REPORT

SUBJECT:	**2023/24 Capital Strategy and 2023/24 Treasury Management Strategy**
DIRECTORATE:	**Resources**
MEETING:	**Governance & Audit Committee**
DATE:	**16th February 2023**
DIVISION/WARDS AFFECTED:	**Countywide**

1. PURPOSE

1.1. The purpose of this report is to collect the Committee's views and response to the Council's draft Capital and Treasury Management Strategies, including the Minimum Revenue Provision (MRP) policy.

1.2. The report summarises and highlights the key areas relating to the strategy, alongside those areas of key implications and risks resulting from it which are bought to the Committees attention for their review and comment. As per prudential code requirements, following committee scrutiny the strategies will subsequently be reported to full Council for their own consideration and approval.

2. RECOMMENDATIONS

2.1. That Governance & Audit Committee considers the draft Capital strategy for 2023/24 as found at ***Appendix 1*** and endorses for onward circulation and approval by full Council.

2.2. That Governance & Audit Committee considers the draft Treasury management strategy for 2023/24 as found at ***Appendix 2*** and endorses for onward circulation and approval by full Council. This includes the:

- 2023/24 Minimum Revenue Provision Policy Statement
- 2023/24 Investment & Borrowing Strategies

2.3. That Governance & Audit Committee note the requirement to review the Council's treasury management activities on behalf of the Council by receiving quarterly treasury management activity updates during 2023/24 as per the requirements of the updated CIPFA Treasury Code of Practice.

3. KEY ISSUES

3.1. **2023/24 Capital Strategy**

Overview

3.2. The Capital Strategy sets out the longer-term context in which capital investment decisions are made and demonstrates that the Authority takes capital investment decisions that are in line with its Corporate priorities, and gives consideration to both risk, reward and impact. It also demonstrates that these decisions are taken whilst having proper regard to the stewardship of public funds, value for money, prudence, sustainability and affordability.

3.3. The capital plans of the Authority are inherently linked with the treasury management activities it undertakes, and therefore this report is brought alongside the Treasury management strategy report.

3.4. The main considerations arising from the Capital strategy shown in ***Appendix 1*** are summarised in this report below.

3.5. 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.

3.6. The Cabinet's draft Community and Corporate Plan establishes a clear purpose to become a zero-carbon county, supporting wellbeing, health and dignity for everyone at every stage of life and sets the goals for Monmouthshire to be a:

- A fair place to live where the effects of inequality and poverty have been reduced;
- A green place to live and work with reduced carbon emissions, making a positive; contribution to addressing the climate and nature emergency;
- A thriving and ambitious place, full of hope and enterprise;
- A safe place to live where people have a home and community where they feel secure;
- A connected place where people feel part of a community, are valued and connected;
- A learning place where everybody has the opportunity to reach their potential.

3.7. Achievement of these objectives will be pursued via actions driven by an array of enabling plans and individual service plans. In some instances, these actions will involve a requirement for capital investment.

3.8. Whilst Cabinet make recommendations regarding the capital investment to be included within the programme, it is full Council that approves the borrowing limits that the overall programme must adhere to. A large degree of capital investment is funded from grants, or internal resources such as capital receipts and specific reserves, which do not impact on borrowing levels, but where borrowing is required, it is important that the approved limits are not exceeded. This is an important area of overall financial management governance in that debt funded capital expenditure, and the external borrowing that results, locks in the Council into financing costs sometimes for as long as 50 years. These costs are comprised of the external loan interest costs and the provision for financing the debt funded capital expenditure, known as Minimum Revenue Provision (MRP).

3.9. In the current climate of financial constraints and a continued Medium Term Financial Projection (MTFP) revenue budget gap, capital investment needs to remain within affordable limits. Demand for capital resources remains high and therefore inevitably, prioritisation of projects, leveraging in other sources of funding and working with partners remain key to meeting this demand.

3.10. Within the context of significant demands for capital resources and limited availability, there is the need to develop our use of the various strategic plans across the organisation which drive the need for capital investment and develop alternative strategies to meet demand so the Councils own capital programme is prioritised within an affordable framework. This will include clearer and corporate visibility and assessment of demand for schools, highways and other operational assets.

