Appendix E2: Capital Strategy Report 2021/22

Introduction

This capital strategy report gives an overview of how capital expenditure, capital financing and treasury management activity contribute to the achievement of council priorities and provision of services in Islington. It also presents an overview of how associated risk is managed and the implications for future financial sustainability.

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 a local policy framework, summarised in this report.

Planned Capital Expenditure

Capital expenditure is where the authority spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The authority 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.

The council committed to a new Corporate Asset Strategy in March 2020. The strategy aims to establish a bold new approach that ensures investment is directly linked to core council ambitions around fairness and community wealth building. It is designed to deliver a strategic, long-term approach to managing and enhancing our community asset base. As part of this approach, in 2021/22, the authority is planning capital expenditure of £187m (including expected reprofiling as at Month 8 in 2020/21) as summarised below:

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

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**	**2024/25-2030/31 indicative**	**2019/20-2030/31 Total**
General Fund services	41.590	34.897	70.555	53.941	50.673	362.538	**614.194**
Council housing (HRA)	76.937	91.164	116.234	136.394	111.403	747.555	**1,279.687**
TOTAL	118.527	126.061	186.789	190.335	162.076	1,110.093	**1,893.881**

The capital programme will deliver £539m of capital investment over the next three years to support the achievement of council objectives. Key projects contributing to these objectives are summarised below along with spend over the next three years.

Decent and genuinely affordable homes for all

- Housing new build programme (£302m); our major programme of investment in new, affordable social housing in Islington. Ensuring everyone has a decent, secure and genuinely affordable home is a key council priority and the council has been building well-designed, good quality new council homes for 10 years – out of old garages, on car parks, in old undercrofts and on top of existing buildings. The majority of this spend occurs in the HRA but there is also General Fund spend relating to the open market sales elements of the housing programme (£76m), with the upfront costs of building funded by temporary borrowing for cash flow purposes. This is recouped by the capital receipts when the completed units are sold and funds further investment in our council house building programme.
- In 2021/22 alone the council will invest £80m in our ongoing New Build Programme, as we work towards our commitment to build 550 new council homes by 2022 – the largest new-build programme for council homes in Islington in 30 years. Housing major works and improvements programme (£135m), ongoing investment in council homes and estates, including cyclical improvements, mechanical and electrical works, fire safety and energy efficiency.

Jobs and opportunity

- Improving our early years accommodation, schools and youth provision (£10m)
- Modernising our libraries and museum (£1.4m)

A safer borough for all

- CCTV upgrade (£3m); upgrades to the council's core CCTV network and investment in CCTV-enabled vehicle to increase coverage for hot-spots

A greener and cleaner Islington

- Vehicle electrification infrastructure and replacement (£16m); programme to develop electric charging infrastructure and replace our fleet with electric vehicles as part of our Net Zero Carbon Strategy
- People Friendly Streets (£9m) and School Streets (£1m); borough-wide programme to reduce car trips and improve neighbourhoods for walking, cycling and living

- Pilot retrofitting on Housing estates (£3m); installing energy efficiency measures across Housing Estates to reduce energy consumption and decrease carbon emissions
- Cycle Schemes (£2m); significant expansion of our borough-wide cycle parking and cycle hangars provision
- Solar Panels and LED Lighting (£2m); install solar panels where feasible on our corporate estate and replace traditional light fittings with LED to lower emissions

In addition to these programmes, the capital programme will support the effective management of Islington's infrastructure, modernisation of community assets, and investments to enhance specific parts of the borough. This includes:

- Structural maintenance of the highways infrastructure including carriageways, footways and drainage (£4m)
- Compliance and modernisation (£8m); funds to deal with urgent property compliance issues and to assisting in providing funds for a cyclical maintenance and modernisation programme
- Use of Community Infrastructure Levy and s106 payments to make targeted investments across the borough (£15m), with spending decisions led & managed by local ward councillors

Full details of the authority's capital programme are found at Appendix E1.

Capital Governance

Oversight and governance of the capital programme is supported by a comprehensive framework of advisory boards with member and officer involvement:

- The Corporate Asset Delivery Board, comprised of officers and members, is accountable for the overall delivery of the corporate asset strategy, with oversight of all material asset and capital related decisions. It reviews the 10-year capital strategy and supporting annual programmes, subject to formal budget approval.
- The Major Projects Board, comprised of officers, is accountable for initiating and monitoring delivery of significant mixed-use developments including those led by development partners, as well as smaller but complex schemes cutting across different directorates and/or with complex stakeholder management issues.
- The Housing Delivery Board, comprised of officers and members, integrates governance of new homes delivery and major works across the council's existing stock.
- The Borough Investment Panel, comprised of officers and members, is accountable for recommending approval of all CIL/s106 investment decisions and spend oversight.

