APPENDIX 2

CABINET – 7 FEBRUARY 2024 **PORTFOLIO: FINANCE AND CORPORATE**

CAPITAL STRATEGY 2024/25

1. RECOMMENDATIONS

1.1. That the Cabinet recommend to Full Council that the Capital Strategy 2024/25 be approved, including the adoption of the MRP statement.

2. INTRODUCTION

2.1. The Capital Strategy is a high-level document, giving an overview of how capital expenditure, capital financing and treasury management come together, with an overview of current activities and the implications for future financial sustainability.

2.2. By producing this strategy report, the Council is following statutory guidance issued by the Government in January 2018.

3. OVERVIEW OF WHAT IS INCLUDED IN THE CAPITAL STRATEGY

3.1. The Capital Strategy confirms at high level what the Council is intending to spend its money on over the medium term and how it intends to finance this expenditure. Over the period covered by 2024/25 to 2026/27, total capital expenditure is forecast at around £128 million.

3.2. As demonstrated throughout the report, the Council is initially intending to utilise the cash balances it has accrued to deliver the various adopted strategies, including the acquisition and development of Commercial Property, which aims to provide a sustainable and buoyant economy within the New Forest and present options for regeneration, Residential Property Ownership and additional Council owned Housing.

3.3. The Council will supplement internal resources, when necessary, with external borrowing and in accordance with advice it receives from its contracted Treasury Management experts. Based on the current set of prudential indicators, external borrowing will be required each year from 2023/24.

3.4. It is vitally important that the Council has regard to the relationship between the financing costs of the capital programme and the revenue General Fund, and Housing Revenue Account. This is covered within the report by the prudential indicators.

3.5. This Council has established a sound level of governance surrounding its capital investments and employs suitably qualified personnel in order to fulfil the objectives of the Strategy. External support and expertise is sought where necessary, and officers have the ability to communicate openly and freely with members of the Cabinet.

4. MINIMUM REVENUE PROVISION

4.1. Where General Fund capital spend has been financed by loan (including internal borrowing) and has increased the Capital Financing Requirement (CFR), the Council is required to make a provision to repay a proportion of the accumulated amount each year. This amount is charged to revenue and is called the Minimum Revenue Provision (MRP). This charge reduces the CFR each year and is based on the expected economic use period related to the capital expenditure.

4.2. Full Council is required to approve an MRP statement in advance of each financial year. The Council is recommended to approve the following MRP statement:

> ***"For capital expenditure that has been incurred, and which has given rise to a CFR, the MRP policy for expenditure other than that incurred on investment property and dwellings, shall be to charge revenue an amount equal to the depreciation of any asset financed by loan. The MRP policy specific to investment properties and dwellings financed by loan, shall be to charge revenue an amount equivalent to the sum of borrowing utilised, over a repayment period of 50 years."***

5. ENVIRONMENTAL / CRIME AND DISORDER IMPLICATIONS

5.1. There are no implications arising from this report.

6. OVERVIEW AND SCRUTINY PANEL COMMENTS

6.1 The Resources and Transformation Overview and Scrutiny Panel at their meeting on 18 January 2024 supported the Capital Strategy 2024/25 for approval.

7. PORTFOLIO HOLDER COMMENTS

7.1 This gives a broad outline for the capital expenditure over the coming year, providing direction for the prudent use of resources and ensuring that any requirement for outside funding is maintained at an affordable level. I am pleased that the Council has managed to maintain its mandatory (as a result of government legislation) borrowing position for as long as it has, despite significant investment in property supporting the New Forest Economy and in new housing, to support the most vulnerable within our district. The Strategy supports a proportionate capital programme, and affordable costs of finance over the medium term.

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Background Papers:

Capital Strategy 2024/25

1.0 Introduction

This capital strategy 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.

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.

The report also includes the prudential indicators, as required by the Prudential Code.

2.0 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 £10,000 are generally not capitalised and are charged to revenue in year.

In 2024/25, the Council is planning capital expenditure of £49.459 million as summarised below:

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

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
General Fund services	6.682	13.654	17.079	16.297	7.169
Council housing (HRA)	22.077	28.095	32.380	27.400	27.380
Capital investments	13.203	0.250	0.000	0.000	0.000
TOTAL	**41.962**	**41.999**	**49.459**	**43.697**	**34.549**

The General Fund capital programme includes the cyclical replacement of vehicles and plant, the new depot facility at Hardley and containers/vehicles for the new Waste Strategy. A couple of additional projects have been allowed for within the capital strategy, but are not included within the Capital programme at this time, as they are subject to further feasibility work and will require approval through specific business cases in due course. Due to the recent increase in interest rates, no further expenditure on commercial and residential properties is assumed at this time (save for exceptional opportunities).

