CAPITAL INVESTMENT STRATEGY 2022/23

1 Statutory Requirements

1.1 The Council is required by the Prudential Code of Practice to have an annual Capital Investment Strategy and prudential indicators and limits relating to capital expenditure, affordability, external debt and investments.

1.2 This strategy must be approved by full Council before the start of the financial year and be published on the Council's website.

2 Objectives

2.1 The objectives of the Capital Investment Strategy for 2022/23 are to provide a high-level overview of how capital expenditure, income and financing along with how all types of investment contribute to the provision of public services and how the associated risks are managed and the implications for future financial stability.

3 Capital Expenditure Plans

3.1 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, loans and grants to other bodies enabling them to incur capital expenditure.

3.2 Total capital expenditure is one of the risk indicators required by the prudential code and the Council's capital expenditure plans over the medium term (detailed in the Council Capital Programme and Strategy Update Report) are summarised in Table 1.

3.3 The updated capital programme includes £40.00M expenditure in respect of a new Property Investment Strategy (PIS) which forms part of the Strategic Asset Management Plan for the council. The main objective of the PIS is to balance the portfolio risk to generate future revenue growth and capital appreciation. Property investment activity will only be undertaken once an appropriate capital receipt has been made from an asset disposal. This scheme will therefore be funded from disposal capital receipts. It is however, recognised that it may be necessary to forward fund activity to make strategic purchases prior to an appropriate disposal being actioned. A maximum sum of £10.00M will be allocated and funded from existing capital receipts to fund the programme spend as needed, to be reimbursed from disposal income and held as a rolling available sum. Further explanation can be found in the Investment Strategy (Non-Treasury) for 2022/23.

3.4 The capital programme further includes a new scheme to enable the council to provide funding to the Manydown North Development to meet the costs of accelerated infrastructure. The total maximum investment would be £25M. Further details can be found in the Investment Strategy (Non-Treasury) for 2022/23.

Table 1 – Capital Expenditure (Prudential Code Indicator)

	Estimate 2021/22 £M	Estimate 2022/23 £M	Estimate 2023/24 £M	Estimate 2024/25 £M	Estimate 2025/26 £M	Estimate Total £M
Service Based Capital Expenditure	14.89	13.50	7.13	6.11	3.67	45.30
Investment Property	4.76	0.47	0.17	0.23	0.10	5.73
Basing View Investment Property	0.47	0.00	0.00	0.00	0.00	0.47
Property Investment Strategy	0.00	10.00	10.00	10.00	10.00	40.00
Manydown Investments	0.97	13.95	0.67	0.41	0.41	16.41
Manydown Infrastructure Funding	0.00	5.59	8.82	10.59	0.00	25.00
Total Capital Expenditure	**21.09**	**43.51**	**26.79**	**27.34**	**14.18**	**132.91**

3.5 The main service based capital projects are; home improvement financial assistance (disabled facilities grants) of £7.65M; Transformation Programme £4.47M; rolling IT and operation vehicle replacement programme £5.06M; Council owned asset management plan works of £4.68M; the 5G Living Lab scheme £1.93M; improvements to sport and recreation schemes of £8.14M; play area and open space enhancements of £3.22M; community facilities of £2.70M; Local Infrastructure Fund schemes of £2.10M; and parking and access schemes of £2.12M.

3.6 The capital programme expenditure is monitored in the following ways:-

- Through monthly budget monitoring reports to budget managers and the senior leadership team (SLT);
- Through the Capital Programme Board, which meets monthly;
- Through quarterly reports to Cabinet and,
- Through annual reports to full Council.

3.7 To ensure that capital assets continue to be of long term use, the Council has a Strategic Asset Management Plan (SAMP) and ongoing revenue and capital budgets for maintenance, major repairs and enhancements. The property maintenance and running costs in 2022/23 are estimated at £6.38M and are expected to be at similar levels in future years.

3.8 A key indicator of affordability for the Council to consider in setting the capital programme is the impact on the Council's overall resources.

