

1. Introduction

- 1.1 This 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 in Tower Hamlets Council 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 some of these technical areas.
- 1.2 Decisions made this year on capital and treasury management will have financial consequences for the Council 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.
- 1.3 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. The Council has some limited discretion on what counts as capital expenditure.
- 1.4 In 2023-24, the Council is planning General Fund (£122.3m) and HRA (156.2m) capital expenditure as summarised below:

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

Capital Expenditure	2021-22 Actual	2022-23 Revised Estimate	2023-24 Forecast	2024-25 Forecast	2025-26 Forecast
Non-HRA	106.331	111.867	122.281	80.875	35.482
HRA	52.102	74.458	156.185	139.331	94.109
Total	158.433	186.325	278.466	220.206	129.591

**No adjustments for capital expenditure in 2024/25 arises from a change in the accounting for leases as these do not represent cash expenditure*

The main General Fund capital projects include work on the New Leisure Centre, waste and recycling, capital footway and public realm improvement and new infrastructure.

- 1.5 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 £311.3m of new homes over the forecast period 2023/24 to 2025/26 of which £181.6m is forecast to be funded from prudential borrowing.

- 1.6 **Governance:** Following an officer process, taking account of service priorities and Mayor’s Advisory Board approval. The final capital programme is then presented to Cabinet in January and to Council in February/ March each year.
- 1.7 All capital expenditure must be financed, either from external sources (government grants, CIL and other contributions), the Council’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

	2021-22 Actual (reinstated)	2022-23 Estimate	2023-24 Budget	2024-25 Budget	2025-26 Budget
External resources	60.056	64.065	101.611	50.924	24.113
Capital resources	21.618	40.972	36.919	27.207	23.368
Revenue resources	12.184	48.780	63.905	24.251	20.875
Debt	64.575	32.508	76.031	117.824	61.235
TOTAL	158.433	186.325	278.466	220.207	129.591

* debt arising from changes to accounting for leases are not included in the above.

- 1.8 Debt is only a temporary source of finance, since loans and leases must be repaid. This is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP). Proceeds from capital receipts is also used to finance the capital program. Table 3 below shows the level of capital receipts used in place of debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of debt finance in £millions

	2021-22 Actual (restated) £m	2022-23 Budget (revised) £m	2023-24 Budget £m	2024-25 Budget £m	2025-26 Budget £m
Planned MRP Payments	11.158	13.015	17.235	18.709	21.389
Capital Receipts	10.794	8.076	12.874	8.952	17.168

*capital program funded from capital receipts

Minimum Revenue Provision (MRP) Policy Statement 2023/24

- 1.9 The Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods. This statement is consistent with that approved by the Council for 2022-23:
- 1.9.1 For supported capital expenditure MRP will be determined in accordance with the former regulations that applied on 31st March 2008, incorporating an “Adjustment A” of £17.5m. (*DLUHC Guidance Option 1 – the Regulatory Method*).
- 1.9.2 For unsupported capital expenditure incurred after 31 March 2008, MRP will be determined by charging over the expected useful life of the relevant asset in equal instalments, starting in the year after that in which the asset becomes operational. There are two areas where asset lives are bound by regulation. 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. (*DLUHC Guidance Option 3 – the Asset Life Method*).
- 1.9.3 For assets acquired by leases or the Private Finance Initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability (*per DLUHC Guidance*).
- 1.9.4 Where former operating leases are brought onto the balance sheet due to the adoption of the IFRS 16 Leases accounting standard, the asset values adjusted for accruals, prepayments then, the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.
- 1.9.5 For loans to third parties that are required to be capitalised and are to be repaid in annual or more frequent instalments of principal, the Council will not make MRP but will instead apply the capital receipts arising from the principal repayments to finance this expenditure. In years where there is no principal repayment MRP will be charged based on the estimated life of the relevant asset. While this is not one of the options in the DLUHC Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred is fully financed.
- 1.9.6 Under the DLUHC Guidance MRP is not required to be charged in respect of assets held within the Housing Revenue Account (HRA). Following removal of the HRA debt cap by central government. The Council has determined to make a Voluntary Revenue Provision (VRP) on new HRA debt funded capital expenditure. VRP is charged over the expected useful life of the relevant assets

in equal instalments, starting in the year after that in which the assets become operational.

