

CAPITAL STRATEGY 2022/23 TO 2026/27

Presented by the Head of Finance

EXECUTIVE SUMMARY

This paper sets out a capital strategy that gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services. This strategy integrates the Capital Programme, the Annual Investment Strategy, Treasury Management Strategy and the Minimum Revenue Provision Statement.

It also includes the prudential indicators to be approved by the Authority.

RECOMMENDATIONS

- Executive Committee Recommend to Authority:
- (1) the Capital Strategy as an overarching strategy document as set out within the body of the report, and Appendices B to D of this report; and
 - (2) the Prudential Indicators for 2022/23 to 2026/27 as set out in Appendix A of this report.

BACKGROUND

- 1 Publication of CIPFA's Prudential Code 2021 and Treasury Management Code 2021 updated and strengthened the reporting requirements around investment within local authorities.
- 2 The Capital Strategy is an overarching document with a simple guide on the capital programme, borrowing, investments, and sets out the prudential indicators that the Authority defines as parameters to work within when setting a prudent and sustainable approach to its investment to meet service needs.
- 3 The Capital Programme provides more details on capital expenditure and financing from the information provided in the Capital Strategy.
- 4 The CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) requires a range of Prudential Indicators which provide assurance that the Authority's capital expenditure plans are affordable and proportionate.

- 5 There are five Prudential Indicators which are defined and quantified within this strategy.

The Prudential Indicators are:

- Estimates of Capital Expenditure;
- Estimates of Capital Financing Requirement;
- Gross Debt and the Capital Financing Requirement;
- Authorised Limit and Operational Boundary for Borrowing; and
- Proportion of Financing Costs to Net Revenue Stream.

CORE PRINCIPLES THAT UNDERPIN THE CAPITAL PROGRAMME

- 6 The key principles for the capital programme are summarised below:
- capital investment decisions reflect the aspirations and priorities included within the Authority's Business Plan and supporting strategies;
 - schemes to be added to the capital programme will be subject to Member approval, and prioritised according to availability of resources and any specific funding, business needs of the Authority, and with reference to the longer-term impact on the Authority's financial position;
 - the cost of financing capital schemes, net of any revenue benefits that they may provide, are profiled over the lifetime of each scheme and incorporated, where applicable, into the budget.

CAPITAL EXPENDITURE AND FINANCING

- 7 The current projected capital programme and financing is shown elsewhere on this agenda (Paper E/793/23) and is summarised below. It includes current estimates for capital expenditure for 2022/23 and beyond.

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| | 2022/23 Estimate £0m | 2023/24 Estimate £0m | 2024/25 Estimate £0m | 2025/26 Estimate £0m | 2026/27 Estimate £0m |
|------------------------------|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| Capital Expenditure | 16.519 | 6.837 | 1.703 | 1.621 | 0.660 |
| Financed By | | | | | |
| - Capital Receipts | 3.751 | 1.845 | 0.400 | 0.350 | 0.150 |
| - Revenue Contributions | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| - Asset Maintenance Reserves | 1.017 | 0.992 | 1.303 | 1.271 | 0.511 |
| - Short Term Borrowing | 11.751 | 4.000 | 0.000 | 0.000 | 0.000 |
| Total Financed | 16.519 | 6.837 | 1.703 | 1.611 | 0.660 |

- 9 The Authority is able to finance capital expenditure from a number of different sources, described below.

Capital Receipts – monies received by the Authority in respect of the disposal of an interest in a capital asset. This can only be used to finance capital expenditure, or paying off debt, and cannot be used to fund revenue expenditure.

Revenue Contributions – the Authority is able to make contributions from its revenue budget to fund in-year capital expenditure. Currently, the Authority does not make any direct revenue contributions to capital.

Asset Maintenance Contributions – the Authority does however make contributions to its Major Repairs/Asset Management Reserve, to fund its Asset Maintenance programme. Generally this work is classified as repairs, rather than enhancement, but major works may be of a capital nature.

Short-term borrowing – under the Local Government Act 2003, the Authority, as a specified Levying Body, is able to borrow monies to fund its capital programme, either in short, or long-term. To date, the Authority has only entered into short-term borrowing; loans of up to two years, to fund Lee Valley Ice Centre Redevelopment project.

- 10 Appendix A to this report sets out the Capital Expenditure and Financing Prudential Indicators that require approval. Appendix E to this report sets out the description of what should be included as capital expenditure, and what is revenue.

