Appendix 1

WORCESTER CITY COUNCIL

CAPITAL STRATEGY

2024/25 – 2026/27

DRAFT

March 2024

Introduction

This document sets out Worcester City Council's Capital Strategy. It gives residents and other stakeholders an overview of why, where and how we intend to spend money to provide services and meet some of the Council's wider strategic aims. Supported by other documents including the Asset Management, Treasury Management and Investment Strategies, it spells out our approach in the short, medium and long-term.

In particular, this document demonstrates how our Capital Strategy will help to deliver the five themes of the City Plan by:

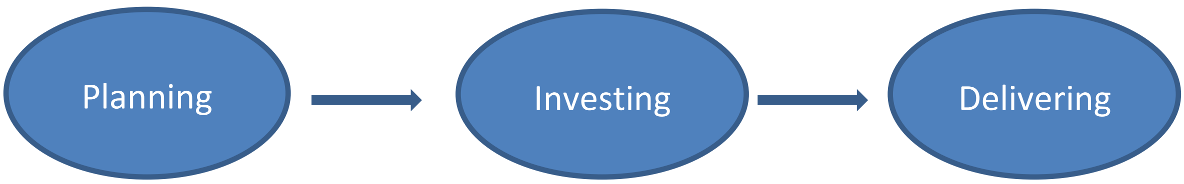
- investing in infrastructure and strengthening the Council's role in making our communities stronger and more connected
- delivering the Masterplan and regenerating High Streets to help secure a prosperous city
- supporting partners to develop facilities to help people become more healthy and active
- securing the heritage of the city for future generations
- acquiring and investing in Council assets to support service delivery.

How capital expenditure is defined

Capital expenditure is money used by the Council to acquire, upgrade, and maintain physical assets such as property, operational buildings and equipment. Capital expenditure can include everything from replacing a roof or purchasing a piece of equipment to buying an old building or constructing a brand new one. Capital expenditure is different to revenue expenditure, which is the money used by the Council for the day-to-day delivery of services, staffing and supplies.

Capital Strategy

In summary, our aim is to use the total capital resources available to create the best arrangements for meeting the aims of the City Plan. This means:



Planning: Following the publication of the **City Plan** in 2016, which has been updated in 2022 and sets out our ambitions for the city, we published a **MasterPlan** which details how we want to help shape Worcester for the future. We have also published our **South Worcestershire Development Plan** and identified sites in the city that can be brought forward for development. In 2021 we received a grant of £17.9m from the **Future High Streets Fund** to develop a specific area of the City and in 2022 we received an additional grant of £19.6m from the **Towns Fund** to support a range of initiatives in the city in conjunction with other key stakeholders.

Investing: we are targeting investment at strategic sites and looking to purchase properties that will support engagement with partners and developers, give the Council a stronger stake in the city, and support further infrastructure and service development. This includes acquisition of **the Scala Theatre and Corn Exchange** and other acquisitions to support the **Future High Streets** Fund and investment in Community Centres and infrastructure through the **Towns Fund**. We have also applied for £1.4m grant funding to support the development of the **Crematorium** to replace old gas cremators with new environmentally sustainable alternatives.

Delivering: we are working with partners to create new facilities such as a new **pedestrian bridge** across the river Severn and new infrastructure to support **active travel**, helping to address housing need through the new residential development at **Sansome Walk**; supporting businesses and communities through the **Towns Fund** investment programme; and improving energy efficiency by adding new **solar panels** and **electric vehicle charge points** to Council assets.

Our Capital Strategy will also help us meet our need to upgrade and maintain:

- Operational buildings
- Community facilities
- Our vehicle fleet
- Our ICT infrastructure

To ensure that capital assets continue to be of long-term use, the Council has established a Capital and Asset Management Framework. This requires all assets to be subject to a five year 'fit for purpose' assessment which will determine whether the asset continues to meet the Council's needs and whether it should be retained or disposed of. Assets that are retained will have a detailed forward maintenance programme.

A new Asset Management Plan for the period 2022/23 to 2024/25 was approved in February 2023. The plan details key initiatives arising out of asset reviews and the Asset Management Programme for planned and preventative maintenance over the same period.

