

## Rother District Council

**Report to:** Cabinet

**Date:** 8 February 2021

**Title:** Capital Strategy 2021/22 to 2025/26

**Report of:** Finance Manager

**Cabinet Member:** Councillor Dixon

**Ward(s):** All

**Purpose of Report:** To present the draft Capital Strategy and updated Capital Programme for approval

**Decision Type:** Key

### Officer

**Recommendation(s):** **Recommendation to COUNCIL:** That:

- (1) the Draft Capital Strategy 2021/22 to 2025/26 be approved and adopted; and
- (2) the updated Capital Programme 2020/21 to 2025/26 be approved.

### Reasons for

**Recommendations:** The Council is required to have an approved Capital Strategy which gives a high-level overview of how capital expenditure, capital financing and treasury management activities 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. The Strategy is intended to be a longer term view of investment and go beyond the detailed five year Capital Programme.

---

## Introduction

1. This report updates the Council's Capital Strategy and provide details of the latest Capital Programme. The Strategy aims to gives Members an overview of the Council's approach to capital. This requirement comes from the Chartered Institute of Public Finance and Accountancy (CIPFA) 2017 codes for Prudential and Treasury Management.

## Capital Strategy

2. The draft Capital Strategy at Appendix A gives a high-level overview of how capital expenditure, capital financing and treasury management activities 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. The Strategy is intended to be a longer term view of investment and go beyond the detailed five year Capital Programme. However it should be

recognised that the strategy is likely to change in the near future to reflect the Corporate Plan which is currently out to consultation.

3. Members will see that the Capital Programme is now of a scale to deliver on the ambition set out in the draft Corporate Plan and make a significant contribution to the social and economic future of the district. Investment in new housing (both market and affordable) and a commitment through the Property Investment Strategy to the development of new and good quality commercial space aim to ensure that Rother remains an attractive place to work and live.
4. The Strategy covers the following areas:
  - (i) Capital Expenditure and its financing
  - (ii) The role of Asset Management
  - (iii) Projected Asset Disposals
  - (iv) Treasury Management
  - (v) Sets out the expected borrowing needs of the Council
  - (vi) Sets the borrowing limits for the Council
  - (vii) Sets out the expected returns on the cash investments
  - (viii) Outlining other liabilities on the Council
  - (ix) The impact of capital spending on the Revenue Budget
  - (x) Sets out the relevant knowledge and expertise of relevant officers and advisors.
5. The Strategy is based on the draft Capital Programme detailed below.

### **Revised lending criteria by Public Works Loans Board (PWLB)**

6. From the 26 November 2020, the Government confirmed the introduction of new lending criteria from the PWLB designed to prevent Council's accessing low cost finance for investments made purely for financial return. This is a prospective change and doesn't affect any previous investment made by the Council prior to this date. A preliminary review of the draft Capital Programme indicates that all loan funded projects remain eligible for PWLB support, but further work is being undertaken to ensure this is the case. The guidance can be found at:

<https://www.dmo.gov.uk/media/17136/pwlb-guidance-for-applicants.pdf>

### **Capital Programme**

7. The Council's capital programme totals some £186.7m, although £80.0m is yet to have funding secured. A significant part of the programme relates to the Council's approved Property Investment Strategy (PIS) and capital support to the Council's company Alliance Homes (Rother) Ltd. To date, £16.0m has been expended or committed on eight properties/sites. Income of approximately £1m is included within 2021/22 revenue budget for PIS assets that have been acquired.
8. In response to the significant financial challenges the Council is managing, the draft Capital Programme continues to minimise the use of Revenue (including Revenue Reserves) to fund capital expenditure. For 2021/22, some £0.619m is planned to be used but this reduces thereafter. Largely this will be replaced by

low cost borrowing where appropriate which while having a revenue impact is spread over a longer time period.

9. The draft Capital Programme shows the investment in approved schemes over the next five years. It also shows where schemes are part or fully funded. Accurately forecasting spend is difficult for a number of these projects where there is a high level of uncertainty concerning issues such as funding, planning approval and land acquisition. Projects and schemes can only commit spending to the value of what is financed. The unfunded element of the programme is shown in Appendix B. These projects will only be allowed to proceed once funding is secured. The Programme is broadly the same in total as that reported to Cabinet in November, save for the rephrasing of expenditure in line with the latest information. The Programme now includes the cost of improvements being made to Sidley Recreation Ground, which are being funded externally in addition to the Council's own contribution to the scheme.