MINIMUM REVENUE PROVISION

- 11 Each year the General Fund sets aside sums known as the Minimum Revenue Provision (MRP) to reduce its borrowing liabilities. The policy for MRP is set out in Appendix B to this report and complies with the latest guidance issued by the DLUHC.
- 12 Government guidance on the MRP requires that the General Fund set aside prudent sums to reduce debt and any other long term liabilities arising from capital spend and that the Authority produces a statement on its MRP policy. MRP costs fall on revenue budgets and runs on for many years into the future, usually over the period to which the capital item provides an economic benefit.

TREASURY MANAGEMENT

- 13 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 resources can be met by prudential borrowing.
- 14 The Authority's Treasury Management Policy was approved in April 2021 (paper A/4297/22) and no amendments to that Policy are proposed.

ANNUAL INVESTMENT STRATEGY

- 15 The Local Government Act 2003 requires local authorities to have regard for the latest guidance on local authority investments, the latest update being 2018.
- 16 Central to the guidance is an Annual Investment Strategy that each authority must approve. Key to that strategy should be the principal for security, liquidity, and then yield.
- 17 The Annual Investment Strategy sets out the general policy objective for investments, the procedures for determining which investments in the specified

and non-specified categories the Authority will use in the forthcoming financial year, and the maximum periods for which funds may be committed in each asset class.

- 18 Attached at Appendix C to this report is the Annual Investment Strategy for 2023/24 for Member consideration and approval. Definitions for specified and non-specified investments are also set out in Appendix A to this report.

BORROWING STRATEGY

- 19 The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.
- 20 Appendix D to this report sets out the Authority's borrowing strategy 2023/24, in line with its current Treasury Management Policy.

KNOWLEDGE AND SKILLS

- 21 The Authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions.
- 22 Where Authority staff do not have the knowledge and skills required, or where further support is needed, use is made of external advisors and consultants that are specialists in their field. The Authority currently employs Tullet Prebon as treasury management advisors.
- 23 The Authority also has a service level agreement with the London Borough of Enfield for provision of Section 151 services, and is able to utilise this knowledge and experience to assist with its own decisions.

ENVIRONMENTAL IMPLICATIONS

- 24 There are no environmental implications arising directly from the recommendations in this report.

FINANCIAL IMPLICATIONS

- 25 These are dealt with within the body of the report.

HUMAN RESOURCE IMPLICATIONS

- 26 There are no human resource implications arising directly from the recommendations in this report.

LEGAL IMPLICATIONS

- 27 There are no legal implications arising directly from the recommendations in this report.

RISK MANAGEMENT IMPLICATIONS

- 28 There are no risk management implications arising directly from the recommendations in this report. However, future capital expenditure and its

phasing may require additional support from borrowing as the level of cash receipts is dependent on future land sales that are yet to be fully determined in both terms of value and timing.

EQUALITY IMPLICATIONS

- 29 There are no equality implications arising directly from the recommendations in this report.

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BACKGROUND INFORMATION

None

PREVIOUS COMMITTEE REPORTS

| | | | |
|-----------|-----------|---|-----------------|
| Executive | E/765/22 | Annual Report on Treasury Management Activity 2021/22 | 26 May 2022 |
| Authority | A/4313/22 | Proposed Capital Programme 2021/22 (Revised) to 2025/26 | 20 January 2022 |
| Authority | A/4314/22 | Capital Strategy 2021/22 to 2025/26 | 20 January 2022 |
| Authority | A/4297/21 | Treasury Management Policy | 29 April 2021 |

APPENDICES ATTACHED

| | |
|------------|--|
| Appendix A | Prudential Indicators 2022/23 to 2026/27 |
| Appendix B | Annual Minimum Revenue Provision Statement 2023/24 |
| Appendix C | Annual Investment Strategy 2023/24 |
| Appendix D | Borrowing Strategy 2023/24 |
| Appendix E | Capital Expenditure |

LIST OF ABBREVIATIONS

| | |
|-------|--|
| CFR | Capital Financing Requirement |
| PWLB | Public Works Loans Board |
| MRP | Minimum Revenue Provision |
| CIPFA | Chartered Institute for Public Finance and Accountancy |
| DLUHC | Department for Levelling Up, Housing and Communities |

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Capital Expenditure and Financing Prudential Indicators 2022-23 – 2026-27

The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

Capital expenditure is the money the Authority spends on assets, such as equipment, property and vehicles, which will be used for more than one year. The Authority's capital development programme is geared to the management and development of its existing assets, legacy venues on its land and business development schemes to generate further income for the Regional Park. The capital programme reflects the Authority's key role as a development and enabling organisation and includes a number of projects which are crucial in achieving the objectives set out in the Strategic Business Plan.

