Resources Directorate
7 Newington Barrow Way,
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Report of: Executive Member for Finance, Planning and Performance

Meeting of: Full Council

Date: 28 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 an alternative funding option to invest in schemes which deliver savings or improvements.

1.3. This report recommends the approval of a Flexible Use of Capital Receipts Strategy for 2023/24 for the schemes detailed in **Section 4** of the report. Approving the strategy does not commit the council to using it. The Section 151 Officer will consider the optimal funding strategy based on the actual and forecast level of reserves at the end of the financial year.

1.4. 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 significant uncertainty around the medium-term financial position and reserves projections, it is prudent for the council to have multiple options available it to fund these costs. It should be noted that, at this stage, there are sufficient reserves to cover projected one-off expenditure on the known transformation projects over the medium term, partly as the medium-term financial strategy (MTFS) already assumes some replenishment of reserves. However, in the event of a significant overall depletion of reserves in a single year and/or deterioration in the financial outlook, the financial resilience of the council could be weakened whilst it waits for the schemes to ‘pay back’ through savings and reserves to be replenished over time.

1.5. By utilising the capital receipts flexibility, the capital receipts would no longer be available to finance capital expenditure. This gap in capital financing would need to be backfilled with an increase in the underlying need to borrow. The consequences would be that reserves are protected, but the council’s borrowing and annual interest costs increase.

1.6. The council would not be reliant on making any additional disposals of assets as a result of this strategy, as it would relate to the use of existing available and forecast capital receipts.

2. Recommendations

2.1. To approve the Flexible Use of Capital Receipts strategy for 2023/24 and note that approving the strategy does not commit the council to using it.

2.2. To delegate responsibility for the adoption of the Flexible Use of Capital Receipts strategy to the Section 151 Officer, if it is considered appropriate to do so at the end of the financial year in the context 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 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 would 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. The council currently has a number of transformation schemes with one-off budget implications. The potential use of Flexible Use of Capital Receipts is focused on the general fund impact of the schemes, where funding is currently assumed to be drawn from the earmarked Budget Strategy reserve. The proposed schemes, at this stage, 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 would 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.

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 would 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 Budget Strategy reserve.

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

5.1. In the opinion of the Section 151 Officer the scheme expenditure for those programmes listed in **Section 4,** for the council to apply the 'flexible use of capital receipt strategy' freedom, qualifies on the basis that the expenditure would "…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 approval of the flexibility is to reduce the burden on the council's earmarked reserves, if needed, and therefore support the wider financial resilience of the council. In 2022/23, the council's General Fund earmarked and unallocated reserves decreased by £37.2m from £143.3m to £106.1m. Whilst a substantial proportion of this decrease in reserves was due to timing differences caused by COVID-19 funding, it was a higher decrease than other comparable authorities. As set out in the council's budget report, there is a need to replenish earmarked reserves to maintain financial resilience. The council's MTFS currently assumes an annual contribution of £4m to earmarked reserves to bolster the council's financial resilience over the medium term, although this is currently exceeded by forecast drawdowns from reserves.

5.3. Capital receipts are ordinarily used to support the funding of the council's capital programme. Re-directing capital receipts under a 'flexible use of capital receipts strategy' would therefore lead to a corresponding increase in the council's underlying need to borrow to fund its planned capital programme, and a significant, additional annual revenue cost of capital. The council would not be reliant on making any additional disposals of assets as a result of this strategy, as it would relate to the use of existing available and forecast capital receipts.

5.4. Based on an indicative £20m borrowing impact, this would equate to an estimated additional £2m per annum revenue cost of capital, split between £1m annual interest costs and £1m statutory provision for the repayment of debt ('minimum revenue provision'). This will need to be factored into the council's budget planning assumptions from 2024/25 (subject to phasing).

Alternative Option

5.5. An alternative course of action could be to replenish earmarked reserves by an additional £2.0m annually (on top of the existing £4m per annum budget for reserves replenishment and financial resilience). This would mean using the annual amount that we would be budgeting to service and repay the additional borrowing to instead increase the annual replenishment of reserves. Over the long term this alternative option could achieve the same outcome of replenishing reserves, albeit at a less expedited rate. This option should be considered when considering whether to utilise the flexible capital receipts policy at the end of the financial year. It would save an estimated £1m in annual interest charges compared to the option to use the capital receipts flexibility (again based on an indicative £20m increase in the council's underlying need to borrow).

6. Financial Implications

6.1. Utilising the capital receipts flexibility would mean that the council's reserves would not decrease for the indicative £20m indicative cost of the transformation schemes. However, it would also lead to an increase in the council's underlying need to borrow for the capital programme. The estimated additional revenue cost of capital would be £2m per annum. This will need to be factored into the council's budget planning assumptions from 2024/25 alongside the savings that are expected to be generated from the transformation schemes.

6.2. Not utilising the flexibility would mean that there would be a decrease in the council's earmarked Budget Strategy reserve in respect of the transformation schemes. However, through the alternative option set out, this could instead be replenished over a longer period whilst avoiding an additional £1m in annual interest costs.

6.3. Approving the strategy in this report does not commit the council to adopting it. The Section 151 Officer will consider the optimal funding strategy, including the alternative option set out, based on available capital receipts and the actual and forecast level of reserves at the end of the financial year. This should consider any scope to re-purpose funding from other earmarked reserves to replenish the depletion of the Budget Strategy reserve. It should also weigh up the short and medium term need to protect reserves against the significant additional annual interest costs that could be incurred.

Impact on prudential indicators

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

6.5. The prudential indicator for the revenue impact on interest rate risk would increase by a further £0.200m for every £20m of additional borrowing. This would mean that at £20m additional borrowing, the Upper Limit on a 1% rise in interest rates would 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.

6.6. The proportion of financing costs to net revenue stream would increase due to the increased borrowing. This will change the 2022/23 indicator 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 would be offset by corresponding revenue savings.

7. Legal Implications

7.1. 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.

7.2. 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 …".

7.3. 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.

7.4. Capital receipts are the money the council receives 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.

7.5. 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.

7.6. 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.

7.7. 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.

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

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

8.1. None arising from the content of this report.

9. Equalities Impact Assessment

9.1. 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.

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

Background Papers: None

Appendices: None

Authorised by:

Executive Member for Finance, Planning and Performance

Date: 20 September 2023

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