3.11. **Setting Capital Budgets**

Capital Medium Term Financial Plan

Scheme type	Indicative Budget 2023/24	Indicative Budget 2024/25	Indicative Budget 2025/26	Indicative Budget 2026/27
Asset Management Schemes	2,230,049	2,230,049	2,230,049	2,230,049
School Development Schemes	29,324,638	19,456,606	4,151,797	0
Infrastructure & Transport Schemes	6,272,740	3,627,740	3,527,740	3,527,740
Regeneration Schemes	602,900	730,200	730,200	730,200
Inclusion Schemes	1,200,000	1,200,000	1,200,000	1,200,000
ICT Schemes	413,000	413,000	413,000	413,000
Vehicles Leasing	1,500,000	1,500,000	1,500,000	1,500,000
Capitalisation Directive	3,007,500	507,500	507,500	507,500
Other Schemes	1,126,000	1,126,000	1,126,000	1,126,000
TOTAL EXPENDITURE	**45,676,828**	**30,791,096**	**15,386,287**	**11,234,490**

3.12. The capital MTFP and capital strategy seek to work towards a financially sustainable core capital programme, whilst balancing the need to deliver capital investment plans in line with policy commitment and need. When considering the relative merits of further capital investment, the Capital and Asset Management Working Group (CAMWG) will apply the priority matrix in the capital strategy, either endorsing or amending the proposal for onward consideration by SLT and Members through the agreed mechanisms in place.

3.13. Council approve the overall revenue and capital budgets following recommendations from Cabinet. They also approve the borrowing limits of which the capital programme will need to remain within (the Authorised limit). This limit is a key performance indicator for treasury management and ensures that capital expenditure is limited and borrowing remains within an affordable limit.

3.14. **Capital Financing**

3.15. All capital expenditure incurred has to be physically financed. Once the finite available sources of internal financing (capital receipts, reserves/revenue) and external grant financing are extinguished the Authorities only recourse is to debt (borrowing).

Capital financing in £m

Source of funding	2023/24 budget	2024/25 budget	2025/26 budget	2026/27 budget
External sources	23.1	17.8	7.7	4.0
Capital Receipts	4.3	1.7	1.6	1.6
Revenue Reserves	0.1	0.1	0.1	0.1
Debt	18.2	11.1	6.0	5.5
Total	**45.7**	**30.8**	**15.4**	**11.2**

3.16. Approval of capital expenditure funded through borrowing locks the Council into committing revenue funding over a very long period (as long as 50 years). Minimum Revenue Provision (MRP) is required to be funded from revenue budgets to cover expected borrowing repayments and the level of MRP is increasing over the medium-term so the Authority needs to ensure its capital plans remain affordable and sustainable.

Proportion of financing costs to net revenue stream

Proportion of financing Costs to net revenue stream	2022/23 Estimate £m's	2023/24 Estimate £m's	2024/25 Estimate £m's	2025/26 Estimate £m's	2026/27 Estimate £m's
Net Interest payable	3.9	6.4	6.7	6.9	7.1
MRP	6.7	7.0	7.1	7.5	7.6
Total Financing costs	**10.6**	**13.4**	**13.8**	**14.4**	**14.7**
Net Revenue Stream	175.1	189.4	195.8	199.4	203.1
Proportion of net revenue stream %	**6.06%**	**7.07%**	**7.06%**	**7.20%**	**7.24%**

3.17. The table above compares financing costs to the net revenue stream i.e. the amount of income from Council Tax, business rates and general government grants. The overall proportion of financing costs remains fairly static over the MTFP window which is reflective of the total revenue stream increasing in line with expected inflationary impacts whilst the financing costs increase moderately in line further capital investment made, most notably the completion of the new Abergavenny 3-19 school.

3.18. Total financing costs remain sustainable within the context of the Authorities overall revenue budget in so much that they are fully provided for within the medium term financial plan.

Ongoing Capital Programme Development

3.19. In light of continuing local government funding constraints, it is important that the Council understands the key risks and future aspirations for capital investment. These are captured through various plans and strategies across the Council. As noted previously, there will be a range of priorities originating from these plans, particularly the draft Community and

Corporate Plan which will look to deliver on aspirational long term objectives such as the decarbonisation agenda and affordable housing.

3.20. Alongside this, it is important to consider the requirement to maintain the Councils current asset base. Constrained funding levels in previous years has resulted in a maintenance backlog which gives rise to the potential for major asset failures to occur where issues have developed over time. Although the risks associated are captured through ongoing condition surveys and monitoring, it is inevitable that as time progresses that more significant sums of investment will be required to maintain or substantially refurbish ageing assets.

3.21. There will inevitably be other priorities to be considered for inclusion within the capital programme over the medium to longer term, with the next phase of WG's Sustainable Communities for Learning Programme and further regeneration schemes that will require substantial match funding commitments. The consideration to support such priorities will need to be carefully balanced against other competing demands.

3.22. **Capital Receipts**

3.23. Any assets which are deemed to be surplus to service requirements will be identified for possible sale/income generation in consultation with the Estates department. The procedures governing disposals are captured in the Council's Surplus asset disposal policy.

