Capital Strategy 2022/23

Author	Finance
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CAPITAL STRATEGY 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. Further details of the capital accounting policies of the Council are provided as part of the Statement of Accounts which are available at https://www.great-yarmouth.gov.uk/article/2466/Budgets-and-spending

2.2. In 2022/23, the Authority is planning capital expenditure of £61.36m 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	7.79	30.25	52.19	20.57	7.90
Council housing (HRA)	11.91	10.89	8.90	8.42	8.17
Capital investments	-	0.23	0.28	-	-
TOTAL	**19.69**	**41.37**	**61.36**	**28.99**	**16.07**

2.3. The main General Fund capital projects include:

- The new Health & Leisure Centre £26m over 4 years (2019/20 to 2022/23)
- Share purchase in Council's company, Equinox Property Holdings
- North Quay Redevelopment £2.4m
- Market Redevelopment £4.8m.

2.4. The Council has developed Town Deal and Future High Street Funding proposals looking to regenerate the Great Yarmouth town centre, which incorporates the North Quay and market redevelopment projects that are already in progress. Funding of £34m from Future High Streets and Town Deal has been confirmed and initial budgets have been included in the programme, but the final details on costs, plans and timing of the projects within the funding envelope available have not yet been fully finalised. The capital programme will be updated during the year as these projects develop further. The Authority also plans to incur £0.5m of capital expenditure on investments, which are detailed elsewhere in this report.

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 and acquisition of new homes over the forecast period to replace sales under Right to Buy in line with government guidance. Programmed capital expenditure is also driven to maintaining and improve the overall stock currently held by the HRA, this is prepared over the medium term and reviewed and updated annually.

2.6. Capital investments include loans and shares made for service purposes and property to be held primarily for financial return in line with the definition in the *CIPFA Treasury Management Code.*

2.7. **Governance**: Heads of Service bid annually in October to include projects in the Council'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 Council's Executive Leadership Team appraises all bids based on a comparison of service priorities against financing costs and identifies projects to be put forwards as part of the annual budget setting and those that will be considered separately via a subsequent business case. The final capital programme is then presented to the Policy and Resources Committee and Council in February each year as part of the approval of the budget for the coming financial year.

2.8. For full details of the Authority's capital programme, including the project appraisals undertaken, see: https://www.great-yarmouth.gov.uk/article/2466/Budgets-and-spending.

2.9. It should be noted that other capital projects may be brought forward during the financial year as business cases which are initially appraised by Executive Leadership Team before being passed for approval to the Policy and Resource Committee. Those capital projects costing over £100,000 would then go onto to Council for final approval. The business cases put forward to Executive Leadership Team have been considered for affordability by Finance and, if relating to an IT project, the IT Investment Group.

2.10. 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

General Fund	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
External sources	3.25	11.97	25.87	16.76	7.80
Own resources	1.14	1.54	2.61	-	-
Debt	3.40	16.97	23.99	3.81	0.10
Total	**7.79**	**30.48**	**52.47**	**20.57**	**7.90**

Housing Revenue Account	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
External sources	**0.02**	**0.87**	**0.02**	**0.02**	**0.02**
Own resources	**8.59**	**8.09**	**7.78**	**6.90**	**6.90**
Debt	**3.29**	**1.93**	**1.10**	**1.50**	**1.25**
Total	**11.90**	**10.89**	**8.90**	**8.42**	**8.17**
TOTAL	**19.69**	**41.37**	**61.36**	**28.99**	**16.07**

2.11. 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. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of debt finance in £ millions

	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
Own resources	1.41	1.48	1.73	2.63	2.98

2.12. The Authority's full minimum revenue provision statement is available here as part of the budget for the year: https://www.great-yarmouth.gov.uk/article/2466/Budgets-and-spending

2.13. 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 and capital receipts used to replace debt. The CFR is expected to increase by £23m 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	58.90	74.17	96.33	97.00	94.00
Council housing (HRA)	88.30	90.20	91.30	92.80	94.00
Capital investments	0.00	0.23	0.27	0.00	0.00
TOTAL CFR	**147.20**	**164.60**	**187.90**	**189.80**	**188.00**

2.14. **Asset management:** To ensure that capital assets continue to be of long-term use, the Authority has an asset management strategy in place. The primary aim of the asset management strategy is to support the corporate priorities, achieve service requirements and comply with statutory duties by setting out the vision to improve the management and utilisation of the Council's land and buildings. The strategy provides the basis for developing a more robust and integrated approach to asset management across the Council.

