Appendix 1

Capital Strategy Report 2022/23

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. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

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

2. Capital Expenditure and Financing

2.1 Capital expenditure is where the Authority 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 Authority has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not capitalised and are charged to revenue in year.

2.2 For details of the Authority's policy on capitalisation, please refer to the Accounting Policies within the Statement of Accounts.

2.3 In 2022/23, the Authority is planning capital expenditure of £25.8 million as summarised below:

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

	2020/21 actual	**2021/22* forecast**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**
General Fund services	10.2	21.3	10.8	3.0	1.3
Council housing (HRA)	6.7	15.1	15.0	15.6	12.2
TOTAL	**16.9**	**36.4**	**25.8**	**18.6**	**13.5**

*2021/22 forecast figures include budgeted spend that is expected to be carried forward into the next financial year

2.4 The main General Fund capital projects include the new Coalville and Whitwick Leisure Centre, the regeneration of Coalville and fleet replacement programme.

2.5 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately and includes the building of 77 new homes over the forecast period.

2.6 **Governance**: Service managers bid annually in October to include projects in the Authority's capital programme. Bids are collated by finance who calculate the financing cost (which can be nil if the project is fully externally financed). The finance team appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to the Corporate Leadership Team (CLT). The final capital programme is then presented to Cabinet and Council in February each year.

2.7 For full details of the Authority's capital programme, please see the Budget and Council Tax 2022/23 Report.

2.8 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Authority's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2020/21 actual £,000	**2021/22 forecast* £,000**	**2022/23 budget £,000**	**2023/24 budget £,000**	**2024/25 budget £,000**
General Fund					
Capital Receipts	8	2,830	0	0	0
Government Grants	716	670	670	670	670
Grants	80	0	0	0	0
Reserves	719	2,116	36	2	0
S106 Contributions	0	0	0	0	0
Revenue Contributions	89	62	22	0	0
Leasing/Unsupported Borrowing	8,600	15,609	10,117	2,341	619
General Fund Total	**10,212**	**21,287**	**10,845**	**3,013**	**1,289**
Housing Revenue Account					
Capital Receipts	3,286	2,961	2,471	2,670	2,257
Government Grants	183	459	208	207	207
Reserves	2,253	7,780	8,581	5,186	3,195
S106 Contributions	6	271	219	601	12
Revenue Contributions	934	3,650	3,550	4,250	4,364
External Borrowing	0	0	0	2,700	2,200
HRA Total	**6,662**	**15,121**	**15,029**	**15,614**	**12,235**
TOTAL	**16,874**	**36,408**	**25,874**	**18,627**	**13,524**

*2021/22 forecast figures include funding that is expected to be carried forward into the next financial year.

2.9 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)/loan fund repayments. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP/loan fund repayments and use of capital receipts are as follows:

Table 3: Replacement of prior years' debt finance in £ millions

	2020/21 actual £,000	**2021/22 forecast £,000**	**2022/23 budget £,000**	**2023/24 budget £,000**	**2024/25 budget £,000**
Capital resources	3,294	5,791	2,471	2,670	2,257
Revenue resources	1,869	15,142	2,483	3,317	3,630
TOTAL	**5,163**	**20,933**	**4,954**	**5,987**	**5,887**

2.10 The Authority's full minimum revenue provision statement is available as part of the Prudential Indicators and Treasury Strategies 2022/23 Report.

2.11 The Authority'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 / loans fund repayments and capital receipts used to replace debt. The CFR is expected to increase by £10.4 million during 2022/23. Based on the above figures for expenditure and financing, the Authority's estimated CFR is as follows:

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

	31.3.2021 actual	**31.3.2022 forecast**	**31.3.2023 budget**	**31.3.2024 budget**	**31.3.2025 budget**
General Fund services	25.2	37.1	48.7	49.0	47.2
Council housing (HRA)	70.6	56.4	55.2	56.7	57.6
TOTAL CFR	**95.8**	**93.5**	**103.9**	**105.7**	**104.8**

2.12 **Asset management:** To ensure that capital assets continue to be of long-term use, the Authority has an asset management strategy in place. The Authority's asset management strategy can be read on the council's website.

2.14 **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 Authority plans to receive £4.1 million of capital receipts in the coming financial year as follows:

Table 5: Capital receipts receivable in £ millions

	2020/21 actual	**2021/22 forecast**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**
Asset sales	2.6	3.5	4.1	4.1	2.9
Loans etc repaid	0	0	0	0	0
TOTAL	**2.6**	**3.5**	**4.1**	**4.1**	**2.9**

3. Treasury Management

3.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Authority'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. The Authority 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.

3.2 Due to decisions taken in the past, the Authority currently (as at 31.12.21) has £78.5 million borrowing at an average interest rate of 3.4% and £60.5 million treasury investments at an average rate of 0.04%.

3.3 **Borrowing strategy:** The Authority's main objectives 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 Authority therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.10%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5 to 2.5%).

