APPENDIX 6

CAPITAL STRATEGY 2019/20 – 2021/22

1. Introduction

The Local Government Act 2003 requires local authorities to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out their capital budgeting and treasury management activities.

The CIPFA Prudential Code establishes a framework designed to support local strategic planning, local asset management planning and option appraisal. The objectives of the CIPFA Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice.

A fundamental part of the CIPFA Prudential Code is the calculation of a number of prudential indicators. These indicators provide the basis for the management and monitoring of capital expenditure, borrowing and investments. Each indicator either summarises the expected capital activity or introduces limits upon that activity and reflects the outcome of the Council's underlying capital appraisal systems.

Following a period of consultation, a new version of the Code was published in December 2017. One of the requirements of the revised Code is that a Capital Strategy is prepared for and approved by the Council. This Capital Strategy is therefore is intended to provide a high–level overview of how the Council approaches the planning and financing of capital expenditure and should be considered in conjunction with the following appendices that form part of this report::

- Treasury Management Strategy Statement 2019/20 – 2021/22 (appendix 7)
- Investments Strategy 2019/20 2021/22 (appendix 8)

Taken together, these appendices show how capital expenditure, capital financing and treasury management activity contribute to the provision of services to the residents of Broxtowe. They set out how the associated risk is managed and the implications for future financial sustainability.

2. Background

Cabinet on 23 June 2015 previously approved a Capital Strategy 2015/16 to 2019/20. This Capital Strategy replaces the former document but is based upon the same core principles. It is intended to ensure that decisions about capital spending are taken in alignment with agreed corporate priorities and make the best use of scarce resources.

The Capital Strategy has been developed in conjunction with the Council's Corporate Plan, ICT Strategy, Asset Management Strategy and People Strategy and seeks links to other approved strategies and policies .

The Council will have regard to the following in determining its capital expenditure plans::

- Corporate objectives (e.g. strategic planning)
- Stewardship of assets (e.g. asset management planning)
- Value for money (e.g. appraisal of options)
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing)
- Affordability (e.g. implications for long–term resources and ultimately on the level of council tax)
- Practicality (e.g. the achievability of the Corporate Plan)

The production of the capital programme will be based upon the following eight core principles:

(i) All assets will be periodically reviewed to determine whether they remain fit for purpose
(ii) Asset management systems will be used to increase the proportion of expenditure on planned as opposed to reactive maintenance and to determine appropriate levels of contingency in each planning period
(iii) Capital expenditure, particularly in respect of investment in commercial assets, will be undertaken within the context of the Council's defined risk appetite and adopted priorities
(iv) The decision to procure or build new assets will take into account the full revenue implications of the life cycle of the asset
(v) Income from asset disposals will be retained centrally for the funding of future capital programmes
(vi) Capital submissions produced by departments will be included in the third year of the three-year rolling capital programme unless they meet the specific criteria outlined above.
(vii) Capital submissions will be reviewed by the Council's Section 151 Officer in conjunction with General Management Team (GMT) using a pre-determined scoring matrix set out in the submission template
(viii) Borrowing will only be pursued as an option for financing capital expenditure after all other potential financing options have been considered

The capital programme is a three-year rolling programme with new submissions, based upon an agreed template, accepted only for year three unless they meet the following criteria:

- The project has health and safety implications which must be addressed as a priority or is a statutory requirement
- The project generates more income over time than the investment required (an "invest to save" project)

- The project is required to match income from external sources that would otherwise be lost

Unforeseen factors may arise will require schemes to be swiftly incorporated within the capital programme. These schemes will be subject to the same appraisal process set out above and will be funding will be assisted by the inclusion of suitable contingencies within the capital programme to avoid disrupting other planned capital schemes.

3. Prudential Indicators for Capital Expenditure

These indicators are set to ensure that the proposed level of capital expenditure remains within sustainable limits.

(i). Capital Expenditure Estimates

Capital expenditure can be paid for immediately by applying capital resources, such as capital receipts or capital grants, or by using revenue resources. However, if these resources are insufficient then any residual expenditure will add to the Council's borrowing need.

This prudential indicator is a summary of the Council's three-year estimates of capital expenditure and anticipated financing. It is intended to ensure that the proposed level of capital expenditure remains within sustainable limits with particular regard to the impact on council tax and housing rent levels. The following table summarises the three-year capital programme as presented to the Finance and Resources Committee on 14 February 2019:

	2017/18 Actual	**2018/19 Revised**	**2019/20 Estimated**	**2020/21 Estimated**	**2021/22 Estimated**
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
General Fund	1,858	5,012	7,492	8,215	4,528
Housing Revenue Account	4,645	6,171	5,503	5,568	5,568
Total	**6,503**	**11,183**	**12,995**	**13,783**	**10,096**
Financed by:					
Borrowing – GF	0	804	3,571	6,519	3,495
Borrowing - HRA	444	0	0	0	0
Vehicle Renewals Fund	320	0	0	0	0
Major Repairs Reserve	3,900	3,889	3,886	3,889	3,889
United Living	8	0	3	0	0
Tesco	14	0	0	0	0
Capital Receipts	157	1,829	320	0	0
Direct Revenue Financing - GF	190	152	0	0	0