3.9 The proposed capital programme is currently financed from revenue contributions, revenue and capital reserves, external grants and contributions and short term internal borrowing (which is only temporary financing).

4 Capital Expenditure Approval Process

4.1 The process for approving schemes for capital expenditure is set out in the Capital Programme Strategy which sets out how capital expenditure will help deliver the Council's long term vision and Council plan priorities and how capital resources are prioritised and funding decisions are made.

4.2 The Capital Programme Strategy also sets out the various funding streams for capital expenditure including capital receipts and contributions.

5 Capital Income

5.1 When assets are no longer needed, they may be sold so that the proceeds can be spent on new assets or to repay debt. These proceeds are known as capital receipts. Repayment of capital grants, loans and capital investments also generate capital receipts and the Council also receives grants and contributions towards capital expenditure.

5.2 The Council's estimated capital income over the medium term as shown in table 2.

Table 2 – Capital Income

	Estimate 2021/22 £M	Estimate 2022/23 £M	Estimate 2023/24 £M	Estimate 2024/25 £M	Estimate 2025/26 £M
Asset Sales	0.45	12.52	10.02	10.10	10.10
Property Lease Restructuring	5.10	0.00	0.00	0.00	0.00
Loans Repaid	0.64	0.64	1.03	1.65	3.08
Total Capital Receipts	**6.19**	**13.16**	**11.05**	**11.75**	**13.18**
Capital Grants	1.56	1.37	1.37	1.37	1.37
Other Grants and Contributions	2.30	0.09	0.09	0.69	0.09
Developers Contributions	2.00	0.83	0.83	0.83	0.82
Total Grants and Contributions	**5.86**	**2.29**	**2.29**	**2.89**	**2.28**

5.3 Asset sales include a £12.50M anticipated receipt from the development partner for Manydown in respect of the acquisition of the land to support the project and receipts of £10.00M each year from 2023/24 from the disposal of council property under the Property Investment Strategy. There have been £5.10M of receipts received from capital premiums linked to the restructuring of existing property leases in 2021/22. Loans repaid relate mainly to service based loans for the development of Manydown, new waste vehicles and loans made to housing associations in respect of the Existing Satisfactory Purchases scheme which are due to be repaid after 10 years. Capital grants relate to Disabled Facilities Grants from the Government. Other Grants and Contributions relate mainly to funding from the Hampshire EM3 Local Enterprise Partnership (LEP) in respect of the 5G Living Lab scheme in 2021/22.

5.4 The Council issued its first significant Community Infrastructure Levy (CIL) Liability notice in November 2021 for the sum of £2.03M. The Council introduced the levy in July 2018 (estimated annual income over the next 10 years averaging £2.00M to £3.00M per year). However, whilst the first notice has been issued, no significant income has been received at this stage, as the levy is only payable on commencement of the development. As part of future budget strategy processes there will be an annual opportunity for the Council to consider, consult and agree how CIL funding is allocated to meet priority community infrastructure needs resulting from development e.g. expanded or new facilities for sport, education, transport or community facilities. This could be to address infrastructure needs due to the impact of neighbouring new development or to provide additional strategic infrastructure.

6 Capital Financing

6.1 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council’s own resources (reserves and capital receipts) or debt (borrowing and leasing). The planned financing of the expenditure in Table 1 is shown in Table 3.

<u>Table 3 – Capital Financing</u>

	Estimate 2021/22 £M	Estimate 2022/23 £M	Estimate 2023/24 £M	Estimate 2024/25 £M	Estimate 2025/26 £M	Estimate Total £M
External Sources						
Grants & Contributions	6.19	3.85	3.39	2.16	1.55	17.14
Own Resources						
Capital Receipts	8.65	30.10	13.51	14.01	12.63	78.90
Revenue Contributions	6.25	3.97	1.07	0.58	0.00	11.87
Debt (CFR)						
Internal Borrowing	0.00	5.59	8.82	10.59	0.00	25.00
Total Capital Expenditure	**21.09**	**43.51**	**26.79**	**27.34**	**14.18**	**132.91**