Forecast Capital receipts

	2022/23	**2023/24**	**2024/25**	**2025/26**	**2026/27**
	£000	**£000**	**£000**	**£000**	**£000**
Balance as at 1st April	8,773	10,849	9,249	8,152	6,655
Less: capital receipts used for financing	(3,776)	(1,547)	(1,194)	(1,094)	(1,094)
Less: capital receipts used to support capitalisation directive	(2,650)	(3,008)	(508)	(508)	(508)
Capital receipts Received	7,072	0	0	0	0
Capital receipts Forecast	1,430	2,954	604	104	104
Forecast Balance as at 31st March	**10,849**	**9,249**	**8,152**	**6,655**	**5,158**

3.24. The value of Capital receipts forecast after 2023/24 drops off quite considerably which is reflective of the replacement local development plan (RDLP) not proceeding as quickly as envisaged in the original delivery agreement. This will have a substantial impact on the balance of receipts available to fund future capital investment demands. It is therefore important that reliance on capital receipts used to support capitalisation direction (to fund one-off revenue costs eligible to be met from capital resources) is seen as a short term measure only.

3.25. Traditionally receipts have been earmarked to finance the Authorities future schools investment. Whilst the Council has further future schools aspirations, in recent years it was not proposed to advocate a similar approach to members in respect of tranche B. Schools based assets commonly have a useful life of 50 years+, and as such traditional long term loan funding can be sourced at competitive rates with limited annual revenue volatility. The Council derives greater revenue benefit by using capital receipts in affording replacement of short life assets, given the avoidance of proportionately more significant minimum revenue provision.

4. 2023/24 Treasury Management Strategy

Overview

4.1. The treasury management strategy sets out the Council's longer term borrowing requirement and plans, which is driven mainly by the capital programme requirements and the resulting impact on the revenue budget.

4.2. It includes how it will manage and invest its surplus cash which also have various targets/limits set as part of prudential indicators, treasury management indicators and also includes additional guidance of the Welsh Government Investment Guidance and the Minimum Revenue Provision Policy.

4.3. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the TM Code) which outlines that capital expenditure plans should be:

Affordable: It is important that the Council's capital investment remains within sustainable limits. The Code requires Councils to consider the resources currently available to them and those estimated to be available in the future, together with the totality of the capital plans and income and expenditure forecasts. As well as capital expenditure plans, Councils should consider the cost of past borrowing, ongoing and future maintenance requirements, planned asset disposals and the MRP policy, which all impact upon affordability.

Prudent: All external borrowing and other long-term liabilities are within prudent levels. The full Council set an authorised limit and operational boundary for external debt, these need to be consistent with the Council's plans for affordable capital expenditure and financing, and with its treasury management policy statement and practices.

Sustainable: taking into account the arrangements for repayment of debt (including through MRP) and consideration of risk and the potential impact on the Council's overall financial sustainability in the medium to longer term.

4.4. The Governance & Audit Committee in its role as the Council's delegated body to review and scrutinise the authority's financial affairs must receive as a minimum a quarterly treasury update report including an annual report after its close on treasury management activities during the year.

4.5. Overall responsibility for treasury management remains with the full Council. In effect, that body delegates the execution and administration of treasury management decisions to the Section 151 officer or deputy who will act in accordance with the Treasury management strategy, treasury management practices and CIPFA's Standard of Professional Practice on treasury management.

4.6. The detailed Treasury strategy for 2023/24 is included at ***Appendix 2***. Key points of interest are summarised below.

Annual Minimum Revenue Provision (MRP) Policy Statement

4.7. The annual Minimum Revenue Provision is the mechanism used for spreading the capital expenditure financed by borrowing over the years to which benefit is provided. Regulations state that the authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent. In addition, there is the requirement for an Annual Minimum Revenue Provision Policy Statement to be drafted and submitted to full Council. This is shown in section 8 of the strategy. The policy also makes consideration of the Welsh Government MRP guidance.

Borrowing Strategy

4.8. With short-term interest rates currently lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. This is known as internal borrowing and will form a key part of the borrowing strategy for 2023/24.

4.9. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.

4.10. The Council has previously raised the majority of its long-term borrowing from the PWLB and expects to continue to do so during 2023/24. PWLB loans are no longer available to local Councils planning to buy investment assets primarily for yield and the Council intends to avoid this activity in order to retain its access to PWLB loans.

4.11. Short term borrowing has traditionally been sourced from the inter-Local authority market and this is expected to continue during 2023/24 as it provides a low administration cost option for borrowing at competitive rates of interest.

Borrowing prudential indicators

(Prudential indicator) - Gross Debt and the Capital Financing Requirement in £m

Gross Debt Forecast compared to CFR	2022/23 Estimate £m's	2023/24 Estimate £m's	2024/25 Estimate £m's	2025/26 Estimate £m's	2026/27 Estimate £m's
Debt (Inc. PFI, leases, right of use assets)	194.4	190.2	190.4	193.6	195.7
Capital Financing Requirement (Total)	206.9	223.2	227.3	225.9	223.8
(Under) / Over borrowed	(12.5)	(33.0)	(36.9)	(32.3)	(28.1)

4.12. Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen in the table above, the Council expects to comply with this over the medium term window based on current estimates of future debt levels.