The decision to acquire new assets, including property investments, will include assessment of revenue costs of maintaining the asset over its expected life.

Our duty to look after public money

As a Council, we have a duty to look after the public purse, and residents, businesses and the Government expect us to do so in a sensible and rational way. This Capital Strategy will demonstrate how we:

- Spend wisely and safely, especially in relation to the acquisition of property assets

- Finance our spending through prudent borrowing or use of reserves (called capital financing) within the upper level of our borrowing (called the external debt boundary) set by Council

- Manage risk and make decisions, ensuring we have the appropriate skills and expertise, and taking a measured approach to investment

- Ensure we have enough in reserves to keep services running and deal with any shocks to the system

- Maximise our returns on monetary investments, as set out in our Investment and Treasury Management strategies.

Underpinning the Capital Strategy is the need to ensure that the Council is financially sustainable in the future and able to meet forthcoming expected challenges to its Medium-Term Financial Plan.

Planned capital spending

Our aim is to: *spend wisely and safely, especially in relation to the acquisition of property assets*

Acquisition and development

In 2024/25, the Council is planning capital expenditure of £24.787m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2022/23 Actual £m	**2023/24 Forecast £m**	**2024/25 Forecast £m**	**2025/26 Forecast £m**	**2026/27 Forecast £m**
General Fund services	5.363	8.884	7.184	2.347	1.860
Future High Streets Fund	1.984	2.419	9.984	0	0
Towns Investment Plan	3.244	5.570	5.519	4.961	0
Capital Loans (Hockey)	0	0	2.100	0	0
TOTAL	10.591	14.873	24.787	7.308	1.860

The main General Fund capital projects in the Budget include:

- Delivering the new Public Arts Venue at the Scala Theatre and Corn Exchange: £9.984m
- Progressing work on Towns Investment Plan projects, including the construction of a new pedestrian bridge in partnership with the County Council and investing £1.832m in community centres: £10.480m;
- Continuing development of the Arches Worcester following a £3m grant from the Arts Council's Community Development Fund: £0.944m;
- Housing Adaptations funded from Disabled Facilities Grants: £3.859m
- Full renewal of Council-owned vehicles £4.446m.

Capital investments include development of the Scala theatre and Corn Exchange buildings which were acquired using the Future High Street Fund (FHSF) grant, totalling £17.939m. These investments form part of the proposed redevelopment of Angel Street and the surrounding area as set out in the FHSF proposal. Much of the investment is complete but the main focus in 2024/25 and 2025/26 will be the creation of the Performing Arts Venue and the redevelopment of Angel Place.

The projected cost of the Arches Worcester project is £5.72m, of which £3.04m is capital spending. Six railway arches between The Hive and Farrier Street have been developed. The final stage is the opening of the walkway from Foregate Street down to the riverside by the demolition of 56 Foregate Street which the Council has acquired for the purpose. The Council has made a contribution of £310k from its reserves to help finance this important development, which forms one of the key sites in the Masterplan, and has contributed a further £300k to acquire associated assets. The Department for Culture, Media and Sport (DCMS) has contributed £1.733m of the capital funding through its Cultural Development Fund.

The Town Investment Plan includes a programme of investments made possible by the Towns Fund allocation to the council of £19.6m. A new Health and Wellbeing Centre has already been created by Worcester University and the building of a new pedestrian bridge over the river Severn is well underway. The next development is investment of £1.3m for the construction of a new facility to deliver vocational training (Building Block 2) alongside investment in local community centres to support delivery of other forms of training and skills development.

Prudent capital financing

Our aim is to: *Finance our spending through prudent borrowing or use of reserves within the upper level of our borrowing set by Council*

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenues, 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

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m
External sources	8.403	10.132	18.520	4.985	0.688
Own resources	1.290	1.074	1.389	0.914	0.250
Debt	0.898	3.667	4.878	1.409	0.922
TOTAL	**10.591**	**14.873**	**24.787**	**7.308**	**1.860**

<u>Asset disposals</u>

When a capital asset is no longer needed, it may be sold so that the proceeds can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive capital receipts in the coming financial years as follows:

Table 3: Estimated capital receipts

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Budget £m	2026/27 Budget £m
Asset sales	0.224	1.480	1.000	0.100	0.100
Loans repaid	0	0	0	0	0
TOTAL	**0.224**	**1.480**	**1.000**	**0.100**	**0.100**

Asset sales are estimates only based on average sales in prior years and include the re-sale value of assets (such as vehicles and equipment) no longer required or replaced. Potential disposals will be notified to Policy and Resources Committee as and when identified.

