APPENDIX A

Capital Strategy Report 2022/23

Introduction

1. The 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.

2. 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

3. 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, in addition, spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £5,000 are not capitalised and are charged to revenue in year.

4. The Council's policy on capitalisation can be found in the Accounting Policies in the annual Statement of Accounts.

5. In 2022/23, the Council is planning capital expenditure of £48.8 million as summarised in Table 1:

Table 1: Prudential Indictor – Estimates of Capital Expenditure

	Actual 2020/21 £,000s	Revised 2021/22 £,000s	Budget 2022/23 £,000s	Budget 2023/24 £,000s	Budget 2024/25 £,000s	Budget 2025/26 £,000s	Budget 2026/27 £,000s
Non-Housing Capital Programme							
Core Programme	2,271	6,335	6,451	4,805	2,821	3,296	991
Elm Hatch	63	105	268	3,210	1,070		
Enterprise Zone	7,040	4,572					
HTS Equity Share & Loan	2,131						

	Actual 2020/21 £,000s	Revised 2021/22 £,000s	Budget 2022/23 £,000s	Budget 2023/24 £,000s	Budget 2024/25 £,000s	Budget 2025/26 £,000s	Budget 2026/27 £,000s
Towns Fund Schemes		784	6,885	3,476	9,555	3,000	
Town Centre Limited Liability Partnership			5,000				
Sub total	11,504	11,796	18,603	11,492	13,446	6,296	991
Housing Capital Programme							
Core Programme	8,264	23,223	19,532	21,107	19,219	19,236	19,059
Prentice Place	395	477					
House Purchases	12,216	384					
New Build	380	3,094	10,637	10,074	1,950		
Sub Total	21,556	27,177	30,169	31,181	21,169	19,236	19,059
Total	33,060	38,973	48,772	42,672	34,615	25,532	20,050

6. It can be seen from Table 1 that in 2022/23 a significant element of the Non-Housing Capital Programme (NHCP) relates to the investment in the new Town Regeneration Partnership which will act as catalyst to regenerate the town centre in addition to the delivery of the Government's Town Fund projects.

7. The Housing Capital Programme (HCP) is split between the core programme such as compliance, lift maintenance and the house purchase and new build projects. In line with business plan assumptions the core programme is financed from the Major Repairs Reserve (MRR).available capital receipts and direct revenue financing. The house purchase and new build programme is financed from right to buy receipts and borrowing.

8. Further details of projected capital expenditure are contained in the 'Capital Programme Strategy Statement' (see Appendix B to this Report).

Governance

9. Service Managers commence a process annually in September to bid for projects in the Council's Non Housing Capital Programme. Bids are collated by the Finance Service who calculate the financing costs (which can be nil if the project is fully externally financed) and formulate capital project appraisals. The Deputy to the Chief Executive and Director of Finance presents capital proposals to the Senior Management Board (SMB) for review. The review is based on a comparison of corporate priorities and

service priorities and considers projected capital costs, financing costs and any resulting ongoing service costs. Recommendations from SMB formalise the Capital Programme for approval by Cabinet and to Full Council in January / February each year.

10. For full details of the Council's latest Capital Programme, see the report entitled 'Capital Programmes 2022/23', which is presented separately in the agenda to Cabinet (27 January 2022) and, upon publication, is available on the Council's website pages.

11. Capital expenditure may only be financed either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, and leasing).

12. The planned financing of the above expenditure is set out in Table 2 as follows:

Table 2: Prudential Indictor – Financing Capital Expenditure

	Actual 2020/21 £,000s	**Revised 2021/22 £,000s**	**Budget 2022/23 £,000s**	**Budget 2023/24 £,000s**	**Budget 2024/25 £,000s**	**Budget 2025/26 £,000s**	**Budget 2026/27 £,000s**
NHCP							
Earmarked Grant Funding	(20)	(20)	(20)	(20)			
Capital Receipts	(1,006)	(1,913)	(14)				
Earmarked Capital Reserves	(80)	(708)	(45)				
Direct Revenue Financing	(210)	(328)	(166)	(136)	(136)	(136)	(136)
Disabled Facilities Grant	(283)	(621)	(500)	(500)	(500)	(500)	(500)
Salix Decarbonisation Grant	(68)	(351)					
Towns Fund – Eastgate Grant	(61)	(939)					
Towns Fund – Various Sites		(784)	(6,885)	(3,476)	(9,555)	(3,000)	
SELEP Getting Building Fund Grant		(3,560)					
Home Renovation Loan Repayments	(12)	(5)	(5)	(5)	(5)	(5)	(5)
Other Contributions	(151)	(20)	(9)	(19)	(19)	(19)	(16)