- A series of Directorate level programme delivery boards, comprised of officers, are accountable for all other asset development and capital programme activity and linked to wider Directorate governance arrangements.

In relation to the annual capital programme, service managers submit capital submission bid requests annually to include projects in the authority's capital programme. Bids are collated by corporate finance who calculate the financing cost (which can be nil if the project is fully externally financed) and assess the overall affordability of the capital programme. This includes an assessment of the revenue implications of the projects as part of the revenue budget setting process.

A rigorous assurance and prioritisation exercise is then undertaken, assessing capital projects against their contribution to council priorities and their deliverability. The prioritisation process supports the council in making decisions about which project to progress, especially in an environment of challenging financial resources. All bids are appraised at Corporate Management Board who then make recommendations to members. The final capital programme is then presented to the Executive in January and to council in February each year.

Capital Financing

All capital expenditure must be financed, either from external sources (government grants and other contributions), the authority's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The main sources of capital funding the council uses are summarised below:

- Capital Grants: predominantly government grants and are usually provided to the council for the specific use of funding capital expenditure for certain schemes and programmes (e.g. Department for Education funding for schools' condition works)
- Section 106/CIL: developer contributions towards infrastructure; Section 106 contributions relate to specific projects and outcomes
- Capital receipts: 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 primarily generates capital receipts from the open market sale homes used to finance the building of the council homes.
- Other capital contributions: specific contributions received for projects from third parties who may have a specific output or benefit achieved through the capital works the council is providing (e.g. landlord/tenant contributions to modernisation works)
- Revenue contributions: direct revenue contributions towards capital expenditure; a minimal source of funding due to pressures on the revenue budget

- HRA Reserves: direct funding from the HRA to support its capital programme through the use of the Major Repairs Reserve and revenue contribution to capital works
- Borrowing: typically, Public Works Loan Board (PWLB) loans to support capital expenditure. This form of capital funding has revenue implications (i.e. interest and provision to pay back loan) which are accounted for as part of the budget setting process.

The planned financing of the council's capital programme is shown in table 2. This only includes the years to 2023/24 as these are the years which are currently financed as part of the council's Medium-Term Financial Strategy (MTFS).

Table 2: Capital financing in £ millions

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
General Fund Programme					
Capital Grants	6.959	4.291	6.206	1.400	1.400
Section 106/CIL	7.042	5.031	10.430	8.482	6.500
Capital Receipts	10.129	1.237	30.358*	17.249	6.818
Other capital contributions	0.555	0.740	0.000	0.000	0.000
Revenue contributions	0.161	0.000	0.000	0.000	0.000
General Fund Borrowing	16.744	23.598	23.561	26.810	35.955
Total General Fund	**41.590**	**34.897**	**70.555**	**53.941**	**50.673**
HRA Programme					
Capital Grants	0.081	1.700	0.000	0.000	0.000
Section 106/CIL	10.545	3.172	1.717	0.000	0.000
Capital Receipts	19.983	27.457	43.471	48.062	57.080
HRA Reserves	46.328	58.835	70.496	50.721	22.348
HRA Borrowing	0.000	0.000	0.550	37.611	31.975
Total HRA	**76.937**	**91.164**	**116.234**	**136.394**	**111.403**
Total Capital Programme	**118.527**	**126.061**	**186.789**	**190.335**	**162.076**

** £8.318m of the 2021/22 General Fund Capital Receipts are assumed to repay prior year temporary borrowing as shown in table 3. This is related to the building of private dwellings to sell on the open market as part of the council's housing new build programme. The upfront cost of building these private dwellings is funded by temporary borrowing for cash flow purposes, recouped by the capital receipts when the completed units are sold.*

The largest risk in relation to capital financing relates to capital receipts, of which the council expects to generate £74m in 2021/22. All these projected capital receipts are from the open market sales of housing and are intrinsically linked with the housing new build capital programme. Given present economic conditions there is uncertainty around the timing and value of these receipts. To mitigate these risks the council maintains a regular review of the property market and has been prudent in its financial assumptions. Timing delays can largely be managed through the use of HRA reserves. In the event of a decrease in projected capital receipts, the new build programme would need to be re-assessed in line with the overall available funding.