The Authority's planned capital expenditure and financing may be summarised as follows. These estimates only include the capital expenditure that has been agreed by Members.

| | 2022/23 Estimate £0m | 2023/24 Estimate £0m | 2024/25 Estimate £0m | 2025/26 Estimate £0m | 2026/27 Estimate £0m |
|------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Capital Expenditure | 16.519 | 6.837 | 1.703 | 1.621 | 0.660 |
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| - Capital Receipts | 3.751 | 1.845 | 0.400 | 0.350 | 0.150 |
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| - Asset Maintenance Reserves | 1.017 | 0.992 | 1.303 | 1.271 | 0.511 |
| - Short Term Borrowing | 11.751 | 4.000 | 0.000 | 0.000 | 0.000 |
| Total Financed | 16.519 | 6.837 | 1.703 | 1.611 | 0.660 |

Table 1 : Estimates of Capital Expenditure

Estimates of Capital Financing Requirement

The Capital Financing Requirement (CFR) is a measure of the amount of capital spending that has not yet been financed by capital receipts, capital grants or contributions from revenue income. It measures the underlying need to borrow for a capital purpose, although this borrowing may not necessarily take place externally. The Authority has been able to make prudent use of cash that it has already invested for long-term purposes. In doing so, the level of funds we hold for longer-term investment does not reduce but we have been able to adopt an efficient and effective treasury management strategy. This practice, is known as ‘internal borrowing’, and is common in local authorities and means there is no immediate link between the need to borrow to pay for capital spending and the level of external borrowing.

The CFR increases with new debt-financed capital expenditure and reduces with Minimum Revenue Position (MRP) and any capital receipts used to replace debt. The CFR will increase in 2022/23 as the new Ice Centre becomes operational, with some additional borrowing required in 2023/24 as final payments in relation to construction costs and retention are made during the year.

The Authority’s estimated CFR is as follows.

| | 2022/23 Estimate £0m | 2023/24 Estimate £0m | 2024/25 Estimate £0m | 2025/26 Estimate £0m | 2025/26 Estimate £0m |
|---------------------------|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| Opening CFR | 11.206 | 30.756 | 33.824 | 32.819 | 31.831 |
| Long Term Borrowing | 20.000 | 4.000 | - | - | - |
| Minimum Revenue Provision | (0.450) | (0.932) | (1.005) | (0.988) | (0.973) |
| Closing CFR | 30.756 | 33.824 | 32.819 | 31.831 | 30.858 |

Table 2 : Estimates of Capital Financing Requirement

Affordable Borrowing Limit

Irrespective of plans to borrow or not, the Authority is required to set an affordable borrowing limit (also known 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. There are currently plans to borrow long term only to fund the Ice Centre Development in 2022/23 and 2023/24, and whilst the actual borrowing amounts are subject to further Member approval, the limits are set to include the current budgeted amount less contingency.

In addition, the Authority should set its limit to include provision for additional borrowing that may be required to deliver the operational strategy as well as for capital development.

The limit reflects the possible need to borrow, subject to timing of capital receipts, to finance the capital programme. It also includes coverage of the internal borrowing level the Authority has adopted to fund past capital programme. It does not mean that the Authority will actually borrow, rather that it is authorised, subject to further Member approval, to borrow up to that limit.

| | 2022/23 Estimate £0m | 2023/24 Estimate £0m | 2024/25 Estimate £0m | 2025/26 Estimate £0m | 2026/27 Estimate £0m |
|----------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Operational Boundary | 30.0 | 30.0 | 30.0 | 30.0 | 30.0 |
| Authorised Limit | 45.0 | 45.0 | 45.0 | 45.0 | 45.0 |

Table 3 : Authorised Limit and Operational Boundary for Borrowing

Ratio of Financing Costs to Net Revenue Stream

Although capital expenditure is not charged directly to the revenue budget, the MRP, and if applicable, interest payable on loans 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 of revenue budget to be met from the Levy. For the purposes of this table, the Levy is assumed to increase to the level as set out in the Budget and Levy Paper (A/xxxx/23) and to then remain at the 2023/24 cash level.

