Appendix E

CAPITAL STRATEGY REPORT 2023/24

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.

Decisions made this year on capital and treasury management will have financial consequences for the Council 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 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.

In 2023/24, the Council is planning capital expenditure of £101.343m as summarised below:

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

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
School Investment Programme and Children's Services	6.413	17.457	17.445	1.679	8.445
Housing Regeneration, Development and Growth	8.517	3.339	18.016	15.873	1.266
Town Centres	7.643	14.313	53.314	30.362	14.757
Transportation	10.831	21.397	8.725	4.437	8.873
Community & Environment, Culture & Leisure	3.376	6.167	3.686	1.110	0.588
Adults & Public Health	0.518	0.045	0.157	0.000	0.150
TOTAL	**37.298**	**62.718**	**101.343**	**53.461**	**34.079**

The main General Fund capital projects in 2023/24 include programme of works for the School Investment Strategy, Children's Investment Strategy, Town Centre investment works across the Borough and a number of Transport schemes. The Council has no plans to incur capital expenditure on investments.

Governance: All capital projects are fully appraised and Cabinet approval is required before a project or programme can be included in the approved Capital Programme. Projects are monitored from business case appraisals through to project delivery and completion via individual Directorate governance arrangements. They are overseen and monitored on a Corporate level by the Capital Programme Group, which includes Senior Officers from all Directorates, with updates to CMT, a newly formed Strategic Place Group and approvals by Cabinet/Council as required. The Strategic Place Group sits above the Capital Programme Group and is responsible for developing and delivering place-based strategies as well as providing direction and authorisation for strategic place-based programmes and projects. This covers both strategic project governance and pipeline development/proof of concept. This group will retain oversight of projects that it deems necessary due to their impact on the Borough/Council, be that physical, service need or financial.

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

Table 2: Capital financing in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Capital receipts	0.941	0.730	1.757	0.930	2.435
Capital grants	8.869	45.336	59.642	33.675	17.368
Capital contributions	19.759	8.101	4.291	0.037	0.000
Revenue	3.360	6.051	5.125	1.819	1.748
Borrowing	4.369	2.500	30.528	17.000	12.528
TOTAL	**37.298**	**62.718**	**101.343**	**53.461**	**34.079**

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 but capital receipts are not being used for this purpose within the current financial plan. Planned MRP is as follows:

Table 3: Replacement of debt finance in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Own resources	3.164	2.815	2.583	3.076	3.354

Department for Levelling Up Housing and Communities (DLUHC) Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. **The recommended statement is attached at schedule 1 for approval.**

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 and capital receipts used to replace debt. The CFR is expected to increase by £27.887m during 2023/24. 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

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
General Fund services	185.296	184.981	212.868	226.589	235.505
Capital investments	0.000	0.000	0.000	0.000	0.000
TOTAL CFR	**185.296**	**184.981**	**212.868**	**226.589**	**235.505**

Asset management: Asset Strategy and Management is a systematic process of lifecycle management including strategic planning, investment, operation, and maintenance of building assets in a cost effective and environmentally sustainable manner. To ensure that the capital assets continue to be of a long term and sustainable use, the Council provides Strategic Asset Management Planning by maintaining up to date building condition information, developing a pipeline of investment, and managing programmes from inception to delivery. This ensures that Council building assets continue to be a safe and fit for purpose environment which supports the Council's local and statutory obligations.

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 Council plans to receive £0.946m of capital receipts and loan repayments in the coming financial year as follows:

Table 5: Capital receipts receivable in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Asset sales	1.029	1.096	0.846	1.464	4.256
Loans repaid	0.900	0.624	0.100	0.090	0.090
TOTAL	**1.929**	**1.720**	**0.946**	**1.554**	**4.346**

Flexible Use of Capital Receipt's Strategy

DLUHC permit local authorities to treat revenue expenditure "incurred on projects designed to reduce future revenue costs and/or transform service delivery" as capital expenditure until 2024/25.

As part of this local authorities are required to approve a "flexible use of capital receipts strategy" each year, as part of the revenue budget setting process. This strategy must include details of:

- each project that plans to make use of the capital receipts flexibility
- the expected savings and service transformation to be achieved
- actual savings being achieved on projects approved in previous strategies.

Qualifying expenditure is expenditure on any project that is designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery in a way that reduces costs or demand for services in future years for any of the public sector delivery partners.