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 maintenance and decarbonisation of existing stock and the building and acquisition of new homes over the forecast period, in line with the Housing strategy.

Governance: Service managers bid annually in the early Autumn to include projects in the Council's capital programme. Bids are collated by the Chief Finance Officer and reviewed collectively by the Executive Management Team. The Resources and Transformation Overview and Scrutiny Panel appraises the proposed programme and makes recommendations to the Cabinet. The final capital programme is then presented to Cabinet and to Council in February each year.

- Full details of the Council's capital programme are available within the Feb 2024 Cabinet papers (Medium Term Financial Plan / Annual Budget 2024/25)

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

Table 2: Capital financing in £ millions

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
External sources (Grants / DC's)	4.543	10.469	15.620	10.998	7.391
Capital Receipts	3.977	3.000	3.381	2.000	2.000
Capital Reserves	3.640	5.474	6.666	2.444	2.555
Revenue Contributions	11.946	10.360	10.700	10.700	10.700
Debt / Loan	17.856	12.696	13.092	17.555	11.903
TOTAL	**41.962**	**41.999**	**49.459**	**43.697**	**34.549**

Prior to 2023/24 any borrowing required to meet the Council's capital expenditure was met by using cash held in reserves rather than raising loans. This action is known as internal borrowing. Internal borrowing is replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP, explained further below). Alternatively, additional (beyond those already anticipated within the financing as shown within table 2) proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and debt repayment are as follows:

Table 3: Replacement of debt finance in £ millions

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
Capital Expenditure Financed by Debt / Loan	17.856	12.696	13.092	17.555	11.903
Own resources - Debt Repayment	-4.100	-2.749	-4.100	-4.100	-4.100
Own resources - MRP Provision	-1.615	-2.210	-2.746	-3.259	-3.798
Movement in CFR	**12.141**	**7.737**	**6.246**	**10.196**	**4.005**

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, debt repayments and capital receipts used to replace debt. The CFR is expected to increase by £6.246 million during 2024/25. 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

	31.3.2023 actual	31.3.2024 forecast	31.3.2025 budget	31.3.2026 budget	31.3.2027 budget
General Fund services	6.105	7.721	7.988	13.887	12.858
Council housing (HRA)	128.846	135.082	141.495	146.228	151.696
Capital investments	21.400	21.285	20.850	20.415	19.980
Total CFR at Year End	**156.351**	**164.087**	**170.333**	**180.530**	**184.534**
Movement in CFR from one year to the next	**12.141**	**7.737**	**6.246**	**10.196**	**4.005**

Minimum Revenue Provision: Where General Fund capital spend has been financed by loan (internal borrowing), and has increased the CFR, the Council is required to make a provision to repay a proportion of the accumulated amount each year. This amount is charged to revenue and is called the Minimum Revenue Provision (MRP). This charge reduces the CFR each year and is based on the expected economic use period related to the capital expenditure.

Full Council is required to approve an MRP statement in advance of each financial year. The Council is recommended to approve the following MRP statement:

> ***"For capital expenditure that has been incurred, and which has given rise to a CFR, the MRP policy for expenditure other than that incurred on investment property and dwellings, shall be to charge revenue an amount equal to the depreciation of any asset financed by loan. The MRP policy specific to investment properties and dwellings financed by loan, shall be to charge revenue an amount equivalent to the sum of borrowing utilised, over a repayment period of 50 years."***

For Council Housing and the refinancing settlement of 2012, the Council approved a business plan that charged amounts to revenue to ensure that any borrowings are reduced in accordance with the maturity of the debt outstanding. The proposed 2024/25 HRA budget confirms that new borrowing is required to provide the necessary finance to the Capital Programme.

Asset management: Service Managers from across the Council manage assets in their service delivery areas. The Council's Service Manager for Estates and Valuation has overall responsibility for the management of the Council's property estate records, including liaising with the Council's Accountancy department on statutory annual financial reporting. To ensure that property assets continue to be of long-term use, the Council will be producing an overarching Accommodation Strategy.

