Capital Strategy Update 2023/24 – 2028/29

Report of the Finance and Resources Portfolio Holder

Recommended:

That the Capital Strategy 2023/24 to 2028/29 be approved.

Recommendation to Council

SUMMARY:

- The Capital Strategy sets out the framework within which all Council capital expenditure is approved, monitored and financed. The CIPFA Prudential Code requires that it be updated annually.
- This report provides an update of the existing Capital Strategy and includes forecast changes to its timescale and total cost.

1 Introduction

1.1 The approval of a Capital Strategy is an annual requirement under the revised CIPFA Prudential Code 2021. The Code requires that councils have in place a strategy that sets out the long term context in which capital expenditure and investment decisions are made, giving due consideration to both risk and reward and the impact resulting from those decisions.

1.2 As local authorities become increasingly complex and diverse it is important that those charged with governance understand the long term context in which investment decisions are made and the financial risks to which the council is exposed.

1.3 The objectives of the Capital Strategy are to:

- Provide an overview of the governance process for approval and monitoring of capital expenditure.
- Provide a longer term view of planned capital expenditure.
- Provide expectations around debt and use of internal borrowing to support capital expenditure.
- Define the council's approach to commercial activities including due diligence and risk appetite.
- Define the available knowledge and skills of the council in relation to capital investment activities.

2 Background to the Capital Strategy

2.1 The Capital Strategy was last updated for the period 2022/23 to 2027/28 in February 2023.

2.2 The Capital Strategy demonstrates how the Council takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability.

2.3 The Capital Strategy addresses in detail the following key areas:

- Linking together capital requirements related to corporate priorities for new projects and the ongoing capital need to maintain / repair existing assets through the Asset Management Plan.
- Managing the approved Capital Programme in an affordable, financially prudent and sustainable way.
- The process of how new bids are introduced to the Capital Programme.
- Monitoring progress against approved budgets.
- Financing capital expenditure, including borrowing requirements and Minimum Revenue Provision (MRP).
- Knowledge and skills.

2.4 The Capital Strategy does not allocate resources. This is included in the decision-making process in setting the three-year rolling capital programme as part of the annual budget-setting process.

2.5 The Capital Strategy is written to give a broad view of anticipated spending in the longer term and how it will be financed. This includes estimates of potential capital expenditure towards delivery of the regeneration programmes, which is expected to be debated by Council on 29 February.

2.6 All capital receipts and expenditure identified in this document are subject to the Council's Financial Regulations and the authority limits contained therein.

3 Definition of Capital Expenditure

3.1 In order to qualify as capital expenditure an item must meet the following three criteria:

- Have a total cost greater than £10,000.
- Have a useful economic life greater than one year.
- Expenditure must be for the purchase of new land / equipment that can be separately identified on the asset register OR
  Materially lengthen the expected useful economic life of an asset OR
  Add value to the asset being modified.

3.2 All other expenditure on the routine maintenance and repair of assets will be treated as revenue expenditure.

4 Corporate Objectives and Priorities

4.1 The objective of the Capital Strategy is to ensure that the overall strategy, governance procedures and risk appetite are clear to Councillors.

4.2 The Council's Corporate Plan sets out the Council's strategic aims over the period 2023 – 2027 and details five priority areas.

4.3 The Capital Strategy enables delivery of projects within the Corporate Action Plan to deliver these priority areas. Some examples of projects in the current Capital Programme that contribute to meeting these priorities are given below.

Sustainability – delivery lasting benefits for our Communities

4.4 Over £2.4M has been approved from accumulated Community Infrastructure Levy payments towards delivery of fifteen projects across the borough. These projects will help to ensure the ongoing sustainability of the communities using those various facilities.

Prosperity – economic growth that impacts positively on our communities

4.5 Over £1M is approved for the delivery of interventions in respect of the UK Shared Prosperity Fund and the Rural England Prosperity Fund.

Inclusion – working together to create opportunities for our communities

4.6 The Council continues to operate an extensive grants scheme providing adaptations to homes to enable residents to continue living independent lives for as long as possible.