Direct Revenue Financing - HRA	753	2,006	1,617	1,679	1,679
Better Care Fund	550	1,210	747	747	747
Liberty Leisure	3	0	90	0	0
Section 106 receipts	61	159	18	0	0
Kimberley School			11		
Rushcliffe Borough Council	(6)	0	0	0	0
Notts County Council	25	0	0	5	0
Notts Pre-Development Fund		70			
Notts FA			650		
6C's Growth Point	26	2	0	0	0
D2N2 LEP			250	500	
Homes England		20	0	0	0
WREN	52	50	144	0	0
Other Bodies	6	13	1	0	0
Total	**6,503**	**10,204**	**11,308**	**13,339**	**9,810**
Shortfall still to be funded	**0**	**979**	**1,687**	**444**	**286**

One of the key risks to the capital expenditure plans above is the level of resources available within the HRA to support capital expenditure. The HRA business plan model update to be reported to the Housing Committee on 5 June 2019 demonstrates that this should not be a major risk over the three year period, particularly in view of the availability of capital receipts from right to buy sales.

Similarly, a risk to General Fund capital expenditure plans is that some of the estimates for other sources of funding may also be subject to change over this timescale. The table above, for example, assumes there are limited capital receipts available to finance General Fund capital expenditure from 2019/20 to 2021/22. One notable exception is with regards to the Council's £500,000 contribution to the Local Authority Mortgage Guarantee Scheme (LAMS) with Lloyds Bank made on 31 January 2014. This contribution was required to be classed as capital expenditure. The Council was reimbursed with this sum on 31 January 2019 on the fifth anniversary of the original payment.

Council on 17 October 2018 agreed that the Town Hall in Beeston be sold to the Redeemer/Cornerstone Church for the sum of £425,000. The resulting capital receipt can be used to finance capital expenditure on schemes such as the migration of services out of the Town Hall and the roll out of the New Ways of Working Project.

Finance and Resources Committee on 13 December 2018 resolved that an unconditional offer of £470,000 for Cavendish Lodge in Beeston be accepted. The resulting capital receipt will also be available to finance capital expenditure.

Finance and Resources Committee on 8 January 2019 resolved that land forming part of the site to be developed in Beeston Town Centre be sold and delegated to the Interim Deputy Chief Executive responsibility in consultation with the three party leaders for concluding the sale. Whilst this will produce a capital receipt that can be used to finance General Fund capital expenditure, no allowance has been made for this in the table above. The resulting capital receipt will enable the borrowing requirement to be reduced accordingly.

Further capital receipts are anticipated following the acquisition by NET of a number of retail businesses in The Square which are owned by the Council but which were on a long term lease to Henry Boot. This matter is being progressed in conjunction with the Council's advisors. No assumptions have been made with regards to either the value or timing of any further receipts that may subsequently be received.

The Council's land and property holdings will continue to be reviewed in line with the Asset Management Strategy 2015/16 to 2019/20 to identify opportunities to bring forward recommendations to dispose of or make alternative use of surplus assets.

It is anticipated that borrowing of £3,571,000 will be undertaken to finance General Fund capital expenditure in 2019/20 with further borrowing of £6,518,500 in 2020/21 and £3,495,000 in 2021/22. The primary factor behind this will be the need to finance the proposed £10,865,000 scheme to redevelop Beeston Town Centre.

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 may sometimes be conflicting and the Council therefore seeks to strike a balance between cheap short-term loans (currently available between 0.75% and 1.0%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0% to 3.0%).

The tight revenue situation is such that it has been assumed that the capital programme from 2019/20 will be revisited and re-aligned as far as possible to tie into available capital resources in order to minimise the level of prudential borrowing required.

(ii) <u>The Capital Financing Requirement</u>

The Capital Financing Requirement (CFR) represents the Council's underlying need to borrow for capital purposes. It is the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. The CFR will change each year in accordance with the value of the approved capital programme and the financing available. The capital expenditure above which has not been financed from available internal resources or from grants or third party contributions will increase the CFR.

	2018/19 Revised	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Financing Requirement	**£'000**	**£'000**	**£'000**	**£'000**
CFR – General Fund	18,706	21,585	27,201	29,622
CFR – HRA	81,330	81,330	81,330	81,330
Total CFR – 31 March	**100,036**	**102,915**	**108,531**	**110,952**
Movement in CFR represented by:				
Borrowing need for the year	804	3,572	6,518	3,495
MRP/VRP and other financing movements	(664)	(693)	(902)	(1,074)
Movement in CFR	**140**	**2,879**	**5,616**	**2,421**

4. Prudential Indicators for External Debt

The Council has an integrated Treasury Management Strategy and manages its treasury activities in accordance with this, therefore borrowing activity will arise as a consequence of all the financial transactions of the Council and not just those arising from capital expenditure as reflected in the CFR.

i) Authorised Limit for External Debt

This prudential indicator is the statutory limit for external debt determined under section 3 (1) of the Local Government Act 2003. It represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which could be afforded in the short term to maximise treasury management opportunities and cover temporary cash flow shortfalls, but is unlikely to be sustainable over the longer term. It is the expected maximum borrowing needed with some headroom for unexpected movements.

