Appendix I

Capital Strategy Report 2023/24

1. Introduction

The capital strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.

2. Capital Expenditure and Financing

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 £20,000 are not capitalised and are charged to revenue in year.

In 2023/24, the Council is planning capital expenditure of £64.4m summarised in Table 1.

Table 1 Prudential Indicator: Estimates of Capital Expenditure

Priority Area	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m	Total £m
Your Council	1.1	6.0	2.1	2.3	0.3	11.8
Your City	15.8	56.1	10.5	1.4	0.4	84.1
Fairness for You	2.3	2.4	2.6	1.7	0.0	8.9
Estimated Expenditure	19.2	64.4	15.2	5.4	0.6	104.8

The table above highlights planned capital spend in relation to the Council's key priorities. Work is ongoing in relation to the Harris Quarter Cinema and Leisure (Animate) scheme and the £104.8m capital programme includes the full capital costs for this scheme (£39.5m).

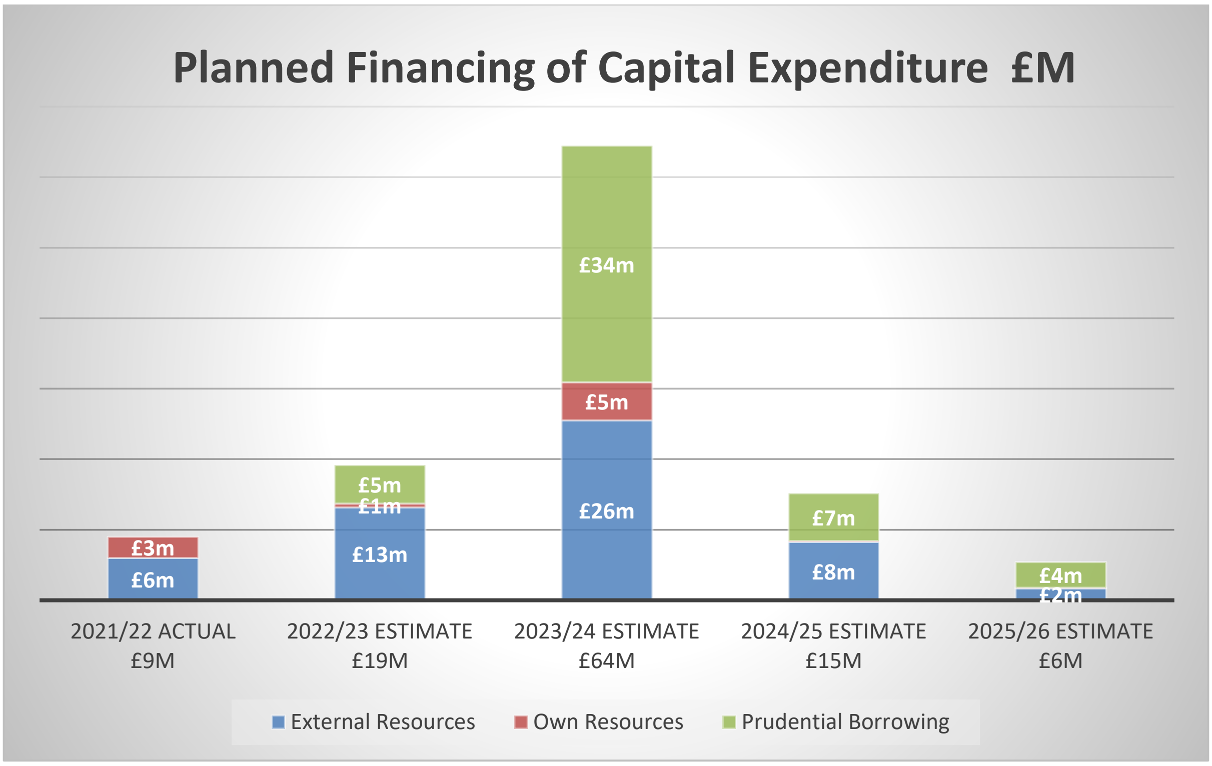
Governance: A strategic review of the Capital Programme including a review of the Council's investment assets and operational assets is carried out annually. The reviews take into consideration works identified from stock condition surveys (over a ten-year time frame) and investments/capital expenditure. The normal process is for bids to be formulated based on the outcome of reviews and recommends projects for inclusion in the Council's capital programme. Bids are collated by Finance who calculate the financing cost (which can be nil if the project is fully externally financed). The Budget Working Group consisting of Cabinet Members, backbenches and Corporate Management Team appraise all bids based on a comparison of strategic priorities against financing costs. The final capital programme is then presented along with the Cabinet budget proposals in January and to Council in February each year.

