Appendix 1

Capital Strategy 2023/24

1. Introduction

1.1 This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

1.2 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.

2. Capital Expenditure and Financing

2.1 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. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not capitalised and are charged to revenue in year.

2.2 In 2023/24, the Council is planning capital expenditure of almost £57m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m
General Fund services	6.422	8.138	16.109	14.078	1.604
Council housing (HRA)	11.136	14.720	12.738	7.786	7.502
Capital investments	8.317	12.747	27.966	32.160	9.107
TOTAL	**25.875**	**35.605**	**56.813**	**54.024**	**18.213**

2.3 The main General Fund capital projects with expenditure planned for 2023/24 include Folkestone – A Brighter Future (£11m) largely met from the Council's successful Levelling Up Funding Bid, Private Sector Housing Improvement initiatives (£1.4m), funding for the East Cliff Landfill Protection scheme on land owned by the Folkestone

Parks and Pleasure Grounds Charity (£1.2m) and the Folkestone and Hythe Green Business Grant scheme (£0.2m).

2.4 The main capital investment projects for 2023/24 include further expenditure on the Otterpool Park Garden Town Development (£24.4m), funding of Oportunitas Ltd (£1m) to support its housing and regeneration activities, the redevelopment of land at Biggins Wood, Folkestone for employment purposes (£1.4m) and the Coastal Drive Seafront Development scheme at Littlestone (£0.8m).

2.5 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately. A four-year medium term capital programme for the HRA to 2026/27 has been prepared which focuses on maintaining and improving the existing stock to meet both the Decent Homes Standard Plus and the EPC C energy efficiency rating. A new 30-year HRA Business Plan is due to be considered by the Council in the spring of 2023. This will consider future capital expenditure required to maintain the existing stock, increase the supply of homes for rent and what is affordable under the existing HRA regime.

2.6 **Climate Change Emergency** – On 24 February 2021 Cabinet approved a Carbon Action Plan which identified themes and initiatives the Council intends to pursue to tackle climate change locally and reduce its own carbon emissions. £5m has been provided in the Climate Change Reserve to support this work. Any new capital schemes arising from the plan will need approving before including in the capital programme. To date, funding from the Climate Change Reserve has been committed towards the following General Fund capital schemes:

	Scheme	£'000
i)	Electric Vehicle Charging Points	40
ii)	District Street Lights Scheme	408
iii)	Folkestone & Hythe Green Business Grant Scheme	250
iv)	Princes Parade Leisure Centre (Solar Panels) – scheme currently paused	100
v)	Folkestone – A Brighter Place (LUF)	450
	Total	1,248

2.7 **Governance:** Service managers bid annually in September through a formal project appraisal process for growth proposals to include projects in the Council's capital programme. Bids are initially evaluated by the Finance Team against a series of criteria to determine their business need against the Council's existing corporate priorities and the financial impact of the proposal. The Finance Team submit a summary of the evaluated growth bids to the Corporate Leadership Team (CLT) to consider against the funding available (including external funding). CLT then makes recommendations to Cabinet for consideration initially through the Budget Strategy in November or December. The final capital programme is then presented to Cabinet in January or February and to Council in February each year.

For full details of the Council's capital programme, see:

- General Fund Capital Programme – link to MTCP to follow
- HRA MTCP Capital Programme – link to follow

2.8 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 (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m
External sources	5.626	4.869	12.816	12.323	1.019
Own resources	12.622	18.594	14.280	8.796	6.837
Debt	7.627	12.142	29.967	32.905	10.357
TOTAL	**25.875**	**35.605**	**56.813**	**54.024**	**18.213**

2.9 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of prior years' debt finance

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m
MRP	1.211	1.634	1.625	1.662	1.691
Capital receipts	0	0	1.148	0.055	0.055
TOTAL	**1.211**	**1.634**	**2.773**	**1.717**	**1.746**

- The Council's full minimum revenue provision statement is available here: See Appendix X – link to follow

2.10 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 £27m during 2023/24 in accordance with the latest GF and HRA capital programmes. 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

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m
General Fund services	15.583	16.559	16.873	16.257	15.378
Council housing (HRA)	47.416	47.416	50.620	51.120	52.370
Capital investments	70.178	79.710	103.136	134.440	142.680
TOTAL CFR	**133.177**	**143.685**	**170.629**	**201.817**	**210.428**

2.11 In line with the existing approved HRA Business Plan, no provision is made to reduce the HRA CFR in the future. This helps to support the HRA's financial position over the life of the business plan. This position will be reviewed as part of the new HRA Business Plan due to be considered in the spring of 2023.