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds (capital receipts), can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. Council dwelling sales through the Right to Buy scheme also generate capital receipts. The Council plans to receive £2.3 million of capital receipts in the coming financial year as follows:

Table 5: Capital receipts in £ millions

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
Asset sales	4.293	2.400	2.000	2.000	2.000
Loans repaid	0.451	0.301	0.300	0.000	0.000
TOTAL	**4.744**	**2.701**	**2.300**	**2.000**	**2.000**

- The majority of forecast asset disposals relate to Right to Buy receipts.
- In 2014, the Council arranged £2m of prudential borrowing on behalf Lymington Harbour Commissioner. This is being repaid annually, with the final payment in 2023/24.
- In 2022/23, the Council provided a loan facility to the New Forest Enterprise Centre to finance planned maintenance works. The outstanding loan value at the end of 2023/24 is expected to be £300,000, with full repayment due by 31/3/2025.

3.0 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, while a shortage of cash 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[1] but will become cash poor in

[1] 'spent' in this context also includes the payment of collected council tax to the relevant precepting authorities

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.

At the last balance sheet date (31/03/23), the Council had £118.3 million borrowing at an average interest rate of 3.32% (due principally to the HRA refinancing settlement in 2012) and held £31.50 million treasury investments (including sums received from Central government for redistribution) earning an average rate of 3.77%.

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 cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher.

The Council does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board.

Projected levels of the Council's total outstanding debt are shown in table 6 below, compared with the capital financing requirement (see above).

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

	31.3.2023 actual	31.3.2024 forecast	31.3.2025 budget	31.3.2026 budget	31.3.2027 budget
Debt - HRA Settlement	118.1	114.0	109.9	105.8	101.7
Debt - Capital Programme	0.2	7.4	25.1	41.5	52.2
Total Debt	118.3	121.4	135.0	147.3	153.9
Capital Financing Requirement	156.4	164.1	170.3	180.5	184.5

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 Council expects to comply with this for the duration of the current programme.

The figures shown in the Debt – Capital Programme row highlight the amount of external borrowing that is anticipated to be needed from 31 March 2024, but this will be managed against actual overall cash balances, as part of the Treasury Strategy.

Affordable borrowing limit: The Council is legally obliged to set an affordable borrowing limit (also termed 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 limit.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £millions

	2022/23 limit	2023/24 limit	2024/25 limit	2025/26 limit	2026/27 limit
Authorised limit – total external debt	202.9	229.9	230.5	231.1	231.8
Operational boundary – total external debt	185.1	211.5	211.5	211.5	211.5

- Further details on borrowing are included within the treasury management strategy.

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. 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 Council may request its money back at short notice.

Table 8: Treasury management investments in £millions

	31.3.2023 actual	31.3.2024 forecast	31.3.2025 budget	31.3.2026 budget	31.3.2027 budget
Near-term investments	17.9	1.1	1.1	1.0	1.0
Longer-term investments	13.6	9.0	9.0	9.0	9.0
TOTAL	**31.5**	**10.1**	**10.1**	**10.0**	**10.0**

- Further details on treasury investments are included within the treasury management strategy

Table 8 highlights that the majority of the Council's cash will be utilised over the period through internal borrowing to fund the needs of the Council's capital programme, until minimum balances reach £10 million. Use of cash for capital programme financing will then be supplemented through external borrowing, when required. The Council should expect to retain a minimum level of cash, known as the **Liability Benchmark**. The General Fund balance reserve at £3 million and the HRA reserve at £1 million are an absolute minimum, with further headroom added to set where the Council's basic benchmark should be (**£10 million** in total).

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. A mid-year and an outturn report on treasury management activity are presented to the audit committee. The audit committee is responsible for scrutinising treasury management decisions.

4.0 Commercial Activities for the Purpose of Economic Sustainability, Regeneration and Income

The Council has invested in commercial and residential property to support a sustainable local economy within the New Forest and encourage regeneration projects. The Council will invest in and will lend to its Wholly Owned Trading Company and will in return receive an income. Investment properties were valued at £30.7 million on the Council's balance sheet as at 31/03/23 and long terms loans to the WOC totalled £3.713 million as at the same date.

