



## **CORPORATE AND REGENERATION SCRUTINY COMMITTEE - 20TH FEBRUARY 2024**

**SUBJECT: CAPITAL STRATEGY REPORT 2024/2025**

**REPORT BY: CORPORATE DIRECTOR FOR EDUCATION AND CORPORATE SERVICES**

### **1. PURPOSE OF REPORT**

- 1.1 To submit prior to its presentation to Council on the 27<sup>th</sup> February, the Authority's Capital Strategy report for the 2024/25 financial year in accordance with the Prudential Code that was introduced by the Local Government Act 2003.
- 1.2 The report cross-references to the report by the Corporate Director of Education and Corporate Services on Revenue and Capital Budgets ["the budget report"]; and the Treasury Management Annual Strategy, Capital Finance Prudential Indicators and Minimum Revenue Provision Policy Report for 2024/2025.

### **2. SUMMARY**

- 2.1 The Capital Strategy outlines the principles and framework at the very high level that shape the Authority's capital investment proposals. The principal aim is to deliver an affordable programme of capital consistent with the financial strategy that contributes to the achievement of the Council's priorities and objectives as set out in the Authority's Corporate Plan; consider associated risks; recognise financial constraints over the longer term; and represent value for money.
- 2.2 The Strategy defines at the highest level how the capital programme decision making identifies the issues and options that influence capital spending and sets out how the resources and capital programme will be managed. In addition, the Capital Strategy should comply with the Prudential Code for local authority capital investment introduced through the Local Government Act 2003. The key objectives of the Code are to ensure that capital investment plans are affordable, prudent, and sustainable.
- 2.3 The Capital Strategy sets out the framework for capital investment decisions. The strategy for funding this investment is underpinned by the Prudential Code for Local Authority investment, which was introduced by The Local Government Act 2003. The Prudential Code has the following key objectives:
  - That capital investment plans are affordable, prudent and sustainable;
  - That treasury management decisions are taken in accordance with good professional practice;
  - That local strategic planning, asset management and proper option appraisal are supported.

### **3. RECOMMENDATIONS**

- 3.1 That the annual Capital Strategy Report be noted by the Corporate and Regeneration Scrutiny Committee prior to Council approval.

### **4. REASONS FOR THE RECOMMENDATIONS**

- 4.1 The Annual Capital Strategy report is a requirement of the CIPFA's Prudential Code.
- 4.2 The Prudential Code was first introduced through the Local Government Act 2003. Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003.

### **5. THE REPORT**

#### **5.1 Corporate Priorities**

- 5.1.1 Underlying the capital strategy is the recognition that the financial resources available to meet corporate and departmental priorities are constrained in the current economic climate. Therefore, the Authority must rely more on internal resources and seek ways in which investment decisions can be no less than self-sustaining or generate positive returns both in terms of meeting corporate objectives and producing revenue savings.
- 5.1.2 The Authority's corporate priorities and well-being objectives are set out in its Corporate Plan, which is published on the Council's website:

[corporate-plan-2023-28.aspx](http://corporate-plan-2023-28.aspx) ([caerphilly.gov.uk](http://caerphilly.gov.uk))

#### **5.2 Capital Expenditure and Financing**

- 5.2.1 Capital expenditure is defined as costs incurred by the Authority in acquiring new property, plant, and equipment (PPE) that will be used for more than one year; or costs incurred by enhancing the existing PPE asset base. Capital expenditure can also be incurred in instances where the asset is owned by a third party, but the Authority has provided the third party with a loan or grant. In such instances the expenditure is recorded as if incurred directly by the Authority.
- 5.2.2 In accordance with accounting definitions, expenditure can be capitalised when it relates to:
- The acquisition or creation of a new fixed asset - capitalisation will depend on the creation of rights to future economic benefits controlled by the Authority;
  - The enhancement of an existing fixed asset - capitalisation will depend on the works substantially increasing the value of the asset, extending its useful life, or increasing its use in service provision.
- 5.2.3 The Authority has a de-minimus limit for capital expenditure of £10k. Capital expenditure that is below this de-minimus limit, irrespective of meeting the definition set out in paragraph 5.2.2, is charged to a revenue budget with the exception being the purchase of vehicles which are always capitalised.

