SOMERSET
County Council

Somerset County Council

Capital Strategy 2020/21– 2022/23

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Capital Strategy Report 2020/21

Contents

1. Background and Context

This capital strategy is a report for 2020/21, giving a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.

It addresses the capital components of the wider financial strategies adopted by the Authority. It identifies the links and relationships that need to be made in considering and implementing the Capital Programme to support the County Plan objectives. This is done through the Medium Term Financial Plan (MTFP) and alerts services to the governance and control framework within which the investment planning and delivery takes place.

The Capital Programme is the term used for the Council's rolling plan of investment in both its own assets and those of its partners. The programme spans multi-years and contains a mix of individual schemes, many spanning more than one year. Some schemes will be specific investment projects while others may provide for an overarching schedule of thematic works e.g. "Highways".

Investing in assets can include expenditure on:

- Infrastructure such as highways, open spaces, coast protection;
- New build;
- Enhancement of buildings through renovation or remodelling;
- Major plant, equipment and vehicles;
- Capital contributions to other organisations enabling them to invest in assets that contributes to the delivery of the Council's priorities.

The Capital Programme is distinct from the Council's revenue budget which funds day-to-day services, but they are both linked and are managed together. This ensures they contribute to the Council's objectives set out in its County Plan to achieve the most beneficial balance of investment within the resources available.

There is a strong link with the Treasury Management Strategy[1] that provides a framework for the borrowing and lending activity of the Council supporting the historic investment programme. Asset information can be obtained from the Corporate Property Group which manages the built estate as Corporate Landlord. Additional (non-property information) can be found within various service plans maintained by Services.

[1] Treasury Management Strategy link: *to be added when approved at Full Council*

2. 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 the ability to set a de-minimis level to capture only significant assets, however does not opt to do so. This allows the Council to review every item of expenditure and capitalise as appropriate.

- For details of the Council's policy on capitalisation, see the accounting policy (No.14 PPE) within the annual statement of accounts: http://www.somerset.gov.uk/information-and-statistics/financial-information/budgets-and-accounts/

In 2020/21, the Council is planning capital expenditure of £133.543m. The following table shows our planned spend for the future:

Table 1: Estimates of Capital Expenditure

	2018/19 actual £m	2019/20 forecast £m	2020/21 budget £m	2021/22 budget £m	2022/23 budget £m
Capital Expenditure	114.412	184.702	133.543	86.616	81.888

This table includes both the current approved capital programme and the proposed 2020/21 programme due to be put to Full Council on 19th February 2020. For example, the 2020/21 budget of £133.543m is made up of £91.429m current programme and £42.114m 2020/21 proposed new schemes.

Service managers bid annually to include projects in the Council's capital programme. Bids are collated by corporate finance who calculate the financing cost (which can be nil if the project is fully externally financed). The bids are appraised against a set criterion including a comparison of service priorities against financing costs. The Senior Leadership Team undertakes a final review before the draft capital programme is then presented to relevant Scrutiny Committee(s) prior to its consideration by the Cabinet in February for recommendation to Council in February each year.

For full details of the Council's 2020/21 capital programme, see the council's website at: *link for Full Council paper*

All capital expenditure must be financed, either from external sources (government grants and other contributions such as S106 and CIL), 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

	2018/19 actual £m	**2019/20 forecast £m**	**2020/21 budget £m**	**2021/22 budget £m**	**2022/23 budget £m**
External sources	96.273	122.348	72.867	43.565	42.707
Own resources	1.967	3.136	3.546	4.957	2.181
Debt	16.172	59.218	57.130	38.094	37.000
TOTAL	**114.412**	**184.702**	**133.543**	**86.616**	**81.888**

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). Planned MRP budgets are as follows:

Table 3: MRP for the repayment of debt

	2018/19 actual £m	**2019/20 forecast £m**	**2020/21 budget £m**	**2021/22 budget £m**	**2022/23 budget £m**
Own resources	1.439	2.508	4.043	5.392	6.405

- The Council's full minimum revenue provision statement is available here: *link to MRP statement*

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, lease principal repayments and capital receipts used to replace debt. The CFR is expected to increase by £52.173m during 2020/21. 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

	31.3.2019 actual £m	31.3.2020 forecast £m	31.3.2021 budget £m	31.3.2022 budget £m	31.3.2023 budget £m
TOTAL CFR	**380.118**	**435.902**	**488.075**	**519.776**	**549.274**

Asset management: To ensure that capital assets continue to be of long-term use and support the county plan, the Council has an asset management strategy in place. This strategy is currently under review and is planned to be updated during 2020.

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. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £6.020m of capital receipts in the current financial year.

Table 5: Capital receipts

	2018/19 actual £m	2019/20 forecast £m	2020/21 budget £m
TOTAL asset sales	**11.590**	**2.957**	**4.800**

Ministry of Housing, Communities and Local Government (MHCLG) have issued a 'flexible use of capital receipts' directive. This allows transformation projects which will save revenue budget to be funded from capital receipts. This directive was issued in 2016 and is extend until 2021/22. It is forecasted by 31/03/2020 that a total of £17.267m of receipts has been used. It is not anticipated that any further use of the flexibility will be made in 2020/21.

3. Treasury Management

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 budget for debt interest paid in 2020/21 is £17.900m, based on an average debt portfolio of £437.550m at an average interest rate of 4.06%. The budget for investment income in 2020/21 is £2.440m, based on an average investment portfolio of £130m at an average return of 1.3%. (These figures are net of balances held on behalf of external investors i.e. the Local Enterprise Partnership).

