Capital Strategy Report 2024/25

West Oxfordshire District Council

Summary

We continue to pursue our Council set investment strategy to deliver on our Council priorities whilst also covering the cost of capital and supporting our revenue budget. This ambitious strategy was laid out in 2020 but it has proved difficult to find many suitable investments that meet the criteria set by the Public Works Loan Board (PWLB) – which is a source of lending we are not currently in a position to forego our eligibility to - and deliver a yield that makes the risk of investment worthwhile and clears the hurdle rates set out in the Council's investment strategy.

We are realistic however that appropriate investment opportunities are relatively ad hoc and that while we always seek to find them, there is not a reliable pipeline of them available so we cannot place too much reliance on new income in future years generated from this source. We are taking a financially responsible approach to all of our plans, ensuring that optional expenditure is at the very least cost neutral to the Council and, where possible, delivers ongoing revenue to support services.

The investment income forecast over the life of the Medium Term Financial Strategy (MTFS) has been reduced in line with the difficulty of finding suitable opportunities as outlined above, however there is still an approved expenditure of £75 million from the 2020 Investment Recovery Strategy, of which £12.3 million has been spent.

Some capital expenditure is of course unavoidable in the delivery of statutory services and our other activities and investments need to deliver financial returns in order to support those.

Introduction

This Capital Strategy provides 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.

While the annual revenue budget can often feel like the main focus for the Council each year, the Capital Strategy affects not only the in-year activity but the longer-term elements in the MTFS.

While some elements of the capital programme are financed by revenue, some of the projects in it will require the Council to borrow. This can be because it is outside of our normal revenue expenditure or, previous internal borrowing (which is discussed at greater length later in this paper) means that we now need external borrowing to fund the expenditure.

What is Capital Expenditure?

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 can include 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 £10,000 are not capitalised and are charged to revenue in year.

For details of the Council's policy on capitalisation, see the Council's accounting policies which are contained within the annual Statement of Accounts:

In 2024/25, the Council is planning new capital expenditure of £7.195m:

Estimates of capital expenditure in £m

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m
Capital Expenditure	15.01	9.44	7.20	4.77	1.72

Governance: Service managers will typically update Finance, as part of the budget process, who include projects in the Council's capital programme. Proposals are collated by the Finance team who calculate the financing cost (which could be nil if the project is fully funded by external contributions). The financing cost is included in the MTFS and detailed budgets for the forthcoming financial year.

For full details of the Council's proposed capital expenditure see Annex E which itemises the proposed capital programme.

While future expenditure is estimated for the purpose of calculating our borrowing requirement and projecting a cost of capital through the MTFS, individual projects still require business cases to be presented to the S151 Officer, Executive and Council for approval before expenditure can be committed.

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 and leasing). The planned financing of the above expenditure is as follows:

Sources of capital funding £m

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m
External Sources	3.16	2.10	2.53	0.88	0.88
Own Resources	8.15	1.05	1.17	0.54	0.84
Internal & External Borrowing	3.70	6.29	3.50	3.35	0.00
	15.01	9.44	7.20	4.77	1.72

External funding could come in the form of:

- Government grants – these have been used successfully to support the rollout of Gigaclear high speed broadband, ensuring that our rural district is well connected. During 2024 the Council will be exploring the use of Public Sector Decarbonisation Scheme (PSDS) funding to decarbonise the leisure centres in Carterton and Witney.
- Section 106 contributions from developers – these are used to provide additional infrastructure in communities where new homes have increased the number of residents. They have funded play parks, community facilities, new affordable housing and public art amongst other things. S106 monies are currently being used to provide Electric Vehicle charging points in the Woolgate development.
- The Disabled Facilities Grant (DFG) – this grant funds adaptations to residents' homes and other supporting activities.
- The Oxfordshire Growth Deal (now delivered through the Future Oxford Partnership) – this has funded the provision of affordable housing in partnership with registered providers such as Cottsway Housing and Heylo.

Minimum Revenue Provision (MRP)

Before the start of the financial year, a statement of MRP policy for the forthcoming financial year must be approved by Full Council.

The Local Government Act 2003 requires the Authority to have regard to the Ministry of Housing, Communities and Local Government's (MHCLG's) *Guidance on Minimum Revenue Provision* (the Guidance), most recently issued in 2018.

