Appendix 1 - Capital and Investment Strategy 2024-25

CAPITAL AND INVESTMENT STRATEGY

2024/2025

Cherwell

DISTRICT COUNCIL
NORTH OXFORDSHIRE

CONTENTS

A. Capital Strategy

A1. Introduction

As part of its annual budgeting cycle, Cherwell District Council proposes a capital programme that sets out the capital expenditure that is expected to take place over the next 5 years. The programme is a series of projects undertaken by service departments for which there has been an identifiable business need.

Capital expenditure is money spent on acquiring and enhancing non-current assets that are used in the delivery of services and providing economic benefits to the council and its residents.

The Council has had, and continues to put forward, an ambitious programme that seeks to deliver on its key corporate priorities as detailed in the 2023-24 Business plan, namely:

- Healthy, resilient, and engaged communities
- An enterprising economy with strong and vibrant local centres
- Supporting environmental sustainability
- Housing that meets your needs
- Running the business - support service

To ensure that the council can deliver upon these priorities, a medium to long-term view is taken of planned capital expenditure to ensure that the programme is affordable, sustainable, and deliverable.

Owing to the nature of capital spend, there are financial and non-financial factors that need to be evaluated and monitored to ensure council stakeholders and decision makers are kept fully informed, in line with the CIPFA Prudential Code for Capital Finance.

The Prudential Code for Capital Finance sets out that to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability, authorities should have in place a capital strategy. The capital strategy should set out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes. The Strategy must be approved by full Council.

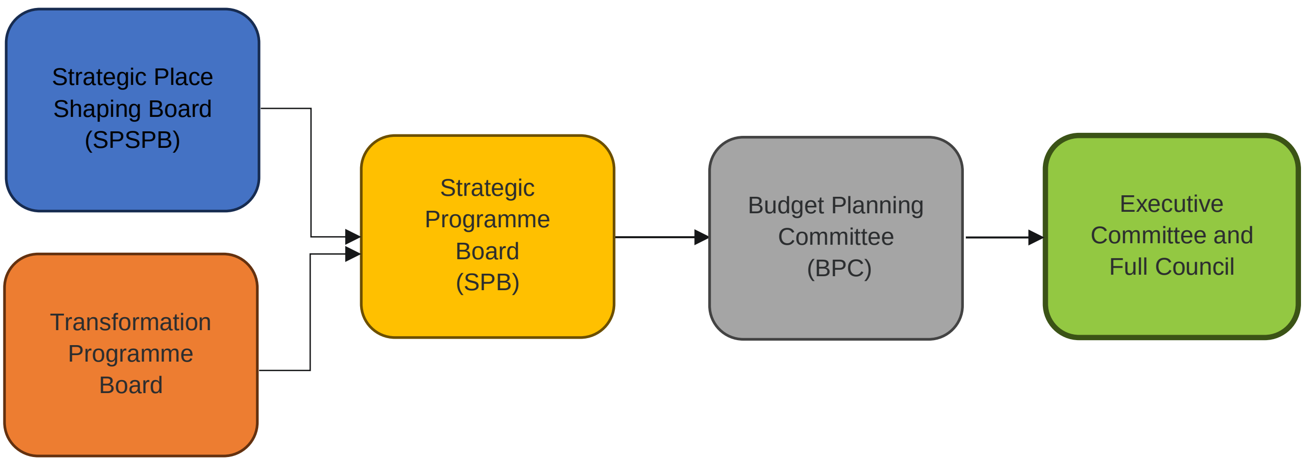
A2. Capital Planning and Project Approval

Starting in the Spring of each new budget cycle, service managers are tasked with conceptualising, proposing, and developing capital projects that are linked to corporate or service priorities as part of the Budget & Business Planning process.

The council operates a gateway process to ensure that projects have appropriate governance arrangements in place to identify and manage risk.

