Appendix 3: Capital Strategy 2022-2025

1. Introduction

1.1. This capital strategy report gives 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.

1.2. Decisions made this year on capital and treasury management will have financial consequences for the Council for many years to come. They are therefore subject to both a national regulatory framework and a local policy framework, summarised in this report.

1.3. This report is prepared in line with the requirements of the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code). In December 2021 CIPFA published a revised version of the Prudential Code replacing the previous version published in 2017.

2. Capital expenditure and financing

2.1. 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 is treated as capital expenditure, for example, land and building assets costing less than £25k are generally not capitalised and are instead charged to revenue in the year of purchase.

2.2. The Council's planned capital expenditure is detailed in Appendix 4 and summarised in the table below. (As highlighted in the budget strategy report, significant slippage is expected between years and this is not reflected in the figures below.)

Table 1: Prudential Indicator: Estimated Capital Expenditure (£m)

	2021/22 Forecast	**2022/23 Budget**	**2023/24 Budget**	**2024/25 Budget**
Projects with full external funding	55	0	0	0
Projects with partial external funding	54	6	3	6
Projects with no external funding	78	36	37	31
TOTAL	**187**	**42**	**40**	**37**

2.3. Service managers bid annually for approval of capital projects.

2.4. The Capital Strategy and Asset Management Group (CSAMG) appraises all bids based on a comparison of service priorities against financing costs and makes proposals to Cabinet. The final capital programme is then presented to Cabinet and then Council for approval. Capital projects with the most beneficial impact on the revenue budget will be prioritised. The Council also intends to repurpose assets for better service delivery.

2.5. 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, leasing and Private Finance Initiative). The planned financing of the above expenditure is set out in detail in Appendix 4 and summarised below:

Table 2: Capital Financing (£m)

	2021/22 Forecast	2022/23 Budget	2023/24 Budget	2024/25 Budget
Grants and contributions	59	2	1	0
Capital receipts applied	0	0	0	0
Reserves	0	0	0	0
Minimum Revenue Provision (MRP)	10	10	11	12
Other revenue contributions	0	0	0	0
Debt	118	30	28	25
TOTAL	**187**	**42**	**40**	**37**

2.6. 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). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance.

2.7. 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 Council's estimated CFR is as follows:

Table 3: Prudential Indicator: Estimated Capital Financing Requirement (£m)

	31-Mar 2021 Actual	31-Mar 2022 Forecast	31-Mar 2023 Budget	31-Mar 2024 Budget	31-Mar 2025 Budget
Capital Financing Requirement	335	357	433	511	536

2.8. 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. The Council is currently also permitted to spend capital receipts on service transformation projects until 2022/23.

2.9. The capital programme does not assume any application of capital receipts as financing at this stage. A decision about the use of capital receipts will need to be taken by Cabinet as they can either be used to finance new capital expenditure, or flexibly to finance revenue transformation costs.

3. <u>Treasury Management</u>

3.1. 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.

Borrowing strategy

3.2. The Council's main objective when borrowing is to achieve a low and 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 relatively inexpensive short-term loans (currently available at annual interest rates less than 1%) and long-term, fixed-rate loans where the future cost is known but higher (currently available at annual interest rates of 2% to 3%).

3.3. Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities and leases) are shown below and compared with the capital financing requirement.

Table 4: Prudential Indicator: Capital Financing Requirement and Gross Debt (£m)

	31-Mar 2021 Actual	31-Mar 2022 Forecast	31-Mar 2023 Budget	31-Mar 2024 Budget	31-Mar 2025 Budget
Capital Financing Requirement	**335**	**357**	**433**	**511**	**536**
External Debt (incl. PFI & leases):					
External borrowing	221	233	319	397	422
Long-Term PFI Liabilities	22	21	20	19	18
Obligations under Finance Leases	3	3	3	3	3
Total External Debt	**246**	**257**	**342**	**419**	**443**
Internal Borrowing	**89**	**100**	**91**	**92**	**93**

3.4. Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. The Council expects to comply with this requirement in the medium-term, as shown in the table above.