Borrowing, both internal and external, must be paid back and so every year the Council calculates how much has to be charged to the Revenue Budget to pay off the borrowing over the life of the asset – this is called the Minimum Revenue Provision – MRP.

It is in effect a replacement for the depreciation that you would expect to see within a company's accounts in the private sector. In local government accounting, depreciation is charged and then reversed out so it does not affect the level of Council Tax required to fund the Council's costs, however MRP is charged to the General Fund and therefore does affect the required level of funding.

For the purpose of the calculation we determine the useful life of each asset as no less than 5 and no more than 50 years. The broad aim of the Policy is to ensure that MRP is charged over a period that is reasonably consistent with the period over which the capital expenditure, which gave rise to the debt, provides benefits. Where a local authority's overall Capital Financing Requirement (CFR) (see below) is £nil, or a negative amount, there is no requirement to charge MRP.

If no life can be reasonably attributed to an asset, such as freehold land, the life is taken to be a maximum of 50 years. In the case of freehold land on which a building or other structure is constructed, the life of the land will be treated as equal to that of the structure. In exceptional cases, where a Qualified Valuer has estimated the useful life of the asset to be more than 50 years, that useful life will be used.

So, if we borrowed £1m to buy an asset with a useful life of 40 years we would need to provide (1,000,000/40) = £25,000 per year for 40 years in our revenue budget. If the asset were only expected to last for 7 years, like for example some of our vehicles, then the charge to the revenue budget would be £1m / 7 = £142,857 per year.

There are two main ways we could calculate MRP – the equal instalment method and the annuity method. The equal instalment method has been used in the example above while the annuity method has lower repayments in the early years which increase every year over the repayment period. MRP is only concerned with the repayment of the principal amount borrowed, so, if viewed like a repayment mortgage, the repayment of the principal under the annuity method is much lower in the early years.

MRP commences in the financial year following that in which the expenditure is incurred or, in the year following that in which the relevant asset becomes operational.

Where capital loans and finance leases made to third parties are repaid in annual or more frequent instalments of principal, these "capital receipts" arising from principal repayments reduce the capital financing requirement and thereby the need for MRP.

West Oxfordshire District Council has chosen to use the Equal Instalment Method in general but uses the Annuity Method where this most closely matches corresponding capital receipts, for example in the case of the loan to Cottsway housing which is being repaid in that profile. This avoids a mismatch between attributable MRP and the offsetting capital receipt.

If appropriate, shorter repayment periods (i.e. less than asset life) may be used for new investments.

Taking all available advice into account, the final decision on the determination of asset life rests with the Chief Finance Officer.

The General Fund MRP charge using the above method is estimated at £569,116 for 2024/25

MRP

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m
MRP on internal/external borrowing	1.19	1.34	1.55	1.74	2.22
Capital Receipts (exc Asset Disposal)	(0.77)	(0.84)	(0.99)	(1.06)	(1.54)
MRP provision applied	0.42	0.50	0.57	0.68	0.68

Capital Financing Requirement

The Council's cumulative outstanding amount of debt finance is expressed as its Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and is reduced by MRP and capital receipts used to replace debt. The CFR is expected to increase by £2.83m during 2024/25. Based on the figures shown above for expenditure and financing, the Council's estimated CFR is as follows:

Capital Financing Requirement (CFR)

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m
General fund services	17.78	20.14	22.98	24.59	22.63
Capital Investments	10.60	10.60	10.60	10.60	10.60
Total CFR	28.38	30.74	33.57	35.19	33.22

One of the ongoing items of significant capital expenditure is the waste fleet. Waste vehicles typically have a long lead time which means that expenditure for vehicles ordered in one year can actually take place the following year.

Each replacement vehicle is reviewed to see whether lower running costs create sufficient savings for us to purchase a more expensive electric vehicle but this is not always practical for the heavy collection vehicles that make up the core of the fleet. In a rural district such as ours, most of the collection fleet have to have an operational range that exceeds that currently offered by their electric vehicles. Ubico are investigating alternative fuel vehicles and the hope is that when the alternative fuel market matures, that technology will have developed enough to be more readily available and affordable and will offer a practical solution that can deliver at the scale required.