5.2.4 The Authority's core capital programme is approved by Council annually as part of the Budget Report and is funded from the General Capital Grant and Supported Borrowing Approvals. Both of these funding streams are confirmed annually by Welsh government as part of the Local Government Finance Settlement.

5.2.5 The Authority's three year capital programme from 2024/25 is summarised below:

|                                  | <b>2024/25<br/>budget</b> | <b>2025/26<br/>budget</b> | <b>2026/27<br/>budget</b> |
|----------------------------------|---------------------------|---------------------------|---------------------------|
|                                  | £m                        | £m                        | £m                        |
| Corporate Services               | 1.697                     | 3.139                     | 3.069                     |
| Education and Lifelong Learning  | 48.570                    | 16.183                    | 4.651                     |
| Community and Leisure Services   | 15.073                    | 17.897                    | 0.230                     |
| Business Enterprise Renewal Team | 12.822                    | 0.983                     | 0.098                     |
| Infrastructure                   | 4.671                     | 2.572                     | 2.572                     |
| Public Protection                | 0.866                     | 0.493                     | 0.493                     |
| Property Services                | 0.690                     | 0.690                     | 0.690                     |
| Social Services                  | 0.340                     | 0.340                     | 0.340                     |
| Private Housing                  | 2.167                     | 2.167                     | 2.167                     |
| <b>Total Council Fund</b>        | <b>86.896</b>             | <b>44.464</b>             | <b>14.310</b>             |
| Housing Revenue Account          | 84.133                    | 64.957                    | 25.087                    |
| <b>TOTAL</b>                     | <b>171.029</b>            | <b>109.421</b>            | <b>39.397</b>             |

Table 1: Prudential Indicator: Estimates of Capital Expenditure

5.2.6 Further details of the 2024/25 – 2026/27 core capital programme can be found attached at Appendix 1 which details the individual schemes.

5.2.7 The Authority's capital programme is funded from the Welsh Government (WG) Capital Grant, WG Supported borrowing,; external grants and contributions; section 106 funding; and virement of revenue budgets (revenue contribution to capital outlay {RCCO}) as summarised in table below.

|                     | <b>2024/25<br/>budget</b> | <b>2025/26<br/>budget</b> | <b>2026/27<br/>budget</b> |
|---------------------|---------------------------|---------------------------|---------------------------|
|                     | £m                        | £m                        | £m                        |
| WG Core Grant       | 4.919                     | 4.919                     | 4.919                     |
| Supported Borrowing | 4.790                     | 4.790                     | 4.790                     |
| Grant Income        | 72.212                    | 45.557                    | 24.493                    |
| Reserves            | 25.743                    | 12.618                    | 1.098                     |
| HRA Borrowing       | 31.500                    | 24.200                    |                           |
| RCCO                | 31.796                    | 17.337                    | 4.097                     |
| Other               | 69                        |                           |                           |
| <b>TOTAL</b>        | <b>171.029</b>            | <b>109.421</b>            | <b>39.397</b>             |

5.2.8 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not get subsidised, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded and funded separately and includes building 432 affordable homes between 2023/4 and 2026/27, and the implementation of the Post Asset Management Programme which is designed to maintain the Council Housing Stock to the WHQS standard over the next 30 years.

5.2.9 The HRA Budget is an indicative figure and the final budget will be as per the HRA Business Plan 2024/25 which will be approved by full Council prior to the 31<sup>st</sup> March 2024.

5.2.10 **Governance:** the core capital budget is approved annually by Full Council as part of the revenue budget setting process. All other capital projects / capital works that do not form part of the core capital programme will require a cabinet report prior to commencement of the capital scheme. Capital projects / works that require to be funded by prudential borrowing will need a decision by full Council. The Cabinet report will need to include the following:

- A link to Corporate Priorities and how the capital project would seek to fulfil such priorities
- Full option appraisal of the project to demonstrate value for money;
- That capital investment plans are affordable, prudent and sustainable;
- Where prudential borrowing is considered that treasury management decisions are taken in accordance with good professional practice;
- That local strategic planning and asset management plans are supported.

