Appendix C

Capital Strategy 2024-25

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 these sometimes-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.

Capital Expenditure and Financing

1.3 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. At this stage capital budgets are still subject to change, including changes arising due to the implementation of IFRS 16 - Accounting for Leases.

1.4 In 2024-25 the Council's planned capital spending is £250.4m, £128.3m in the General Fund and £122.2m in the HRA, as summarised below:

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

Capital Expenditure	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
General Fund	94.199	88.862	128.282	59.672	14.301
HRA	43.079	72.260	122.161	151.993	109.465
TOTAL	**137.278**	**161.122**	**250.443**	**211.665**	**123.766**

* Capital expenditure arising from a change in the accounting for leases does not represent cash expenditure.

1.5 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.

1.6 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 £357.9m on the building of new homes over the period 2023-24 to 2026-27 of which £151.3m is forecast to be funded from prudential borrowing.

1.7 **Governance**: Following an officer process, taking account of service priorities and Mayor's Advisory Board direction, the final capital programme is presented to Cabinet in January and to Council in February/March each year for approval.

1.8 All capital expenditure must be financed, from external sources (e.g., government grants, Community Infrastructure Levy (CIL) and other contributions), the Council's own resources (revenue, reserves, capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the approved capital programme is as follows:

Table 2: Capital financing in £ millions

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
External resources	53.170	73.694	121.657	45.869	16.949
Capital receipts	11.343	19.504	42.320	58.735	26.409
Revenue resources	23.748	35.303	31.884	30.067	30.000
Debt	49.017	32.621	54.582	76.994	50.408
TOTAL	**137.278**	**161.122**	**250.443**	**211.665**	**123.766**

** debt arising from changes to accounting for leases are to be reflected in the approved capital programme*

1.9 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

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
Planned MRP	13.503	17.627	16.738	18.288	16.985
Capital receipts	-	-	-	-	-
TOTAL	**13.503**	**17.627**	**16.738**	**18.288**	**16.985**

1.10 The Council's full Minimum Revenue Provision Statement is attached at Annex A.

1.11 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 CFR is expected to increase by £38.3m during 2024-25. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

Capital Financing requirement (CFR)	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
General Fund	404.222	403.653	423.473	434.576	423.092
HRA	165.503	181.067	219.091	266.694	311.601
TOTAL CFR	**569.725**	**584.720**	**642.564**	**701.270**	**734.693**

The CFR has been increased in respect of changes 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. The Authority is currently also permitted to spend capital receipts “flexibly” on service transformation projects until 2025-26. Repayments of capital grants, loans and investments also generate capital receipts.

Table 5: Capital Receipts receivable in £ millions

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
General Fund	28.650	25.000	20.000	20.000	20.000
Loans repaid	-	-	-	-	-
TOTAL CFR	**28.650**	**25.000**	**20.000**	**20.000**	**20.000**

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 2023, the Council had £68.7m of borrowings at an average interest rate of 3.01% and £225.15m of treasury investments at an average rate of 4.9%.

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. 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 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 (see above).

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

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
Actual debt (including PFI & leases)	114.729	109.995	124.498	118.382	114.779
Estimated new borrowing	-	-	50.000	135.000	205.000
Total debt	**114.729**	**109.995**	**174.498**	**253.382**	**319.779**
Capital Financing Requirement	**569.725**	**584.720**	**642.564**	**701.270**	**734.693**

2.5 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.

2.6 **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 £60m at each year-end. This benchmark is forecast to increase to £267.7m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.03.23 Actual	31.03.24 Forecast	31.03.25 Budget	31.03.26 Budget	31.03.27 Budget
Forecast borrowing	68.709	68.709	118.709	203.709	273.709
Liability benchmark	(124.122)	1.457	110.743	200.965	267.691

2.7 The table shows that the Council expects to remain borrowed above its liability benchmark.

2.8 **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

	2023-24	2024-25	2025-26	2026-27
	Limit	**Limit**	**Limit**	**Limit**

Authorised limit – borrowing	573.000	637.000	702.000	788.000
Authorised limit - PFI and leases	47.000	76.000	70.000	67.000
Authorised limit - total external debt	**620.000**	**713.000**	**772,000**	**855.000**
Operational boundary – borrowing	543.000	587.000	652.000	688.000
Operational boundary - PFI and leases	47.000	56.000	50.000	47.000
Operational boundary – total external debt	**585.000**	**643.000**	**702.000**	**735.000**

2.9 **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.

2.10 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 in £ millions

	31.03.23 actual	**31.03.24 forecast**	**31.03.25 budget**	**31.03.26 budget**	**31.03.27 budget**
Near-term investments	197.000	71.000	12.000	7.000	10.000
Longer-term investments	56.000	56.000	56.000	56.000	56.000
TOTAL	**253.000**	**127.000**	**68.000**	**63.000**	**66.000**

2.11 Further details on treasury investments are in pages 5.1 to 5.26 of the Treasury Management Strategy

2.12 **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.

2.13 The treasury management prudential indicators are at paragraphs 6.1 to 6.6 of the Treasury Management Strategy.

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 £2.1m 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

3.4 Prudential indicator: Net income from commercial and service investments to net revenue stream. The Council has nominal commercial/service investments and has not borrowed to invest in the commercial portfolio.

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 discretional liabilities are taken by service managers in consultation with the Strategic Heads of Finance and Corporate Director Resources. The risk of liabilities crystalising 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 10a: Proportion of Financing Costs to Net Revenue Stream (General Fund)

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
Financing costs (£m)	4.126	7.324	6.131	8.839	10.985
Proportion of net revenue stream	1.4%	1.6%	1.3%	1.9%	2.4%

Table 10b: Proportion of Financing Costs to Net Revenue Stream (HRA)

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
Financing costs (£m)	6.985	7.634	8.426	9.086	10.463
Proportion of net revenue stream	6.9%	6.7%	6.8%	7.0%	7.7%

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. The Corporate Director Resources is satisfied that the proposed capital programme is prudent, affordable and sustainable.

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.

Annex A

Minimum Revenue Provision (MRP) Policy Statement 2024-25

1. 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 2023-24

2. For supported capital expenditure MRP will be determined in accordance with the former regulations that applied on 31 March 2008, incorporating an “Adjustment A” of £17.5m. (DLUHC Guidance Option 1 – the Regulatory Method).

3. 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).

4. 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).

5. 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.

6. For capital expenditure loans to third parties, the Authority will make nil MRP unless (a) the loan is an investment for commercial purposes and no repayment was received in year or (b) an expected credit loss was recognised or increased in-year, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment on loans that are investments for commercial purposes, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. Sufficient MRP will be charged to ensure that the outstanding capital financing requirement (CFR) on the loan is no higher than the principal amount outstanding less the expected credit loss. This option was proposed by the government in its recent MRP consultation and in the Authority’s view is consistent with the current regulations.

7. Under the DLUHC Guidance MRP is not required to be charged in respect of assets held within the Housing Revenue Account (HRA). Since removal of the HRA debt cap by central government in 2018, the Council has made a voluntary revenue provision (VRP) on new HRA debt funded capital expenditure. Future provision will

be subject to affordability and the HRA Business Plan.

8. 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 the change is prudent.

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