During 2022/23, due to the additional work commitments in relation to major investment schemes such as the Towns Fund programme, any new capital requirements have been dealt with by individual council reports. Examples of schemes approved are Harris Quarter Cinema and Leisure Scheme, Conway park refurbishment (Phase 2), Riversway Lock gates plus grant funded schemes including; Safer Streets Initiative, UK Shared Prosperity Fund and Levelling Up Parks Fund.

- For full details of the Council's capital programme see Appendix G

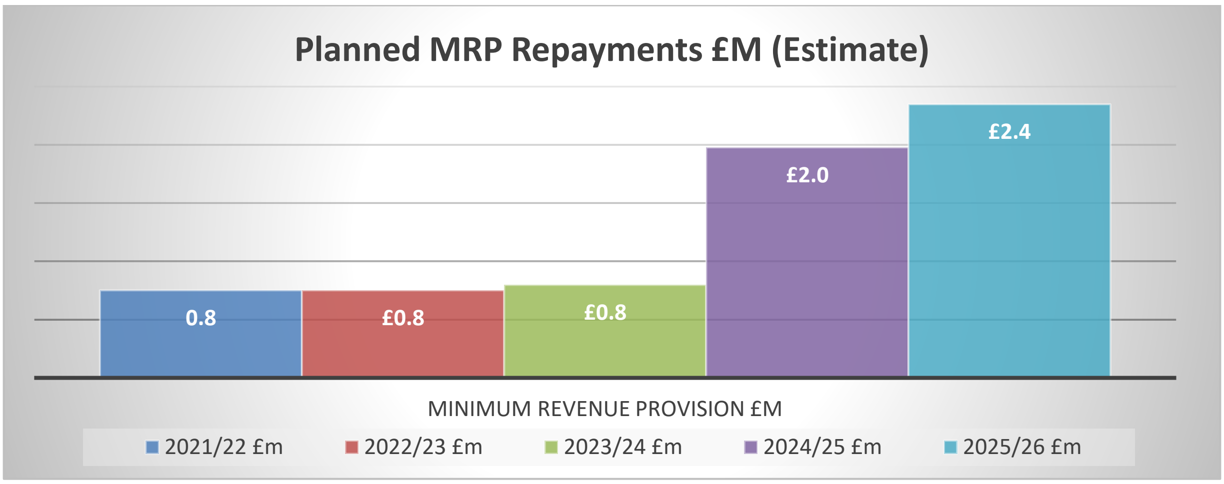
All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves, and capital receipts) or debt (borrowing or leasing). The planned financing of the expenditure in Table 1 is as follows:

Table 2 Capital financing



Prudential Borrowing 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). Planned MRP repayments are as follows.

