APPENDIX F - CAPITAL STRATEGY 2022/23

1.0 BACKGROUND

1.1 The purpose of the Capital Strategy is to demonstrate that the Council takes capital expenditure and investment decisions in line with Corporate and service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. It sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

1.2 The Capital Strategy comprises a number of distinct, but inter-related, elements as follows:

(a) Capital expenditure (Section 2)

This section includes an overview of the governance process for approval and monitoring of capital expenditure, including the Council's policies on capitalisation, and an overview of its capital expenditure and financing plans.

(b) Capital financing and borrowing (Section 3)

This section provides a projection of the Council's capital financing requirement, how this will be funded and repaid. It therefore sets out the Council's borrowing strategy and explains how it will discharge its duty to make prudent revenue provision for the repayment of debt.

(d) Alternative investments (Section 4)

This section provides an overview of those of the Council's current and proposed **alternative investment activities** that count as capital expenditure, including processes, due diligence and defining the Council's risk appetite in respect of these, including proportionality in respect of overall resources.

(e) Chief Financial Officer's statement (Section 5)

This section contains the Chief Financial Officer's views on the deliverability, affordability and risk associated with the capital strategy

2.0 CAPITAL EXPENDITURE

Capitalisation Policy

2.1 Expenditure is classified as capital expenditure when it results in the acquisition or construction of an asset (e.g. land, buildings, roads and bridges, vehicles, plant and equipment etc.) that:

- Will be held for use in the delivery of services, for rental to others, investment or for administrative purposes; and
- Are of continuing benefit to the Council for a period extending beyond one financial year.

Subsequent expenditure on existing assets is also classified as capital expenditure if these two criteria are met.

2.2 There may be instances where expenditure does not meet this definition but would be treated as capital expenditure, including:

- Where the Council has no direct future control or benefit from the resulting assets, but would treat the expenditure as capital if it did control or benefit from the resulting assets; and
- Where statutory regulations require the Council to capitalise expenditure that would not otherwise have expenditure implications according to accounting rules

2.3 The Council operates de-minimis limits for capital expenditure. This means that items below these limits are charged to revenue rather than capital. The limits are currently as follows:

- **General Limit:** £10,000

Governance

2.4 The Executive shall, during each financial year and after consultation with the relevant Overview and Scrutiny Committee(s), approve a capital expenditure programme for the next following and subsequent 2 financial years. Such programmes shall be in a form and in accordance with deadlines approved by the Chief Finance Officer and in accordance with the Council's Financial Strategy. Capital expenditure plans shall be prepared by the respective Director, in conjunction with the Chief Finance Officer for submission to The Executive and then Council for approval.

2.5 The Council's Financial and Contract Procedure Rules, along with the Asset Management Strategy provide a framework for the preparation and appraisal of schemes proposed for inclusion in the Capital Programme, appropriate authorisations for individual schemes to proceed and facilitate the overall management of the Capital Programme within defined resource parameters.

Capital Expenditure and Funding Plans

2.6 Capital expenditure plans are set out in **Appendix C.**

2.7 When expenditure is classified as capital expenditure for capital financing purposes, this means that the Council is able to finance that expenditure from any of the following sources:

(a) **Capital grants and contributions** - amounts awarded to the Council in return for past or future compliance with certain stipulations.

(b) **Capital receipts** – amounts generated from the sale of assets and from the repayment of capital loans, grants or other financial assistance.

(c) **Revenue contributions** – amounts set aside from the revenue budget in the Reserve for Future Capital Funding.

(d) **Borrowing** - amounts that the Council does not need to fund immediately from cash resources, but instead charges to the revenue budget over a number of years into the future.

2.8 The implications of financing capital expenditure from 'borrowing' are explained in section 3 below.

3.0 CAPITAL FINANCING REQUIREMENT AND BORROWING

Context

3.1 The Council is required to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities (referred to as the 'Prudential Code') when assessing the affordability, prudence and sustainability of its capital investment plans.

3.2 Fundamental to the prudential framework is a requirement to set a series of prudential indicators. These indicators are intended to collectively build a picture that demonstrates the impact over time of the Council's capital expenditure plans upon the revenue budget and upon borrowing and investment levels, and explain the overall controls that will ensure that the activity remains affordable, prudent and sustainable.

3.3 A summary of the actual prudential indicators for 2020/21, and the estimates for 2021/22 through to 2024/25 are provided in Appendix C.

Capital Financing Requirement

3.4 When capital expenditure is funded from borrowing, this does not result in expenditure being funded immediately from cash resources, but is instead charged to the revenue budget over a number of years. It does this in accordance with its policy for the repayment of debt, which is set out in Appendix B.