Debt 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). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 4: Replacement of debt finance

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m
Own resources	1.514	1.738	2.112	1.630	1.902

The Council's full minimum revenue provision statement is provided as an **Annex** to this report.

The amount that the Council needs to borrow to fund the planned capital programme 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 £3.7 million during 2024/25 as MRP applied will be exceeded by new debt financing. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 5: Prudential Indicator: Estimates of Capital Financing Requirement

	31.03.23 Actual £m	**31.03.24 Forecast £m**	**31.03.25 Budget £m**	**31.03.26 Budget £m**	**31.03.27 Budget £m**
General Fund services	27.610	30.420	34.088	34.081	33.315

Affordable borrowing limit

Under the Prudential Code, the Council is required to set an affordable borrowing limit (also termed the authorised limit for external debt). In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

The Council last significantly revised the Operational Boundary and Authorised Limit in February 2019. However, the limits must be reviewed annually as part of the Prudential regime.

During 2020/21 the Treasury issued guidance on PWLB loans that disbar councils from using the PWLB to finance acquisitions primarily for the purposes of generating an income from them. The guidance, however, does not prevent councils from borrowing to acquire properties for the purposes of developing them or as part of wider regeneration activities. The Council's proposals in respect of the FHSF and the Town Improvement Plan envisage the acquisition of sites in order to deliver regeneration or other improvements for the City and its communities.

The proposed limits set out in Table 6 allow sufficient capacity to borrow to meet existing borrowing requirements based on the Capital Financing Requirement (CFR) 2024/25, allowing for in year seasonal fluctuations in cashflow and the anticipated financing needs in the subsequent two years.

Table 6: Prudential Indicators: Authorised limit and operational boundary for external debt

	2023/24 limit £m	**2024/25 limit £m**	**2025/26 limit £m**	**2026/27 limit £m**
Authorised limit	38.5	44.8	52.4	53.5
Operational boundary	28.9	33.6	39.3	40.1

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 low-cost short-term loans and long-term fixed rate loans where the future cost is known but higher.

Projected levels of the Council's total outstanding debt are shown below, compared with the capital financing requirement.

Table 7: Prudential Indicator: Gross Debt and the Capital Financing Requirement

	31.03.23 Actual £m	31.03.24 Forecast £m	31.03.25 Forecast £m	31.03.26 Forecast £m	31.03.27 Forecast £m
Debt (incl. leases)	17.499	16.203	20.888	26.594	27.429
Capital Financing Requirement	27.610	30.420	34.088	34.081	33.315

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term, to ensure that the Council is not borrowing in excess of its needs. As can be seen from Table 7, the Council expects to comply with this in the medium term. Any decisions made with regard to borrowing under the Development Fund will need to continue to meet this criterion. Therefore, this Prudential Indicator will be revised and reported as such proposals are brought forward.

Risk management and commercial investment with appropriate skills and knowledge

Our aim is to: ***Manage risk and make decisions, ensuring we have the appropriate skills and expertise, and taking a measured approach to investment.***

Investments for Service Purposes

The Council may make investments to assist local public services, including making grants to local service providers and local small businesses to promote economic growth. In light of the public service objective, the Council is willing to take more risk than with treasury investments. The details of the Council's risk approach to such investments is set out in the Commercial Strategy, approved by the Policy & Resources Committee at its meeting of 17 January 2018.

Decisions on service investments are made by the Corporate Director Finance and Resources in accordance with 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.

Prudent commercial investment

With central government financial support for local public services declining, the Council has had a greater need to ensure that where it invests in property to promote economic benefits locally, or outside the Worcester City boundary, there is also a sufficient return on that investment. Existing commercial investments in 2023/24 are currently valued at £19.182m, providing a gross income of £1,229,950 p.a.