3.4 Projected levels of the Authority's total outstanding debt (which comprises borrowing, and transferred 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

	31.3.2021 actual	31.3.2022 forecast	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget
Debt (incl. PFI & leases)	79.0	64.9	70.6	69.6	75.8
Capital Financing Requirement	95.8	93.5	103.9	105.7	104.8

3.5 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 Authority expects to comply with this in the medium term.

3.6 **Liability benchmark:** To compare the Authority'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 £10 million at each year-end. This benchmark is currently £59.8 million and is forecast to rise to £86.4 million over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2021 actual	31.3.2022 forecast	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget
Outstanding borrowing	79.0	64.9	62.6	59.9	58.6
Liability benchmark	41.5	59.8	74.2	81.9	86.4

3.7 The table shows that the Authority expects to remain borrowed above its liability benchmark in 2022/23. From 2022/23, the outstanding borrowing falls below the liability benchmark as we are expecting that we will need to undertake new borrowing to cover the capital programmes for both General Fund and HRA.

3.8 **Affordable borrowing limit:** The Authority 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

	2021/22 limit	**2022/23 limit**	**2023/24 limit**	**2024/25 limit**
Authorised limit – total external debt	89.0	82.9	82.3	87.1
Operational boundary – total external debt	79.0	72.9	72.3	77.1

3.9 Further details on borrowing can be found in the treasury management strategy.

3.10 **Treasury 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.

3.11 The Authority'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 Authority may request its money back at short notice.

Table 9: Treasury management investments in £millions

	31.3.2021 actual	**31.3.2022 forecast**	**31.3.2023 budget**	**31.3.2024 budget**	**31.3.2025 budget**
Near-term investments	50.3	5.0	5.0	5.0	5.0
Longer-term investments	0	14.0	5.0	5.0	5.0
TOTAL	**50.3**	**19.0**	**10.0**	**10.0**	**10.0**

3.12 Further details on treasury investments are available in the of treasury management strategy.

3.13 **Risk management:** The effective management and control of risk are prime objectives of the Authority's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

3.14 The treasury management prudential indicators are included in the treasury management strategy.

3.15 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and staff, who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity are presented to the Audit Committee who are responsible for scrutinising treasury management decisions.

4. Investments for Service Purposes

4.1 The Authority can make investments to assist local public services, including making loans to and buying shares in local service providers, local small businesses to promote economic growth, the Authority's subsidiaries that provide services]. In light of the public service objective, the Authority is willing to take more risk than with treasury investments, however it still plans for such investments to generate a profit after all costs.

4.2 The Authority does not currently have any investments for service purposes.

4.3 **Governance:** Decisions on service investments are made by the relevant service manager in consultation with the Head of Finance and must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

4.4.1 Further details on service investments are in available in the Investment Strategy.

5 Commercial Activities

5.1 At present, the Authority does not have any plans to investment in commercial activities purely for financial gain. If the Authority's plans change in this respect, this policy will be revised and approval sought from Full Council before proceeding with any activity. Further details on the Authority's approach to Commercial Activities can be found in the Commercial Strategy.

6 Liabilities

6.1 In addition to debt of £64.9 million detailed above, the Authority is committed to making future payments to cover its pension fund deficit (valued at £65.5 million at 31/03/21). It has also set aside £2 million to cover risks of Business Rates valuation appeals.

6.2 **Governance:** Decisions on incurring new discretional liabilities are taken by the relevant Head of Service in consultation with Head of Finance. The risk of liabilities crystallising and requiring payment is monitored by the Finance Team and reported to committee annually. New liabilities exceeding £1 million are reported to full council for approval/notification as appropriate.

7. Revenue Budget Implications

7.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP / loans fund repayments 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 10: Prudential Indicator: Proportion of financing costs to net revenue stream

	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
Financing costs (£m)	1.22	1.43	1.77	2.64	2.89
Proportion of net revenue stream	6.9%	8.45%	10.52%	14.21%	15.52%

7.2 **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 50 years into the future. The Head of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable because the authority maintains processes to ensure that all capital expenditure is subject to adequate financial planning with all revenue implications being accounted for in the annual budget process.

8. Knowledge and Skills

8.1 The Authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Head of Finance and Section 151 and Finance Team Manager and Deputy Section 151 Officer are both qualified accountants and the Head of Property Services and Economic Regeneration is a qualified surveyor. The Authority pays for junior staff to study towards relevant professional qualifications including Charted Institute of Public Finance and Accountancy (CIPFA), Association of Accounting Technicians (AAT) and Royal Institute of Chartered Surveyors (RICS).

8.2 Where Authority staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Authority currently employs Arlingclose Limited as treasury management advisers, and Wilks, Head and Eve as valuation consultants. This approach is more cost effective than employing such staff directly and ensures that the Authority has access to knowledge and skills commensurate with its risk appetite.