Borrowing strategy: The Council's main objectives when borrowing continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. It strives to achieve as low but more 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 cheaper short-term loans and long-term fixed rate loans where the future cost is known but is higher.

Projected levels of the Council's total outstanding debt (which comprises of borrowing and Private Financing Initiatives (PFI) liabilities, are shown below, compared with the capital financing requirement (with reference to table 4 above).

Table 6: Prudential Indicator: External Debt and the Capital Financing Requirement

	31.3.2019 actual £m	**31.3.2020 forecast £m**	**31.3.2021 budget £m**	**31.3.2022 budget £m**	**31.3.2023 budget £m**
Short term debt	7.480	10.000	10.000	10.000	10.000
Long term debt *	310.740	307.770	303.257	297.387	290.500
Assumed debt not yet taken	0.000	0.000	112.520	150.614	187.614
PFI & leases	42.948	41.972	42.533	39.872	38.676
Total external borrowing	**361.168**	**359.742**	**468.310**	**497.873**	**526.790**
Capital Financing Requirement	**308.118**	**435.902**	**488.075**	**519.776**	**549.274**

*(reduces for MRP & debt repayment)

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

	2018/19 limit £m	**2019/20 limit £m**	**2020/21 limit £m**	**2021/22 limit £m**	**2022/23 limit £m**
Authorised limit – borrowing	415.631	392.367	640.027	720.962	797.976
Authorised limit – PFI and leases	53.948	43.972	55.533	53.872	52.301
Authorised limit – total external debt	**469579**	**436.339**	**695.560**	**774.834**	**850.277**
Operational boundary – borrowing	385.631	362.367	595.027	675.962	752.976
Operational boundary – PFI and leases	47.948	46.972	47.533	44.872	43.301
Operational boundary – total external debt	**433.579**	**409.339**	**642.560**	**720.834**	**796.277**

**There is change to the accounting standards for leasing, due for adoption 1st April 2020. The impact of this will be to bring all material leases greater than one year onto the authority's balance sheet, thus creating additional borrowing liability. The full value of this is yet to be quantified so an estimate of this has been allowed for separately within the Authorised borrowing Limit.*

4. Investment Strategy

Treasury investments: arise from receiving cash before it is paid out again. Investments made for service reasons or for the purpose of generating a positive income (net of costs) 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 in accordance with MHCLG guidance. 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, 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.

This capital strategy contains the prudential indicators approved by the council. The Treasury management strategy contains further details on treasury investments criteria and governance. There are also 3 Treasury management indicators that are set out in section 4 of the TMS for the adoption by the authority.

- the treasury management strategy is here *to be added when approved at Full Council*

Non-Treasury investments: describing the Council's approach to non-treasury investment is a requirement of the Ministry of Housing, Communities and Local Government (MHCLG).

With central government financial support for local public services declining, the Council intends to explore investing in non-treasury investment options purely or mainly for financial gain. With this in mind, and as members have indicated that they wish to investigate options, a policy paper was endorsed at Cabinet on 18th December 2019, the full paper can be found here; http://democracy.somerset.gov.uk/ieListDocuments.aspx?CId=134&MId=740&Ver=4

This sets out the regulatory boundaries, options available and outlines the appropriate governance be put in place should any of the arrangements be taken forward.

5. Other long-term liabilities

In addition to debt of £361.168m detailed above, the Council is committed to making future payments to cover its pension fund deficit. The deficit reported in the 2018/19 accounts was £801.670m (as at 31/03/2019). It has also set aside £12.550m (as at 31/03/2019) to cover risks of insurance claims, business rate appeals and other legal claims. The Council is also at risk of having to pay for contingent liabilities but has not put aside any money because of the low risk and uncertainties around potential value.

Governance: Decisions on incurring new discretional liabilities will initially be considered by service managers for discussion with the relevant director. If it is recommended that the liability may be undertaken then the relevant director will consult with the Chief Finance Officer (S151 Officer), Monitoring Officer and County Solicitor before any recommendation is made to the Senior Leadership Team prior to any decisions taken. Depending on the extent of the liability envisaged, it may be necessary to make a formal decision through a democratic process. The risk of liabilities crystallising and requiring payment is monitored by corporate finance and reported quarterly to audit committee. New liabilities exceeding £500m are reported to Cabinet and Full Council for approval.

- Further details on provisions and contingent liabilities are on pages 150 and 162 of the 2018/19 statement of accounts: http://www.somerset.gov.uk/information-and-statistics/financial-information/budgets-and-accounts/

6. 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 8: Prudential Indicator: Proportion of financing costs to net revenue stream

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Financing costs (£m)	19.930	21.741	25.134	27.422	29.276
Proportion of net revenue stream	6.15%	6.36%	7.25%	7.70%	8.00%

Sustainability: Due to the long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend into the future years. The Interim Finance Director is satisfied the proposed capital programme is prudent, affordable and sustainable. This follows full challenge of all capital bids against set criteria of affordability and service need.

Only schemes that will have fully approved funding in place are consider as part of the capital programme and the cost impact of borrowing forms part of the revenue medium term financial planning.

7. Knowledge and Skills

The Council employs professionally qualified and experienced staff in all positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Chief Finance Officer will always be a qualified accountant with substantial experience and there is a range of significant experience and expertise within the Treasury Team. Where necessary, the Council pays for junior staff to study towards relevant professional qualifications, for example CIPFA.

Where the Council needs additional resources, external validation of officers work or 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 more cost effective than employing additional resources directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.