Report of: Executive Member for Finance, Planning and Performance
Meeting of: Executive
Date: 7 September 2023

Flexible Use of Capital Receipts Strategy

1. Synopsis

1.1. In December 2017, the Secretary of State announced the continuation of the capital receipts flexibility programme, which provides Local Authorities the freedom to use capital receipts generated from the sale of assets (except for Right to Buy disposals) to fund revenue costs arising from transformational revenue projects that deliver savings or service improvements. With extensions since, the current flexibility direction runs until 31 March 2025.

1.2. Normally, only expenditure qualifying as capital may be funded from these capital resources. The additional flexibility therefore provides the council with a resource to invest in schemes which deliver savings or improvements.

1.3. This report recommends the adoption of Flexible Use of Capital Receipts for the schemes detailed in **Section 4** of the report and the implications section confirms this is a viable course of action.

1.4. Should the recommendations to use capital receipts flexibility be agreed then this proposed 'flexible use of capital receipts strategy' will be considered for agreement at Full Council in the financial year 2023/24. This is because a large proportion of the one-off spend for the schemes detailed in **Section 4** falls in 2023/24, and the receipts flexibility term is due to end on 31 March 2025. Any extension beyond 2023/24 will be considered as part of the 2024/25 budget setting process.

1.5. The Council has a number of high cost, transformation projects and the current funding strategy is to utilise some of its earmarked reserves to meet this cost. Given the increasing uncertainty around future funding settlements, it is prudent for the Council to have multiple options available to it to fund these costs. Committing such a large value of its earmarked reserves will reduce the financial resilience of the Council whilst it waits for the schemes to 'pay back' through savings.

1.6. Approving the strategy does not commit the Council to pursuing this route for funding. It is recommended that should the flexibility be approved, that a decision is delegated to the Section 151 Officer to make the most financially efficient decision at year end.

1.7. By utilising the capital receipts in this way, these receipts are not available to support capital expenditure. This gap in capital financing will then be backfilled with borrowing. The consequences will therefore be that reserves are protected and the council's borrowing increases.

2. Recommendations

2.1. To agree the Flexible Use of Capital Receipts strategy for approval at Full Council.

2.2. To delegate approval to the Section 151 Officer to make appropriate funding decisions in consideration of the Council's overall financial position.

3. Process and Regulations

3.1. Before the council can flexibly use capital receipts it must prepare, publish and maintain a 'flexible use of capital receipts strategy'. This must consider the impact of this flexibility on the affordability of borrowing by including updated prudential indicators. Full Council must approve this strategy before any qualifying expenditure is incurred. The current government directive allowing the flexible use of capital receipts ends on 31 March 2025.

3.2. Under the Flexible Capital Receipts guidance, the Secretary of State sets out that individual authorities are best placed to decide which expenditure projects are best to be funded by this method in local areas. The key criteria for expenditure to qualify is that the schemes must be designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that reduces costs or demand for services in future years for any of the public sector delivery partners. Within this definition, it is for individual local authorities to decide whether or not a project qualifies for the flexibility'. The Guidance goes on to give examples of qualifying expenditure including: 'Funding the cost-of-service reconfiguration, restructuring or rationalisation (staff or non- staff), where this leads to ongoing efficiency savings or service transformation'.

3.3. Capital receipts used under the direction must be from genuine disposals (qualifying disposals). That is, disposals where the authority does not retain an interest, directly or indirectly, in the assets once the disposal has occurred.

3.4. Each authority should disclose the individual projects that will be funded or part-funded through the capital receipts flexibility to Full Council. This requirement can be satisfied as part of the annual budget setting process. The Guidance recommends that the council produces a 'flexible use of capital receipts strategy' setting out details of projects to be funded through flexible use of capital receipts be prepared prior to the start of each financial year. Failure to meet this requirement does not mean that an authority cannot access the flexibility in that year. However, in this instance, the 'flexible use of capital receipts strategy' should be presented to full council or the equivalent at the earliest possible opportunity in-year. The Guidance allows local authorities to update the strategy during the year.

3.5. It is a required condition of the direction that authorities must send details setting out their planned use of the flexibility to the Secretary of State, in advance of its use for each financial year. This is to make sure that the government is adequately sighted on the use of the flexibility and can monitor how it is used - it is not a process of approval.