	Actual 2020/21 £,000s	Revised 2021/22 £,000s	Budget 2022/23 £,000s	Budget 2023/24 £,000s	Budget 2024/25 £,000s	Budget 2025/26 £,000s	Budget 2026/27 £,000s
Borrowing Requirement	(9,613)	(2,548)	(10,959)	(7,335)	(3,231)	(2,636)	(334)
Sub total	(11,504)	(11,796)	(18,603)	(11,492)	(13,446)	(6,296)	(991)
HCP							
Direct Revenue Financing		(10,898)	(4,736)	(2,255)	(2,418)	(2,434)	(2,237)
Major Repairs Reserve	(8,842)	(12,310)	(11,228)	(11,512)	(11,802)	(12,056)	12,299)
1-4-1 Receipts Used	(3,802)	(224)	(4,255)	(4,029)	(780)		
Other Capital Receipts	(12)	(1,179)					
Right to Buy Receipted Arriving in Year		(1,449)	(1,517)	(1,560)	(1,598)	(1,637)	(1,676)
Other Grants and Contributions		(1,117)					
Borrowing Requirement	(8,899)		(8,443)	(11,824)	(4,571)	(3,109)	(2,847)
Sub Total	(21,556)	(27,177)	(30,169)	(31,181)	(21,169)	(19,236)	(19,059)
Total	(33,060)	(38,973)	(48,772)	(42,672)	(34,615)	(25,532)	(20,050)

Borrowing and Capital Financing Requirement

13. Borrowing and leasing is an intermediate source of finance, since loans and leases must be repaid. The 2003 England and Wales Regulations place on local authorities in England and Wales a duty to charge to the revenue account a 'minimum revenue provision' (MRP) which is deemed to be prudent for the repayment of debt'. Set out in Appendix E is the Councils statement on the calculation of MRP and Table 3 shows the estimated MRP over the next five years

Table 3: Minimum Revenue Provision

	Actual 2020/21 £,000s	Revised 2021/22 £,000s	Budget 2022/23 £,000s	Budget 2023/24 £,000s	Budget 2024/25 £,000s	Budget 2025/26 £,000s	Budget 2026/27 £,000s
General Fund	513	420	569	639	687	749	749

14. The capital financing requirement (CFR) is the Council's cumulative debt outstanding and is split between the HRA and General Fund. The CFR increases with new capital expenditure financed by borrowing and reduces

with MRP. The CFR is expected to increase by £18.8 million during 2022/23. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Capital Financing Requirement

	Actual 2020/21 £,000s	Revised 2021/22 £,000s	Budget 2022/23 £,000s	Budget 2023/24 £,000s	Budget 2024/25 £,000s	Budget 2025/26 £,000s	Budget 2026/27 £,000s
General Fund CFR	71,756	73,884	84,275	90,971	93,515	95,402	95,736
HRA CFR	196,269	196,269	204,702	216,526	221,097	224,206	227,503
Total CFR	268,025	270,153	288,977	307,497	314,611	319,608	322,789

Asset Management and Non-Housing Capital Receipts

15. The Council has reviewed its Asset Management Strategy and has undertaken a detailed stock condition survey of all of its non-housing property assets. The strategy and associated action plan combined with the results of the stock condition survey have been applied to develop a future non housing capital investment programme.

16. The strategy also sets out the intention to dispose or transfer those assets which no longer fulfil an operational, community or commercial objective. This is essential especially where there is a clear investment requirement which would outweigh the long term benefits of undertaking that investment.

17. The objective of the strategy is to recognise the Council's asset portfolio as a resource which whilst providing operational and community benefits. The Strategy sets out a framework for governance of the portfolio which seeks to achieve greater engagement with users and elected councillors in order to ensure that capital investment decisions are aligned with the agreed corporate priorities as set out in the Council's Corporate Plan.

Asset disposals

18. When an asset is no longer required it may be sold and the capital receipts used to repay debt or finance new capital expenditure. The Council plans to receive £14,000 in non-housing capital receipts in the coming financial year 2022/23, as shown in Table 5:

Table 5: Movements in Non-Housing Capital Receipts

	Actual 2020/21 £,000s	Original 2021/22 £,000s	Revised 2021/22 £,000s	Estimates 2022/23 £,000s
Balance at 1 April	(1,895)	(1,919)	(2,349)	(2,234)
Non-Housing Receipts Received	(1,472)	(300)	(1,798)	(14)
Non-Housing Receipts Used	1,018	650	1,913	14
Balance in Hand at 31 March	(2,349)	(1,569)	(2,234)	(2,234)

19. Further details of projected asset disposals are included in the 'Capital Programme Statement' (Appendix B).

Treasury Management

20. 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 temporary 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.