6.2 Debt is only a temporary source of finance, since borrowing 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.

6.3 The Council's cumulative outstanding amount of debt finance is referred to as the Capital Financing Requirement (CFR) and is another prudential code indicator. The CFR increases with capital expenditure and reduces when capital receipts and contributions are used to replace debt. Prior to 2020/21, the council has had a CFR of £NIL and has historically not had any external debt. In 2020/21, however, the council utilised a loan from the Hampshire M3 LEP (Local Enterprise Partnership) to fund part of the capital works at Basing View. In December 2021, the council repaid the £2.20M loan and in accordance with accounting practice, the council has opted to use capital receipts to finance the prior year capital expenditure on the scheme. The proposed capital programme includes expenditure in respect of Manydown infrastructure of £25.00M which is to be financed from internal borrowing.

6.4 The capital financing requirement indicator is a measure of the Council's underlying need to borrow for a capital purpose taken from the balance sheet. This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits.

6.5 The proposed future capital programme will be financed from existing resources. Any unfinanced capital expenditure is deemed to be "internal borrowing" even if the council does not need to physically borrow (i.e. where the council has the cash resources to use internal cash balances in place of external loans).

7 Overall Resources

7.1 The Council's capital expenditure, capital income and financing plans will significantly reduce the Council's overall resources available to fund future capital schemes. The estimated resources over the medium term can be seen in Table 4.

Table 4 – Overall Resources

	Estimate 31/3/22 £M	Estimate 31/3/23 £M	Estimate 31/3/24 £M	Estimate 31/3/25 £M	Estimate 31/3/26 £M
Supporting Capital Programme	28.53	25.52	24.52	27.31	33.43
Supporting Infrastructure	13.42	11.18	10.11	10.86	11.63
Housing and Homelessness	2.72	2.55	2.48	2.40	2.32
Supporting Investment Strategies	16.33	1.66	0.98	0.56	0.15
Supporting Revenue Plans	5.91	4,89	4.01	3.90	3.82
Available Resources	**66.91**	**45.80**	**42.10**	**45.03**	**51.35**
Invested Capital Resources	21.28	20.76	20.22	19.91	19.60
Risk Reserves	23.13	20.12	21.15	20.40	19.81
Unavailable Resources	**44.41**	**40.88**	**41.37**	**40.31**	**39.41**
	111.32	**86.68**	**83.47**	**85.34**	**90.76**

7.2 The Council's overall available resources are forecast to reduce from £111.32M to £90.76M by March 2026 of which £51.35M will be available to support future capital programmes. This assumes that all capital spending plans are met.

7.3 The figures in Table 4 include the impact of including an annual revenue contribution to capital (via contributions to revenue reserves) over the medium term as part of the revenue budget strategy in order to generate capital resources to help fund future programmes.

7.4 The Council has reviewed all of its existing capital programme commitments to ensure that they still align with the Council Plan priorities.

7.5 All future additions to the capital programme will need to have a robust business case that identifies how the scheme can be financed and how the borrowing costs and Minimum Revenue Provision are affordable and can be met from revenue budgets.

8 Annual Minimum Revenue Provision Statement for 2022/23

8.1 Councils with borrowing requirements, as measured by the Capital Financing Requirement (CFR), are required to make provision within their revenue budgets for the redemption of their debts. This provision is called the Minimum Revenue Provision (MRP).

8.2 The Council expects that its CFR will be £NIL as at 31 March 2022. In respect of the CFR balance as at 31 March 2021 (£2.20M), the council elected to repay the £2.20M loan outstanding from the M3 Local Enterprise

Partnership (M3 LEP) in December 2021 and, additionally, to finance the £2.20M capital financing requirement – i.e. which represented the unfinanced element of previous year's capital expenditure – from existing capital receipts. With a CFR of £NIL for external borrowing, there is no requirement to make any MRP.