3.5 The forward projections of the CFR reflect:

- Additional capital expenditure from borrowing or further credit arrangements resulting in an increase to the CFR and

- Revenue budget provision being made for the repayment of debt, which results in a reduction to the CFR).

3.6 The actual CFR for 2020/21 and forward projections for the current and forthcoming years are as follows:

	Actual £000 2020/21	F'cast £000 2021/22	F'cast £000 2022/23	F'cast £000 2023/24	F'cast £000 2024/25
CFR General GF	8,318	7,208	6,606	6,002	5,394
CFR Leases GF	0	0	0	0	0
CFR General HRA	48,074	46,741	45,527	44,312	43,098
Total	**56,392**	**53,949**	**52,133**	**50,314**	**48,492**

3.7 The forecast decrease in the CFR is as a result of a reduction within the current capital programme of capital expenditure that it is intended to be financed from borrowing up to 2024/25, combined with a prudent MRP strategy, which serves to set aside cash resources each year from the revenue budget to repay existing borrowing. A decreasing CFR represents the amount of capital expenditure financed from borrowing that the council has yet to fund from cash resources.

3.8 The forecast decrease in CFR has been driven by a shift in the source of funding for the Housing Delivery Programme within the wider Capital Programme. Future schemes within the Housing Delivery Programme are currently forecast to be funded from existing Council reserve balances, as opposed to future loans to the Selby District Housing Trust, loans that previously served to increase the CFR balance. As investment plans continue to be developed and approved the Capital Programme will be updated and due consideration given to the impact on the CFR to ensure plans are sustainable in the long term and proportionate in terms of a balanced risk approach. CIPFA Prudential Property Investment guidance, issued in Autumn 2019 sets out fundamental considerations Council's should consider prior to undertaking such activities, highlighting key points from existing CIPFA guidance used to formulate the Council's Treasury, Capital and associated strategies. Points relate to understanding the Legal powers the Council is using to invest, borrowing to invest and appropriate MRP policy. The Council's approach to these matters are disclosed in the appropriate sections of the annual strategies. In accordance with new PWLB lending terms introduced in November 2020, the Council will not have access to PWLB borrowing for commercial assets primarily for yield. Other borrowing is permitted but the Council has no plans to invest primarily for yield

External borrowing limits

3.9 The Council is only permitted to borrow externally (including via credit arrangements) up to the level implied by its Capital Financing Requirement (CFR). To ensure that external borrowing does not exceed the CFR, other than in the short term, limits are established for external debt, as follows:

- **Authorised limit** – this defines the maximum amount of external debt permitted by the Council, and represents the statutory limit determined under section 3 (1) of the Local Government Act 2003.

- **Operational boundary** – this is an estimate of the probable level of the Council's external debt, and provides the means by which external debt is managed to ensure that the 'authorised limit' is not breached.

3.10 The proposed limits, which are set out in Appendix D, make separate provision for external borrowing and other long-term liabilities, and are based upon an estimate of the most likely but not worst case scenarios. They allow sufficient headroom for fluctuations in the level of cash balances and in the level of the CFR.

3.11 Alternative investment activities included in the plan are to be classed as capital expenditure. The Alternative Investments Strategy is still evolving though and, in the event that major initiatives are proposed, in excess of those already in the Capital Programme, it may be necessary to review the current borrowing limits.

3.12 The agreed **Operational Boundary** and **Authorised Limits** for external debt are as follows:

Operational Boundary	**2020/21 £'000**	**2021/22 £'000**	**2022/23 £'000**	**2023/24 £'000**	**2024/25 £'000**
Borrowing	84,000	72,000	72,000	72,000	72,000
Other Long Term Liabilities	1,000	1,000	1,000	1,000	1,000
Operational Boundary Total	**85,000**	**73,000**	**73,000**	**73,000**	**73,000**

Authorised Limit for External Debt	**2020/21 £'000**	**2021/22 £'000**	**2022/23 £'000**	**2023/24 £'000**	**2024/25 £'000**
Borrowing	89,000	77,000	77,000	77,000	77,000
Other Long Term Liabilities	1,000	1,000	1,000	1,000	1,000
Total	**90,000**	**78,000**	**78,000**	**78,000**	**78,000**

Borrowing strategy

3.13 The Councils Borrowing Strategy is set out in Appendix D.

3.14 The Council's capital borrowing is slightly lower than the underlying need to borrow. As a result of the capital expenditure plans the Council is expected to be in an under-borrowed position at the end of 2021/22 before moving to an overborrowed position from 2022/23 onwards. This position will be carefully monitored as the Capital Programme is further developed and refined.

