Appendix 1E

Fermanagh & Omagh
District Council

Comhairle Ceantair
Fhear Manach agus na hÓmaí

Capital Strategy
Report 2019/2022

Background
The Capital Strategy is a new report for 2019/20, introduced by the 2017 edition of CIPFA's Prudential Code, 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.

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 £3,000 are not capitalised and are charged to revenue in year.

In 2019/20, the Council is planning capital expenditure of £12.6m as summarised below:

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

Capital Expenditure and Financing	**2018/19 Revised £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Total Expenditure	7.78	12.6	11	10.8

Governance
The estimated capital plan is derived from approved business cases and economic appraisals in line with the Council's Options Appraisal Policy and it includes a general allocation to support in year works planned. The final capital programme (which is reviewed on a quarterly basis) for the forthcoming financial year is presented to Council for approval as part of the Rates Setting Process and is included within the Council's Medium Term Financial Plan 2019/2022.

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 and leasing). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2018/19 Revised £m	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
External Sources	1.86	4.3	2.7	2.3
Own Resources	3.28	4.7	2.0	0.9
Debt	2.64	3.6	6.3	7.6
Total Financing	**7.78**	**12.6**	**11**	**10.8**

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 is as follows:

Table 3: Replacement of debt finance in £ millions

	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
Own resources	1.24	1.5	1.6	1.4

The Council's policy for the calculation of MRP in 2019/20 will be the asset life method for borrowing following the introduction of MRP, and loan principal on borrowings made before the introduction of MRP.

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 £2m 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

	2017/18	2018/19	2019/20	2020/21	2021/22
	Prior Year	Current Year	Year +1	Year +2	Year +3
Capital Investments	10.2	11.6	13.7	18.4	24.6

Asset management

To ensure that capital assets continue to be of long-term use, the Council is developing an Estates Strategy and a Fleet Management Strategy. The Council also have in place a draft Asset Acquisition and Disposal Policy the aim of which is to set out and inform Members, Officers and other interested parties as to the principles and procedures by which the Council will acquire or dispose of land, buildings and facilities.

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, where there is a shortage of cash this 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.

Due to decisions taken in the past, the Council currently has £7.2m borrowing at an average interest rate of 5.27% and £20m treasury investments at an average rate of 0.7% (as at 31st December 2018).

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 are shown below, compared with the capital financing requirement (see above).

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

	2017/18 Prior Year	**2018/19 Current Year**	**2019/20 Year +1**	**2020/21 Year +2**	**2021/22 Year +3**
Capital Financing Requirement	10.2	11.6	13.7	18.4	24.6
Debt	8.3	7.3	6.2	5.3	4.6

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.

Liability benchmark: To compare the Council's actual external borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. In line with advice received from the Councils Treasury Management Advisors, this benchmark is equal to the Councils outstanding external borrowing, showing there is no need to externally borrow in the medium term to finance the capital programme as it is advisable to first reduce cash balances held. However, this strategy may need to be reviewed depending on how the capital programme progresses.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2018 actual	**31.3.2019 forecast**	**31.3.2020 budget**	**31.3.2021 budget**	**31.3.2022 budget**
Outstanding borrowing	8.3	7.3	6.2	5.3	4.6
Liability benchmark	8.3	7.3	6.2	5.3	4.6

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 8: 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 – total external debt	8.3	7.2	6.3	5.6
Operational boundary – total external debt	7.3	6.2	5.3	4.6

The Council's borrowing strategy is included in the Treasury Management Policy for 2019/20.

<u>Liabilities</u>

As at 31 March 2018, the Council has debt of £8.3m as detailed above. In addition to this, the Council has a liability of £28.1m which represents the Council's share of the Net Pension Liability of the Northern Ireland Local Government Officers' Pension Fund. It has also set aside £6m to cover obligations for the closure and aftercare of its landfill sites in compliance with Northern Ireland Environment Agency Financial Regulations.

Governance: Decisions on incurring new discretional liabilities, if required, will be taken by the Director of Corporate Services and Governance in conjunction the relevant Director of Service and the Chief Financial Officer and reported to the Policy and Resources Committee. Further details on the Council's liabilities are included within the Annual Statement of Accounts.

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. The Council holds invested funds in line with its Annual Investment Strategy which is also included in the Council's Treasury Management Policy for 2019/20.

Governance
Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Corporate Services and Governance and the finance staff, who must act in line with the treasury management strategy approved by the Council. Quarterly reports on treasury management activity are presented to the Policy & Resource Committee. This committee is responsible for scrutinising treasury management decisions.

Revenue Budget Implications
The direct revenue financing element of the capital plan, interest payable on loans and MRP / loans fund repayments are charged to revenue. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from general grant, district rates and capital grants and contributions.

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
Financing costs (£m)	2.0	1.7	1.9	1.9	1.7
Proportion of net revenue stream	5.4%	4.4%	4.5%	4.5%	3.9%

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 35 years into the future.

Knowledge and Skills
The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions.
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 treasury management advisers and property consultants. This approach is cost effective and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.