Table 3 Repayment of Debt Finance

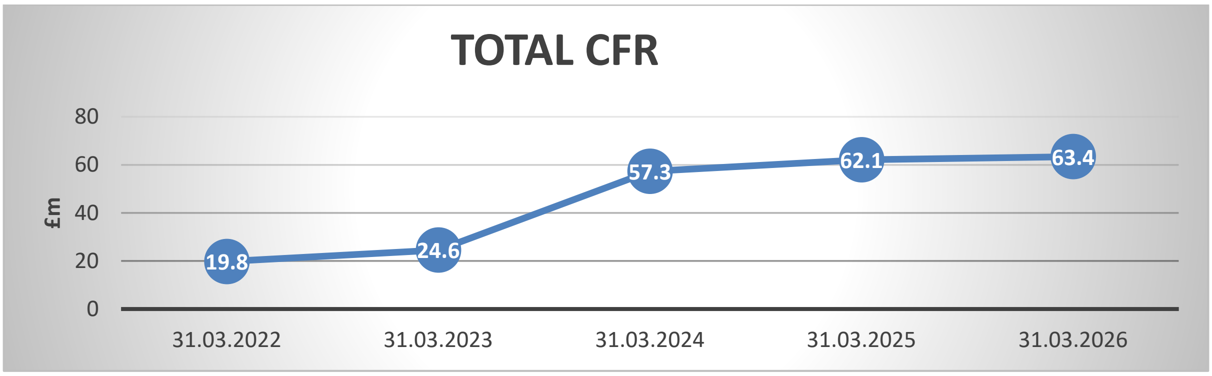


The overall trend of MRP is increasing due to the cost of financing the Capital Programme.

- The Council's Minimum Revenue Provision statement is available in Appendix L.

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. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Estimates of Capital Financing Requirement



The CFR increases significantly in the year 2023/24 as capital expenditure on the Animate project accelerates.
Asset management: To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy.

A review of the future capital requirements of the council's investment and operational assets has recently been carried out and updates made to the capital programme. Further work is planned during 2023 to review the Investment Properties long term requirements along with regeneration and development opportunities.

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 also permitted to spend capital receipts on service transformation projects until 2022/23. The Council plans to receive £5.1m of capital receipts in the coming financial year as follows:

Table 5: Capital Receipts

	2021/22 Actual £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	Total Estimate £m
Asset sales*	0.8	0.3	1.5	2.0	1.5	6.1
Right to Buy Receipts	0.7	0.5	0.1	0.1	0.1	1.5
TOTAL	**1.5**	**0.8**	**1.6**	**2.1**	**1.6**	**7.6**

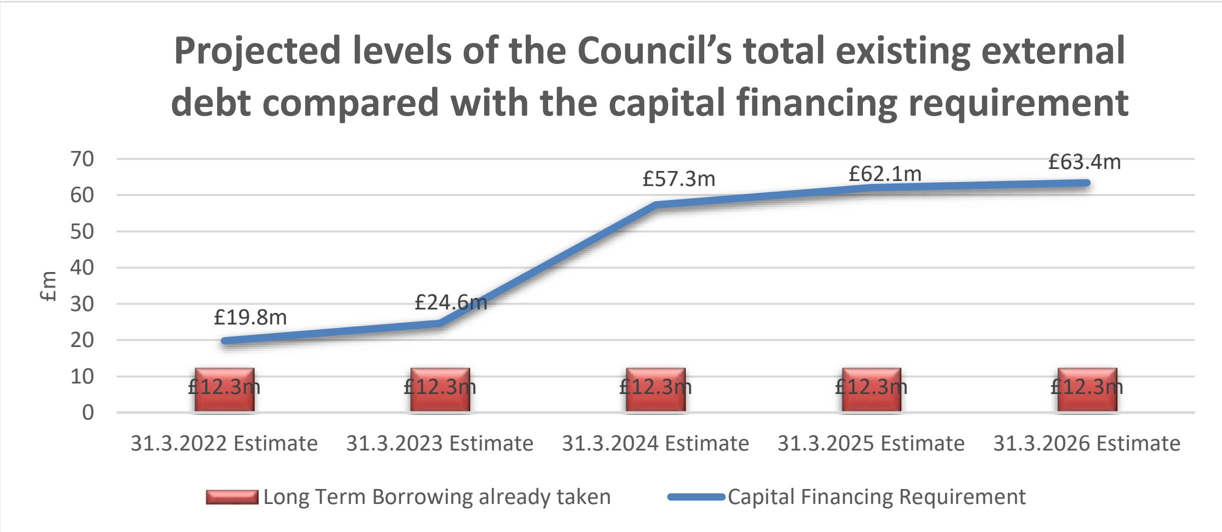
- Further details of financing from capital receipts are included within the capital programme in Appendix G
- The Council has formally agreed to the flexible use of capital receipts however there are no specific plans to use capital receipts to fund efficiency plan revenue expenditure in the budget's forecasts.
- The Council has recently agreed to review sale opportunities to obtain a higher level of capital receipts thereby reducing the borrowing requirement. However, some capital receipts may be achieved from restructuring existing leases. In addition, the Council is negotiating outstanding rent reviews which may reduce the level of capital receipts requirement.