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 3: Replacement of debt finance in £ millions

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
MRP	1.893	2.463	3.376	4.368	4.874
Use of capital receipts	0.000	0.000	8.318	0.000	0.000
Repayment of PFI/Leases	11.754	14.301	12.343	3.469	3.133
TOTAL	**13.647**	**16.764**	**24.037**	**7.837**	**8.007**

Each year the council is required to agree a MRP policy for the 'prudent' annual repayment of debt associated with the financing of capital expenditure. The guiding principle of the regulations and statutory guidance is that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure which gave rise to the debt provides benefits.

Since 2017/18, the council has adopted the asset life (annuity) method (based on a prudent assessment of average asset life). In calculating the asset life (annuity) MRP, the average interest rates published by the Public Works Loans Board in the relevant financial year for new annuity loans will be used. Based on this policy, the estimated MRP in 2021/22 is £3.376m.

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 £8.392m during 2021/22. Based on the above figures for expenditure and financing, the authority's estimated CFR is as follows:

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

	31.3.20 actual	**31.3.21 forecast**	**31.3.22 budget**	**31.3.23 budget**	**31.3.24 budget**
General Fund Services	135.483	155.174	175.359	197.801	228.882
HRA	466.254	466.254	466.804	504.415	536.390
PFI Liabilities	110.674	96.373	84.030	80.561	77.428
Total CFR	**712.411**	**717.801**	**726.193**	**782.777**	**842.700**

Treasury Management

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the authority'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 authority 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.

Due to decisions taken in the past, the authority currently has (as at 15 January 2021) £383m borrowing at an average interest rate of 3.83% and £208m treasury investments at an average rate of 0.87%.

Borrowing strategy: The authority'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 authority therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.10%) and long-term fixed rate loans where the future cost is known but higher (currently 1.25 to 1.78%).

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

Table 5: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.20 actual	31.3.21 forecast	31.3.22 budget	31.3.23 budget	31.3.24 budget
Debt (incl. PFI & leases)	441.600	525.000	559.400	718.600	782.700
Capital Financing Requirement	712.411	717.801	726.193	782.777	842.700

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the authority expects to comply with this in the medium term.

Liability benchmark: To compare the authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This strategy assumes that you would take up all your borrowing need and hold minimum surplus cash. .Hence foregoing investment income to minimise debt interest. This assumes that cash and investment balances are kept to a minimum level of £10m at each year-end. This benchmark is currently £298.2m and is forecast to rise to £455.9m over the next three years.

Table 6: Borrowing and the Liability Benchmark in £ millions

	31.3.20 actual	31.3.21 forecast	31.3.22 budget	31.3.23 budget	31.3.24 budget
Outstanding borrowing	346.100	383.600	477.200	591.600	659.500
Liability benchmark	308.200	339.100	367.400	428.600	465.900

The table shows that the authority expects to remain borrowed above its liability benchmark. This is because cash outflows to date have been below the assumptions made when the loans were borrowed and a surplus in working capital.

Affordable borrowing limit: The authority 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.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2020/21 limit	2021/22 limit	2022/23 limit	2023/24 limit
Authorised limit – borrowing	430.000	577.000	642.000	710.000
Authorised limit – PFI and leases	106.000	92.000	88.000	83.000
Authorised limit – total external debt	536.000	739.000	730.000	793.000
Operational boundary – borrowing	400.000	527.000	592.000	660.000
Operational boundary – PFI and leases	101.000	87.000	83.000	78.000
Operational boundary – total external debt	501.000	614.000	675.000	738.000

- Further details on borrowing are included in the Treasury Management Strategy (**Appendix E4**).

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.

The authority'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, 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 near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which investments to buy and the authority may request its money back at short notice.

Table 8: Treasury management investments in £millions

	31.3.20 actual	31.3.21 forecast	31.3.22 budget	31.3.23 budget	31.3.24 budget
Near-term investments	148.800	108.700	70.000	70.000	70.000
Longer-term investments	0.000	0.000	30.000	20.000	20.000
TOTAL	**148.800**	**108.700**	**100.000**	**90.000**	**90.000**

- ➢ Further details on treasury investments are included in the Treasury Management Strategy (**Appendix E4**).

Risk management: The effective management and control of risk are prime objectives of the authority's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Corporate Director of Resources and staff, who must act in line with the treasury management strategy approved by council. The Audit committee is responsible for scrutinising treasury management decisions.