4.7 In the current year, nearly £2M has been spent delivering fourteen new homes for families new to Test Valley who have been displaced from their homes in Ukraine.

Connection – building upon the identity, strengths and ambitions of our communities

4.8 The next phases of the ambitious regeneration plans for both Andover and Romsey will be delivered over a period beyond the life of this strategy.

4.9 These programmes will be of significant importance in taking forward the ambitions and opportunities for the people using our town centres.

Environment – a greener borough for our communities

4.10 A commitment has already been approved in the Capital Programme for the purchase of vehicles and bins necessary to implement food waste collections across the borough. Works are also planned to prepare the depots to manage the increased size of the vehicle fleet and staff parking provision.

5 Capital Expenditure required to maintain Council Assets

5.1 In addition to the above, the Council also has the responsibility of maintaining its existing asset base.

5.2 The Asset Management Plan (AMP) for 2024/25 was approved by Council on 17 January 2024. The plan identifies a combination of both revenue repairs and capital replacements for assets owned by the Council.

5.3 Whilst the AMP is a key document in planning future capital expenditure requirements, funding for the identified projects is only approved for current year and 2024/25 projects.

5.4 The Council has an earmarked reserve for Asset Management expenditure, which covers both revenue and capital expenditure. The balance on this reserve was £2.728M at 31 March 2023. Currently, it is forecast to have a balance of £459,000 remaining by the end of March 2025.

The Council's strategy is to fund the AMP in three ways:

- Through ongoing contributions from the revenue budget. This is recommended to be £2.0M in 2024/25.
- An allocation of any revenue surpluses at the end of the year can be used to top-up the reserve.
- Use of earmarked reserves or other sources of income to finance specific projects. For example, some community based projects are regularly funded by New Homes Bonus receipts in the year.

5.5 The level of the contribution to the Asset Management Reserve is reviewed annually as part of the budget setting process.

6 The Council's Capital Expenditure and Financing 2023/24 to 2028/29

Current Asset Portfolio as at 31/3/23

6.1 The Council holds an investment property portfolio that supports both its operational activities and non-operational activities from which it receives an element of rental income. For 2023/24 the value was £8.177M which represents a gross yield of 4.9%.

Asset Category	**Valuation 31/03/23**	**Rental Income**
	£'000	**£'000**
Investment Properties	**166,245**	**8,177**
Operational Assets		
Land & Buildings	109,802	
Vehicles, Plant & Equipment	3,822	

Community Assets	12,821	
Infrastructure Assets	604	
Surplus Assets	315	
Total Operational Assets	**127,364**	
Total Assets	**293,609**	

The rental income the Council receives is used to support General Fund services.

Investment Property (Non-Operational)

6.2 These assets include Business Parks, commercial property investments and land held solely for capital appreciation and rental income.

Land and Buildings

6.3 These are operational properties, land, infrastructure and community assets that are used to deliver council services and include Council offices and car parks.

Vehicles, Plant & Equipment

6.4 These assets are used in the delivery of Council services and include all council owned vehicles, IT equipment, play equipment and green spaces equipment.

Community Assets

6.5 These assets include parks and open spaces.

Infrastructure Assets

6.6 These assets include footpaths and cycle ways.

Surplus Assets

6.7 These are assets that are not being used to deliver services, but which do not meet the criteria to be classified as either investment properties or assets for sale.

6.8 Capital Expenditure Forecast

Details of capital expenditure form one of the prudential indicators (these show the affordability of capital expenditure). The table below shows the capital expenditure for 2022/23 to 2028/29 based on the approved Capital Programme; estimated costs of regeneration projects in Andover and Romsey; continuation of ongoing schemes (such as disabled facilities grants); and estimates from services of other new schemes that may come forward in the future.

Any amounts included beyond the period of the current capital programme (to 2025/26) are not yet approved by Council and are subject to change. It is also very likely that further capital expenditure will be approved that is not reflected in the table below.

It should, therefore, be seen as a forecast of the Council's potential capital commitments over the next five year period, rather than a set programme.