3.15 The use of internal borrowing has been an effective strategy in recent years as:

- Rising cash balances as a result of MRP set aside mean available cash for the medium to longer term;
- It has enabled the Council to avoid significant external borrowing costs; and

- It has mitigated significantly the risks associated with investing cash in what has often been a volatile and challenging market.

3.16 Further long term external borrowing may be undertaken, in excess of the current forecasts, in the event that it is not possible or desirable to sustain the anticipated internal borrowing position.

3.17 The external borrowing requirement will be kept under review long term external loans will be secured within the parameters established by the **authorised limit** and **operational boundary** for external debt (as set out within Appendix B).

3.18 Opportunities to generate savings by refinancing or prematurely repaying existing long term debt will also be kept under review. Potential savings will be considered in the light of the current treasury position and the costs associated with such actions.

Minimum Revenue Provision

3.19 The Council sets cash resources aside from the Revenue Budget each year to repay the borrowing. This practice is referred to as the minimum revenue provision (MRP) for the repayment of debt.

3.20 The Capital Financing Requirement (CFR) provides a measure of the amount of capital expenditure which has been financed from borrowing that the Council yet to fund from cash resources.

3.21 Statutory guidance requires MRP to be provided annually on a prudent basis. In accordance with the requirement to make a prudent 'revenue provision for the repayment of debt', the Council ensures that debt is repaid over a period that is commensurate with the period over which the capital expenditure provides benefit. This is achieved by applying the methodology set out in Appendix B. The revenue budget provision for MRP charges in 2022/23 has been compiled on a basis consistent with this policy

3.22 The HRA Business Plan shows that the cost of planned improvement works will exceed the funds available in the major repairs reserve and consequently Voluntary Revenue Provisions previously set-aside to repay the self-financing debt will be needed to support the capital programme. This will mean that debt repayment will have to be deferred beyond the 30 years originally planned, with the intention being to reprofile HRA VRP over the remaining life of the existing debt.

3.23 The DLUHC has recently commenced a consultation on amending MRP rules, with proposed changes to be in place for the financial year beginning 1 April 2023. It is not the government's intention that changes to MRP rules are applied retrospectively and any changes will therefore be reflected in the 2023/24 Treasury Management Strategy.

4.0. Alternative Investments

Introduction

4.1 The prolonged low interest rate environment has resulted in reduced returns on treasury management investments. Moreover, the introduction of the general power of competence has given local authorities far more flexibility in the types of activity they can engage in. These changes in the economic and regulatory landscape, combined with significant financial challenges, have led many authorities to consider different and more innovative types of investment.

4.2 CIPFA recently issued an update to its Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (the Treasury Management Code). One of the main changes introduced by the new Code is to require authorities to incorporate all of the financial <u>and</u> non-financial assets held for financial return in authorities' annual capital strategies.

4.3 Separately, the Department for Levelling Up, Housing and Communities recently updated its Statutory Guidance on Local Authority Investments which reinforces the need for Commercial Activities to be included in the Capital Strategy. In addition, on 25 November 2020, Her Majesty's Treasury introduced revised lending terms for borrowing from the PWLB. Under these revised terms, the government has now ended access to the PWLB for Local Authorities that wish to buy commercial assets primarily for yield (as assessed by the s151 officer). Local authorities remain free to buy commercial assets primarily for yield but are not able to take out new loans from the PWLB in year where they have any plans to buy to buy such assets at any point over the following 3 years.

4.4 More recently, CIPFA published updated Treasury Management and Prudential Codes on 20 December 2021 – these updated Codes will need to be reflected in local authority Treasury Management and Capital Strategies from 2023/24. The new CIPFA Codes further tighten regulations around financing capital expenditure on investments in commercial projects for yield. This corresponds with further proposals from DLUHC to tighten up regulations in this area, having already closed access to all PWLB borrowing if such schemes are included in an authority's capital programme. This does not mean however, that local authorities may not currently have the legal powers to undertake such capital expenditure despite such guidance and regulation.

4.5 All alternative investment activities are subject to approval in accordance with the Council's governance framework for decision making.

<u>Alternative Investment Objectives</u>

4.6 The primary objectives of the commercial investment activities are:

- Security – to protect the capital sums invested from loss; and
- Liquidity – ensuring the funds invested are available for expenditure when needed.

4.7 The generation of **yield** is distinct from these prudential objectives. However, once proper levels of security and liquidity are determined, it is then reasonable to consider what yield can be obtained consistent with these priorities.

