

South Somerset District Council

Capital Strategy 2019/20

Introduction

This capital strategy is a new report for 2019/20, giving a high-level overview of:

- how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services
- how associated risk is managed and;
- the implications for future financial sustainability.

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 assets costing below £10,000 are not capitalised and are charged to revenue in year.

In 2019/20, the Council is planning capital expenditure of £28.1m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure and financing in £ millions

| | 2017/18 actual | 2018/19 forecast | 2019/20 budget | 2020/21 budget | 2021/22 budget |
|----------------------------|---------------------------|-----------------------------|---------------------------|---------------------------|---------------------------|
| Capital Expenditure | 17.9 | 24.0 | 28.1 | 24.7 | 20.5 |
| Financed by: | | | | | |
| External sources | 1.0 | 2.5 | 1.7 | 0 | 0 |
| Own resources | 16.9 | 2.6 | 12.9 | 3.5 | 0 |
| Debt | 0 | 18.9 | 13.5 | 21.2 | 20.5 |
| Total Financing | 17.9 | 24.0 | 28.1 | 24.7 | 20.5 |

Service managers bid October to include projects in the Council's capital programme. Bids are collated by Finance who calculate the financing cost (which can be nil if the project is fully externally financed). The Strategic Leadership Team appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to District Executive. The final capital programme is then presented to District Executive in January and to Council in February each year.

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 included in table 1.

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 minimum revenue provision (MRP). The Council is required to make an annual MRP statement which is submitted to Full Council for approval. The planned MRP payments are as follows:

Table 3: MRP Payments in £ millions

| | 2017/18 actual | 2018/19 forecast | 2019/20 budget | 2020/21 budget | 2021/22 budget |
|-----|---------------------------|-----------------------------|---------------------------|---------------------------|---------------------------|
| MRP | 0.169 | 0.186 | 0.401 | 0.440 | 0.430 |

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 and capital receipts used to replace debt. The CFR is expected to increase by £22m during 2019/20. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

| | 31.3.2018 actual | 31.3.2019 forecast | 31.3.2020 budget | 31.3.2021 budget | 31.3.2022 budget |
|-----|-----------------------------|-------------------------------|-----------------------------|-----------------------------|-----------------------------|
| CFR | 17.44 | 39.18 | 61.73 | 84.11 | 104.60 |

Asset management: To ensure that capital assets continue to be of long-term use, the Council has an asset management plan which is incorporated in the Council's Commercial Strategy and an Asset Disposal and Community Asset Transfer Policy.

This Asset Disposal and Community Asset Transfer Policy provides a transparent, robust and strategic framework to enable Asset Disposal and Community Asset Transfer decisions to be made, together with a clear process for both SSDC and community organisations to progress with transfers/disposals, with long term sustainable benefits both to the Council and the community.

The Disposals element of the policy refers to Council owned assets that are sold on the open market for a financial consideration or otherwise transferred out of Council ownership. The aim is to enable SSDC to retain only sound assets that support the effective and efficient delivery of services, achieve corporate priorities or produce a healthy financial return each year in accordance with the Commercial Land and Property Strategy.

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. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £3.78 million of capital receipts in the coming financial year as follows:

Table 5: Capital receipts in £ millions

| | 2017/18 actual | 2018/19 forecast | 2019/20 budget | 2020/21 forecast | 2021/22 forecast |
|--------------|---------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|
| Asset sales | 0.13 | 0.60 | 0.18 | 0.15 | 0.15 |
| Loans repaid | 0.21 | 0.25 | 3.60 | 2.71 | 2.36 |
| TOTAL | 0.34 | 0.85 | 3.78 | 2.86 | 2.51 |

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 bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but 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.

The Council held a short-term loan of £1.5million at 31 December 2018. This loan was required for working capital cash flow purposes and was for a period of only 13 days. The loan was repaid on 2 January 2019, there has been no borrowing requirement since this date.

Borrowing strategy: The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in 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 (which comprises borrowing, liabilities, leases are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

| | 31.3.2018 actual | 31.3.2019 forecast | 31.3.2020 budget | 31.3.2021 forecast | 31.3.2022 forecast |
|-------------------------------|-----------------------------|-------------------------------|-----------------------------|-------------------------------|-------------------------------|
| Debt (incl. leases) | 0.10 | 30.10 | 52.60 | 75.00 | 95.50 |
| Capital Financing Requirement | 17.44 | 39.18 | 61.73 | 84.11 | 104.60 |

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.