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. In the current situation though, where PWLB guidance would not permit the Council to purchase replacement assets if it were to sell some of its current portfolio, it is unlikely that we would benefit in the long term from high levels of asset disposal. As can be seen from the table below, the estimates of potential asset sale are very low and are estimated based on previous years.

The lease and loan repayments relate to vehicles purchased and then leased to Ubico and loan repayments from Cottsway Housing Association and Southill Solar.

Capital Receipts

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m
Asset Disposal	0	0	0	0	0
Leases and Loans	0.77	0.84	0.99	1.06	1.54
	0.77	0.84	0.99	1.06	1.54

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 shortfall in cash may be met by borrowing. Treasury management is discussed in more detail in the Treasury Management Strategy paper but in terms of Capital we will look at the impact that our capital plans have on projected borrowing requirements.

In the past all asset purchases, even those that might have been expected to require external borrowing to fund them, have been able to be funded out of existing cash balances, also known as internal borrowing. Our cashflow forecast shows that this is no longer possible and we will need to borrow externally before the end of 2024/25 and for most capital expenditure going forward unless funded by a future receipt of external funding.

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 as a warning level should debt approach the limit.

As part of the review of prudential indicators, the Council is asked to approve the following:

Authorised limit and operational boundary for external debt £m

	2023/24 Budget £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m	2027/28 Forecast £m
Capital Financing Requirement (CFR)	30.74	33.57	35.19	33.22	31.34
Operational Boundary	50.06	35.57	37.19	35.22	33.34
Authorised Borrowing Limit	55.06	40.57	42.19	40.22	38.34

Although capital expenditure is not charged directly to the revenue budget, as has been explained above, 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 and expressed as a percentage of that.

Estimates of financing costs to net revenue stream

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m
Interest Payable	0	0.013	0.079	0.212	0.246
MRP	0.420	0.502	0.569	0.682	0.682
Total borrowing costs	0.420	0.515	0.648	0.894	0.927
Net Revenue Stream (per MTFS)	13.91	15.15	15.23	15.47	15.16
Proportion of Net Revenue Stream	3.02%	3.40%	4.26%	5.78%	6.12%

The Council makes investments to assist local public services. Many of these are crucial to our statutory provision of services but where the expenditure is not mandatory, the Council is required to find the most efficient way of delivering this service and where possible, seek grants or external funding to provide additional investment. Proposals should be brought forward with an appropriate business case to protect the Council from risk around unforeseen costs and to ensure that wherever possible any opportunity to raise additional revenue to support service delivery for the Council is explored.

Net income from commercial & service investments to net revenue stream

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m
Capital Investments	4.06	3.33	3.66	3.66	3.66
Service Investments	0.19	0.19	1.40	1.40	1.40
	4.25	3.53	5.06	5.06	5.06
Net Revenue Stream (per MTFS)	13.91	15.15	15.23	15.47	15.16
Proportion of Net Revenue Stream	30.56%	23.29%	33.21%	32.71%	33.37%

Governance

Decisions on service investments are made by the Council on advice from the Chief Finance Officer and must comply with the Capital Strategy and Investment Strategy. Most loans are capital expenditure and purchases will therefore also be approved as part of the capital programme.

Further details on service investments can be found in the Investment Strategy.

Current Projects

The Council owns assets totalling £111,045,000. These Assets are held principally as either commercial investments (£61m), to provide services such as Leisure, Waste or Council offices (£47m) or as a result of historic ownership, particularly of small plots of land (£3m).

In order to effectively manage this estate, the Council needs to understand its condition so it can plan for, and budget for, pro-active repairs and maintenance and future investment can form part of decision making on whether an asset is retained, redeveloped or sold.

An Asset Management Strategy is therefore being developed to provide a strategic approach to property, establishing what the Council wishes to achieve from its estate, aligning it with other Council priorities and ensuring decision making is based on clear policy. Decisions on purchasing, investing in or disposing of property would be based on pre-agreed principles to maximise return, reduce expenses and manage risk, enabling a far more strategic approach rather than consideration of individual properties in a piecemeal way.

The overarching strategic document would then be complimented by a review of the Council's assets to consider what future approach should be taken. This would be based on data such as current value, how the property is performing (lease income and return on investment) and broader opportunities to maximise income or in some cases dispose of a financial liability.