21. Due to decisions taken in the past, the Council currently (as at 31 December 2021) has borrowing of £211.837m at an average interest rate of 3.492%. Investments held at the same date were worth £33.714m and earned an average income return of 0.349%.

Borrowing strategy

22. 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 low cost short-term loans (currently available at around 0.1%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5% to 2.5%). The Council also utilises its ability to "internally borrow" which is very attractive when it has surplus funds available and it is unable to achieve any significant return through its Treasury Management activities with external interest rates for investments being at historic lows.

23. Projected levels of the Council's total outstanding debt are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross Debt and the CFR

	Actual 31/03/2021 £,000	Forecast 31/03/2022 £,000	Budget 31/03/2023 £,000	Budget 31/03/2024 £,000	Budget 31/03/2025 £,000
Gross Debt	216,551	215,898	235,086	254,036	261,627
Capital Financing Requirement	268,025	270,153	288,977	307,497	314,611

25 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.

Affordable Borrowing Limit

26 The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warming level should debt approach the limit

Table 7: Prudential Indicators: Authorised limit and operational boundary

	2021/22 Limit £,000	2022/23 Limit £,000	2023/24 Limit £,000	2024/25 Limit £,000
Authorised limit – borrowing	315,500	320,200	325,200	325,200
Operational boundary – borrowing	305,500	310,200	315,200	315,200

27 Further details on borrowing are given in paragraphs 16 to 27 of the 'Treasury Management Strategy' (Appendix C).

Investment strategy

28 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.

29 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 is invested more widely, which might include 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.

30 Further details on treasury investments are in paragraphs 28 to 51 of the 'Treasury Management Strategy' (Appendix C).

Governance

31 Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Deputy to the Chief Executive and Head of Finance & Property Services 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 Cabinet. The Cabinet Overview Working Group is responsible for scrutinising treasury management decisions.

Investments for Service Purposes

32 The Council makes investments to assist local public services, including making loans to promote economic growth and lending to its wholly owned companies within the HTS Group, which provides extensive building maintenance, grounds and environmental maintenance services to the Council. 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 at least break even after all costs.

33 All decisions to date have been made subject to formal reporting and approval by Cabinet. Further details on service investments are in paragraphs 6 to 17 of the 'Appendix D'.

Commercial Activities

34 With central government financial support for local public services declining, some Councils are investing in commercial property purely or mainly for financial gain. Harlow Council has not followed this course of action to date.

35 New Guidance requires Councils to disclose any property that it holds primarily or partially to generate a profit. Councils are no longer allowed to borrow from the Public Works Loan Board at favourable rates to finance commercial investments.

36 Harlow Council has only four such assets, namely, the golf course, two cottages and a former farmhouse. These generate an income of just under £82,000 a year (see Appendix D, 'Investment Strategy').

37 Both the Nexus and Modus buildings at the Harlow Enterprise Zone have been completed. They are wholly owned assets constructed to stimulate economic growth and regeneration and will be let to commercial tenants. Whilst they will deliver an income stream to the Council a key determinant in the decision to

proceed with the buildings was the regeneration and economic benefits it would bring to Harlow. The Council has been successful in obtaining additional grant funding of £3.6 million to further develop the Enterprise Zone

Liabilities

38 In addition to debt of £216.4m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £65.039m as at 31 March 2021). The Council is also covers the risk of having to pay for small-value insurance claims for which self-insurance is in place and managed through earmarked reserves.

Governance

39 Decisions on incurring new discretional liabilities are taken by Senior Management Board in consultation with the Deputy to the Chief Executive and Director of Finance. It is the responsibility of Senior Managers to consult the Deputy to the Chief Executive and Director of Finance on any matter liable to affect the Council's finances materially (for values above £50,000). In the event of any substantial liabilities arising during the course of the financial year, these are highlighted in the finance and performance monitoring reports, presented quarterly to Cabinet and onwards to Full Council.

40 Further details guarantees are set out in the Investment Strategy 2022/23 (Appendix D, paragraph 26), whilst further details of contingent liabilities are contained in Note 32 of the Statement of Accounts 2020/21.