In addition, the Council has invested £3m in the CCLA property Investment Fund. This is a fund which is based on income returns from a wide range of property investments. The returns are pooled and distributed to investors which must be Charities, Churches or Local Authorities. Anticipated income from the £3m investment in 2023/24 is £130,000 – a return of approximately 4.3%.

Where financial return is a significant objective, the Council accepts a higher level of risk on commercial investments than with treasury investments. A report approved by the Policy & Resources Committee July 2018 provides a maximum investment limit for this type of investment. This is to ensure that such investments remain proportionate to the Council's size.

Principal risk exposures include:

- falls in the capital value of investment properties;
- increase in the costs of maintaining properties;
- void periods
- other periodic reductions in income.

These risks are considered and assessed as part of the proposal for each investment. Moreover, a governance framework relating to risk has been established through the Council's Commercial Strategy (2018) and the Capital and Asset Management Framework (October 2018). The latter summarises the risk arrangements relating to the acquisition of assets:

"The primary objective of strategic capital spending is to acquire and dispose of assets and to maintain the value of existing assets, with the best possible financial benefit while ensuring the effective management of risk, in accordance with the following principles:

- *The purchase value of non-financial investment assets will not exceed the total value approved for the Development Fund*

- *Borrowing will not be undertaken to finance assets unless other options have been exhausted*

- *Assets will not be acquired unless there is reasonable assurance of sufficient revenue capacity to maintain the asset at its expected value during its lifetime*

- *Assets will be retained to the maximum life value and only disposed of when they have ceased to be fit for purpose (as opposed to adherence to fixed lifecycles)*

- *Planned and programmed maintenance will be co-ordinated to maintain the maximum value of assets over their lifetimes."*

Assessment of 'reasonable assurance' will be undertaken in consultation with professional experts, including the Council's Treasury Advisers, estate management experts and property professionals. No assets will be acquired without full financial assessment and survey of physical conditions, in accordance with the Commercial Strategy and the Policy and Resources Development Fund statement, July 2018.

Decisions on commercial investments are made by the Corporate Director - Finance and Resources in line with the criteria set out above and limits approved by the Policy and Resources Committee. 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 provided in the Commercial Strategy and Capital and Asset Management Framework.

Managing reserves

Our aim is to: ***ensure we have enough in reserves to keep services running and deal with any shocks to the system***

Revenue Budget Implications

To manage the risks relating to long-term investment, the Council needs to think about how much it is prepared to spend each year in interest payments and the repayment of debt. The amount set aside every year to repay debt is called the Minimum Revenue Provision (MRP).

The main overall limit is defined by the Operational Boundary shown in Table 6 which limits the amount of borrowing, and therefore the level of annual spending on interest and loan repayment.

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. This net annual charge is known as financing costs. The Council needs to be sure that its reliable sources of income are sufficient to cover these financing costs. The following table shows how the proportion of Council Tax, business rates and general government grants is to be spent on financing costs in the next three years.

Table 8: Prudential Indicator: Proportion of <u>gross</u> 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
Gross Financing costs	1.283	1.350	1.698	1.880	2.152
Net Revenue Stream	12.261	11.851	12.229	12.668	13.036
Proportion of net revenue stream	10.46%	11.39%	13.89%	14.84%	16.51%

Table 9: Prudential Indicator: Proportion of <u>net</u> 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
Net Financing costs	0.552	0.089	0.514	0.922	1.371
Net Revenue Stream	12.261	11.851	12.229	12.668	13.036
Proportion of net revenue stream	4.51%	0.75%	4.20%	7.28%	10.52%

The Commercial Strategy requires that any investment proposal must make a positive return over the lifetime of the scheme and a positive return over the first five years.

<u>Managing Liabilities</u>

In addition to debt detailed above, the Council is committed to making future payments to cover its pension fund deficit. It also maintains a General Fund balance to cover unforeseen risks and aims to hold reserves of £0.5m to mitigate reductions in planned income from activities and £1.4m to help manage reductions in expected business rates and other risks. As at 31 March 2024, the projected balances on the Income Risk reserve has been depleted and it is important for the future management of liabilities that it is replenished at the earliest opportunity.