### Environmental Implications

10. The environmental considerations of the projects within the Capital Programme will be assessed as part of the design, development and delivery of each project to ensure they align with the organisation's strategic objectives and policies. Relevant internal functions will be consulted on the proposals.

### Conclusion

11. The draft Capital Programme shows that, despite the continued impact of the pandemic and Government austerity measures, the Council aims to make a significant commitment to invest in the district to improve it economically and socially; to ensure it remains an outstanding place to work and live in. The programme and the accompanying Capital Strategy do not come without significant risk. Members will need to recognise these risks and manage them to ensure the programme can be delivered.

Other Implications	Applies?	Other Implications	Applies?
Human Rights	No	Equalities and Diversity	No
Crime and Disorder	No	Consultation	No
Environmental	Yes	Access to Information	No
Sustainability	No	Exempt from publication	No
Risk Management	No		

1.

Assistant Director, Resources:	Robin Vennard
Report Contact Officer:	Tony Baden, Finance Manager
e-mail address:	<a href="mailto:Antony.baden@rother.gov.uk">Antony.baden@rother.gov.uk</a>
Appendices:	Appendix A – Capital Strategy 2021/22 to 2025/26 Appendix B – Capital Programme 2020/21 to 2025/26
Relevant Previous Minutes:	None
Background Papers:	None
Reference Documents:	None

## Capital Strategy 2021/22 to 2025/26

### Introduction

1. This Capital Strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activities 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.

### Capital Expenditure and Financing

2. Capital expenditure is where the Council spends money on assets, such as property or major equipment that will be used for more than one year. In local government, this includes spending on assets owned by other bodies or individuals (e.g. disabled adaptations) 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 normally capitalised and are charged to revenue in year. Further details of the Council's policies on capital expenditure are contained in its annual Statement of Accounts.
3. In 2021/22, the Council is planning capital expenditure of £62.6m, as summarised below:

*Table 1: Prudential Indicator: Estimates of Capital Expenditure in £'000*

	<b>2020/21 forecast</b>	<b>2021/22 budget</b>	<b>2022/23 budget</b>	<b>2023/24 budget</b>	<b>2024/25 budget</b>	<b>2025/26 budget</b>
General Fund Serv	13,016	42,195	42,785	23,418	1,937	1,880
Regen Investments	13,044	20,374	27,598	403	0	0
<b>TOTAL</b>	<b>26,060</b>	<b>62,569</b>	<b>70,383</b>	<b>23,821</b>	<b>1,937</b>	<b>1,880</b>

4. The main capital projects in 2021/22 include the Property Investment Strategy, £20.4m, Blackfriars housing development, £10.3m and support to Alliance Homes (currently unfunded), £25m.
5. In terms of governance around new capital items, Services have two main opportunities to bid for projects to be included in the Council's Capital Programme, mid-year at the time of the Medium-Term Financial Strategy Review and at year end when setting the following years' budgets. Depending on circumstances, bids can come forward at other times of the year. The Strategic Management Team appraises all bids and will assess their relevant priority against other schemes and the affordability of any associated financing costs. This then forms part of the financial reporting to Cabinet for approval and recommendation to full Council.
6. 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 or leasing for example). The Council is currently reviewing its financing of those schemes where funding is yet to be identified. This is shown as unfunded in the table below. The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £'000

	2020/21 Forecast	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget	2025/26 budget
Own Resources	2,296	619	378	186	187	130
External Resources	4,207	13,186	1,625	1,625	1,625	1,625
Debt	19,557	23,764	31,380	4,010	125	125
Unfunded	0	25,000	37,000	18,000	0	0
<b>TOTAL</b>	<b>26,060</b>	<b>62,569</b>	<b>70,383</b>	<b>23,821</b>	<b>1,937</b>	<b>1,880</b>

7. 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 the minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of debt finance in £'000

	2020/21 Forecast	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget	2025/26 budget
MRP & Capital Receipts	1,245	513	837	1,196	1,202	1,157

8. 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 be £58,436,000 during 2021/22. Based on the above figures for expenditure (excluding unfinanced) and financing, the Council's estimated CFR moves as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £'000

	31.3.21 forecast	31.3.22 budget	31.3.23 budget	31.3.24 budget	31.3.25 budget	31.3.26 budget
	£'000	£'000	£'000	£'000	£'000	£'000
Opening Balance	15,788	35,185	58,436	88,979	91,792	90,715
General Fund Services#	7,067	125	125	125	125	125
Regen Investments	12,490	23,639	31,255	3,883	0	0
Less MRP	(160)	(513)	(837)	(1,196)	(1,202)	(1,157)
<b>Closing Balance</b>	<b>35,185</b>	<b>58,436</b>	<b>88,979</b>	<b>91,792</b>	<b>90,715</b>	<b>89,683</b>

### Asset management

9. To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place. This ensures that capital assets continue to be of long-term use. This sets out the Council's strategy for acquisitions, disposals, and development to meet its corporate plan objectives

and statutory requirements. It includes taking a proactive approach to acquisitions to invest in the local economy and generate income to the Council, in accordance with the Council's Property Investment Strategy. It sets out the Council's approach to maintaining its assets in a usable state of repair, and towards the management of data. The Asset Management Plan also addresses issues relating to governance, risk management, performance management and monitoring.