3. Treasury Management

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.

- **Borrowing strategy:** The Council's main objectives when borrowing is to achieve a low but certain cost of finance while retaining flexibility should plans change in future. Due to decisions taken in the past, the Council currently has £12.3m borrowing at an average interest rate of 4.8%.
- 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.
- Projected levels of the Council's total outstanding debt are shown below, compared with the capital financing requirement.

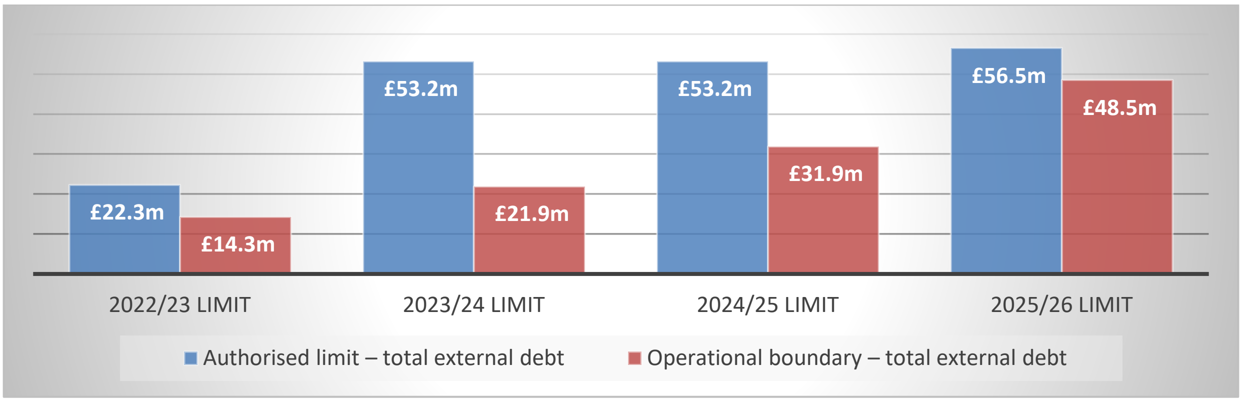
Table 6: Actual Debt and the Capital Financing Requirement



Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term and the Council expects to comply with this in the medium term.

Affordable borrowing limit: The Council 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 and is based on the Council's estimate of most likely but not worst-case scenario and should equate to the maximum level of external debt projected by this estimate.

Table 7: Prudential Indicators: Authorised limit and Operational Boundary for External Debt

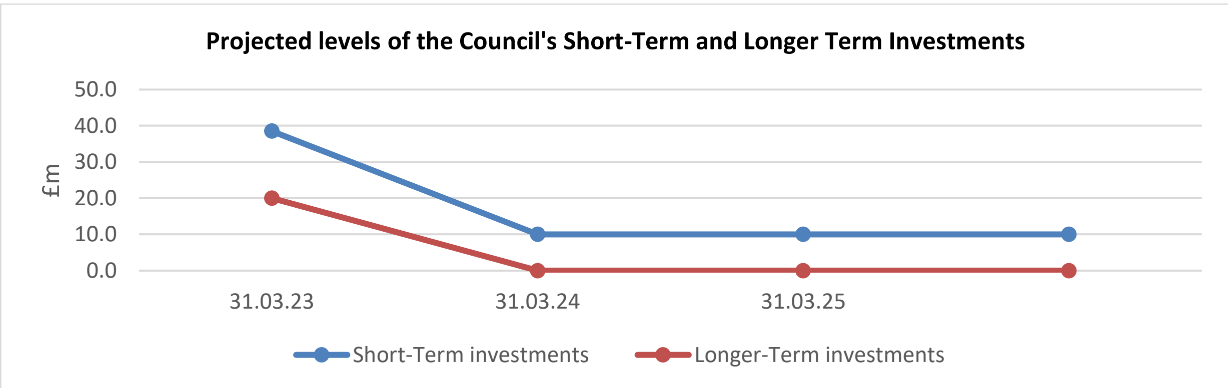


Further details on borrowing are in the treasury management strategy (Appendix J)

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.