Capital Expenditure	**2022/23 Actuals £'000**	**2023/24 Forecast £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**	**2026/27 Estimate £'000**	**2027/28 Estimate £'000**	**2028/29 Estimate £'000**
Asset Management Plan	1,702	2,088	2,510	1,500	1,500	1,500	1,500
Community Assets	1,764	4,825	4,728	2,312	2,000	2,220	2,000
Infrastructure Assets	14	1,533	7,315	6,300	1,200	1,000	
Investment Properties	2,850	186	1,148	1,000	1,000	1,000	1,000
Vehicles, Plant & Equipment	34	260	1,649				
Total Capital Expenditure	**7,155**	**9,261**	**25,313**	**26,731**	**20,200**	**11,470**	**13,500**

The main sources of funding capital expenditure are set out in paragraph 10. The funding for all capital projects is identified at the time the expenditure is approved to ensure that the Council does not enter into unaffordable capital commitments.

7 Managing the Capital Programme

7.1 A Capital Working Group (CWG) which includes the Deputy Chief Executive, together with representatives from Finance & Revenues and other Services with capital expenditure requirements is responsible for assessing new capital bids against a range of criteria, and considering the available capital financing options.

7.2 The Capital Programme is updated and reported to Cabinet three times per year. Bids for new expenditure are generally included in the autumn report (see para 8.1). Each update contains details of approved projects together with the budget profile of each project.

7.3 The process for adding new projects to the Capital Programme is detailed below.

8 Adding new projects to the Capital Programme

8.1 The timetable for new bids to be prepared and assessed before being presented for approval is as follows:

July/August – CWG reviews bids together with draft business cases and options appraisals. All bids are subject to an objective scoring exercise. Bids are prioritised according to the score attained.

October – Management review of scored bids.

November – The proposed Capital Programme is considered by Cabinet.

January – The Capital Programme is considered by Council for final approval.

8.2 In order to ensure the most efficient use of capital resources, an objective scoring methodology is used. The scoring system gives priority to bids that meet the Council's Corporate Plan objectives or improve efficiency in service delivery whilst considering other key factors such as the Climate Emergency.

9 Monitoring Progress against the Capital Programme

9.1 The Capital Programme contains details of approved projects together with the budget profile of each project. Where budget variances or potential slippage are identified, they are reported to Cabinet as part of the Capital Programme reporting process.

9.2 Cabinet receives three updates per year on the progress of the Capital Programme. On each occasion, the progress of each project is assessed and if any change is required to the budget or timing of the project, the reasons are explained and the necessary approvals sought.

10 Financing the Capital Programme

10.1 Consideration of the financing of capital projects is integral to the governance procedures outlined above.

10.2 In general, the Council finances capital expenditure from existing resources including reserves and capital receipts or from specific grant funding sources. There is also a revenue contribution to capital included within the substantive Council budget.

10.3 As at February 2024, the forecast balance of the Capital Receipts Reserve used for the financing of the approved Capital Programme at 31 March 2026 was £5.2M.

<u>Resource Streams to fund the Capital Programme</u>

10.4 The Council has five main sources of income generation to fund future capital expenditure:

- Proceeds from the sale of assets
- Grants and contributions for specific projects, including New Homes Bonus and developers' contributions
- Contributions from the Revenue Budget
- Use of existing balances
- Borrowing

10.5 This strategy recommends a sustainable approach to capital investment by placing maximum emphasis on utilising the first three options. Use of existing balances will only be used for the reasons discussed in paragraph 10.19-23. Borrowing will only be used for funding where there is a good business case for doing so.

Sale of redundant / obsolete assets

10.6 The Property and Asset Management Service monitors the useful economic life of the Council's land and buildings assets. Where it is determined that an asset is surplus to Council requirements or is not economically advantageous to retain it will be considered for disposal.

10.7 Disposals will not be for less than the best consideration that can reasonably be obtained unless there are exceptional circumstances (e.g. discounted disposal for affordable housing).

10.8 In considering whether an asset is surplus to requirements, the following will all be considered; the Council's ability to control future uses of the property, the net income foregone by disposal and the costs of making good or creating a suitable replacement of the asset sold.