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 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

| | 2018/19 limit | 2019/20 limit | 2020/21 limit | 2021/22 limit |
|--|------------------|------------------|------------------|------------------|
| Authorised limit – borrowing | 124.0 | 124.0 | 124.0 | 124.0 |
| Authorised limit – leases | 1.0 | 1.0 | 1.0 | 1.0 |
| Authorised limit – total external debt | 125.0 | 125.0 | 125.0 | 125.0 |
| Operational boundary – borrowing | 30.0 | 50.0 | 75.0 | 95.5 |
| Operational boundary – leases | 0.8 | 0.8 | 0.8 | 0.8 |
| Operational boundary – total external debt | 30.8 | 50.8 | 75.8 | 96.3 |

- Further details on borrowing are included in the 2019/20 treasury management strategy.

Investment strategy: Treasury investments arise from receiving cash before it is paid out again. 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, that is 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 more widely, including in bonds, shares and property, 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 8: Treasury management investments in £millions

| | 31.3.2018 actual | 31.3.2019 forecast | 31.3.2020 budget | 31.3.2021 budget | 31.3.2022 budget |
|-------------------------|---------------------|-----------------------|---------------------|---------------------|---------------------|
| Near-term investments | 27.88 | 3.00 | 3.00 | 3.00 | 2.00 |
| Longer-term investments | 7.16 | 32.00 | 30.00 | 30.00 | 30.00 |
| TOTAL | 35.04 | 35.00 | 33.00 | 33.00 | 32.00 |

- Further details on treasury investments are included in the 2019/20 treasury management strategy.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated by the S151 Officer to specified staff members, who must act in line with the treasury management strategy approved by Full Council in February 2019. A mid-year update report on treasury management activity is presented to Audit Committee and Full Council every October. The audit committee is responsible for scrutinising treasury management decisions.

Investments for Service Purposes

The Council can make service investments; service investments can be in the form of a loan to an organisation or the purchase of shares in organisations. The purpose of service investments is to support local public services and to stimulate local economic growth.

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 after all costs.

Governance: Decisions on service investments are presented to Strategic Leadership Team which includes the Section 151 Officer. Investments must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

Commercial Activities

The commercial property investment portfolio is an integral part of the Council's medium term financial plan and contributes towards the overall income generation target that is needed to mitigate the significant reduction in government funding, enable the Council to maintain and improve services and service standards, and meet our priorities and objectives. The Commercial Strategy details the Council's approach to commercialisation. One of the aims of the strategy is to align with and support the Council Plan and ensure that the Council is the partner of choice for the community and commercial sectors by demonstrating its commercial awareness and effective delivery of services.

The value of the property held for investment purposes was £17,632,682 as at 31 March 2018 and is anticipated to be £25,596,322 at 31 March 2019, the forecast rate of return is anticipated to be in the region of 3.6%

With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. It has a robust risk assessment process in place which includes assessing the risk of loss before entering into and whilst holding service investments.

This increased risk is balanced with an efficient and proportional regard to governance, policy, management, processes and systems to ensure robust decision-making, performance and success of new commercial enterprises, contracts and partnerships. All of which will continue to evolve and be refined over time to ensure that the Council adheres to its statutory responsibilities and that public money continues to be appropriately invested, used and accounted for.

In considering investment opportunities, a predetermined set of assessment criteria for each proposed investment is used and a business case is completed to ensure transparency, due diligence, governance and consistency to aid achievement of the investment objectives.

In order that commercial investments remain proportionate to the size of the authority, these are subject to an overall maximum investment limit of £75m.

If the returns on investments are not maintained at the required levels contingency plans to continue to provide services in place. The contingency plan includes holding adequate general reserves and a specific investment risk earmarked reserve.

Governance: Decisions on commercial investments are made in line with the criteria and limits approved by council in the 2019/20 investment strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

- Further details on commercial investments and limits are included in the investment strategy

Liabilities

In addition to debt detailed above, the Council is committed to making future payments to cover its pension fund deficit should it arise. The Council is also at risk of having to pay for its contingent liabilities, such liabilities arise where an event has taken place that gives the authority a possible obligation whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the Council's control.

Governance: Decisions on incurring new discretionary liabilities are taken by the Senior Leadership Team which includes the Section 151 Officer. The risk of liabilities crystallising and requiring payment is monitored by Finance and reported to committee. New liabilities are reported to full council for approval/notification as appropriate.

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP 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 9: 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 |
|----------------------------------|---------------------------|-----------------------------|---------------------------|---------------------------|---------------------------|
| Proportion of net revenue stream | (2.8%) | (1.2%) | (6.6%) | (5.8%) | (5.2%) |

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 for up to

50 years into the future. The Section 151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable.

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 Section 151 Officer is a qualified accountant, and the Director of Commercial Services and Income Generation is highly experienced in the commercial property field. The Council pays for staff to study towards relevant professional qualifications including CIPFA.

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, and utilises services of property consultants who provide a diligent assessment of the market and assists in preparing a bid, acting as the sounding board for the in house Investment Surveyor. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.