4. Proposed Strategy – Flexible Use of Capital Receipts

4.1. There are a number of transformation schemes with one-off budget implications. The use of the Flexible Use of Capital Receipts is focussed on the general fund impact of the schemes, where funding is currently assumed to be drawn from the Budget Strategy Reserve. The proposed schemes are as follows:

Resident Experience Programme Phases 1 to 3

4.2. The Resident Experience Programme Funding Approval report agreed at the 20 April 2023 Executive set out the one-off revenue funding requirement. The scheme is intended to deliver service improvements and efficiencies in the way that our residents interact with us. This will include the greater and smarter use of omnichannel technology as well as our approach to direct resident interactions.

4.3. There is a £3.042m one-off revenue requirement in 2023/24 for Phases 1 and 2, of which the scheme financial implications assume that £987k is funded by the Housing Revenue Account

(HRA). The remaining **£2.055m** is budgeted to be funded from the Budget Strategy Reserve in 2023/24. The 'flexible use of capital receipts strategy' is forward looking so to qualify 2023/24 spend we would need to agree the strategy in advance of using the flexibility at year-end.

4.4. For Phase 3, running to June 2025, there is a £10m one-off funding requirement, with **£5m** assumed to be funded from the Budget Strategy Reserve and the remaining 50% funded by the HRA. **The capital receipts flexibility ends on 31 March 2025, so some of the one-off expenditure for Phase 3 may not be covered.** The profiling of spend will be closely monitored and financing strategies updated as appropriate.

FutureWork Programme

4.5. The FutureWork Programme is a scheme looking at our accommodation strategy for our municipal buildings together with our technology offer increasing productivity and efficiency. There are recurring savings agreed of £1.7m so far with the scope for this to be higher. Funding Approval report agreed at the 20 April 2023 Executive set out a one-off revenue funding requirement in 2023/24 of **£7.749m** to be funded from the general fund Budget Strategy Reserve. The 'flexible use of capital receipts strategy' is forward looking so to qualify 2023/24 spend we would need to agree the strategy in advance of using the flexibility.

5. <u>Rationale and Considerations</u>

5.1. The scheme expenditure for those programmes listed in **Section 4** for the council to apply the 'flexible use of capital receipt strategy' freedom, in the opinion of the Section 151 Officer qualifies on the basis that the expenditure will "…generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that reduces costs or demand for services in future years…". The Guidance gives an example of a project that could generate qualifying expenditure as '…Driving a digital approach to the delivery of more efficient public services…' which describes quite closely the Resident Experience Programme.

5.2. The underlying rationale for the application of the freedom is to reduce the burden on the council's earmarked reserves and therefore support the financial resilience of the Council. At the end of the financial year 2022/23, provisionally the earmarked and general reserves have reduced from an opening balance of £143.3m to £106.1m, a reduction of £37.2m over the course of the financial year. Given this, there is a need to replenish earmarked reserves going forward to maintain financial resilience.

5.3. Capital receipts generated are currently used to support the funding of the Council's capital programme. Using capital receipts under the 'flexible use of capital receipts strategy' would therefore have a corresponding impact on the amount the Council would need to borrow to fund its planned capital programme.

5.4. Due to the 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. Other than the repayment of the principal sum borrowed (effectively the 'minimum revenue provision') which if the borrowing is spread over 20 years would be, for budgeting purposes, 5% per annum, there is also the interest to pay on the loan. Currently, 20-year PWLB rates are approximately 5.5%, meaning that on indicative £20m borrowing, the council would be budgeting to repay £1.1m per annum in interest, on top of the budgeted £1m principal repayment. The £2.1m potential ongoing cost (on £20m borrowing) would need to be added to the general fund budget gap from 2024/25 (subject to phasing). As the principal would alternatively be paid out through reserves up front, the net difference in approach would be the incurring of £1.1m per year interest.

5.5. The annual cost of serving the additional borrowing needs to be weighed against the potential need to do this to protect the level of earmarked reserves. It is essentially a choice to borrow to protect our financial resilience.