To support the wider objective of economic sustainability and regeneration the Council accepts higher risk on commercial and residential investment than with treasury investments. The principal risk exposures include vacancies and falls in capital values. These risks in relation to commercial property are managed by predominantly targeting acquisitions with existing medium-long term tenancies in place and being sensible about the purchase price in relation to the Council's desire to promote and sustain employment sites within the district, and the income yields achievable. In order that commercial investments remain proportionate to the size of the authority, these are currently subject to an overall maximum investment limit of £50 million. Residential property investments are currently subject to an overall investment limit of £10 million.

Expenditure on these approved strategies is currently paused due to the increased interest return that can currently be received on cash balances, and as the Council is now in an external borrowing position, the interest charges are currently too high to satisfy the financial parameters of the business case requirements.

Governance: Decisions on commercial investments are made by an investment panel in line with the criteria and limits approved by Council in the Commercial Property Investment strategy. Decisions on residential investments are taken by the Board of Directors of the wholly owned company, in line with the criteria and limits approved by Council in the Residential Property Strategy. Property and most other commercial investments are also capital expenditure and purchases have therefore also been pre-approved as part of the capital programme.

- Further details, including the risk management on commercial and residential investments are outlined in these respective strategy documents;
  - Commercial Property Investment Strategy - 2022
  - Residential Property Investment Strategy

5.0 Other Liabilities

In addition to debt of £118.3 million detailed above, the Council is committed to making future payments to cover its pension fund liability (valued at £21 million as at 31/03/23), It has also set aside £4.5 million in provisions, with £4 million of this to cover risks of business rate appeals.

Governance: Decisions on incurring new discretional liabilities are taken by the Chief Finance Officer. The risk of liabilities crystallising and requiring payment is monitored by Accountancy and reported when necessary.

- Further details on liabilities are shown within the Council's draft balance sheet on page 18 of the 2022/23 draft Annual Financial Report, further supported by notes to the accounts:
  - Annual Financial Report - 2022-23

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable[2]. 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 for the General fund, and the income receivable from rents within the HRA.

Table 9: Prudential Indicator: Proportion of financing costs to net revenue stream

	31.3.2023 actual	31.3.2024 forecast	31.3.2025 budget	31.3.2026 budget	31.3.2027 budget
General Fund; Financing costs (£m)	0.31	0.31	0.85	1.63	2.12
General Fund; Proportion of net revenue stream	1.5%	1.4%	3.6%	7.0%	9.6%
HRA; Financing costs (£m)	4.2	4.1	4.9	5.6	6.4
HRA; Proportion of net revenue stream	13.8%	12.4%	13.6%	15.4%	17.2%

The Financing costs of both the General Fund and HRA are set to increase as a result of the required Capital Financing Requirement, reducing cash balances (and assumed interest rates) for investment and costs of external borrowing. Financing costs for the General Fund will increase from 23/24 to 24/25 principally as a result of increased prices of Vehicles and Plant, the application of MRP to the new Platinum Jubilee Business Park and the allowance for borrowing charges as a result of the Capital Financing Requirement. The further increase to 31/3/27 is principally down to expected reductions in treasury management earnings and the capital expenditure requirements associated with the roll out of the new waste strategy, and the MRP / financing thereof. There is a working assumption that

[2] In relation to the finance costs incurred within the General Fund, the income to be generated from Commercial and Residential property will exceed the additional MRP and interest charges, but as this income is to be used to directly contribute towards the funding of services, the income is not netted off against the finance costs within the table 9.

reduced service costs, as a result of the collection methodology change will counter this increase, and that the additional revenue costs associated with regards to Food Waste collection will be supported with government funding.

Financial 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 Chief Finance Officer is satisfied that the proposed capital programme is appropriate according to required projects aligned to service delivery. The medium-long term affordability remains reliant on service change savings being delivered, and government transitional support (with regards to the waste strategy roll-out & the large decarbonisation requirements within the HRA).

6.0 Knowledge and Skills

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Chief Finance Officer, the Finance Service Manager and the Council's Principal Corporate Accountant are all qualified accountants with several years' experience between them. The Service Manager for Estates, Valuation & Facilities is highly experienced in commercial property transactions and facilities management and is supported by experienced and professionally qualified surveyors and valuers (members of the Royal Institution of Chartered Surveyors).

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 Arlingclose Limited as treasury management advisers and has a Service Level Agreement with Hampshire County Council's Treasury Management department for day-to-day treasury management activities. The Council instructs external surveyors, valuers, architects and quantity surveyors to provide specialist advice on specific projects, where required. 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.