The Council's policy on treasury investments is to prioritise security and liquidity over yield in that order with an ethical approach. 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 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 8: Treasury Management Investments



Further details on treasury investments and the treasury management prudential indicators are in the Treasury Management Strategy (see Appendix J).

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Section 151 Officer (Director of Resources) who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity are presented to the Cabinet Member for Resources. The Audit Committee is responsible for scrutinising treasury management.

4. Commercial Activities

With central government financial support for local public services declining, the Council invests in commercial property mainly for the aim of regeneration of the Preston Area whilst seeking to achieve financial gain in order to produce a balanced overall financial budget and to minimise the charges to Council Taxpayers. The commercial investments are currently valued at £40.6m and providing a net return after all costs of 5.08%.

With regeneration and financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include increased vacancies and potential fall in capital values. These risks are managed by Property Services team monitoring and actively seeking to lease vacant premises and effective monitoring of performance of investment portfolio including reports to the Cabinet Member for Resources. A programme of works has been developed which have achieved a review of the managed workshops, undertaking of rent reviews, and identifying surplus areas of land and freeholds to maximise the rental returns and achieve future capital receipt along with regeneration opportunities all within the Preston area.

Governance: Decisions relating to capital expenditure for all purposes, including for the acquisition of property assets, are made in accordance with the Financial Regulations of the Council, this requiring the approval of Full Council/Cabinet or Cabinet Member for Resources as appropriate. The Director of Resources is responsible for ensuring that adequate due diligence is carried out before an investment is made. 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 and limits on their use are in the Investment Strategy (see Appendix K)

5. Liabilities

In addition to debt of £12.3m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £72.6m at 31st March 2022). It has also set aside £3.4m (as at 31st March 2022) in a Business Rates Appeal Provision to cover risks arising from the costs of Business Rates appeals as a consequence of the transference of such risks under the localisation of business rates arrangements introduced in 2013.

Provisions are made where an event has taken place that gives the Authority a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation.

The Council also faces a number of contingent liabilities for which it has not set aside a specific sum. A contingent liability arises where an event has taken place that gives the authority a possible obligation whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the authority. Contingent liabilities also arise in circumstances where a provision would otherwise be made but either it is not probable that an outflow of resources will be required, or the amount of the obligation cannot be measured reliably.

Governance: Decisions on incurring new discretional liabilities are taken in consultation with the Section 151 Officer (Director of Resources). Further details on liabilities and guarantees are on pages 83 to 84 of the 2020/21 statement of accounts see https://www.preston.gov.uk/thecouncil/Councilspending/statement of accounts/.

Revenue Budget Implications

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. A change in the Prudential Code 2021 means that investment income has been removed from the calculation of financing costs so the amounts in the Table below are higher as a result of this accounting change. The financing costs increase in 2024/25 due to a forecast increase in interest payable and MRP costs due to the Animate project.

Table 9: Prudential Indicator: Proportion of Financing Costs to Net Revenue Stream

	2022/23 budget	2023/24 budget	2024/25 budget	2025/26 budget
Financing costs/(income) (£m)	1.4	1.8	4.4	4.8
Proportion of net revenue stream	6.3%	8.1%	21.4%	22.5%

- Further details on the revenue implications of capital expenditure are included within the Capital Programme Appendix G.

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 may extend for up to 50 years into the future. The Director of Resources is satisfied that the proposed capital programme is prudent, affordable, and sustainable.

6. Knowledge and Skills

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 Resources (Section 151 Officer) is a qualified accountant with over 30 years of Local Government experience. The Council pays for accountancy staff to study towards relevant professional accountancy qualifications and the staff within the treasury team, whom are all qualified accountants, attend treasury seminars and workshops provided by CIPFA and other external service providers. Training is provided to Councillors as part of the financial management training delivered by the Director of Resources and more detailed treasury management training to Councillors on the Audit Committee by treasury management advisors Arlingclose Limited.

The Councils appoints external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers, Jonas Lang LeSalle (JLL) as property consultants on the Animate development scheme. This approach is more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills