

Appendix 5 Capital Strategy Report 2022/23

Oadby and Wigston Borough Council

Introduction

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.

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.

Capital Expenditure and Financing

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 £3k are not capitalised and are charged to revenue in year.

- For details of the Authority's policy on capitalisation, see the accounting policies section of the Statement of Accounts: https://www.oadby-wigston.gov.uk/files/documents/draft_unaudited_statement_of_accounts_202021_including_the_annual_governance_statement_202021/OWBC%20Draft%20Annual%20Statements%202021.pdf

In 2022/23, the Authority is planning capital expenditure of £8.226m 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	0.912	1.957	4.396	*1.000	*1.000
Council housing (HRA)	1.237	2.449	3.830	1.500	1.500
Capital investments	0	0	0	0	0
TOTAL	2.149	4.406	8.226	2.500	2.500

**These figures are provisional*

The main General Fund capital projects include Invest to Save projects (£350k); Transformation (£400k); and Energy Efficient Technologies (£200k). The Authority does not plan to incur capital expenditure on investments during 2022/23.

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 a new housing development at Horsewell Lane (£2.330m) and other capital works per the HRA Business Plan (£1.5m).

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

Governance: Service managers bid annually 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 Policy, Finance and Development Committee appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to Full Council. The final capital programme is presented to Full Council in December with any amendments being made by Full Council in February when the finalised budget is approved each year.

- For full details of the Authority's capital programme, see: <https://moderngov.oadby-wigston.gov.uk/documents/b6705/Agenda%20update%2021st-Dec-2021%2018.30%20Full%20Council.pdf?T=9>

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	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
External sources	0.163	0.469	0.695	0.000	0.000
Capital resources	0.000	0.000	0.910	0.000	0.000
Revenue resources	1.132	1.807	1.500	1.500	1.500
Debt	0.854	2.130	5.121	1.000	1.000
TOTAL	2.149	4.406	8.826	2.500	2.500

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 Minimum Revenue Provision payments (MRP) are as follows:

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

	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
Capital resources	0.000	0.000	0.000	0.000	0.000

Revenue resources	0.805	0.851	0.505	0.614	0.661
TOTAL	0.805	0.851	0.505	0.614	0.661

- The Authority's full minimum revenue provision review is available here at Agenda Item 14:

<https://moderngov.oadby-wigston.gov.uk/documents/b6705/Agenda%20update%2021st-Dec-2021%2018.30%20Full%20Council.pdf?T=9>

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 £4.615m 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	17.375	18.011	20.797	21.182	21.521
Council housing (HRA)	19.732	20.375	22.204	22.204	22.204
Capital investments	0.000	0.000	0.000	0.000	0.000
TOTAL CFR	37.107	38.386	43.001	43.386	43.725

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 c£1.6 m 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	0.158	0.400	1.600	0.400	0.400
Loans etc. repaid	0.000	0.000	0.000	0.000	0.000
TOTAL	0.158	0.4000	1.600	0.400	0.400

- The Authority's Flexible Use of Capital Receipts Policy is available as part of the Full Council reporting pack in February 2022.

Treasury Management

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.

Due to decisions taken in the past, the Authority currently has £33.161m borrowing at an average interest rate of 3.09% and £5m treasury investments at an average rate of 0.1%.

Borrowing strategy: The Authority'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 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%).

Projected levels of the Authority's total outstanding debt (which comprises borrowing, PFI liabilities, leases 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
GF and HRA Debt (incl. PFI & leases)	34.751	33.161	38.069	38.974	39.877
Capital Financing Requirement	37.107	38.386	43.001	43.386	43.725

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.

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 – borrowing	43.0	48.0	49.0	50.0
Operational boundary – borrowing	38.0	43.0	44.0	45.0

- Further details on borrowing are in the Council’s Treasury Management Strategy

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.

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	5.000	0.000	0.000	0.000	0.000
Longer-term investments	0.000	0.000	0.000	0.000	0.000
TOTAL	5.000	0.000	0.000	0.000	0.000

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.

- The treasury management prudential indicators are detailed in the Treasury Management Strategy

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance and staff, who must act in line with the treasury management strategy approved by Full Council. Half-yearly reports on treasury

management activity are presented to Policy, Finance and Development Committee who scrutinise the treasury management decisions.

Commercial Activities

The Authority has very limited commercial activity which relates to three small shops which form part of an apartment block which is owned by the Council. The rental is c£17k per annum and is therefore not material and as such present little risk.

Governance: Decisions on commercial investments are made by Director of Finance alongside the Senior Leadership Team. Any plans would then require approval by Full Council. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

Liabilities

In addition to debt of c£38m (2022/23) detailed above, the Authority is committed to making future payments to cover its pension fund deficit (valued at £30m). It has also set aside £223k to cover risks arising from Business Rates appeals.

Governance: Decisions on incurring new discretionary liabilities are taken in consultation with the Director of Finance. The risk of liabilities crystallising and requiring payment is monitored by Finance and reported to Committee.

- Further details on liabilities and guarantees are shown each year in the Statement of Accounts.

Revenue Budget Implications

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 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) General Fund	0.990	1.006	0.715	0.830	0.883
Financing costs (£m) HRA	0.529	0.507	0.542	0.542	0.539
Proportion of net revenue stream GF	10.7%	15.5%	11.7%	13.9%	14.2%
Proportion of net revenue stream HRA	10.9%	10.4%	10.6%	10.4%	10.1%

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 Director of Finance/S151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable following scrutiny of the available funding; the medium term financial strategy and the due diligence of each project.

Knowledge and Skills

The Authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Finance/S151 Officer is a qualified accountant with substantial experience. The Authority pays for junior staff to study towards relevant professional qualifications including CIPFA, ACT (treasury) and AAT.

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. 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.