10.9 The Head of Property and Asset Management will periodically produce a list of properties considered appropriate for potential disposal and, if required, report to Cabinet accordingly.

Grants and Contributions

10.10 Certain projects will attract grants from the Government or other bodies. Where these grants are available, the Council will seek to fully utilise them, having due consideration to ongoing revenue costs that will have to be borne following the removal of the grant. The level of external funding available is considered when approving bids to be added to the Capital Programme.

10.11 The Council also uses income received under the New Homes Bonus scheme to contribute to new capital expenditure. For example, receipts from this source are used to fund playground replacements through the AMP.

10.12 Part funding is available on some projects from partners (e.g. Hampshire County Council). Where such contributions are available, they will be applied against approved capital expenditure.

10.13 As part of the terms of certain planning consents, developers are required to make contributions to local infrastructure in areas such as affordable housing, open space, green travel, highways improvements etc. (often referred to as section 106 agreements). Where these contributions are available they will be applied against the total cost of relevant projects.

10.14 The S106 regime is supplemented by the Community Infrastructure Levy (CIL).

Revenue Contributions

10.15 The annual revenue budget includes contributions to capital reserves for specific projects as well as a general contribution towards future capital spending.

10.16 Additional revenue contributions may be made in the event of revenue surpluses at the end of each year. However, the allocation of any underspend will be decided by Cabinet and cannot be relied upon as a sustainable source of financing for the capital programme.

10.17 Where the Council has existing reserves, these balances could be considered for transfer to the Capital Programme. However, reserve balances are one-off in nature and do not provide an ongoing funding option.

10.18 In light of recent increases in the base interest rate, the Council forecasts generating additional income from its cash investments over the medium term. The Medium Term Financial Strategy allows for a transfer from revenue to allocate some of this income to capital expenditure.

Use of Existing Balances

10.19 At 1 April 2023 the Council had £7.929M of useable capital receipts.

10.20 The strategy allows for the use of accumulated capital reserves for the delivery of new capital expenditure. However, it is recommended that the forecast balance not be taken below £1.5M at any time to ensure there is capacity to deliver an ongoing capital programme that meets the needs of the Council.

10.21 Use of balances or internal borrowing will also be considered appropriate as a short term measure where expenditure is made before expected capital receipts are generated. There is some risk with this approach as expenditure will be incurred before assets are sold and income is realised.

10.22 The current Capital Programme is fully financed and can be delivered with available resources.

Borrowing

10.23 The Council borrowed £5.9M in 2018/19 to part fund the redevelopment of Andover Leisure Centre. In April 2019 a further £1.55M was borrowed to fund the purchase of property in Andover. The Council, as an eligible local authority, has accessed funds from the Public Works Loan Board (PWLB).

10.24 The Prudential Indicators, annexed to the Treasury Management Strategy Statement and Annual Investment Strategy report elsewhere on this agenda, set out the maximum borrowing limits for the Council and show the affordability of the borrowing in the context of the Council's overall budget.

Minimum Revenue Provision (MRP) Policy Statement

10.25 Councils have a statutory duty to set aside revenue funds to repay borrowing. Minimum Revenue Provision (MRP) is the revenue charge that the Council is required to make for the repayment of debt, as measured by the underlying need to borrow, rather than actual debt.

10.26 The underlying debt is needed to finance capital expenditure which has not been fully financed by revenue or capital resources. As capital expenditure is generally expenditure on assets which have a life expectancy of over one year it is prudent to charge an amount for the repayment of debt over the life of the asset or a similar proxy figure (this can be compared to the capital repayment element of a mortgage).

10.27 The Local Authorities (Capital Financing and Accounting) regulations require local authorities to calculate for the financial year an amount of MRP which is considered to be 'prudent'. There are two methods available for calculating this.

10.28 Asset Life method - where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the useful life of the asset.

10.29 Depreciation method – MRP is deemed to be equal to the provision required in accordance with depreciation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amount for impairment charged to the income and expenditure accounts.