1.9.7 Where there is a change in policy from the previous year for any category of expenditure, this change will be reported to Council including reason why the change is prudent.

1.9.8 Capital expenditure incurred during 2023-24 will not be subject to a MRP charge until 2024-25 or later.

1.10 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 used to replace debt. The estimated CFR is expected to increase by £58.8m during 2023/24. Based on the above figures for expenditure and financing, the Council's estimated CFR is shown in the table 4 below.

Capital Financing requirement (CFR)	2021/22 Draft Actual £m	2022/23 Revised Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Non-HRA CFR	365.673	387.658	394.281	410.305	407.511
HRA CFR	152.485	149.993	202.166	285.257	327.898
Total	518.158	537.651	596.447	695.562	735.409

1.11 No CFR increase have been made in respect of change in the accounting for leases.

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

1.13 **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. Repayments of capital grants, loans and investments also generate capital receipts. No specific capital receipts is earmarked to repay debt. The Council's Chief Accountant's team is responsible for the financing of capital projects in line with agreed project financing.

Table 5: Capital Receipts Receivable

	2022-23 Forecast £m	2023-24 Budget £m	2024-25 Budget £m	2025-26 Budget £m
Asset sales	16.667	13.334	10.667	8.534
Loans repaid	1.163	-	-	-
TOTAL	17.83	13.334	10.667	8.534

2 Treasury Management

- 2.1 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. The Council 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.
- 2.2 As of 31 December 2022, the Council had £68.71m of borrowings at an average interest rate of 3.01% and £225.15m of treasury investments at an average rate of 2.71%.
- 2.3 **Borrowing strategy:** The Council'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 Council therefore seeks to strike a balance between cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher (PWLB certainty rates currently range from 4.36% to 4.45% without Certainty Rate adjustments). There are several factors that the Council needs to consider when setting its borrowing strategy. The Council does not borrow to invest for the primary purpose of financial return and therefore retains full access to Public Works Loans Board as its main source of borrowing.
- 2.4 The provisional capital programme is £628.3m over the next 3 financial years (2023-4 to 2025-26). This programme is partly funded by borrowing of £55.9m in both General Fund and HRA for 2023-26. The rest of the programme is being funded by other sources including payments from developers (CIL and Section 106), capital receipts and revenue contributions (the HRA). However, in previous years the capital programme has had major slippage, including in the current year.

2.5 The above increasing capital programme is taking place at a time when interest rates have risen and expected to continue to rise.

2.5 Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities and leases) are shown below, compared with the capital financing requirement.

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £millions

	2021-22 Actual (reinstated) £m	2022-23 Estimate £m	2023-24 Budget £m	2024-25 Budget £m	2025-26 Budget £m
Actual Debt (incl. PFI & leases)	127.891	123.355	117.768	113.346	108.922
Estimated New Borrowing	-	-	42.552	238.264	333.027
Total Debt	127.891	123.355	160.32	351.61	441.949
Capital Financing Requirement	465.745	537.651	596.447	695.562	735.409

*table above excludes IFRS16 adjustments to balance sheet

2.8 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. Table 6 above demonstrates that the Council expects to comply with this.

2.9 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £76m at each year-end which is currently the level of investment in pooled funds. The table below shows the Council expects to remain borrowed above its liability benchmark.