There is scope to significantly increase the efficiency with which assets are managed by streamlining delegations and decision making based on the adopted strategy and transferring or selling assets that provide no value but take time and money to manage and maintain.

Condition surveys would inform this by identifying current defects or items which will require repair or replacement over the next 5 years. This assessment of condition, and likely costs, would enable work to be planned in advance, efficiencies in procurement and more accurate budgeting, rather than reactive repairs which are often more expensive and harder to manage. The Council currently has £200,000 a year allocated in the capital programme for repair and maintenance.

Condition surveys would be undertaken for properties where the Council retains responsibility for repairs and maintenance. In some cases, responsibility is split between the Council and the tenant e.g the Council is responsible for the main structure of the leisure centres but GLL (leisure contract provider) has responsibility for internal repairs, maintenance and equipment.

The majority of the Councils' commercial investment property is let on a Full Repairing and Insuring Leases. There is a schedule of condition attached to the initial lease and then a Schedule of Dilapidations completed when the tenancy comes to an end. There are not currently the staff resources in place to carry out inspections during the lease. This means there is a risk that a lease ends and the Council suffers financial losses due to the condition, particularly in the case of bankruptcy, even though the lessee is obligated to reinstate the building to its original condition. A view on how this is best managed will be included in the Asset Management Strategy.

In 2023 the Council agreed to invest more in an in-house valuer resource to carry out valuations, rent reviews and option appraisals, all of which are estates functions which have previously been bought in from consultants, due to a lack of capacity. The valuer started at the end of August and the work he has carried out is being recorded so the financial value in terms of consultancy savings and increased income can be identified. The benefit of his role and others within the team will be maximised with a clear strategy for them to apply when undertaking rent reviews and considering options for properties.

The Council's Overview and Scrutiny Committee receives an annual report on the Council's investment property portfolio. In addition, the Council's Audit and Governance Committee also receives information on the Council's asset portfolio as part of the financial statements.

The Council is engaged with SALIX, a non departmental Public Body, who administer grants for Energy Security and Net Zero (formerly BEIS). The grants are used to upgrade heating systems in public buildings to be cleaner, cheaper and powered by renewable energy. The Council's aim is to use available grant funding to decarbonise the leisure centres in Carterton and Witney as part of our pledge to be carbon neutral by 2030.

Grant funding will not cover the entire cost of the decarbonisation project. The Council will have to make a potentially significant capital contribution as well as fund ongoing revenue costs. The final decision on any proposal will therefore need to balance the need to make the best use of finite resources and responding to the Climate emergency.

A phased replacement programme, for waste vehicles, was approved by the Executive in February 2024. This will allow the Council to take advantage of new technologies as they mature and become more reliable in the next two to three years. Spreading the cost over the next three to four years limits the amount of external borrowing needed at the current higher interest rates. In 2024/25 it is anticipated that the Council will purchase 4 replacement waste vehicles with the remainder of the fleet brought in through contract hire arrangements.

Knowledge and Skills

The Council employs (directly or through Publica Ltd), professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Chief Finance Officer and several members of her team are qualified accountants with extensive experience. The Council pays for junior staff to study towards relevant professional qualifications such as the Chartered Institute of Public Finance and Accountancy (CIPFA).

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. The Council employs other specialist consultants to advise upon specific, extra-ordinary transactions as required. Examples of such transactions include property acquisitions, and loans to third parties. This approach is more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

The Council has experience of investing in commercial property in recent years. The Council's property service is provided through its strategic service provider Publica Group (Support) Ltd. The team of property officers have the following qualifications:

- BSc Hons Real Estate Management
- Associate Member Royal Institute Chartered Surveyors
- Member Royal Institute Chartered Surveyors
- Royal Institute Chartered Surveyors Registered Valuer

- Member institute welfare & facilities management
- Technical member of institute for occupational safety and health
- CIMA cert BA

The Council's legal team have experience of carrying out due diligence checks, particularly for commercial property acquisitions, and the legal officers have the following qualifications:

- Fellows of the Chartered Institute of Legal Executives (CILEx)
- Student Member of the Chartered Institute of Legal Executives
- Solicitors

The Property and Legal teams work together with the Finance team to support the Council's Chief Finance Officer in developing investment proposals for the Council. External specialist advice is obtained when required to support these teams.