10.30 For this purpose standard depreciation accounting procedures should be followed, except in the following respects:

- MRP should continue to be made annually until the cumulative amount of provision made is equal to the expenditure originally financed by borrowing or credit arrangements. Thereafter the Council will cease to make MRP.

- On disposal of the asset, the charge should continue in accordance with the depreciation schedule as if the disposal had not taken place. This does not affect the ability to apply capital receipts or other funding sources at any time to repay all or part of the outstanding debt.

10.31 Where the percentage of the expenditure on the asset financed by borrowing or credit arrangements is less than 100%, MRP should be equal to the same percentage of the provision required under depreciation accounting.

10.32 There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding year, nor is a charge required until the financial year after an asset becomes operational.

10.33 The Council's MRP Policy is elsewhere on this agenda, as part of the Treasury Management Strategy Statement and Annual Investment Strategy.

11 Commercial Property Investment

11.1 This strategy sets out that the Council will remain compliant with guidance from central government and CIPFA regarding commercial property acquisitions.

11.2 This guidance has changed considerably in the past two years from a position of commercialisation being encouraged to generate income to one where investment for commercial reasons is discouraged.

11.3 Therefore, this strategy sets out that the only purely commercial activities that will be undertaken will be those that help to achieve best value on assets already owned by the Council; for example, development of currently unused land.

11.4 Commercial investments will be funded through use of reserves, capital receipts and internal borrowing. Any external borrowing required needs to be made in accordance with the Prudential Code. The latest edition of this code states an authority must not borrow to invest primarily for financial return.

11.5 Assets created through these investments, and any associated liabilities will be consolidated in the Council's balance sheet and treated in accordance with the code of Practice on Local Authority Accounting in the United Kingdom, which is supported by the International Financial Reporting Standards.

12 Knowledge and Skills

Financial Assets

12.1 Treasury Management Activity is undertaken by the Principal Accountant (Technical) and a Service Accountant. They are managed by the Accountancy Manager. These three posts are filled by qualified CIMA/CIPFA accountants.

12.1.1 The team is experienced in treasury management activity and has demonstrated its skills by enabling the Council to opt-up to Professional status under the MiFID II (EU law - Markets in Financial Instruments Directive) reforms.

12.2 The CIPFA Code requires the Chief Financial Officer to ensure that Members and Officers are adequately trained in treasury management. Training is arranged as required and is regularly reviewed.

Non-Financial Assets

12.3 The Council's investment property portfolio is managed by the Property and Asset Management Service. The team includes qualified chartered surveyors and a building surveyor all of whom have extensive experience of property dealings within both the public and private sectors. This experience includes dealing with a mix of property types and professional work including professional services, landlord and tenant statutory valuations, acquisitions and disposals, commercial and residential property management.

12.4 The team also work with external agents where specialist expertise is required to deal with particular properties or if resource is not available to deal with matters in a timely way. Examples of where external advice is used include agency, valuation, building surveying and planning work. The Council also has internal building surveying resource in Property and Asset Management to advise on construction, repair and maintenance and statutory compliance matters across its investment and operational properties.

12.5 The Council's asset valuations for its financial statement are prepared by internal and external valuers with an agreed rolling programme of valuations for the whole Council property portfolio. All investment properties are valued on an annual basis.

13 Conclusion and reasons for recommendation

13.1 The Capital Strategy sets out the extent of the Council's forecast capital expenditure over the next five years.

13.2 The main drive of the strategy is to ensure that future capital expenditure is prudent, sustainable and affordable. The current forecast for future capital expenditure can be fully financed from known or anticipated balances without the need for further borrowing.

13.3 Regular reviews will be carried out to identify potential assets for disposal in order to generate capital receipts.

Background Papers (Local Government Act 1972 Section 100D) None			
Confidentiality It is considered that this report does not contain exempt information within the meaning of Schedule 12A of the Local Government Act 1972, as amended, and can be made public.			
No of Annexes:	None	File Ref:	N/A
(Portfolio: Finance and Resources) Councillor M Flood			
Officer:	Karen Green	Ext:	8204
Report to:	Cabinet	Date:	28 February 2024