Currently due to the accounting for Assets Under Construction, the Authority is not required to make a provision for the Ice Centre redevelopment until it becomes operational, so the financing costs for 2022/23 are made up of the existing MRP and investment interest received. The change in financing costs from 2023/24 is based on the Authority borrowing £20m in 2022/23 and a further £4m in 2023/24, with the costs being rolled up into the project and repayments commencing in 2023/24.

| | 2022/23 Estimate £0m | 2023/24 Estimate £0m | 2024/25 Estimate £0m | 2025/26 Estimate £0m | 2026/27 Estimate £0m |
|-----------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Financing Costs | 0.420 | 1.872 | 1.945 | 1.905 | 1.865 |
| Proportions of net revenue cost % | 4.30% | 17.58% | 18.27% | 17.89% | 17.52% |

Table 4 : Ratio of Financing Costs to Net Revenue Stream

Adoption of the CIPFA Treasury Management Code

The Authority has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition. It fully complies with the Code's recommendations.

Annual Minimum Revenue Provision Statement 2023-24

The Minimum Revenue Provision (MRP) is a statutory requirement to make a charge against the Authority's General Fund to make provision for the repayment of the Authority's past capital debt. The Local Government Act 2003 requires local authorities to have regard to statutory guidance on Minimum Revenue Provision. The broad aim of the Guidance is to ensure that capital expenditure is financed over a period that is commensurate with that over which the capital expenditure provides benefits.

The Guidance requires the Authority to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP.

A prudent level of MRP on any significant asset or expenditure may be assessed on its own merits or in relation to its financing characteristics in the interest of affordability or financial flexibility.

Capital Expenditure incurred before 1 April 2008

In relation to any capital expenditure incurred before 1 April 2008, the MRP shall be calculated at an amount equal to 4% of CFR at the end of the preceding financial year.

If the Authority refinanced existing internal borrowing with external loans, MRP should be commensurate with the term of the borrowing, and MRP charged appropriate to the principal loan repayment amount.

Capital Expenditure from 1 April 2008

Where capital expenditure incurred from 1 April 2008 is on an asset financed wholly or partly by self-funded borrowing, the MRP is to be made in instalments over the life of the asset, and calculated on a straight line basis and should be linked to when the asset is brought into operational use. The maximum allowable asset life to be used in calculating MRP is 50 years.

Where an asset is financed by long-term borrowing, the useful life of the asset should ideally be commensurate with the term of the borrowing, and MRP charged appropriate to the principal loan repayment amount. Where there is not a direct relationship between financing and borrowing, the MRP should be calculated with reference to the asset life, rather than the borrowing term.

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Annual Investment Strategy 2023/24

This Authority has regard to the DLUHC's Guidance on Local Government Investments and CIPFA's Treasury Management in Public Services: Code of Practice and Cross Sector Guidance Notes.

This Annual Investment Strategy states which investments the Authority may use for the prudent management of its treasury balances during the financial year. In short these will only be specified investments.

This strategy sets out this Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.

Investment Objectives

All investments will be in sterling. The general objective, as set out in the Treasury Management Policy for this Authority, is the prudent investment of its treasury balances. The Authority's investment priorities are the security of capital and liquidity of its investments. The Authority will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity.

The Authority holds cash in the normal course of its business and any cash not immediately required for settling Authority liabilities should be invested until needed. Investments should be managed prudently and fall within two categories: specified investments and non-specified investments, as set out in government guidance. Specified investments are investments up to one year, as detailed below, with high liquidity and credit quality. Non-specified investments, as set out below, are investments that exceed one year and are potentially more responsive to liquidity, credit and market factors.

The DLUHC maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activity.

Specified Investments

The idea of specified investments is to identify investments offering high security and high liquidity. These investments can be made with minimal procedural formalities. All these investments should be in sterling and normally with a maturity of no more than one year.

Non – Specified Investments

The aim is to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies which do not have a "high" credit rating. Such investments are not proposed for this Authority for 2023/24 and where such investments were to be made they would require the prior approval of Members.

Based upon its cash flow forecasts, the Authority anticipates its Investment balances in 2023/24 to range between **£2m and £5m** at any one institute. This is in line with the current Treasury Management Policy. A prime consideration in the investment of fund balances is liquidity and the Authority's forecast cash flow.

Any in-house investment of more than one month needs the approval of the Chief Executive or Deputy Chief Executive.

Provisions for Credit – related losses

If any of the Authority's investments appeared at risk of loss due to default the Authority will make revenue provision of an appropriate amount.

End of year Investment Report

At the end of the financial year, the Head of Finance will prepare a report on the Authority's investment activity as part of its treasury management activity report and report this to Executive Committee by the end of June. The Annual Investment Strategy will need approval by Executive Committee.