2.12 **Asset management:** To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place. This strategy was adopted in July 2017 by Cabinet, covers the five-year period to 2022 and sets out how property asset management is delivered for the Council to meet its long term objectives and goals. It outlines how the long term objectives for managing the asset portfolio are met, including statutory obligations, stakeholder needs & the overall performance of property within the context of any constraints such as funding. A new 5-year asset management strategy is planned to be submitted to Cabinet during 2023 The strategy is supported by the Asset Management Policy & Asset Management Plan also adopted by Cabinet in July 2017.

- The Council's asset management strategy can be read here:

2.13 **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. The Council is currently also permitted to spend capital receipts on service transformation projects until 2025/26 under the Flexible Use of Capital Receipts Policy. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £10.2m capital receipts in the coming financial year as follows:

Table 5: Projected Capital Receipts

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m
Asset sales – Non Housing	0.075	0	8.240	0	0
Asset Sales - HRA	1.728	1.500	1.500	1.500	1.500
Loans Repaid	0.830	0.537	0.503	0.503	0.503
TOTAL	**2.633**	**2.037**	**10.243**	**2.003**	**2.003**

2.14 The Non-Housing asset sales excludes any future capital receipts from the sale of land at Princes Parade, Hythe for housing development or the disposal of Hythe Swimming Pool. The capital receipts from both sites are committed funding to the paused Princes Parade Leisure and Housing development.

2.15 Restrictions apply to the use of capital receipts generated from HRA 'Right to Buy' asset sales meaning they can only be used to support further HRA capital investment.

- The Council's Flexible Use of Capital Receipts Policy is available here: [link]

3. <u>Treasury Management</u>

3.1 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.

3.2 Due to decisions taken in the past, the Council as at 31 December 2022 has £97.7m borrowing at an average interest rate of 2.68% and £24.9m treasury investments at an average rate of 3.61%.

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

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

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

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

	2021/22 actual £m	2022/23 Forecast £m	2023/24 Budget £m	2024/25 budget £m	2025/26 budget £m
Debt (incl. PFI & leases)	97.700	113.538	146.382	180.070	188.681
Capital Financing Requirement	133.177	143.685	170.629	201.817	210.428

3.6 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.

3.7 **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 and investment balances are kept to a minimum level of £15m at each year-end. This benchmark is currently £113.5m and is forecast to rise to £188.7m over the next three years.

Table 7: Borrowing and the Liability Benchmark

	2021/22 actual £m	2022/23 forecast £m	2023/24 budget £m	2024/25 budget £m	2025/26 budget £m
Outstanding borrowing	97.757	113.538	146.382	180.070	188.681
Liability benchmark	97.757	113.538	146.382	180.070	188.681

3.8 The table shows that the Council expects its borrowing to be in line with its liability benchmark. However, this may change if, for instance, the timing of the capital expenditure changes or if it is beneficial to borrow in advance of need.

3.9 **Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit. The authorised limit provides for borrowing for capital purposes for one year in advance so is higher than both the operational boundary and the figures shown in the Prudential Indicator for gross debt and the CFR in table 7, above.

Table 8: Prudential Indicators: Authorised limit and operational boundary for external debt

	2022/23 limit £m	2023/24 limit £m	2024/25 limit £m	2025/26 limit £m
Authorised limit – borrowing	206.7	207.6	216.2	215.6
Authorised limit – PFI and leases	1.0	-	-	1.0
Authorised limit – total external debt	207.7	**207.6**	216.2	216.6
Operational boundary – borrowing	161.6	171.7	207.6	207.0
Operational boundary – PFI and leases	1.0	-	-	1.0
Operational boundary – total external debt	162.6	171.7	207.6	208.0

- Further details on borrowing are in pages 14 to 16 of the treasury management strategy due to be considered by Cabinet on 22 February 2023 – link to follow

3.10 **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.

