

Appendix E

# Uttlesford District Council Capital Strategy 2022/23



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## Introduction

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.
2. Decisions made this year on capital and treasury management will have financial consequences for the Authority 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 Authority 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 Authority 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. For details of the Authority's policy on capitalisation, see the draft Statement of Accounts 2020/21.
4. In 2022/23, the Authority is planning capital expenditure of £37m as summarised below:

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

	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
General Fund services	10	7	1	1	1
Council housing (HRA)	5	10	10	10	6
Capital investments	107	76	27	0	0
<b>TOTAL</b>	122	93	37	11	6

5. The main capital projects include vehicle replacement programme and housing developments in the Housing Revenue Account. The Authority also plans to incur £27m of capital expenditure on investments.
6. 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 and includes the building of approximately 100 new homes over the forecast period.

7. Capital investments include loans and shares made for service purposes and property held primarily for financial return in line with the definition in the CIPFA Treasury Management Code.

## Governance

8. Service managers bid annually in September to include projects in the Authority's capital programme. Bids are collated by Financial Services who calculate the financing cost (which can be nil if the project is fully externally financed). Capital Officers appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to Corporate Management Team. The final capital programme is then presented annually to Scrutiny and Cabinet for final approval by Council in February.
9. For full details of the Authority's capital programme, including the project appraisals undertaken, see: Appendix F.
10. All capital expenditure must be financed, either from external sources (government grants and other contributions), the Authority'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 in £ millions*

	2020/21 actual	2021/22 forecast	2022/23 budget *	2023/24 budget	2024/25 budget
External sources	1	1	1	2	0
Capital resources	3	11	6	6	6
Revenue resources	10	3	4	4	1
Debt	108	79	24	0	0
<b>TOTAL</b>	<b>122</b>	<b>94</b>	<b>34</b>	<b>12</b>	<b>7</b>

11. 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 in £ millions*

	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
Own resources	1	1	5	5	5
<b>TOTAL</b>	<b>1</b>	<b>1</b>	<b>5</b>	<b>5</b>	<b>5</b>

12. The Council's full Minimum Revenue Provision statement is attached as Annexe E1.

13. The Authority'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 £21m during 2022/23. Based on the above figures for expenditure and financing, the Authority's estimated CFR is as follows:

*Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions*

	<b>31.3.2021 actual</b>	<b>31.3.2022 forecast</b>	<b>31.3.2023 budget *</b>	<b>31.3.2024 budget</b>	<b>31.3.2025 budget</b>
General Fund services	31	16	15	14	13
Council housing (HRA)	83	83	83	83	83
Capital investments	164	239	263	259	255
<b>TOTAL CFR</b>	<b>260</b>	<b>339</b>	<b>361</b>	<b>356</b>	<b>352</b>

14. Asset management: To ensure that capital assets continue to be of long-term use, the Authority has an asset management strategy in place.

15. 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 2022/23. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £2m of capital receipts in the coming financial year as follows:

*Table 5: Capital receipts receivable in £ millions*

	<b>2020/21 actual</b>	<b>2021/22 forecast</b>	<b>2022/23 budget</b>	<b>2023/24 budget</b>	<b>2024/25 budget</b>
Asset sales	3	3	2	2	2
Loans etc repaid	2	2	2	2	3
<b>TOTAL</b>	<b>5</b>	<b>5</b>	<b>4</b>	<b>4</b>	<b>5</b>

## Treasury Management

16. 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 cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current

account. The Authority 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.

17. The Authority currently has £265.9m borrowing at an average interest rate of 2.11% and £13.2m treasury investments at an average rate of 0.04%.

18. Borrowing strategy: The Authority'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 Authority therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.10%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5 to 2.5%).

19. Projected levels of the Authority'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 in £ millions*

	<b>31.3.2021 actual</b>	<b>31.3.2022 forecast</b>	<b>31.3.2023 budget</b>	<b>31.3.2024 budget</b>	<b>31.3.2025 budget</b>
Debt (incl. PFI & leases)	234	305	326	322	316
Capital Financing Requirement	360	339	361	356	352

20. 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 Authority expects to comply with this in the medium term.

21. Liability benchmark: To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This benchmark is currently £228m and is forecast to rise to £322m over the next three years.

*Table 7: Borrowing and the Liability Benchmark in £ millions*

	<b>31.3.2021 actual</b>	<b>31.3.2022 forecast</b>	<b>31.3.2023 budget</b>	<b>31.3.2024 budget</b>	<b>31.3.2025 budget</b>
Outstanding borrowing	230	264	118	109	105
Liability benchmark	228	311	332	328	322

22. The table shows that the Authority expects to remain borrowed above its liability benchmark. This is because a deliberate decision has been made to borrow additional sums for further investments.

23. Affordable borrowing limit: The Authority 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*

	2021/22 limit	2022/23 limit	2023/24 limit	2024/25 limit
Authorised limit – borrowing	415	415	415	415
Authorised limit – PFI and leases	5	5	5	5
Authorised limit – total external debt	420	420	420	420
Operational boundary - borrowing	395	395	395	395
Operational boundary – PFI and leases	5	5	5	5
Operational boundary – total external debt	400	400	400	400

24. Further details on borrowing are in the Treasury Management Strategy.

### **Treasury investment strategy**

25. 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.