8.3 Where the council is proposing to internally borrow against its cash resources as in the case of the funding the Infrastructure Funding for Manydown North where there is a loan to other bodies (development partner) for their capital expenditure and this loan will be repaid, no MRP will be charged. The capital receipts generated by the annual repayment on those loans will be put aside to repay debt instead. MRP will be charged where there are no intended loan repayments.

8.4 For any additional CFR, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

9 Borrowing Requirement and Strategy for 2022/23

9.1 The Council's cash resources are forecast to fall from £115.51M to £74.46M by the end of 2025/26 as capital receipts, contributions and reserves are used to finance the capital programme and revenue reserves are used to support the revenue budget.

9.2 Whilst as part of the Capital Programme update for the period to 2025/26 there is currently no identified needed to fund capital spend through external borrowing, because it has sufficient cash resources and can effectively "internally borrow" in the short term if required, if a need to borrow arises the Council has taken steps to secure preferential borrowing rates (called the preferred certainty rate) from the Public Works Loan Board (PWLB – N.B. Technically HM Treasury) in case the borrowing position changes.

9.3 Were the Council to consider borrowing to finance investment in the future it is important to note that HM Treasury (HMT) issued a new circular (no.162) in November 2020 to outline the new terms for lending to local authorities and these new terms are enshrined in the 2022/23 Prudential Code. The main features of the new lending terms are:

a) Local authorities will be asked to submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB. This process will be closely modelled on the existing Certainty Rate application;

b) As part of this, the PWLB will ask the Chief Financial Officer to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years;

c) Recognising that it isn't possible to reliably link particular loans to specific spending, this restriction applies on a 'whole plan' basis – meaning that the PWLB will not lend to a local authority that plans to buy investment assets primarily for yield anywhere in their capital plans, regardless of whether the transaction would notionally be financed from a source other than the PWLB;

d) When applying for a new loan, the local authority will be required to confirm that the plans they have submitted remain current and that the assurance that they do not intend to buy investment assets primarily for yield remains valid.

9.7 What this means in practice, therefore, is that any plan to buy or construct investment assets primarily for a financial return (i.e. for yield) , regardless of whether or not there are plans to borrow from the PWLB for that specific investment, would mean that PWLB funds could not be accessed. The impact of that this that funds would have to be sought from elsewhere, most likely at less preferential rates and/or a higher risk, or other sources of funds, such as capital receipts and revenue financing would be required to finance capital expenditure. It also means that the expected rate of return on any investment would need to be greater to compensate for any additional costs, including initial costs such as arrangement fees, but, principally, additional borrowing costs.

10 Authorised Borrowing Limit

10.1 The prudential code requires the Council to set external debt indicators which relate to the amount that the Council can prudently borrow. These are shown in Table 5.

Table 5 – External Debt Indicators

	2021/22	2022/23 to 2025/26
Authorised Limit for External Debt	£50.00M	£50.00M
Operational Boundary for External Debt	£25.00M	£25.00M

10.2 Under Section 3(1) of the Local Government Act 2003 the Council is required to set an authorised limit for external debt. This limit is a statutory limit and is gross of investments. It represents the maximum limit for external borrowing both in the long term and for cash flow and treasury management purposes. The limit is based on a prudent but not worse case estimate with sufficient headroom to allow for operational management.

10.3 To support day to day treasury management activity it is recommended that Council approve an authorised borrowing limit of £50.00M for 2022/23. At the current time this is required to enable short term cash flow management. If funding for capital expenditure is required, this limit may need to be reviewed accordingly.

10.4 The operational boundary for external debt is based on the same estimates as the authorised limit for external debt but represents the estimate of normal activity without the additional headroom included in the authorised limit.

10.5 The code of practice specifies that over the medium term net borrowing will only be for a capital purpose. This is demonstrated by ensuring that, except in the short term, net external borrowing should not exceed the total Capital Financing Requirement in the previous year plus the estimates of any additional Capital Financing Requirements for the current and the next two financial years.

11 Investments

11.1 The Council has a significant amount of investments and for the purposes of this report investment means all financial instruments and assets that are used primarily to make a return. This means it includes all of the Council's investment property portfolio.

