net revenue gains, it will also provide Members will an opportunity to review our approach to non-treasury investments.

4.9 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 2020/21 provides further details on potential risks facing the Council.

5. RESOURCE IMPLICATIONS

As detailed in the report.

6. EQUALITIES ASSESSMENT

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. CONSTITUTIONAL CONTEXT

Article and paragraph	Referred or delegated power?
Part 4 Financial Procedure Rules (Article 13.8)	Delegated
Article 4.4	

8. STATEMENT OF CONFIDENTIALITY

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

9. BACKGROUND PAPERS

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

10. STATEMENT OF INTERNAL ADVICE

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

Author: Jon Triggs, Head of Resources

Date: 22nd January 2020

Reference: T:\Technical\Adam\Capital Strategy\Capital Strategy 20-21.doc