Investments for Service Purposes

The authority makes investments to assist local public services, including making loans to and buying shares in local service providers, local small businesses to promote economic growth, the authority's subsidiaries that provide services. In light of the public service objective, the authority is willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs.

Total investments for service purposes are currently valued at £2m with the largest being soft loans to employees of £1.1m providing a net return after all costs of 0%. This also includes loans to and equity investments in:

- Islington Limited (iCo), a wholly owned subsidiary providing local services, a loan of £0.050m;
- Three private companies responsible for managing schools under the Building Schools for the Future programme (a loan of £0.684m);
- A local charity (a loan of £0.098m);
- Equity investment in a private company responsible for managing schools under the Building Schools for the Future programme (fair value of £0.096m)

Governance: Decisions on service investments are made by the relevant service manager in consultation with the Director of Finance and must meet the criteria and limits laid down in the investment strategy.

- ➢ Further details on service investments are included in the Investment Strategy (**Appendix E5**).

Commercial Activities

The council hold investment property (value of £33.2m as at 31/03/2020) in order to generate income to spend on services in Islington. The council has consistently taken a prudent approach to this – no new commercial properties have been purchased in recent years and there are no current plans to invest in commercial properties over the medium term. In November 2020 PWLB guidance was updated and PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield. The authority intends to avoid this activity in order to retain its access to PWLB loans.

The council also has a wholly owned subsidiary – Islington Limited (iCo), the purpose of which is to trade for profit with public bodies, private organisations and members of the public to provide a return to the council. The services provided by iCo are in activities related to municipal functions in which relevant expertise is held (for instance Commercial Waste, Tree Maintenance and Memorials). The council has loaned iCo £0.050m, which is due to be repaid in 2020/21.

Governance: If and when the council does engage in further commercial activity, the council will consider fully its risk exposure against financial returns in order to ensure that commercial investments remain proportionate to the size of the authority with appropriate contingency plans in place should expected yields not materialise. If the council did decide to make a commercial investment it is unlikely that the council would invest in assets outside of the borough and would only do so where there were strategic benefits for the council (e.g. in respect of regeneration).

Decisions on commercial investments are to be made by senior officers in line with the criteria and limits approved by council in the Investment Strategy. 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 are included in the Investment Strategy (**Appendix E5**).

Liabilities

In addition to debt of £384m detailed above, the authority is committed to making future payments to cover its pension fund deficit (£249m as at the last valuation setting contributions – 31st March 2019). The council has also set aside provisions to cover probable liabilities that can be measured reliably. The most significant of these are the NNDR appeals provision (£15.9m as at 31/03/2020 in terms of the council's share, £33.2m in total including the central government and GLA shares) and the insurance fund provision (£14.2m as at 31/03/2020). The insurance fund provision covers anticipated liabilities for Errors and Omissions, Libel and Slander, Motor (Third

Party), Employers' Liability, Public Liability, Fire and other risks – up to a specific limit for any one claim. External policies cover claims in excess of these limits.

Governance: Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Section 151 Officer. The risk of liabilities crystallising and requiring payment is monitored by corporate finance and reported as part of the annual closing of accounts process and as appropriate during the financial year. Corporate risks and risk management are also reported to Executive.

- Further details on liabilities and guarantees can be found in the 2019/20 statement of accounts: https://www.islington.gov.uk/~/media/sharepoint-lists/public-records/finance/information/adviceandinformation/20202021/20201130islingtonstatementofaccounts201920.pdf

Revenue Budget Implications

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. 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 9: Prudential Indicator: Proportion of financing costs to net revenue stream

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
Financing costs (£m)	13.857	12.976	13.832	15.256	15.159
Proportion of net revenue stream	6.4%	5.7%	6.9%	6.8%	6.8%

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 for many years into the future. The Section 151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because revenue costs of borrowing have been fully incorporated in the 2021/22 revenue budget and MTFS. Additionally, the council is moving towards the development of a ten-year capital programme, and indicative requirements to 2030/31 are known. This enhanced long term budgetary planning will continue to be developed.

Knowledge and Skills

The council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The authority pays for junior staff to study towards relevant professional qualifications including CIPFA (Chartered Institute of Public Finance and Accountancy).

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 authority currently employs Arlingclose Limited as treasury management advisers. This approach is more cost effective than employing such staff directly and ensures that the authority has access to knowledge and skills commensurate with its risk appetite.