2.15. The asset management strategy promotes collaboration and visibility of resources as well as embedding a culture of scrutiny that will challenge the use, effectiveness and retention of the land and building assets of the council. The strategy outlines the vision and long-term approach to improve the recognition, management and utilisation of land and buildings.

2.16. The Council's asset management strategy can be found here: Corporate Asset Management Strategy 2018-2022

2.17. **Asset Management Working group:** The purpose of the group is to monitor and manage asset projects for the Council. The group meets on a monthly basis. The group undertakes to review assets in relation to opportunities, developments and disposal ensuring the assets of the Council are used to the best effect. Any recommendations from the group are then formulated into report or business cases for the Consideration by the Executive Leadership team and then by the appropriate Committee.

2.18. **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 £5m 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**
General Fund Asset sales	0.7	2.9	4.0	2.0	1.0
General Fund Loans etc repaid	0.3	0.3	0.1	0.1	0.1
Housing revenue Account Asset sales	0.7	1.3	0.9	0.9	1.0
TOTAL	**1.7**	**4.5**	**5.0**	**3.0**	**2.1**

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 in relation to capital and financing decisions with the General Fund and the Housing Revenue Account, the Council currently has £143.6m borrowing at an average interest rates between 0.09% to 4.95% of and £58m treasury investments at an average rate of 0.19%.

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 0.09% to 0.28%) and long-term fixed rate loans where the future cost is known but higher (currently 3.15 to 4.44%).

3.4. Projected levels of the Authority's total outstanding debt (which comprises borrowing, leases and transferred from local government reorganisation) 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. leases)	135.0	83.3	83.0	82.8	82.6
Capital Financing Requirement	147.2	164.6	187.9	189.8	188.0

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 £12m at each year-end plus any plans the Council has for any longer-term investments. This benchmark is currently £105.63m and is forecast to increase by £23.93m 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	£134.5	£82.6	£82.5	£82.3	£82.3
Liability benchmark	£114.5	£137.2	£163.5	£166.6	£165.2

3.7. The table shows that the Authority expects to be within its liability benchmark in 2021/22 and future years. The liability benchmark was exceeded in 2020/21 as the Council held investments above its preferred limit (£34.3m held rather than £12m) at the end of the year. This was because the Council held increased cash balances in 2020/21 as the Government had provided funds in advance of spend to support Councils cashflows during the COVID response. This position is not anticipated to continue.

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.

3.9. These affordable borrowing limits and operational boundaries and further details on borrowing are included within the treasury management strategy at: https://www.great-yarmouth.gov.uk/policies

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 investments to buy and the Authority may request its money back at short notice.

Table 8: 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		32.76	12.00	12.00	12.00	12.00
Longer-term investments		3.11	3.45	5.22	5.22	5.22
TOTAL		**35.87**	**15.45**	**17.22**	**17.22**	**17.22**

3.12. Further details on treasury investments are in the treasury management strategy https://www.great-yarmouth.gov.uk/policies.

3.13. The near-term investment balance incorporates the £10m investment balance that needs to be held to ensure the Council maintains its professional client status under the Markets in Financial Instruments Directive (MiFID II) requirements.

3.14. **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.

3.15. **Governance:** 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. The Section 151 Officer assesses our investment levels to ensure we retain our status as a professional client under MiFID II in order to provide security of capital, access to better investment returns and borrowing rates.

3.16. Bi-annual reports on treasury management activity are presented to Policy and Resource Committee. The Policy and Resource Committee is responsible for scrutinising treasury management decisions.

4. INVESTMENTS FOR SERVICE PURPOSES

4.1. The Council makes investments by providing discretionary loans to local charities and home improvement loans.

4.2. Details of the Council's discretionary Home Improvement loans are given with the Private Sector Housing Adaptation and Improvement (2019) policy which is available at Private Sector Housing Adaptation and Improvement (2019) policy

4.3. Home Improvement loans made are equity loan agreements, so the Council obtains a share of the equity of the borrower's home as collateral. This reduces the risk of the Council not recovering the loan amount from the borrower.

4.4. Discretionary loans to charities are decided by the Policy and Resources Committee if the spend is below £100,000 or Council if over this amount. These loans incur interest charges which are set at a market rate to reflect the costs and the level of risks. These loans are equity loans to again to reduce the risk of a borrower defaulting on payment in line with the loan agreement.