The Council is also at risk of having to pay for known contingent liabilities, which are reported as part of the Statements of Accounts. As at 31 March 2023 three of these were identified:

- Liabilities arising from the collapse of Municipal Mutual Insurance (MMI);

- Provisions for business rates appeals;

- Provisions for personal injury claim pay-outs;

In all cases the actual level of liability cannot be known and therefore specific level for any reserve cannot be identified. In addition, the MMI liability may be fully paid out (two payments have been made to date totalling £136,170) while the provision for business rates appeals is calculated as part of the budget estimates. This potential liability is therefore already allowed for.

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Corporate Director Finance and Resources is a CIPFA qualified accountant with over 20 years' experience in public finance, the Head of Finance is an ICAEW qualified accountant with a similar level of experience in both private and public sector organisations and the Head of Property is a Fellow of the Royal Institution of Chartered Surveyors and a Register Valuer. The Council pays for staff to study towards relevant professional qualifications including AAT, CIPFA and ACT (treasury).

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 engages with local property consultants according to the needs of each individual proposal. 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.

Treasury Management

Our aim is to: ***maximise our returns on monetary investments, as set out in our Investment and Treasury Management strategies.***

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. Revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

Due to decisions taken in the past, as at 31st December 2023 the Council has £16.4m borrowing at an average interest rate of 2.81% and £33.0m of short-term treasury investments at an average rate of 4.77%.

Liability benchmark

Under the Council's Capital and Asset Management Framework, approved by the Policy & Resources Committee at its meeting of 29 October 2018, external borrowing is only undertaken once all other forms of capital funding have been considered. Paragraph 10.4 of the Framework states that:

As the Council's borrowing limit is related to its revenue streams, and these are likely to remain restricted over the lifetime of this Framework, borrowing will be used only when other forms of financing are unavailable and principally only when financing an asset. Leasing will be considered as an alternative to borrowing to purchase in accordance with Strategy 4 but its use remains restricted by the same considerations of revenue impact.

The alternative is 'internal borrowing' whereby the Council uses cash reserves to fund capital expenditure which are then recovered over time through the Minimum Revenue Provision. The extent to which the Council is maximising opportunities for internal borrowing is considered as part of the Treasury Management Strategy Statement 2024/25 included as an appendix to the Budget Report.

Investment strategy

Treasury investments are necessary to ensure the prudent management of cash balances arising from receiving cash before it is paid out again. Investments made for service reasons or purely for 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: that is, to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the short 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, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both short-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 10: Treasury management investments

	31.3.2023 Actual £m	**31.3.2024 Forecast £m**	**31.3.2025 Forecast £m**	**31.3.2026 Forecast £m**	**31.3.2027 Forecast £m**
Near-term investments	12.8	14.6	7.0	7.0	7.0
Longer-term investments	3.0	3.0	3.0	3.0	3.0
TOTAL	**15.8**	**17.6**	**10.0**	**10.0**	**10.0**

Further details on treasury investments are included in the Treasury Management Strategy Statement included as an appendix to the Budget Report.

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Corporate Director, Finance and Resources and staff, who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity are presented to the Policy & Resources Committee. The Policy & Resources Committee is responsible for scrutinising treasury management decisions.

ANNEX

Annual Minimum Revenue Provision Statement 2024/25

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Ministry for Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The MHCLG 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.

The Council is recommended to approve the following MRP Statement*:*

For capital expenditure incurred before 1 April 2008 the MRP policy will be:

- A straight line repayment starting from 2016/17 of £114,060 which will repay the borrowing in 2047/48;

From 1 April 2008 for all supported and unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations and with effect from 2016/17 the method of repayment will be through an annuity calculation (providing a consistent overall annual borrowing charge).

Capital expenditure incurred during 2024/25 will not be subject to a MRP charge until 2025/26.

Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2024, the budget for MRP has been set as follows:

	2024-25 Estimated MRP (£m)
Capital expenditure before 01.04.2008	0.114
Unsupported capital expenditure after 31.03.2008	1.075
Total General Fund	**1.189**