5.2.11 All capital expenditure must be financed, either from external sources (government grants and other contributions); the Authority's own resources (revenue contribution, reserves and capital receipts); or debt (borrowing {supported and unsupported}; leasing; and Private Finance Initiative).

5.2.12 Debt (including leases) is a source of finance that can be used to fund a capital scheme. However, debt is repayable over time. The Authority sets aside a Minimum Revenue Provision (MRP) every year for the repayment of existing debt. MRP forms part of the debt management budget and is monitored by Corporate Finance. As part of the annual Treasury Management Strategy, which is approved by Full Council in February (along with the Revenue Budget and the Capital Programme), a MRP statement is presented as an appendix to the Strategy annually, and sets out the MRP Policy that is to be adopted by the Authority at the start of the

new financial year. The full MRP statement is set out in Appendix 8 of the Treasury Management Annual Strategy.

- 5.2.13 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 Authority's estimated CFR is set out in Appendix 6 of the Treasury Management Annual Strategy.

### **5.3 Asset management**

- 5.3.1 Asset management is about using assets (property, plant & equipment) to deliver value and achieve the organisation's business objectives. To ensure that capital assets continue to be of long-term use, the Authority has an asset management strategy in place.

- 5.3.2 The Authority's asset management strategy can be found on its website: [Link](#)

- 5.3.3 As at 31st March 2022 the Authority's fixed assets (property, plant, and equipment) had a net book value of £1.241bn. The net book valuation is an accounting valuation, which does not translate to market value. Further details can be found in Note 24 to the Authority's 2021/22 Statement of Accounts:

[financial-accounts-2022.aspx \(caerphilly.gov.uk\)](https://www.caerphilly.gov.uk/financial-accounts-2022.aspx)

The 2023 accounts are currently being audited.

- 5.3.4 **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 acquiring new assets; enhancing the existing asset base; or to repay debt. Repayments of capital grants and loans also generate capital receipts.

### **5.4 Treasury Management**

- 5.4.1 The Chartered Institute of Public Finance & Accountancy (CIPFA) defines treasury management as "The management of the organisation's borrowing; investments and cash flows; its banking; money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

- 5.4.2 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. Investment balances tend to be high at the start of the financial year as revenue income is received before it is spent but reduce in the long-term as capital expenditure is incurred before being financed.

- 5.4.3 Due to decisions taken in the past, the Authority currently has £307.1m nominal debt outstanding as at 31 March 2023, at an average interest rate of 4.36% and £164.0m nominal treasury investments at an average income rate of return of 2.89%.

- 5.4.4 The Annual Treasury Management Strategy is approved by Full Council every February and sets out the Authority's Borrowing Strategy; Investment Strategy; and respective prudential indicators.

## 5.5 Investments for Service Purposes

- 5.5.1 The Authority provides capital grants to local businesses and the voluntary sector for the purpose of economic regeneration (Caerphilly Enterprise Fund – 2024/25 core capital budget of £80k). Such grants are awarded on application and criteria basis.
- 5.5.2 **Governance:** Decisions to award local businesses and the voluntary sector capital grants are undertaken by the relevant service manager in consultation with the Head of Service. The Caerphilly Enterprise Fund grant applications are assessed by the Business Enterprise Renewal Team, the Cabinet Member for Performance, Economy and Enterprise and a Grant Officer from Finance. The final decision to award is undertaken by the Head of Regeneration and Planning. In either case the award decision is posted on the intranet.
- 5.5.3 The decision to make a loan or to purchase share capital will be referred to the Head of Financial Services and S151 Officer, who will in turn make a recommendation to Cabinet and Full Council once an appraisal exercise has been undertaken. The decision to award will need to be funded from the capital programme and will be subject to a robust business case in the first instance.