### 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 has a number of small potential disposals in 2021/22. However, it is prudent not to rely on these until the sale is agreed.

### 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 short term 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.

### 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 short-term loans (currently available at around 2.49%) and long-term fixed rate loans where the future cost is known but higher (currently 3.09%).
- Projected levels of the Council's total outstanding debt is shown below, compared with the capital financing requirement (see above).

*Table 5: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £'000*

	<b>31.3.21 forecast</b>	<b>31.3.22 budget</b>	<b>31.3.23 budget</b>	<b>31.3.24 budget</b>	<b>31.3.25 budget</b>	<b>31.3.26 budget</b>
Gross Debt	31,083	<b>54,066</b>	78,641	75,826	69,429	68,556
Capital Financing Requirement	35,185	<b>58,436</b>	88,979	91,792	90,715	89,683

- Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from Table 5, the Council expects to comply with this in the medium term.

## Affordable borrowing limit

15. The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower “operational boundary” is also set as a warning level should debt approach the limit.

*Table 6: Prudential Indicators: Authorised limit and operational boundary for external debt in £'000*

	<b>2020/21 limit £'000</b>	<b>2021/22 limit £'000</b>	<b>2022/23 limit £'000</b>	<b>2023/24 limit £'000</b>	<b>2024/25 limit £'000</b>	<b>2025/26 limit £'000</b>
Authorised limit – total external debt	66,370	<b>98,629</b>	169,012	192,833	194,770	196,650
Operational boundary – total external debt	61,370	<b>93,629</b>	164,012	187,833	189,770	191,650

16. Further details on the borrowing strategy is contained in the Councils treasury management strategy.

## Other Liabilities

17. In addition to the debt detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £17.9m as at 31 March 2020). It has also set aside provision to cover risks to business rate income from appeals. The Council is also at risk of having to pay for a share of any unfunded liabilities of the Councils' former insurer Municipal Mutual Insurance Ltd (MMI) but has not put aside any money because the amount of any payment is uncertain. This is common to all local authorities insuring with MMI prior to 1993. Further details on liabilities and guarantees are shown in the 2019/20 statement of accounts.

## Investment strategy

18. 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.
19. 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 7: Treasury management investments in £'000

	<b>31.3.21 forecast</b>	<b>31.3.22 budget</b>	<b>31.3.23 budget</b>	<b>31.3.24 budget</b>	<b>31.3.25 budget</b>	<b>31.3.26 budget</b>
Near-term investments	8,434	<b>4,323</b>	4,890	3,833	4,245	4,990
Longer-term investments	8,000	<b>8,000</b>	5,000	5,000	5,000	5,000
<b>TOTAL</b>	<b>16,434</b>	<b>12,323</b>	<b>9,890</b>	<b>8,833</b>	<b>9,245</b>	<b>9,990</b>

*Note: Near term investments will be higher in year due to the level of cash resources held on behalf of third parties, e.g. council tax receipts*

20. Further details on treasury investments are contained in the Council's Treasury Management Strategy.
21. In terms of governance around treasury activities, decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Chief Executive and relevant staff, who must act in line with the treasury management strategy approved by Cabinet each year. Regular reports on treasury management activity are presented to the Audit and Standards Committee who scrutinise treasury management decisions.

### **Investment in Commercial Property**

22. The Council currently invests in existing and developing new commercial property in its area. Due to the low net returns (target in the region of 2% after all costs), the main driver for the activity is to support the areas economic sustainability by retaining employment space and delivering new employment opportunities. This activity is driven through the Council's Property Investment Strategy. This current activity is in addition to historic investments the Council has made to providing commercial work space in its area.
23. With this type of investment, the Council accepts higher risk on commercial investment than with treasury investments. These risks are actively managed by the Council. It is important that commercial investments remain proportionate to the size of the authority and contingency plans are in place, which include disposing of assets and restructuring debt arrangements, should expected yields not materialise.
24. Decisions on commercial investments are made by the Chief Executive subject to the support of the Property Investment Panel. The Panel comprises five Members and four officers. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

### **Investments for Service Purposes**

25. In the past, the Council has made, on occasion, investments through loans to assist local public services, such as the Hastings Furniture Service. In light of the public service objective, the Council can, if it wishes, take more risk than with treasury investments, however it still should ensure such investments break even after all costs. Decisions on service investments are made by Cabinet and Council. Most loans will be treated as capital expenditure and therefore will also be approved as part of the capital programme.