26. The Authority’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 Authority may request its money back at short notice.

Table 9: Treasury management investments in £millions

	31.3.2021 actual	31.3.2022 forecast	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget
Near-term investments	10	10	10	10	10
Longer-term investments	0	0	0	0	0
<b>TOTAL</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>

27. Further details can be found the Treasury Management Strategy.

28. Risk management: The effective management and control of risk are prime objectives of the Authority'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.

29. Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance and staff, who must act in line with the treasury management strategy approved by council. Quarterly reports on treasury management activity are presented to Cabinet.

### Investments for Service Purposes

30. 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 generate a profit after all costs.

31. The current investments for service purposes is valued at £179m giving the Council an annual net return of £8.5m in the financial year 2021/22.

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

33. Further details on service investments are in the Commercial Strategy

### Commercial Activities

34. With central government financial support for local public services declining, the Council invests in commercial property purely or mainly for financial gain and lends to its subsidiary trading under the Aspire name for the same reason. The Council plans

on making commercial investments totalling £275m over a 5-year strategy of which in year one the council forecasts a return of approximately 4.8%.

35. With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include tenants defaulting on their tenancy agreements resulting in income to be below the interest repayment. These risks are managed by continuously attractive different types of business and regularly monitoring of forecasted income.
36. Governance: Decisions on commercial investments are made by the Director of Finance and Corporate Services in line with the criteria and limits approved by Full Council in the investment strategy. Property and most other commercial investments are also capital expenditure

### **Liabilities**

37. In addition to debt of £326m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £36.6m).
38. Governance: Decisions on incurring new discretionary liabilities are taken by service managers in consultation with the Director of Finance and Corporate Services. The risk of liabilities crystallising and requiring payment is monitored by Financial Services and reported quarterly to Cabinet.

### **Revenue Budget Implications**

39. 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.
40. 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 and Corporate Services is satisfied that the proposed capital programme is prudent, affordable and sustainable.

### **Knowledge and Skills**

41. 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 Finance and Corporate Services is a qualified accountant. The Council pays for junior staff to study towards relevant professional qualifications including CIPFA, AAT and ILM.
42. Where Council staff does 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, other



specialists will differ depending on the expertise required. 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.

### **Minimum Revenue Provision Statement 2022/23**

Where the Authority finances capital expenditure by debt, 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 Authority to have regard to the Ministry of Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

The MHCLG 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. The following are options recommended in the Guidance and locally determined prudent methods of which the Council will apply to unsupported capital expenditure, due to the changing environment Local authorities are currently working within the policy will be reviewed and updated according to any new proposals at the mid-year stage:

#### **Capital Projects**

**Annuity method** – For new unsupported capital expenditure for assets with short lives i.e. vehicles and IT MRP will be determined using the annuity method. An annuity basis considers the time value of money. Like the straight-line method, an annuity method also has the advantage of having a fixed end-point at which point debt will have been fully provided for

**Lease life method** – For assets acquired using finance lease arrangements MRP will match the portion of annual lease payment used to write-down the lease liability

#### **Housing Revenue Account – Self-financing payment**

MRP in respect of the £88.407m payment made in 2012 to exit the Housing Revenue Account subsidy system will be determined as being equal to the principal amount repaid on the loans borrowed to finance that payment.

If an asset is classified as work in progress at the end of the financial year where MRP will be charged the first instalment will take place in year 1 after the asset is operational.

#### **Investment Projects**

##### **Acquisition of investment property**

For long-term projects where an investment property is acquired; MRP will be charged over the life of the asset using the annuity method as detailed above.

##### **Loans to subsidiaries**

For long-term capital loans to other bodies MRP will be charged based fair value of the investment by the subsidiary, for infrastructure investments MRP will be charged over a maximum of 50 years if the projected residual value is below the original expenditure. Where the residual value is projected to be below the expenditure value MRP will be calculated on the balance spread over the remaining of the 50 years since acquisition.

For long-term loans to other bodies where the loan supports expenditure on fixtures and fittings MRP will be charged in equal instalments over the life of the loan.

The following table illustrates the Capital Financing Requirement (CFR) for 2022/23 which underpins the Minimum Revenue Provisions.

	Estimated CFR 31/03/2022 £'000	Estimated CFR 31/03/2023 £'000	Estimated CFR 31/03/2024 £'000	Estimated MRP 2022/23 £'000
Capital Expenditure before 01/04/2008	0	0	0	0
Unsupported Capital Expenditure after 31/03/2008	12,283	11,180	10,091	1,103
Finance Leases and Private Finance Initiative	4,191	4,024	4,024	167
<b>Total General Fund</b>	<b>16,474</b>	<b>15,204</b>	<b>14,115</b>	<b>1,270</b>
Unsupported Capital Expenditure	239,349	262,563	259,037	3,281
<b>Total Investments</b>	<b>239,349</b>	<b>262,563</b>	<b>259,037</b>	<b>3,281</b>
HRA Subsidy Revenue Account	82,753	83,273	83,293	0
<b>Total Housing Revenue Account</b>	<b>82,753</b>	<b>83,273</b>	<b>83,293</b>	<b>0</b>
<b>Total</b>	<b>338,576</b>	<b>361,041</b>	<b>356,444</b>	<b>4,550</b>