4.8 Non-core activities and investments are primarily undertaken by the Council in order to generate income to support the delivery of a balanced budget. Such investments are only entered following a full assessment of the risks and having secured expert external advice (i.e. where it is relevant to do so)

4.9 To ensure that alternative investment plans are financially sustainable, the Council has carefully considered the internal funds available for investment. Since 2014/15 the Council has received substantial payments in relation to Renewable Energy Business Rates, allowing the Council to earmark specific reserves for investment in growth initiatives, known as the Programme for Growth. This has enabled funds to be created for investment in Property funds and Commercial Property.

4.10 In relation to loans to third parties, cash balances have been consistently high and are forecast to remain healthy, which has enabled balances to be earmarked for lending to support our affordable homes agenda. No further loans are anticipated in this regard.

Investment Properties

4.11 The Council has no plans to acquire properties primarily for yield. Funds earmarked through the Programme for Growth for commercial property acquisition are being applied to facilitate property assembly for the Council's Transforming Cities Fund project. Where properties are not being used directly for service provision they will be classed as investment properties.

4.12 Investment properties will be measured at their fair value annually (which will ensure the valuation reflects the market conditions at the end of each reporting period). The fair value measurement will enable the Council to assess whether the underlying assets provide security for capital investment. Where the fair value of the underlying assets is no longer sufficient to provide security against loss, mitigating actions will be considered, to ensure that appropriate action is taken to protect the capital sum invested.

Loans to Third Parties

4.13 Loans to third parties currently relate to the Council's affordable homes programme, with loans to Selby and District Housing Trust. Currently this loan balance stands at £2.8m. At present no further loans to the trust are anticipated, with existing loans currently being repaid over the agreed contract terms of the individual loans. The loan repayments serve to contribute to the Council's reducing CFR position outlined above in section 3.6.

4.14 Any future loans to Third Parties will only be considered once all of the following criteria are satisfied:

- The loan is given towards expenditure which would, if incurred by the Council, be capital expenditure;
- The purpose for which the loan is given is consistent with the Council's corporate / strategic objectives and priorities;
- Due diligence is carried out that confirms the Council's legal powers to make the loan, and that assesses the risk of loss over the loan term;
- A formal loan agreement is put in place which stipulates the loan period repayment terms and loan rate (which will be set at a level that seeks to mitigate any perceived risks of a loss being charged to the General Fund, and takes appropriate account of any state aid rules) and any other terms that will protect the Council from loss;

Property Funds

4.15 During 2018/19 approval was granted to earmark funds from the Special Projects reserve for investment in Property funds. It was identified as an opportunity to diversify the Council's investment portfolio, whilst meeting the objectives set out in 4.6 and 4.7 above.

4.16 The Council undertook an interview and selection process along with the County Council and employed the specialist services of Link Group to act as advisor and guide both Councils through the due diligence and application process.

4.17 At present the Council has a £5.06m holding split between two funds, units were bought on the secondary market in October 2018. Estimated returns on property funds are split between two elements, share of income generated within the fund and the capital value of units held.

4.18 The Council recognises that due to the nature of fluctuating capital value, returns can go down as well as up throughout the life of the investment and as such an earmarked reserve will be established to mitigate against potential losses.

5.0 SECTION 151 OFFICER STATEMENT

5.1 The Prudential Code for Capital Finance in Local Authorities (the Prudential Code) plays a key role in capital finance in local authorities. Local authorities determine their own programmes for investment that are central to the delivery of quality public services. The Prudential Code was developed by CIPFA as a professional code of practice to support local authorities in taking their decisions. Local authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

5.2 In financing capital expenditure, local authorities are governed by legislative frameworks, including the requirement to have regard to CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

5.3 In order to demonstrate that capital expenditure and investment decisions are taken in line with service objectives and properly take account of stewardship, value for money, prudence, sustainability and affordability, the Prudential Code requires authorities to have in place a Capital Strategy that sets out the long term context in which capital expenditure and investment decisions are made, and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

5.4 The Prudential Code requires the Chief Financial Officer to report explicitly on the affordability and risk associated with the Capital Strategy. The following are specific responsibilities of the Section 151 Officer:

- recommending clauses, treasury management policy/practices for approval, reviewing regularly, and monitoring compliance;
- submitting quarterly treasury management reports;
- submitting quarterly capital budget update reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority

- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing

- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources

- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities

- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees

- ensuring that members are adequately informed and understand the risk exposures taken on by an authority

- ensuring that the authority has adequate expertise, either in house or externally provided

- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed

5.5 In summary, the Capital Strategy and Prudential Indicators demonstrate that the capital expenditure, investment and financing plans of the Authority are robust, affordable and sustainable.