4.13. **Authorised limit:** The Council is legally required to approve an Authorised Limit for external debt each year. The Authorised Limit is the absolute maximum amount of borrowing that can be undertaken, in order to manage the overall, day to day, cash requirements of the Council.

It also allows for a level of borrowing in advance of need to be undertaken, where appropriate and affordable. In addition, the Council sets an ‘Operational Boundary’, which is the expected level of borrowing required to finance the current Capital Programme. Any increase required to the Authorised Limit needs to be approved by full Council.

4.14. Based on the capital programme proposed, it is recommended that the Council approve the following authorised limits and operational boundaries:

(Prudential indicator) - Authorised limit and operational boundary for external debt in £m

Authorised limit and Operational boundary	2022/23 Estimate £m's	2023/24 Estimate £m's	2024/25 Estimate £m's	2025/26 Estimate £m's	2026/27 Estimate £m's
Authorised limit - borrowing	251.4	263.9	255.5	244	245.9
Authorised limit - PFI, leases & right of use assets	4.4	4.4	4.4	4.4	4.3
Authorised Limit - total external debt	**255.8**	**268.3**	**259.9**	**248.4**	**250.2**
Operational Boundary - borrowing	227.4	239.9	231.5	220	221.9
Operational Boundary - PFI, leases & right of use assets	2.9	2.9	2.9	2.9	2.8
Operational Boundary - total external debt	**230.3**	**242.8**	**234.4**	**222.9**	**224.7**

Investment Strategy

4.15. Both the CIPFA Code and the WG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority’s objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income

4.16. The Authority continues to hold a minimum of £10m of investments to meet the requirements of a professional client under the Mifid II regulations (Markets in financial instruments directive) and therefore consideration will continue to be given to investing balances with a more medium to long term outlook, albeit within the confines and framework of the internal borrowing approach outlined above.

4.17. The existing portfolio of strategic pooled funds currently provides a degree of risk diversification into different sectors, however the Council will closely monitor the returns on these investments in light of a heightened interest rate environment.

4.18. The approved counterparty list and limits are shown in table 17 of the Treasury strategy. The investment limits proposed complement the Authorities objective of striking an appropriate balance between risk and return, whilst minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

4.19. It is important to note that the counterparty rating limits and investment maturities act as limits and not targets and are further informed by market information alongside bespoke periodic advice from our treasury advisers as to sustainability and financial robustness of specific counterparties.

Environmental, social and governance (ESG) policy

4.20. Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level.

4.21. In 2023/24, when investing in banks and funds, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

4.22. A commitment was made by full Council in September 2022 to investigate how responsibly the Council invests it cash balances, and to develop a sustainable investment policy that is compatible with the Council's Declaration of a Climate Emergency and the Well Being of Future Generations Act. As noted above, the current framework and data sources available to enable a robust assessment of investments are still immature. Alongside this, many of the investments funds or bodies are multifaceted which makes current evaluation increasingly difficult. The Council will continue through 2023/24 to engage with its advisors Arlingclose to evaluate its existing investments and assess whether a more sophisticated ESG policy can be applied. Governance and Audit Committee will be kept informed of progress through the regular reporting of treasury performance into committee.

Prudential Indicators

4.23. The prudential and treasury indicators as recommended under the Prudential Code are outlined within the Treasury strategy and set out the limits and indictors that the treasury function will operate under for 2023/24.

5. REASONS

5.1. The Authority is required to produce a Capital Strategy to satisfy the requirements of the Prudential Code of Capital Finance. Many elements of the strategy are already in place and it is expected that in following an overall strategy that it will improve the process of managing the Authorities assets with the ultimate aim to ensure sustainability, and maximise the financial and social value of our assets for our communities. The ongoing challenging financial conditions mean we must have robust policies and programmes in place to ensure our estate is lean, efficient, meets the needs of service users and is fit for purpose.

5.2. The Authority is required to produce a Treasury Management Strategy including annual investment and borrowing strategies, and an MRP policy statement in order to comply with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code").

6. CONSULTEES:

Chief Officer, Resources (Section 151 officer)

Arlingclose – Treasury Management Advisors to Monmouthshire CC

7. APPENDICIES:

Appendix 1 – 2023/24 Capital strategy

Appendix 2 - 2023/24 Treasury Management Strategy including the Minimum Revenue Provision policy statement and Investment & Borrowing Strategies

8. AUTHORS:

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