Presently the Council has not used these powers previously and has not planned to use this across the medium term. The flexible use of capital receipts will be considered for all appropriate projects going forward and reported accordingly. **This strategy is presented for approval.**

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, 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, at the 31st December 2022 the Council had £78.870m debt and £36.681m treasury investments.

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

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

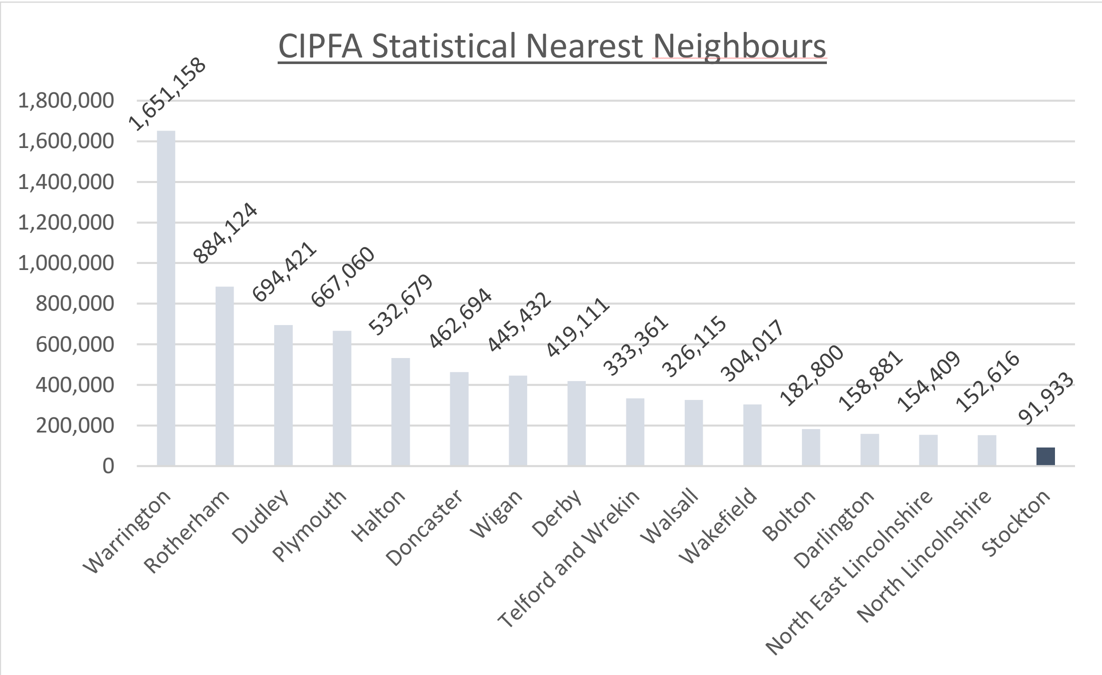
Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities and leases) are shown below, compared with the capital financing requirement (see above).

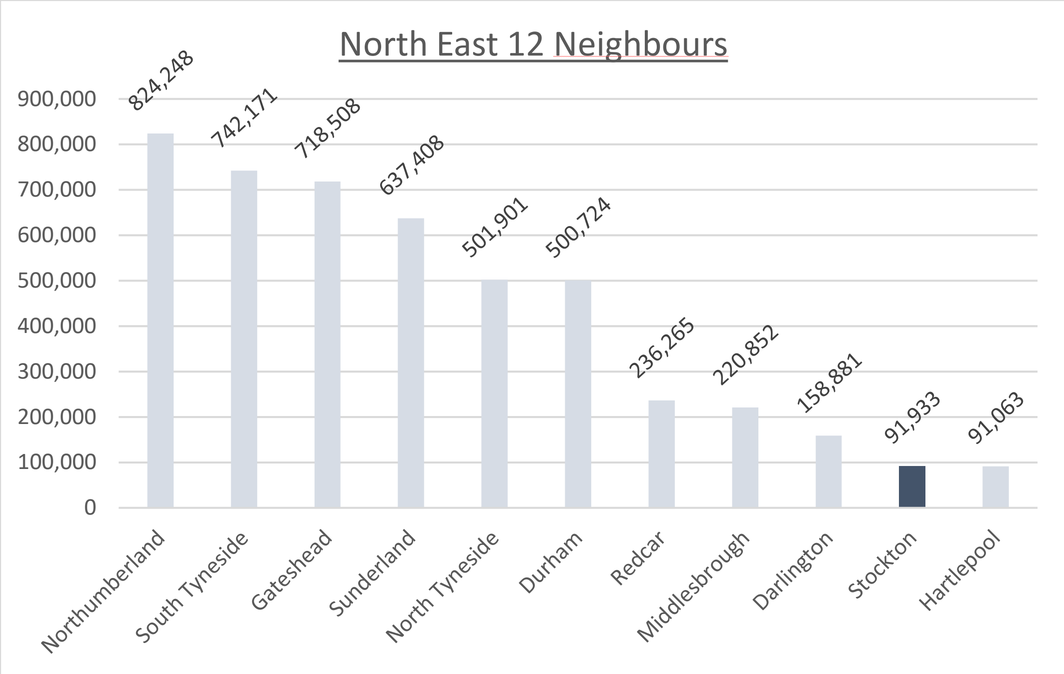
Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2022 actual	**31.3.2023 forecast**	**31.3.2024 budget**	**31.3.2025 budget**	**31.3.2026 budget**
Debt (incl. PFI & leases)	91.933	118.863	176.066	199.445	231.619
Capital Financing Requirement	185.296	184.981	212.868	226.589	235.505

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 in the medium term.

As part of their Financial Resilience Index CIPFA has produced data comparing Gross External Debt to the Councils statistical nearest neighbours and North East 12 neighbours. Comparisons are shown in the two graphs below;





Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash is kept to a minimum level of £0m at each year-end. This benchmark is currently estimated to be £113.5 at 31st March 2023 and is forecast to rise to £229.9m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
Outstanding borrowing	84.5	111.5	169.7	194.3	227.9
Liability benchmark	63.8	113.5	171.6	196.3	229.9

Affordable borrowing limit: The Council 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

	2022/23 limit	2023/24 limit	2024/25 limit	2025/26 limit
Authorised limit	195.0	222.9	236.6	248.5
Operational boundary	185.0	212.9	226.6	238.5

- Further details on borrowing are included in the Treasury Management Strategy included at Appendix F.

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 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 can be 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 9: Treasury management investments in £millions

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
Near-term investments	30.8	0.0	0.0	0.0	0.0
Long-term investments	16.2	14.3	14.3	14.3	14.3
TOTAL	**47.0**	**14.3**	**14.3**	**14.3**	**14.3**

- Further details on treasury investments are included in the Treasury Management Strategy included at Appendix F.

Risk management: The effective management and control of risk are prime objectives of the Council'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 provided within the Treasury Management Strategy included at Appendix F.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance, Development and Regeneration and Deputy Chief Executive and staff, who must act in line with the treasury management strategy and treasury management practices approved by Council. A mid-term and annual report on treasury management activity are presented to the Audit and Governance Committee for scrutinising treasury management decisions.

Investments for Service Purposes

The Council makes investments to assist local public services, including making loans to the Council's subsidiaries. In light of the public service objective, the Council is willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs.

Governance: Decisions on service investments are made by the relevant service manager in consultation with the Director of Finance, Development and Regeneration and Deputy Chief Executive and must meet the criteria and limits laid down in the Investment Strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme via Cabinet / Council.

Based on the current small value of service investments all potential losses could be absorbed in budgets or reserves without unmanageable detriment to local services.

- Further details on service investments are included within the Investment Strategy included at Appendix H.

Commercial Activities

The Council has for a number of years owned investment properties and these make profits which are spent on local public services. Total commercial investments as at 31st March 2022 were valued at £17.407m across a range of properties such as estate shops, garages, ground leases and the Hotel.

With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include reduction in rental payments due to vacancies and a fall in capital value. In order that commercial investments remain proportionate to the size of the authority, these are subject to an overall maximum investment limit of £30m. Any variation from planned budgets will be monitored through the budgetary control and medium-term financial plan process.

Governance: Decisions on commercial investments are made by the Director of Finance, Development and Regeneration and Deputy Chief Executive in line with the criteria and limits approved by Council in the Investment Strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme and via Cabinet / Council.

- Further details on commercial investments are included within the Investment Strategy included at Appendix H.

In relation to the overall net revenue stream of the Council compared to the net income from commercial investments this is not material to the overall financial capacity of the Council. This is demonstrated in table 10 below and any losses can be absorbed in budgets or managed through reserves.

Table 10: Prudential Indicator: Net income from commercial and service investments to net revenue stream

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
Total net income from service and commercial investments £m	0.968	1.035	1.035	1.035	1.035
Proportion of net revenue stream	0.58%	0.65%	0.62%	0.60%	0.58%

Investment Indicators

The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

Total risk exposure: The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third party loans.