## 5.6 Commercial Activities

- 5.6.1 A number of local authorities in England are investing in commercial property, in order to generate enhanced treasury returns above the rate of inflation. The returns generated from this type of investment are supporting revenue budgets in an environment when central government revenue support funding in real terms has been declining year on year.
- 5.6.2 In the event of the Authority purchasing a commercial investment, the Authority may seek to finance the purchase through borrowing, (for debt to yield purchases the Authority will not be able to borrow from the PWLB). In any such case arising the Authority will prepare a detailed report for Council that includes a full option appraisal and risk assessment of the investment. The report will highlight the rationale for the commercial investment.
- 5.6.3 With financial return being the main objective, the Authority would accept higher risk on a commercial investment than with treasury investments. The principal risk exposures include a decline in the property market; volatility in the capital value of property; capital being tied up in the medium/long-term horizon and active management of properties when purchased directly.
- 5.6.4 In recognition of the risks stipulated in the above paragraph, the Authority will adopt a policy whereas any surplus generated over and above the amount required to support the base budget and frontline services will be ringfenced in an earmarked reserve to offset any fall in capital values or capital income; or fund any other associated cost. Periodic reviews will take place at least once a year to review this policy. The Head of Financial Services and S151 Officer would recommend changes to the policy, if appropriate, at any time by way of a report to Cabinet.
- 5.6.5 **Governance:** Treasury management decisions on commercial investments are made in accordance with the approved Treasury management Strategy. Non treasury investments will be referred to the Head of Financial Services and S151 Officer and the Corporate Management Team to consider with further referral to Cabinet and Full Council for the final decision. Monitoring of the commercial investments (treasury management related) will be included within the treasury management monitoring reports (or other Council reports) that are presented to the Policy and Resources Committee. Non-treasury management commercial investments will be reported separately by the Head of Financial Services and S151 Officer.
- 5.6.6 The Authority will seek expert independent and external advice whenever a commercial investment opportunity arises prior to investing. Legal advice will also be sought from within the Authority, and where necessary externally.

## 5.7 **Revenue Budget Implications**

- 5.7.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP repayments 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. This identifies the proportion of the revenue budget required to meet borrowing costs.
- 5.7.2 Further details on the revenue implications of capital expenditure are set in Appendix 6 of the Treasury Management Annual Strategy, Capital Finance Prudential Indicators and Minimum Revenue Provision Policy report for 2024/2025.
- 5.7.3 **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.

## 5.8 **Knowledge and Skills**

- 5.8.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions.
- 5.8.2 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 Authority currently employs Arlingclose Limited as treasury management advisers. This approach is more cost effective than employing such staff directly and ensures that the Authority has access to knowledge and skills commensurate with its risk appetite.
- 5.8.3 The Council will employ, where necessary, consultants and other professional experts to advise upon technical issues relating to non-treasury management commercial investments.
- 5.8.4 **Training:** Key relevant staff will undertake training as and when opportunities arise or whenever there are changes in regulations. The contract for Treasury Consultancy Services includes requirements for Member and Officer training to be provided during any year. Officers will look to schedule treasury management training for Members for Spring 2024. Further Member training will be undertaken as and when required.

## 6. **ASSUMPTIONS**

- 6.1 The details set out in the report are based on information collected from Heads of Service for the delivery of capital works.
- 6.2 It has been assumed that the Authority will fund a proportion of its capital programme through supported borrowing.
- 6.3 It has been assumed that the HRA's borrowing needs are based on the current Business Plan at the time of writing this report.

## 7. **SUMMARY OF INTEGRATED IMPACT ASSESSMENT**

- 7.1 The Capital Strategy report is a requirement of the CIPFA's Prudential code and provides a high-level framework in which the Council can operate. This does not impact on any individuals or any protected characteristic groups and as a result an Integrated Impact Assessment is not required".

## **8. FINANCIAL IMPLICATIONS**

8.1 As detailed throughout report.

## **9. PERSONNEL IMPLICATIONS**

9.1 There are no personnel implications.

## **10. CONSULTATION**

10.1 No external consultation is required for the purposes of the report. However, advice has been sought from the Authority's current Treasury Management Adviser.

## **11. STATUTORY POWER**

11.1 Local Government Act 1972

Author: Rhiann Williams – Group Accountant -Treasury Management and Capital

Consultees: Richard Edmunds - Corporate Director of Education and Corporate Services  
Stephen Harris – Head of Financial Services and S151 Officer  
Leanne Sykes - Deputy S151 Officer  
Andrew Southcombe – Finance Manager, Corporate Finance  
Robert Tranter - Head of Legal Services and Monitoring Officer  
Cllr E. Stenner – Cabinet Member for Finance and Performance

Appendices:

Appendix 1 Capital Programme 2024/25-2026/27