3.11 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, 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

	2021/22 actual £m	2022/23 forecast £m	2023/24 Budget £m	2024/25 budget £m	2025/26 Budget £m
Near-term investments	(15.1)	(5.0)	(5.0)	(5.0)	(5.0)
Longer-term investments	(16.0)	(15.0)	(15.0)	(15.0)	(15.0)
TOTAL	(31.1)	(20.0)	(20.0)	(20.0)	(20.0)

- Further details on treasury investments are in pages 16 to 21 of the treasury management strategy – link to follow

3.12 **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 on pages 21 to 22 of the treasury management strategy – link to follow

3.13 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Corporate Services and staff, who must act in line with the treasury management strategy approved by Council. From 2023/24 quarterly reports on treasury management activity will be presented to Cabinet. The Finance and Performance Sub-Committee are responsible for scrutinising treasury management decisions.

4. Investments for Service Purposes

4.1 The Council can lend money to its subsidiaries, its charities where the Council is the trustee, its external service providers, local residents and its employees to support local public services and stimulate local economic growth. In the future the Council may also lend money to joint ventures it decides to enter into to help deliver its major corporate investment initiatives.

4.2 The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the authority, upper limits on the outstanding loans to each category of borrower have been set.

4.3 Additionally the Council can invest in equity in its subsidiary companies it may choose to establish or other joint venture companies it decides to enter into to help deliver its corporate investment initiatives.

4.4 The Council will have invested £11.7m in its wholly owned Housing and Regeneration subsidiary company, Oportunitas Limited, by 2023/24 to support its housing for rent programme. This investment has been through approximately £6.8 in loan funding and £4.9m in share equity. The Council's funding is secured against the assets of the company.

4.5 The Council's plans to create the Otterpool Park Garden Town Development are now at an advanced stage. Otterpool Park will provide up to 10,000 much needed new homes over a 30-year period, creating significant economic benefits to the district. The Council, as principal land owner, also expects to gain a financial return from its investment in the Otterpool Park development. The Council has created the Otterpool Park Limited Liability Partnership (LLP) as a wholly owned subsidiary to deliver the project. Cabinet approved the latest business plan for the LLP on 26 January 2022. The Council has previously agreed making an investment of up to £75m in the LLP through a combination of approximately 10% equity, through a capital contribution, and 90% loan funding, although these proportions may fluctuate at different stages of the project. The LLP's prime source of income will be through its share of income from house sales from the housing developers. However, it will be several years before the first sales are likely to be completed. The Council's funding will be secured against the assets and future cash flows of the LLP.

4.6 Otterpool Park LLP have recently submitted their updated business plan for consideration. The plan seeks additional funding to be made available through the revolving loan facility. This request is currently being considered and will be reported as soon as the officer assessment has concluded with a clear recommendation to put forward to members for decision. The range of the additional funding being sought is estimated to be between £41m - £76m, depending on whether the Council enter into a collaboration agreement with Homes England to deliver the project. The project is forecast to produce a net return of between £240m to £270m over its lifetime, although the benefit to the Council will be dependent upon whether Homes England invest in it.

4.7 The equated value of investments for service purposes in 2023/24 is approximately £35.5m generating a return of about 2.1%. The return includes accrued interest anticipated to be received from the Council's investment in the LLP.

4.8 **Governance:** Decisions on service investments are made by the relevant service manager in consultation with the Director of Corporate Finance 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.

- Further details on service investments are in sections 3 & 4 of the appendix to the Investment Strategy 2023/24 report being considered separately on this agenda. The Capital Strategy 2023/24 and Investment Strategy 2023/24 will be published together on the Council's website once they are adopted.

5. Commercial Activities

5.1 With central government financial support for local public services declining, the Council has invested in commercial property and land with the intention of making capital gains or generating new revenue streams to spend on local public services. Total commercial investments are currently projected to be valued at £32.4m at 31 March 2023 with the largest being the Connect 38 Offices in Ashford (£16.8m) and the residential and other miscellaneous property held for the Otterpool Park development (£10.9m).

5.2 The Council's major land holdings for the Otterpool Park development of the former Folkestone Racecourse and Otterpool Farm have been reclassified from Investment Assets to Property, Plant and Equipment – Surplus Assets as they are no longer viewed as being held solely for their investment return because both sites will contribute equally contribute towards the housing development and wider community aspects of the Garden Town development

5.3 No net return after all costs is projected on commercial activities for 2023/24 mainly due to the impact of capital financing costs for the Otterpool Park residential property and miscellaneous land holdings.