Table 11: Total investment exposure in £millions

Total Investment Exposure	2021/22 Actual £m	2022/23 Forecast £m	2023/24 Budget £m
Treasury management investments	46.910	14.331	14.331
Service investments: Loans	1.352	0.727	0.627
Service investments: Shares	0.377	0.000	0.000

Commercial investments: Property	17.407	17.407	17.407
TOTAL INVESTMENTS	**66.045**	**32.464**	**32.364**

How investments are funded: Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

Table 12: Investments funded by borrowing in £millions

Investments funded by borrowing	31.03.2022 Actual £m	31.03.2023 Forecast £m	31.03.2024 Forecast £m
Treasury management investments	0	0	0
Service investments: Loans	1.335	0	0
Service investments: Shares	0	0	0
Commercial investments: Property	17.000	17.000	17.000
Total Funded by Borrowing	**18.335**	**17.000**	**17.000**

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 13: Investment rate of return (net of all costs)

Investments net rate of return	2021/22 Actual	2022/23 Forecast	2023/24 Forecast
Treasury management investments	1.1%	2.4%	5.5%
Service investments: Loans	2.8%	4.7%	4.8%
Service investments: Shares	0.0%	0.0%	0.0%
Commercial investments: Property	5.0%	3.3%	3.3%
ALL INVESTMENTS	**2.1%**	**2.6%**	**4.3%**

Liabilities

In addition to debt detailed in Table 6, the Council is committed to making future payments to cover its pension fund deficit valued at £282m as at the 31st March 2022. The Council has also agreed to guarantee the performance of the ARCC (Achieving Real Change in Communities) under the service agreement pursuant to a guarantee with the Secretary of State.

Governance: Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Director of Finance, Development and Regeneration and Deputy Chief Executive. The risk of liabilities crystallising and requiring payment is monitored by Corporate Accounts and reported appropriately. New liabilities are reported to full Council for approval as appropriate.

- Further details on liabilities and guarantees are on page 57 of the draft 2021/22 Statement of Accounts. Pension information is covered in pages 53 – 57 of the same document.