Borrowing Strategy 2023/24

The Authority's debt management strategy has been to pursue a policy of internal borrowing, which is the use of existing reserves and balances to fund capital expenditure rather than the use of external borrowing.

The use of internal borrowing allows the Authority to minimise unnecessary external borrowing costs by only borrowing when needed for liquidity to fund the major redevelopment of the Ice Centre. Borrowing in advance of need from a cashflow perspective would create a 'cost of carry' which is the difference between the short term investment income earned through holding cash balances compared against longer term external debt financing costs of repayments.

The Authority currently only has short-term external borrowing, loans of up to 2 years, used to cash-flow finance the Ice Centre redevelopment. It has been free from long-term external debt since March 2016. When the Authority is in the position where it needs to borrow long-term, its main objectives would be to achieve low but a certain cost of finance, whilst retaining flexibility should plans change. These objectives are often conflicting, and the Authority would seek to strike a balance between short-term loans and long-term fixed rate loans where the future cost is known but higher.

Officers will monitor current and forecast interest rates to determine the benefits of internal/short-term borrowing against the potential for incurring additional costs by taking longer-term borrowing early, due to the current uncertainty of interest rates in the medium term.

The Authority would look to borrow in the short-term from other local authorities, or the Public Works Loans Board (PWLB), with the focus on obtaining the most favourable rates for the period of borrowing.

Longer term borrowing will likely be from the PWLB at fixed rates and interest.

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Capital Expenditure

Under standard accounting practices local authorities are required to account for revenue expenditure and capital expenditure differently. Capital expenditure is defined in the Local Government 2003 Act as expenditure which, in accordance with proper accounting practices, falls to be capitalised. Proper accounting practice is currently accepted to be the CIPFA/LASAAC Code of Practice on Local Authority Accounting: A Statement of Recommended Practice (known as the SORP).

Capital expenditure essentially relates to the provision and improvement of significant fixed assets including land, buildings and equipment which will be of use or benefit in providing services for more than one financial year.

Expenditure that should be capitalised will include expenditure on the:

- Acquisition, reclamation, enhancement or laying out of land;
- Acquisition, construction, preparation, enhancement or replacement of buildings and other structures;
- Acquisition, installation or replacement of plant, machinery and vehicles;
- Replacement of a component of a non-current asset that has been treated separately for depreciation purposes and depreciated over its individual useful life.

In this context, enhancement means the carrying out of works that are intended to:

- Lengthen substantially the useful life of the asset; or
- Increase substantially the open market value of the asset;
- Increase substantially the extent to which the asset can or will be used for the purposes of the Authority.

The Authority can also capitalise Project Management costs where this is directly linked to the delivery of a major project included within the Capital Programme.

Revenue expenditure is expenditure incurred for the purpose of the organisation's daily activity, services or to maintain fixed assets. For example, employees' pay, travel expenses and IT consumables are all deemed to be revenue expenditure.

However, it is often quite difficult to easily distinguish between capital and revenue expenditure so consideration needs to be given to the nature of the expenditure in order to identify what should be classed as capital and what is revenue.

Capital and Revenue Examples

There is no definitive list of items which are revenue and which are capital. All decisions on capitalisation must be made with due regard to legislation, guidance and the individual circumstances of a capital project.

Below is a list of examples for expenditure that falls into each category. This is not intended to be an exhaustive list but should for a guide.

Capital Items

- Land Purchases
- Construction Payments
- Professional fees related to capital projects
- Development costs
- Vehicles
- Major items of Equipment
- Feasibility costs that relate to successful schemes

Revenue Items

- Repair and Maintenance
- General Tools / Equipment
- Stock
- Security Costs
- Rental Costs
- Employee costs, unless directly involved in construction of delivery of projects
- Travel Expenses
- Training
- Abortive feasibility costs
- Costs of Disposal - up to 4% of the proceeds may be netted off the capital receipt;

Expenditure from the Asset Maintenance programme will normally be classed as revenue, as it usually forms repairs or maintenance expenditure. For example, expenditure that simply ensures an asset remains in a condition suitable for its current use would still be classed as revenue. However, some items of asset maintenance expenditure may fall more correctly as expenditure that can be capitalised, and large expenditure items should be reviewed.

De-minimus

Capital expenditure is subject to a de-minimis level of £20,000. Expenditure below this level should usually be classed as revenue. However the limit may be used flexibly as it may be appropriate to add items such as vehicles or equipment of a lower value to the asset register.

In the cases where groups of similar assets are acquired at the same time, which individually would fall under the de-minimus level, can be grouped together to form a collective asset. An example of this would be IT equipment.

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