5.6. An alternative course of action could be to top-up earmarked reserves by an additional £2.1m annually using the amount that we would be budgeting to repay the additional borrowing, and to review existing earmarked reserves to see if there is scope to re-align some funding into the Budget Strategy Reserve for transformational projects. The consequences of doing so would be the further deterioration of the Earmarked reserves position and expectation to build them back up to a sustainable level in the context of expected public sector funding contraction.

6. <u>Timeline</u>

6.1. Given that the capital receipts flexibility runs only until 31 March 2025 and taking into account that the majority of the one-off expenditure detailed in this report occurs in the current financial year, then it is proposed to agree the 'flexible use of capital receipts strategy' at the earliest opportunity in 2023/24.

7. Financial Implications:

7.1. Utilising borrowing instead of capital receipts will increase the Council's borrowing requirement. This is affordable and will remain within prudential indicators. Amendments to the capital financing of items within the capital programme will be required to accommodate the change.

7.2. Going ahead with the borrowing will mean that the Councils reserves will not reduce for the £20m upfront cost of the schemes. There will, however, be an overall additional requirement to pay the costs of the interest (estimated at £1.1m per year) and the spreading of the £20m cost over a period to be defined.

Impact on prudential indicators

7.3. No prudential indicators would be breached through a decision to implement the flexible use of capital receipts.

7.4. The prudential indicator for the revenue impact on interest rate risk will increase by a further £200k for every £20m of additional borrowing. This will mean that at £20m additional borrowing, the Upper Limit on a 1% rise in interest rates will be £2.800m rather than the £2.600m agreed by Full Council in March 2023. This represents an increase in interest rate risk as a result of additional borrowing.

7.5. The Proportion of financing costs to net revenue stream will increase due to the increased borrowing. This will change the 22/23 indicators from £4.654m to £5.754m which increases the proportion of revenue budget supporting borrowing costs from 1.8% to 2.2%. This increase in borrowing costs will be offset by corresponding revenue savings.

8. Legal Implications:

8.1. Section 151 of the Local Government Act 1972 states that: "without prejudice to section 111, every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs". Section 111 of the Local Government Act 1972 relates to the subsidiary powers of local authorities.

8.2. The Local Government Act 2003 ("the Act"), section 15(1) requires a local authority "… to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify …".

8.3. The Statutory Guidance "Statutory Guidance on the Flexible Use of Capital Receipts (updated)" published 11 March 2016 and last updated on 2 August 2022 is issued under section 15(1) of the Act. This is an updated direction and statutory guidance to extend the freedom for local authorities to use eligible capital receipts to fund the revenue costs of projects that deliver ongoing savings or improved efficiency. This direction revokes and replaces the direction of the same name issued on 4 April 2022.

8.4. Capital receipts are the money councils receive from asset sales, the use of which is normally restricted to funding other capital expenditure or paying off debt. The receipts cannot usually be used to fund revenue costs. The direction introduces a new restriction that authorities may not use the flexibility to fund discretionary redundancy payments, i.e. those not necessarily incurred under statute. This does not affect other types of severance payments and, to be clear, does not restrict, including pension strain costs, which may still be qualifying expenditure.

8.5. The Direction allows authorities to use the proceeds from asset sales to fund the revenue costs of projects that will reduce costs, increase revenue or support a more efficient provision of services. This is an extension of the flexibility that has been in place since 2016, and will allow this freedom to continue to 2024/25 to help authorities plan for the long-term.

8.6. This Direction clarifies that the capital receipts obtained must be disposals by the local authority outside the "group" structure. As introduced in the direction issued on 4 April 2022, this direction includes the requirement to submit the planned use of the flexibility in advance of use for each financial year. This condition can be met by sending the authority's own strategy documents provided they contain the detail asked for in the direction. This is not an approval process, the information must be sent to ensure transparency and allow proper monitoring by central government.

8.7. It is the Section 151 Officer's opinion that the approach described within this paper for the Flexible Use of Capital Receipts meets the definition required within the Statutory Guidance.

8.8. Full Council approval is required for the use of the capital receipts.

9. Environmental Implications and contribution to achieving a net zero carbon Islington by 2030

None arising from the content of this report.

10. Equalities Impact Assessment

10.1 The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

An Equalities Impact Assessment is not required in relation to this report.

Background Papers: None

Appendices: None

Signed by:		
	Executive Member for Finance, Planning and Performance	Date August 2023

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