The authorised limit for external debt for the next three years is set out in the following table:

	2018/19 Revised	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£'000	**£'000**	**£'000**	**£'000**
Authorised Limit for External Debt	120,200	124,700	132,500	136,950

ii) Operational Boundary for External Debt

The operational boundary links directly to the Council's estimates of the CFR and of other cash flow requirements. This prudential indicator is based on the same estimates as the authorised limit and reflects the most likely and prudent (but not worst case scenario) but without the headroom included within the authorised limit.

The operational boundary for external debt for the next three years is set out in the following table:

	2018/19 Revised	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£'000	£'000	£'000	£'000
Operational Boundary for External Debt	96,150	99,750	106,000	109,550

iii) Actual External Debt

This prudential indicator is obtained directly from the Council's balance sheet at 31 March 2018. It is the closing balance for actual gross borrowing plus other long-term liabilities.

'Other long-term liabilities' are liabilities outstanding (other than borrowing) in relation to the financing of capital expenditure. They relate to, for example, private finance initiative (PFI) credits or finance leases. The Council did not have such long-term liabilities at 31 March 2018 and none are anticipated up to 2021/2022.

This indicator is measured in a manner consistent for comparison with the authorised limit and operational boundary.

Actual External Debt as at 31 March 2018	**£'000**
Borrowing (PWLB)	79,798
Borrowing (Money Market)	18,000
Borrowing (Bramcote Crematorium)	688
Other Long-Term Liabilities	0
Total	**98,486**

5. Prudential Indicator for Prudence

The framework established by the CIPFA Prudential Code is designed to ensure that the objective of keeping external debt within sustainable, prudent limits is addressed each year.

i) Gross Borrowing and the Capital Financing Requirement

This is a key indicator of prudence. In order to ensure that over the medium term gross borrowing will only be for a capital purpose, the Council needs to ensure that its gross borrowing does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional increases to the CFR for the current and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes.

	2017/18 Actual	2018/19 Revised	2019/20 Estimate	2020/21 Estimate
	£'000	£'000	£'000	£'000
Gross Borrowing				
- PWLB and Market	97,798	94,789	98,352	104,861
- Bramcote Crematorium	688	571	382	354
Net Borrowing – 31 March	**98,486**	**95,360**	**98,734**	**105,215**
Capital Financing Requirement				
CFR – General Fund	18,566	18,706	21,585	27,201
CFR – HRA	81,330	81,330	81,330	81,330
Total CFR – 31 March	**99,896**	**100,036**	**102,915**	**108,531**

The Deputy Chief Executive reports that the Council complied with this prudential indicator in 2017/18. The increases in PWLB and market borrowing for 2019/20 and 2020/21 shown above reflects the borrowings required for the General Fund capital programme as set out in appendix 3. However, as set out in section 2 above, it is anticipated that the increase in the General Fund CFR over this period due to additional borrowing will be partly offset by General Fund minimum revenue provision of £664,050 in 2018/19, £692,600 in 2019/20 and £707,550 in 2020/21. This will reduce the total CFR with the result that the level of borrowing set out above will probably therefore not be required in practice. As set out above, this indicator is not based upon one year in isolation but upon a four year time frame representing the medium term as set out in the table. Any borrowing decisions will therefore take account of the effect upon the total CFR.

6. Prudential Indicators for Affordability

Affordability indicators provide details of the impact of capital investment plans on the Council's overall finances.

i) Actual and estimates of the proportion of financing costs to net revenue stream

This indicator identifies the trend in net financing costs (borrowing costs less investment income) against net revenue income from Revenue Support Grant, non domestic rates, council tax and rent income. The purpose of the indicator is to show how the proportion of net income used to pay for financing costs is changing over time.

Proportion of net financing costs to net revenue stream

	2017/18 Actual	2018/19 Revised	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
General Fund	2.9%	11.3%	12.8%	16.2%	19.4%
HRA	14.6%	14.9%	14.5%	14.1%	13.7%

The estimates of financing costs reflect current commitments and the proposals in the revenue and capital budget reports elsewhere on the agenda.

The actual ratio of General Fund net financing costs to net revenue stream was unusually low in 2017/18 following the review of the MRP policy by the Council's treasury management advisors (Arlingclose) that found, among other items, a significant overprovision for MRP in previous years in respect of borrowing before the introduction of new regulations in 2008. This was corrected in 2017/18 and resulted in a significant one-off adjustment.

The indicators for the General Fund rise significantly from 2018/19 to reflect the increase in MRP following the additional borrowing required to finance the purchase of items such as replacement vehicles and new ICT equipment in these years.

The reduction in the indicators for the HRA from 2018/19 to 2021/22 and are a reflection of the fact that no borrowing is planned to finance capital expenditure over the period and rents will be increased by the consumer price index (CPI) plus 1% from 2020/21.

Overall, the Council intends to undertake a prudent level of borrowing to support the capital programme during the period covered by its medium term financial plans.