Appendix 1E

Fermanagh & Omagh District Council

Comhairle Ceantair Fhear Manach agus na hÓmaí

Capital Strategy

Report 2020-2025

Background

The Capital Strategy was 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.

Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future, they are therefore subject to compliance with the Local Government Finance Act (NI) 2011, CIPFA Prudential and Treasury Management Codes and to the Policy framework summarised in this report.

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 2020/21, the Council is planning capital expenditure of £11.75m as summarised below.

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

Capital Expenditure and Financing	2019/20 Revised £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Total Expenditure	9.20	12.75	13.40	17.60	18.40	13.85

Governance: The Estimated Capital Plan prioritises capital projects that are have received external funding, it is supported by the Council's Options Appraisal Policy and includes a general allocation to support in year works planned and will be subject to review and during the forthcoming financial year. The Plan is presented to Council for approval as part of the Rates Setting Process and is included within the Council's Medium-Term Financial Plan 2020-2025.

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

	2019/20 Revised £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
External Sources	3.81	6.75	4.74	2.10	1.22	-
Own Resources	4.35	4.63	6.70	2.00	1.60	1.60
Debt	1.04	1.37	1.96	13.50	15.58	12.25
Total Financing	**9.20**	**12.75**	**13.40**	**17.60**	**18.40**	**13.85**

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

	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
MRP (£million)	2.00	1.60	1.60	1.60	2.30	4.20

The Council's policy for the calculation of MRP in 2020/21 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 £0.1m from £10.4m in the current year to £10.5m in 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 in £ millions

	2019/20 Current Year (£m)	2020/21 Year +1 (£m)	2021/22 Year +2 (£m)	2022/23 Year +3 (£m)	2023/24 Year +4 (£m)	2024/25 Year +5 (£m)
Capital Financing Requirement	10.40	10.50	11.10	23.20	36.90	45.80

Asset Management

To ensure that capital assets continue to be of long-term use, a draft Estates Strategy is at an advanced stage and work is ongoing on a Fleet Management Strategy. The Council also have in place a Land and Property 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 will have £6.2m borrowing at an average interest rate of 5.27% and £19m treasury investments at an average rate of 0.70% (as at 31st December 2019).

Borrowing Strategy

The Council's main objective when borrowing is 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 at 0.65%) and long-term fixed rate loans where the future cost is known but higher (currently 2.00% to 3.00%).

Projected levels of the Council's total outstanding debt are shown below, compared with the capital financing requirement (see above).

Table 5: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	2019/20 Current Year	2020/21 Year +1	2021/22 Year +2	2022/23 Year +3	2023/24 Year +3	2024/25 Year +3
Capital Financing Requirement	10.40	10.50	11.10	23.20	36.90	45.80
Debt	7.20	6.20	5.60	4.90	18.10	28.40

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6 below, the Council expects to comply with this in the medium term.

Liability Benchmark

Table 6: Borrowing and the Liability Benchmark in £ millions

	2019/20 Current Year	2020/21 Year +1	2021/22 Year +2	2022/23 Year +3	2023/24 Year +4	2024/25 Year +5
	£m	£m	£m	£m	£m	£m
Capital Financing Requirement	10.40	10.50	11.10	23.20	36.90	45.80
Less: external Borrowing (A)	(6.20)	(5.30)	(4.60)	(3.90)	(18.10)	(28.40)
Internal/(over) Borrowing (B)	**4.20**	**5.20**	**6.50**	**19.30**	**18.80**	**17.40**
Useable Reserves	22.50	22.50	22.50	22.50	22.50	22.50
Working Capital Required	(1.80)	(1.80)	(1.80)	(1.80)	(1.80)	(1.80)
useable reserves and working capital surplus (C)	**20.70**	**20.70**	**20.70**	**20.70**	**20.70**	**20.70**
Investments/(New Borrowing) (C-B)=(D)	**16.50**	**15.50**	**14.20**	**1.40**	**1.90**	**3.30**
Net Investment (Borrowing) requirement (D-A)	10.30	10.20	9.60	-2.50	-16.20	-25.10
Preferred Year end Position	(10)	(10)	(10)	(10)	(10)	(10)
Liability Benchmark (Year end)	**0.30**	**0.20**	**-0.40**	**-12.50**	**-26.20**	**-35.10**

To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £10m at each year-end, which attracts a MiFID (Markets in Financial Instruments Directive) Professional Status for the Council, however it is noted with effect from 2021/22 onwards that the minimum level of £10m will not be achievable. The liability benchmark is currently at a £0.3m investment position and is forecast to change to a £35.1m borrowing position over the next five years (based on the assumption that £10m remains the preferred year end investment level). The liability benchmark indicates that the Council does not need to borrow in the medium term to finance the capital programme as cash balances are utilised but there may be a need to borrow in the future depending on how the capital programme progresses.

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

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Authorised limit	7.20	6.30	5.60	4.90	19.10	29.40
Operational boundary	6.20	5.30	4.60	3.90	18.10	28.40

The Council's borrowing strategy is included in the Treasury Management Policy for 2020/21.

Liabilities

As at 31 March 2019, the Council had debt of £7.20m. In addition to this, the Council has a liability of £31.70m 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 £5.90m to cover obligations for the closure and aftercare of its landfill sites in compliance with Northern Ireland Environment Agency Financial Regulations.

Governance

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Corporate Services & Governance, The Head of Finance and staff, who must act in line with the Treasury Management Strategy approved by the Council. Quarterly reports on treasury management activity are presented to Policy and Resources Committee.

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 2020/21.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Corporate Services and Governance, The Head of Finance and 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

	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget	2024/25 budget
Financing costs (£m)	2.00	1.60	1.60	1.60	2.30	4.00
Proportion of net revenue stream	4.40%	3.30%	3.50%	3.50%	5.10%	8.70%

Sustainability

Due to the long-term nature of capital expenditure and financing, the revenue budget implications of capital expenditure to be incurred and financed will extend to a maximum of 35 years.

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.