Revenue Budget Implications

41 Although capital expenditure is not charged to revenue it does have revenue implications. Both the interest payable on loans and the repayment of debt (MRP) is charged to revenue. This is offset by any investment income receivable. The net capital financing charge compared to the net revenue stream (which for the General Fund is council tax, business rates and general government grants and for the Housing Revenue Account is predominantly housing rent income). Set out in Table 8 is the prudential indicator which compare the net capital financing charge with the net income stream:

Table 8: Proportion of financing costs to net revenue stream

	2020/21 Actual £,000	2021/22 Revised £.000	2022/23 Budget £,000	2023/24 Budget £,000	2024/25 Budget £,000
General Fund					
Financing costs	421	805	1.305	1.354	1.383
Proportion of net revenue stream	3.97%	7.22%	11.7%	11.8%	12.0%
HRA					
Financing costs	6,928	7,261	7.261	7.460	7.535
Proportion of net revenue stream	14.25%	13.20%	14.09%	14.07%	13.95%

Sustainability

42 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. Capital investment decision making is not only about ensuring the initial allocation of capital funds meets the corporate and service priorities but ensuring the asset is fully utilised, sustainable and affordable throughout its whole life, which also includes the affordability of its debt financing costs. In approving the inclusion of schemes and projects within the Capital Programme the Deputy to the Chief Executive and Head of Finance & Property Services will need to have been satisfied that the proposed capital programme is prudent, affordable and sustainable.

Knowledge and Skills

43 The Council employs professionally qualified and experienced staff across a range of disciplines including finance, legal and property that follow Continuous Professional Development (CPD). The Council encourages apprenticeships and study programmes for staff with the ambition to achieve a professional qualification.

44 Recognising the scale of the Council’s staffing, where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers, Wilks Head and Eve LLP as property valuation advisers, as well as other reputable firms of property consultants to support it in assessing the condition of its asset, advising on property transactions and any new developments. 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.

45 Internal and external training is offered to elected Members to ensure they have up to date knowledge and expertise to understand and challenge capital and treasury decisions taken by the administration, the Senior Management Board and the Deputy to the Chief Executive and Director of Finance.

Changes to CIPFA Prudential and Treasury Management Codes and DHLHC MRP Guidance

46 CIPFA published a second consultation on proposed changes to the Prudential Code and Treasury Management Code in October 2021 with a closing date for responses of 16th November 2021. Final versions of the codes were published on 20th December 2021 although some of the associated guidance notes are not yet published.

47 Although the new codes took effect immediately on publication authorities may defer introducing the revised reporting requirements until the financial year 2023/24. The 2022/23 strategies are thus based on the previous reporting requirements.

48 The codes explicitly prohibit new borrowing to invest for the primary purpose of commercial return. Borrowing for service purposes that are as a secondary objective expected to return an income is however permitted. As Harlow Council do not plan any new expenditure for the primary purpose of commercial return this change will not have a significant impact for the Council.

49 Harlow Council may be required to give full consideration to the sale of existing commercial assets as an alternative to taking out new loans. An immediate sale of any commercial properties will be a requirement however.

50 The Council will be required to demonstrate that existing commercial investments are proportionate to the to the Council’s capacity to bear losses. As commercial investments represent only a small fraction of Harlow’s income this would not be expected to cause any significant difficulties.

51 The Council may be required to demonstrate that investments in long term pooled funds are required for treasury management purposes. As current pooled fund investments are within the £10m the council is required to hold at all times for MiFID purposes this should not be an issue for Harlow.

52 The counterparty criteria for investments may be required to include Harlow’s policy and practices relating to ESG (Environmental, Social and Governance) considerations.

53 DLUHC published a consultation on Minimum Revenue Provision in November 2021 with a closing date for responses of 8th February 2022. The consultation

is in the early stages and the suggestions are likely to be subject to some revision before being finalised.

54 The consultation suggests prohibiting the practice of making no MRP or very small amounts of MRP on certain assets on the basis that they are expected to retain their value. If formerly written into the guidance this is likely to have a revenue impact on Harlow Council who do not currently make MRP on capital investment aligned with Harlow’s Enterprise Zone or regeneration projects.

55 The consultation suggests prohibiting the practice of applying capital receipts to reducing the MRP charge in a single year rather than to reduce the overall CFR. This may include preventing authorities from using the capital receipts from periodic loan repayments in lieu of making MRP on loans to other organisations and individuals. As Harlow Council currently adopt this practice if this suggestion is put into formal guidance this is likely to have a revenue impact on the authority.