4.5. Total investments for service purposes are currently valued at £2.9m with the largest being the loans to Great Yarmouth Preservation Trust totalling £0.7m providing a net return after all costs of in the region of 3.6%.

5. COMMERCIAL ACTIVITIES

5.1. The Council has invested historically in commercial property and holds a significant asset base for financial gain and to support regeneration. Total commercial property investments are currently valued at £51.7m which provide a net return after all direct costs of £2.4m (as reported in the draft 2020/21 statement of accounts Note 15).

5.2. The Council can accept a higher risk on its historic commercial investment than with treasury investments. The principal risk exposures include:

- vacancies;
- fall in capital value;
- lessee not complying with repairs and maintenance terms of lease agreement;
- changes in demand for property types (e.g. offices, industrial)

5.3. These risks are managed by the Councils Property and Asset Management service and finance.

5.4. **Governance:** Future decisions on historic commercial investments, including potential disposals, will be made following consideration of robust business cases for approval in line with the current decision-making governance arrangements. Future spend on historic commercial investments will be capital expenditure and will therefore also be approved as part of the capital programme.

5.5. The Authority also has commercial activities in its subsidiary companies Equinox Enterprises Limited (EEL) and Equinox Property Holdings Limited (EPH). The companies aim is to increase, regenerate and improve the standard of housing across the borough, whilst at the same time aiming to generate a return to at least break even. The Council receives a margin of earned debt interest from the loan facilities with EPH and EEL. All loans for EPH are secured against the properties purchased by the company. The Council will also receive a return on equity invested which reflects profits back from the company's operation of property sales and market rental income from housing acquired. This return is through dividends paid to the Council once profits and reserves of the companies allows.

5.6. Both Equinox companies regularly review risk using Corporate and Project Risk Registers. The company boards hold bi-monthly meetings throughout the financial year.

5.7. Equinox Enterprises Limited and Equinox Property Holdings Limited are required to agree their respective Business Plans annually. They also provide the Council as shareholder's quarterly update reports as presented to the Policy & Resources Committee.

5.8. The authority does not intend to make any future investment in commercial property assets for the primary purpose of generating a yield.

6. LIABILITIES

6.1. In addition to debt of £83m detailed above, the Authority is committed to making future payments to cover its pension fund deficit (valued at £73.8m as at 31st March 2021). It has also set aside £1.4m to cover risks of Non-domestic Rate appeals (as at 31st March 2021). The Council currently has no contingent liabilities.

6.2. **Governance:** Decisions on incurring new discretional liabilities are taken by Head of Service in consultation with the S151 Officer. The risk of liabilities crystallising and requiring payment is monitored by Finance and where significant would be reported as part of budget monitoring reports present quarterly to Policy and Resource Committee, if relating to General Fund, and Housing and Neighbourhoods Committee if in relation to the Housing Revenue Account. New liabilities exceeding £1m are reported to full council for approval/notification as appropriate.

6.3. Further details on liabilities and guarantees are included within the draft 2020/21 statement of accounts at https://www.great-yarmouth.gov.uk/article/2466/Budgets-and-spending

7. REVENUE BUDGET IMPLICATIONS

7.1. 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. 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 9: 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)	£2.0	£2.7	£2.6	£3.5	£3.9
Net Revenue Stream (£m)	£23.3	£12.3	£13.7	£13.3	£13.9
Proportion of net revenue stream	8.71%	22.18%	19.23%	26.74%	28.13%

7.2. Further details on the revenue implications of capital expenditure are included in the 2022/23 revenue budget at https://www.great-yarmouth.gov.uk/article/2466/Budgets-and-spending

7.3. **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 Section 151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because current and new capital funding decisions have been made in the context of the associated revenue implications.

8. KNOWLEDGE AND SKILLS

8.1. The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Section 151 Officer is a qualified accountant with over 15 years' experience and the Finance Manager is a qualified accountant with over 10 years' experience. The Councils' Property and Asset Management team includes 3 Charter Surveyors (MRICS) who are also registered valuers each with over 10 years' experience. The Council pays for relevant staff to study towards relevant professional qualifications including MRICS, ACCA and AAT.

8.2. 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. The Council currently employs Arlingclose Limited as treasury management advisers and PS Tax as VAT and tax advisors. 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.