5.4 **Risk Management:** With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include fluctuations in future demand of the market including competition, risk of void tenancies, fall in capital values etc. These risks are managed by the project lead as well as assessed through the corporate risk register. The Council has an established a proactive risk management framework, which incorporates key projects, and reports quarterly to the Audit & Governance Committee as well as annually to the Cabinet. The Council is also working on a council wide transformation programme to support the needs of the medium term revenue position so as to not place sole reliance on the investment plans providing the expected yields within the anticipated timeframes.

5.5 **Governance:** Decisions on commercial investments are made by Cabinet and / or Full Council in line with the criteria and limits outlined within the Constitution, in specific circumstances the Executive have delegated authority to progress certain projects to the Director of Place and the Director of Housing and Operations in consultation with the relevant Portfolio Holders. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

- Further details on commercial investments, limits on their use and other risk management controls are in section 5 of the appendix to the Investment Strategy 2023/24 report being considered separately on this agenda. The Capital Strategy 2023/24 and Investment Strategy 2023/24 will be published together on the Council's website once they are adopted.

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

	2021/22 actual	**2022/23 forecast**	**2023/24 budget**	**2024/25 budget**	**2025/26 budget**
Net income from service investments	0.309	0.536	1.557	2.976	4.008
Net income from commercial investments	1.016	1.398	1.395	1.395	1.395
Total income from service and commercial investments	1.325	1.934	2.952	4.371	5.403
Proportion of net revenue stream	**8.79%**	**12.16%**	**22.24%**	**31.97%**	**38.37%**

6. Liabilities

6.1 In addition to debt of projected £146m at 31 March 2024 detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £72.5m). It has also set aside £2m to cover risks of the business rates appeals.

6.2 **Governance:** Decisions on incurring new discretional liabilities are taken by the Director of Corporate Services in liaison with service managers. The risk of liabilities crystallising and requiring payment is monitored by Accountancy and reported through the regular budget monitoring/projected outturn cycle to Cabinet if identified or through the Statement of Accounts process to the Audit & Governance Committee. New liabilities exceeding the auditors materiality threshold would be reported to full council for approval/notification as appropriate.

- Further details on liabilities and guarantees are on pages 36 to 43 of the 2021/22 statement of accounts https://www.folkestone-hythe.gov.uk/media/5757/Draft-Statement-of-Accounts-2021-22-Signed/pdf/Draft_Statement_of_Accounts_2021-22___Signed.pdf?m=638104385661970000

7. Revenue Budget Implications

7.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 11: Prudential Indicator: Proportion of financing costs to net revenue stream

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
General Fund Financing costs (£m)	2.58	2.09	4.18	5.42	7.01
Proportion of net revenue stream	17.11%	13.13%	31.47%	39.62%	49.80%
HRA Financing costs (£)	5.80	1.51	1.91	2.05	2.09
Proportion of net revenue stream	36.65%	8.74%	10.35%	10.68%	10.90%

- The increase to the General Fund’s indicator for 2023/24 and future years is a combination of the increased borrowing requirement mainly for the Otterpool Park development and higher interest rates for new and replacement borrowing.

The General Fund revenue implications of capital expenditure are included in the 2023/24 revenue budget – link to GF Budget to follow

- For the HRA the revenue implications of capital expenditure are included in the 2023/24 HRA revenue budget – link to HRA revenue budget 2023/24 to follow

7.2 **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 Corporate Services is satisfied that the proposed capital programme is prudent, affordable and sustainable because it has been evaluated and risk assessed, it is considered to be a balanced portfolio with minimal risks.

8. Knowledge and Skills

8.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Corporate Services is a qualified accountant with over 20 years' experience, the Director of Housing and Operations has a degree and post graduate certificate in strategic leadership and over 20 years extensive and relevant experience in contract and project management. The Housing and Operations teams include suitably qualified and experienced professionals ranging from FRCIS through to MSc Engineering and senior project management qualifications. The Council pays for staff to study towards relevant professional qualifications including ACCA, ACT (treasury).

8.2 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, Savills and Montague Evans as property consultants, Wilks-Head & Eve LLP as valuers and as well as other bodies on an ad hoc basis. 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.

- Further details on staff training can be found within the People Strategy which was considered by Personnel Committee in June 2019 https://www.folkestone-hythe.gov.uk/moderngov/documents/s30459/Report%20-%20HR%20Annual%20Review%202018-19%20-%20App2%20People%20Strategy%20-%20June%202019.pdf