11.2 The Council invests for three broad purposes:

i) Because it has surplus cash as a result of its day to day activities or cash that it holds pending the Council's spending plans (known as Treasury Management investments).

ii) To support local public services by lending to other organisations (known as service based investments).

iii) To earn investment income from rents or interest (known as commercial investments where this is the main purpose).

11.3 The Council's total investments, estimated at over £400M, are shown in Table 6.

Table 6 – Total Investments

Estimate 31/3/22		**Estimate 31/3/23**	**Estimate 31/3/24**	**Estimate 31/3/25**	**Estimate 31/3/26**
£M		**£M**	**£M**	**£M**	**£M**
115.51	Treasury Management	87.92	78.22	69.31	74.46
316.60	Existing Investment Property	316.60	306.60	296.60	286.60
0.00	Property Investment Strategy	10.00	20.00	30.00	40.00
2.62	Manydown Loan Notes	4.07	4.35	4.15	2.75
0.00	Manydown Infrastructure	5.59	14.41	25.00	25.00
5.21	Service Based Investments	4.57	3.93	2.89	1.62
439.94		**428.75**	**427.51**	**427.95**	**430.43**

11.4 In 2017, the Council approved a transfer of funds from Treasury Management funds to create a Property Investment Strategy, and to allow further investments in the Manydown project.

11.5 To the end of March 2021, £32.49M had been invested in the long term via the 2017 Property Investment Strategy. This concluded the first Property Investment Strategy and these investment properties now form part of the council's overall investment property portfolio and are reported as such. As previously reported, the full planned £35.00M investment in the Manydown scheme is no longer required and now only includes provision for loans totalling £18.06M (before repayments from the development partner).

11.6 The Council Programme Update and Strategy report to Council in February 2022 seeks approval to make further investments of £40.00M in a second Property Investment Strategy (£10M from existing capital receipts and a further £10.00M each year from 2023/24 to be funded from property disposals) and £25.00M to invest in Infrastructure for the Manydown North Development.

11.7 The updated Property Investment Strategy, forming part of the Strategic Asset Management Plan 2022/23 to 2025/26, will commence in 2022/23. Whilst the overall aim of this new strategy is to maintain the current overall level of property investment, the council, assisted by its property advisors (JLL), has identified a number of opportunities to generate improved long-term sustainable revenue by both working its existing capital asset base (e.g. through disposals or re-gearing of leases) or by making new property investments from the capital sums generated by the former activity. The core aims and objectives of this strategy will be to achieve one or more of the following objectives:

- Generate improved sustainable revenue streams
- Diversify the existing asset base to reduce volatility and position for growth
- Modernise the estate and improve lot size
- Enhance the overall sustainability credentials of the portfolio towards net zero carbon
- Stimulate economic regeneration within the Basingstoke area

11.8 To progress this strategy, the council proposes to add a sum of £40M to the capital programme over the period to 2025/26.

11.9 A review of the current treasury management investment holdings has identified two funds that would benefit redemption and reinvestment currently only achieving overall marginal returns. Investment in these two funds totals £30M. This funding has been identified to invest up to £25M to support accelerated infrastructure funding for the Manydown North Development. Further details are included in the Investment Strategy (Non-Treasury) for 2022/23.