Table 7: Borrowing and the Liability Benchmark in £millions

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Loans CFR	464.675	491.63	555.161	659.773	705.736
Balance Sheet Resources - Useable capital	(602.800)	(502.700)	(347.000)	(255.900)	(207.100)
Balance Sheet Resources - Working capital	(96.900)	(96.900)	(96.900)	(96.900)	(96.900)
Net Loans Requirement	(235.025)	(107.970)	111.261	306.973	401.736
<i>Liquidity Allowance</i>	56.000	56.000	56.000	56.000	56.000
Liability benchmark	(179.025)	(51.970)	167.261	362.973	457.736

2.10 **Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. 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.

	2021- 22 Limit £m	2022- 23 Limit £m	2023- 24 Limit £m	2024- 25 Limit £m	2025- 26 Limit £m
Authorised limit - borrowing	599.65	608.665	585.161	689.77	735.74
Authorised limit - PFI and leases	52.469	49.059	41.286	35.789	29.673
Authorised limit - total external debt	652.12	657.724	626.447	725.56	765.41
Operational boundary - borrowing	569.65	568.665	555.161	659.77	705.74
Operational boundary - PFI and leases	52.469	49.059	41.286	35.789	29.673
Operational boundary - total external debt	622.12	617.724	596.447	695.56	735.41

2.11 **Treasury 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.

2.12 The Council’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, money market funds 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, strategic pooled funds, 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 Council may request its money back at short notice.

Table 9: Treasury Management Investment forecast based on current capital program forecast

	2021-22 Actual (draft)	2022-23 Estimate	2023-24 Budget	2024-25 Budget	2025-26 Budget
Near-term investments	265.200	121.279	56.000	56.000	56.000
Longer-term investments	56.000	56.000	-	-	-
TOTAL	321.200	177.279	56.000	56.000	56.000

2.13 **Risk Management:** The effective management and control of risk are prime objectives of the Council'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.

2.14 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Corporate Director Resources and staff, who must act in line with the treasury management strategy approved by Council. The Audit Committee is presented with mid-year and outturn reports on treasury management activities. The Audit Committee is responsible for scrutinising treasury management decisions.

3 Investments for Service Purposes

3.1 The Council makes investments to assist local public services, including making loans to its subsidiaries & associates, local charities, and its employees to support local public services and to stimulate economic growth. 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 protect the real term value of the Council's financial assets.

- 3.2 Total investment for service purposes are currently valued at £2.145m with the largest being loans to Oxford House and PLACE Ltd.
- 3.3 **Governance:** Decisions on service investments are made by the relevant service manager in consultation with the Strategic Heads of Finance and Corporate Director Resources 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.

4 Liabilities

- 4.1 In addition to debt detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £419m at 31 March 22). The Council is also at risk of having to pay for any defaults on loans by housing associations in connection with residential properties transferred to them by the Council, and the pension liabilities of Tower Hamlets Homes should the ALMO not be able to meet its pension obligations. As of 31 March 2022, the Tower Hamlets Homes pension fund had an IAS19 surplus of £8.4m. The Council has not put aside any money for these potential liabilities.
- 4.2 **Governance:** Decisions on incurring new discretionary liabilities are taken by service managers in consultation with the Strategic Heads of Finance and Corporate Director Resources. The risk of liabilities crystallising and requiring payment is reported in the Council’s accounts.

5 Revenue Budget Implications

- 5.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue. 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.

Table 10: Proportion of Financing Costs to Net Revenue Stream

	2023-24 Budget Estimate £m	2024-25 Budget Estimate £m	2025-26 Budget Estimate £m
Financing costs	19.301	20.775	23.455
Proportion of net revenue stream	4.55%	4.71%	5.17%

5.2 **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 in some cases for up to 50 years into the future.

6 **Knowledge and Skills**

6.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Interim Corporate Director Resources is a qualified accountant with over 30 years' experience and the Council pays for junior staff to study towards relevant professional qualifications including CIPFA.

6.2 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 Council currently employs Arlingclose Limited as treasury management advisers and Savills as property consultants. This approach ensures that the Council has access to knowledge and skills commensurate with its risk appetite.