3.5. To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing assuming that cash and investment balances are kept to a minimum level of £20m at each year-end. Whilst a useful comparator, constraints on the Council's ability to repay existing borrowing would make it difficult (and costly) to implement this strategy. The table below shows that the Council expects to remain borrowed above its liability benchmark over the medium-term.

Table 5: Borrowing and the Liability Benchmark (£m)

	31-Mar 2021 Actual	31-Mar 2022 Forecast	31-Mar 2023 Budget	31-Mar 2024 Budget	31-Mar 2025 Budget
Outstanding borrowing	221	233	319	397	422
Liability benchmark	72	118	234	312	337
Difference	149	115	85	85	85

3.6. The Council is legally obliged to set an affordable borrowing limit (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 authorised limit.

Table 6: Prudential Indicator: Authorised Limit and Operational Boundary for External Debt (£m)

	2021/22 Forecast	2022/23 Budget	2023/24 Budget	2024/25 Budget
Authorised Limits:				
Borrowing	372	449	528	554
PFI and leases	35	34	33	32
Total External Debt	**407**	**483**	**561**	**586**
Operational Boundary:				
Borrowing	352	429	508	534
PFI and leases	30	29	28	27
Total External Debt	**382**	**458**	**536**	**561**

Treasury investments strategy

3.7. Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or purely for financial gain are not generally considered to be part of treasury management (see paragraphs 4 and 5 below).

3.8. 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.

3.9. 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 purchase and the Council may request its money back at short notice.

Table 7: Cash and Treasury Investments (£m)

	31-Mar 2021 Actual	31-Mar 2022 Forecast	31-Mar 2023 Budget	31-Mar 2024 Budget	31-Mar 2025 Budget
Cash and cash equivalents	83.6	50	30	30	30
Treasury investments	85.3	85	75	75	75
Total Investments	**168.9**	**135**	**105**	**105**	**105**

3.10. The effective management and control of risk are prime objectives of the Council's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses.

3.11. Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Section 151 Officer and staff, who must act in line with the treasury management strategy approved by Council each year. The Audit and Governance Committee is responsible for scrutinising treasury management decisions, and regular reports on treasury management activity are presented to this committee.

3.12. The Council's Treasury Management Strategy, Appendix 5, includes further details of the Council's borrowing and treasury investments.

4. Investments for Service Purposes

4.1. The Council may make investments to assist local public services, including making loans to or investing in local service providers, including its own subsidiaries. In light of the public service objective, the Council may be willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs.

5. Commercial Activities

5.1 The Council may invest in property or other commercial activities purely or mainly for financial gain. As financial return is the main objective, the Council may accept a higher level of risk on commercial investments than with treasury investments. The value and risks of commercial investments must remain proportionate to the size of the Council, and contingency plans must be put in place should expected yields not materialise. The revised Prudential Code makes clear that, with immediate effect, local authorities must not borrow to invest primarily for financial returns.

6. Revenue Budget Implications

6.1. Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue (gross financing costs), offset by any investment income receivable (net financing costs).

6.2. Estimated financing costs are summarised in the table below and shown as a proportion of the Council's estimated net revenue stream (the amount funded from council tax, business rates and general government grants).

Table 8: Prudential Indicator: Estimated financing costs (£m)

	2021/22 Forecast	2022/23 Budget	2023/24 Budget	2024/25 Budget
Interest Payable	8.8	8.8	9.8	10.8
Minimum Revenue Provision (MRP)	10.0	10.0	11.0	12.0
Gross Financing Costs	**18.8**	**18.8**	**20.8**	**22.8**
Proportion of net revenue stream	**6.0%**	**5.9%**	**6.4%**	**6.8%**
Less Investment Income	-3.4	-3.5	-3.6	-3.7
Net Financing Costs	**15.4**	**15.3**	**17.2**	**19.1**
Proportion of net revenue stream	**4.9%**	**4.8%**	**5.3%**	**5.7%**

6.3. Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP) and is calculated with regard to the then Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance), most recently issued in 2018. The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year, included as Annex 2 to the Treasury Management Strategy.

6.4. Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years may extend many years into the future. The Section 151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable.

7. Knowledge and Skills

7.1. The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council supports junior staff to study towards relevant professional qualifications.

7.2. 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. 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. Arlingclose are employed as the Council's treasury management advisers.