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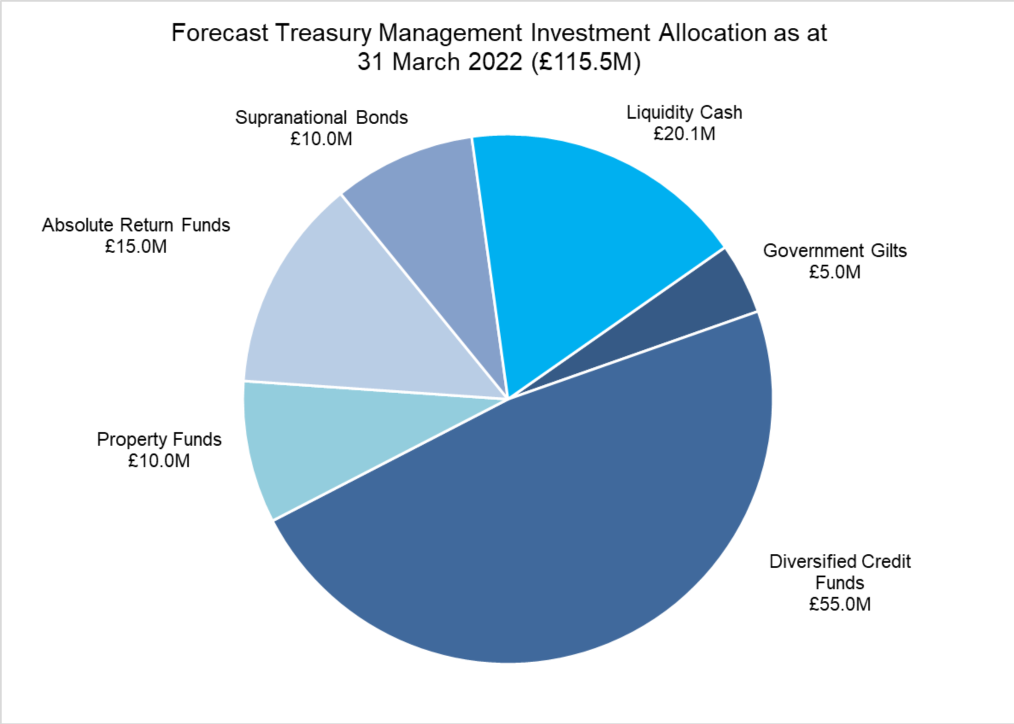
12 Treasury Management Investments

12.1 The Council is expected to have £115.51M of Treasury Investments as at 31 March 2022. A breakdown of the Treasury Investment Portfolio can be seen in Chart 1.

Chart 1 – Estimated Treasury Investment Portfolio 31 March 2022



12.2 Treasury Management investments are budgeted to contribute income of £1.88M to the revenue budget in 2022/23 and also ensure that cash is readily available to fund the Council’s revenue and capital spending plans.

12.3 There are a number of risks associated with treasury management. The main risks are as follows:

i) **Credit and counterparty risk** (risk to capital) – the risk that a third party will fail to meet its contractual investment obligation resulting in a loss of the Council’s capital investment or the risk that there will be a permanent reduction in the capital value of the investment.

ii) **Liquidity risk** – the risk that the Council will commit too much of its investments in fixed term investments and might have to recall investments prematurely resulting in possible additional costs or losses upon disposal of tradable securities.

iii) **Market or interest rate risk** – the risk that fluctuating interest rates will have an adverse impact on the Council’s investment income or the value of its investments.

iv) **Other risks** – this includes risks associated with cash management, legal requirements and fraud.

12.4 The Council's risk appetite with regards to Treasury Management Investments is relatively low because the Council follows the Government's investment guidance which states that the risks should be measured in terms of Security, Liquidity and Yield (returns) in that order. The Council's Treasury Management Policy Statement states that the primary objective is to invest prudently having regard to security and the secondary objectives are liquidity and obtaining optimum returns.

12.5 Details on how these risks are managed and mitigated along with the governance arrangements for treasury management investments are contained within the Council's annual Treasury Management Strategy.

13 Non-Treasury Investments

13.1 Non-treasury investments currently consist of service based investments and investment property.

13.2 Details of how these investments are managed, what contribution they make to the provision of public services and how the associated risks are assessed and managed are set out in the Investment Strategy (Non-Treasury) for 2022/23.

14 Knowledge and Skills

14.1 The Council employees professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions.

14.2 Use is made of external advisers and consultants that are specialists in their field. The Council currently contracts Arlingclose Limited as treasury advisors and Jones Lang LaSalle (JLL) as property consultants.

14.3 This approach ensures that the Council has access to knowledge and skill commensurate with its risk appetite.