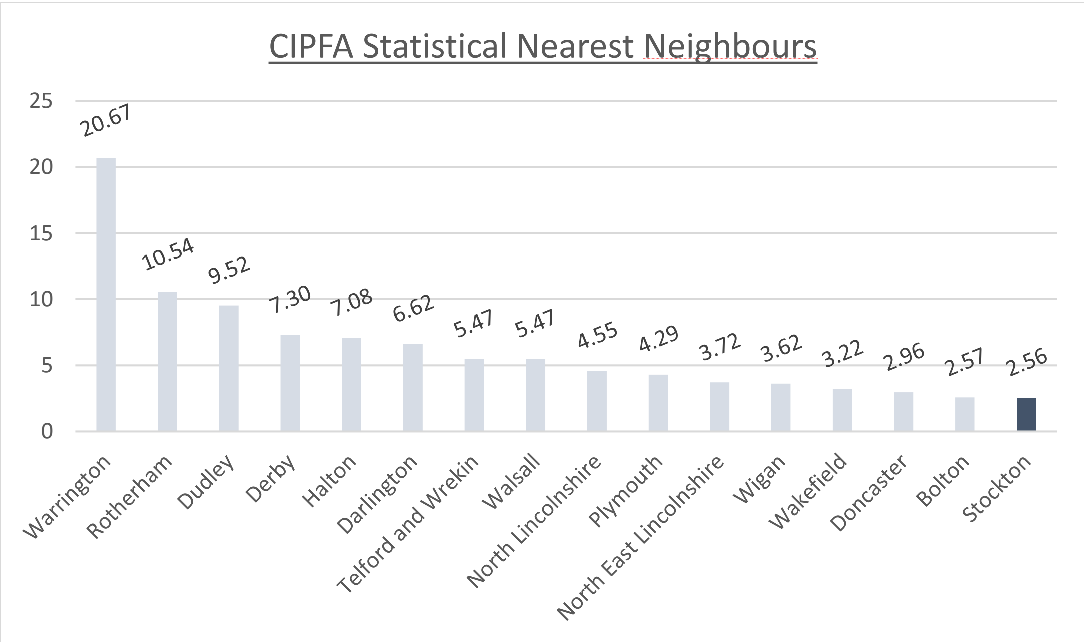
Revenue Budget Implications

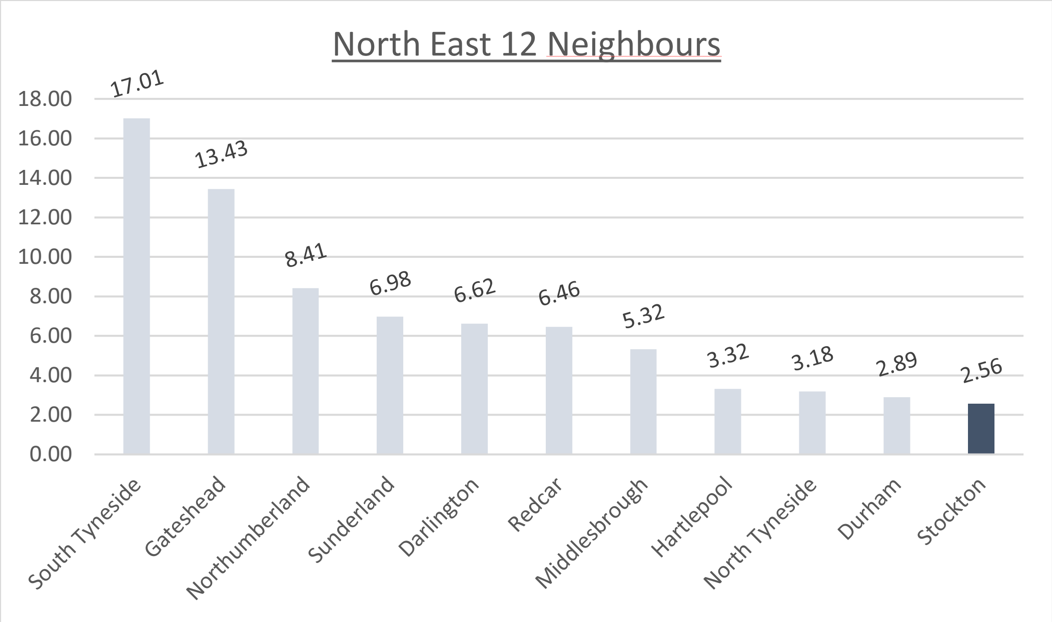
Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from council tax, business rates and general government grants.

Table 14: Prudential Indicator: Proportion of financing costs to net revenue stream

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
Financing costs (£m)	4.2	4.5	5.6	7.8	8.3
Proportion of net revenue stream	2.5%	2.8%	3.4%	4.5%	4.6%

As part of their Financial Resilience Index CIPFA has produced data comparing the above ratio to the Councils statistical nearest neighbours and North East 12 neighbours. Comparisons are shown in the two graphs below.





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, Development and Regeneration and Deputy Chief Executive is satisfied that the proposed capital programme is prudent, affordable and sustainable. Processes and controls ensure that the programme is reviewed regularly in the context of inflation driven cost increases and rising interest rates. The impact of the existing Capital Programme on the MTFP has been considered, and the revenue implications of future capital schemes are included when considering the approval of the capital budget.

Knowledge and Skills

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council pays for staff to study towards relevant professional qualifications including CIPFA, they undertake continuous professional development (CPD) and attend courses on an ongoing basis to keep abreast of new developments and skills. All senior staff with treasury management responsibilities are CIPFA qualified Accountants.

The Council establishes project teams from all the professional disciplines across the Council as and when required to develop and implement major schemes. 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. As an example the Council currently employs Arlingclose Limited as treasury management advisers. 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.

Internal and external training is offered to members to ensure they have up to date knowledge and expertise to understand and challenge capital and treasury decisions taken by the Director of Finance, Development and Regeneration and Deputy Chief Executive.

Schedule 1 – Annual Minimum Revenue Provision Statement 2023/24

Where the Council finances capital expenditure by debt, the Capital Financing Requirement (CFR), it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the DLUHC *Guidance on Minimum Revenue Provision* (the DLUHC Guidance) most recently issued in 2018.

The broad aim of the DLUHC Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The DLUHC Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

For capital expenditure incurred before 1st April 2008 and for supported capital expenditure incurred on or after that date, MRP will be determined on an annuity method.

For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset determined on an annuity method starting in the year after the asset becomes operational.

For assets acquired by finance leases or the Private Finance Initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

Capital expenditure incurred during 2023/24 will not be subject to a MRP charge until the year following the year in which the relevant assets become operational.