Appendix F6: 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 grants 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. With extensions since, the current flexibility direction runs until 31 March 2025. Council agreed the power to use this flexibility in 2023/24 at the 28 September 2023 Council meeting.

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. Approval of a Flexible Use of Capital Receipts Strategy for 2024/25 is recommended for the type of scheme detailed in **Section 4** of this budget report 2024/25 appendix, **Appendix (F6)**, to a maximum of £20m in 2024/25. 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 some 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 considered sensible for the council to have multiple options available 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 from 2025/26 and beyond. 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. 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. Process

2.1. Before the council can flexibly use capital receipts it must prepare, publish and maintain a 'Flexible Use of Capital Receipts Strategy'. This appendix to the 2024/25 budget report (**Appendix F6**) constitutes the 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 direction for the flexible use of capital receipts ends on 31 March 2025.

2.2. Under the Flexible Capital Receipts guidance, the Secretary of State sets out that individual local 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'.

2.3. 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.

2.4. 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.

2.5. 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 application and use for each financial year.

3. Qualifying Schemes – Flexible Use of Capital Receipts

3.1. The Capital Strategy Report 2024/25 (**Appendix F2** of the 2024/25 budget report) sets out at **paragraph 2.20** that the council plans to receive £38.408m of capital receipts in the coming financial year. The Flexible Use of Capital Receipts Strategy would enable capital receipts to be applied flexibly to fund revenue expenditure projects that 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. There are existing transformation-type schemes with one-off budget implications in 2024/25 where funding is assumed to be drawn from the Budget Strategy Reserve (an earmarked General Fund revenue reserve), including most significantly:

Resident Experience Programme Phase 3

3.2. The Resident Experience Programme Funding Approval report agreed at the 20 April 2023 the Executive set out the one-off revenue funding requirement.

3.3. 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).

4. Rationale and Considerations

4.1. In the opinion of the Section 151 Officer the scheme expenditure for those programmes listed in **Section 3** of this Flexible Use of Capital Receipts Strategy (**Appendix F6**) for the council to apply the 'flexible use of capital receipt strategy' freedom, qualifies in line with the Guidance. The 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.

4.2. 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. Based on a recommended maximum £20m flexibility use and 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’).

4.3. It is recommended that the Executive approve and onward recommend Full Council to agree the Flexible Use of Capital Receipts strategy for 2024/25, up to a maximum of £20m, and note that approving the strategy does not commit the council to using it.

4.4. It is further recommended that the Executive approve and onward recommend Full Council 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.

5. Financial Implications

5.1. Utilising the capital receipts flexibility would mean that the council’s reserves would not decrease for the cost of qualifying transformation schemes. However, it would also lead to an increase in the council’s underlying need to borrow for the capital programme. On a recommended maximum £20m application of the flexibility the estimated additional revenue cost of capital would be £2m per annum (split between £1m annual interest costs and £1m statutory provision for the repayment of debt). This is factored into the council’s base budget proposals for 2024/25

5.2. Not utilising the flexibility would mean that there would be a decrease in the council’s earmarked Budget Strategy reserve in respect of qualifying transformation schemes in line with **Appendix C** of the 2024/25 budget report ‘General Fund Earmarked Reserves Balances’. 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.

5.3. Approving the ‘Flexible Use of Capital Receipts Strategy’ 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.

5.4. No prudential indicators would be breached through a decision to implement the flexible use of capital receipts. 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 £0.200m higher than in the 2024/25 budget report (£17.125m to £17.325m). The proportion of financing costs to net revenue stream would increase due to the increased borrowing. Based on an interest rate of 5.72%, this will change this indicator from 6.3% to 7.1%. This increase in borrowing costs would be offset by corresponding revenue savings.

6. Legal Implications

6.1. 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.

6.2. 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 …”.

6.3. 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.

6.4. 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.

6.5. 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.

6.6. 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.

6.7. 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.

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