## Revenue Budget Implications

26. 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 £'000*

	<b>2020/21 Forecast</b>	<b>2021/22 budget</b>	<b>2022/23 budget</b>	<b>2023/24 budget</b>	<b>2024/25 budget</b>	<b>2025/26 budget</b>
Net Financing costs (£000)	226	<b>1,101</b>	1,747	2,061	1,964	1,901
Proportion of net revenue stream	1.60%	<b>8.34%</b>	14.74%	17.12%	15.99%	15.17%

27. Further details on the revenue implications of capital expenditure are contained in the 2021/22 revenue budget.
28. 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 because borrowing is linked to assets that will make a financial return sufficient to meet these costs.

## Knowledge and Skills

29. 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 with 30 years' post qualification experience and the Property Investment and Regeneration Manager is a qualified Chartered Surveyor with approximately 30 years post qualification experience, and is supported by a team which includes RICS and CIH qualified staff. The Council has access to specialist legal, valuation, surveying and procurement advice services. The Council pays for junior staff to study towards relevant professional qualifications including Chartered Institute of Public Finance and Accountancy, Association of Accounting Technicians, Royal Institution of Chartered Surveyors and other relevant qualifications.
30. 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 Link Asset Services as treasury management advisers and Savills. 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.

## **Conclusion**

31. This strategy sets out the Council's approach to its Capital spending and its treasury activities including borrowing. It should be read in conjunction with the Council's revenue budget and the Treasury Management Strategy.

## Capital Programme 2020/21 to 2025/26

Line	2020/21 Budget £ (000)	2021/22 Budget £ (000)	2022/23 Budget £ (000)	2023/24 Budget £ (000)	2024/25 Budget £ (000)	2025/26 Budget £ (000)	Total £ (000)
<b>Acquisitions, Transformation and Regeneration</b>							
<b>Other Schemes</b>							
1	130	130	130	130	130	130	780
2	233						233
3	384						384
4	435						435
5	93						93
6	200						200
<b>Property Investment Strategy</b>							
7	10,611	15,737	19,496				45,844
8	964						964
9	100	900	2,000				3,000
10	140	3,345	6,102	403			9,990
11	554	392					946
12	675						675
<b>Housing Development Schemes</b>							
13	297	303					600
14	975	10,350					11,325
15	3,286	3,657	3,657	3,482			14,082
16	0	25,000	37,000	18,000			80,000
17							0
<b>Housing and Community Services</b>							
18	54	54	55	56	57		276
19	5	811					816
20	1,085						1,085
21	203		193				396
22	0	140					140
23	1,625	1,625	1,625	1,625	1,625	1,625	9,750
24	183	125	125	125	125	125	808
25	100						100
26	50						50
27	0						0
28	3,000						3,000
<b>Strategy &amp; Planning</b>							
29	300						300
30	163						163
<b>Executive Directors &amp; Corporate Core</b>							
31	75						75
<b>Resources</b>							
32	140						140
<b>Total Capital Programme</b>							
	26,060	62,569	70,383	23,821	1,937	1,880	186,650

Line	2020/21 Revised Budget £ (000)	2021/22 Budget £ (000)	2022/23 Budget £ (000)	2023/24 Budget £ (000)	2024/25 Budget £ (000)	2025/26 Budget £ (000)	Total £ (000)
<b>Funded By:</b>							
33 Capital Receipts	1,085	0	0	0	0	0	<b>1,085</b>
34 Grants and contributions	3,594	12,993	1,625	1,625	1,625	1,625	<b>23,087</b>
35 CIL	613	193	0	0	0		<b>806</b>
36 Borrowing	19,557	23,764	31,380	4,010	125	125	<b>78,961</b>
37 Capital Expenditure Charged to Revenue	1,211	619	378	186	187	130	<b>2,711</b>
38 Unfunded	0	25,000	37,000	18,000			<b>80,000</b>
<b>Total Funding</b>	<b>26,060</b>	<b>62,569</b>	<b>70,383</b>	<b>23,821</b>	<b>1,937</b>	<b>1,880</b>	<b>186,650</b>