The Strategic Place Shaping, Transformation and Strategic Programme Boards provide oversight and scrutiny for the process, alongside the Strategic Programme Board and Budget Planning Committee. Project boards comprise officers from the director and assistant director level, as well as project managers, budget holders and finance officers. Approval of capital projects and the capital programme is made by Full Council. Capital projects may occasionally be approved outside of the annual budget cycle in line with the Council's Financial Regulations.

Diagram A2.1: Capital Project Oversight Boards



The capital gateway process has five stages:

Diagram A2.2: Capital Gateway Process

Gateway 0 - Business Need

Capital proposals first and foremost, must have a demonstrable business need. Officers must put forward rationale for why undertaking a project is necessary, including the corporate objectives it aligns with and a high-level budget outline, estimating both capital and revenue impact and any identified sources of capital funding. Bids are considered and discussed by the relevant boards and recommendations are made to the Strategic Programme Board (SPB) which takes a decision on progression of the scheme to gateway 1.

Gateway 1 - Business Case

Progression through gateway 1 requires the development of an outline business case and options for the scheme, ensuring that the council can deliver projects that offer value for money. The business case will include information that will assist board members in appraising the project. Within each option, an analysis of the benefits and drawbacks must be provided, alongside a summary of key risks, a project timeline and more detailed budget proposal. The business case must discuss carbon and climate impact, and any stakeholder engagement. Programme boards consider the business cases and provide feedback to officers, with recommendations made by the board for the project to be taken forward to gateway 2, reworked, paused, or postponed. At this point, finance officers conduct a review of the affordability of the project and prepare revenue budget figures for inclusion in the Medium-Term Financial Strategy (MTFS).

Gateway 2 - Business Decision

Recommendations made by the boards at gateway 1 are considered by SPB, both in terms of priority and affordability. Projects proposed to be included in the Council's capital programme are then considered and appraised by the Budget Planning Committee which provides comments to the Executive on the proposals. The Executive then, taking into consideration any comments, propose which schemes to include in the Capital Programme ahead of the final capital programme being presented to Council in February each year. Once approved by Council, budgets are uploaded to the financial system and project officers can commence work on the approved schemes.

Gateway 3 - Business Delivery

Approved projects are overseen by project managers that are responsible for delivering projects on time and within budget. This responsibility extends to risk management and escalation of issues to ensure that projects remain on track. All capital projects and programmes are reviewed monthly as part of routine budget monitoring, which provides an opportunity to review project costs against budget and escalate potential areas of concern with senior management. The outputs from routine budget monitoring processes feed into the Finance Capital reporting to the Executive, this reporting includes narrative which provides non-financial updates on capital projects.

Gateway 4 - Business Benefit Realisation

As part of project closure, officers are encouraged to reflect on the project undertaken and report back to project boards via a Benefit Realisation Report.

A3. Capital Expenditure

Regulations

Local Authorities operate under a capital prudential framework and under a statutory legal environment through the Local Government Act 2003.

Expenditure can only be capitalised (i.e., recorded as an asset on the Council's balance sheet) under these regulations, if the spend is incurred in:

- Acquiring, constructing, or enhancing physical or intangible assets, such as land, buildings, plant, vehicles, and equipment
- Acquiring share capital in a third party
- Advancing a loan to a third party that would be for capital purposes if incurred by the council
- Granting of funds to a third party which is to be used for a capital purpose
- Purchasing or enhancing assets from which the council does not have the legal right to economic or service benefits from but would otherwise be capital if the council had those rights (Revenue Expenditure Funded by Capital Under Statute).

As part of the capital gateway process outlined in section A2, projects are appraised on whether proposed expenditure falls into the above categories. Proposed expenditure that does not meet capitalisation regulations as determined by the Capital Accountant and/or S151 Officer, is then considered as a potential revenue pressure as part of the revenue budget setting process.

Expenditure on assets that are capital in nature and in the same class, but do not aggregately meet the council's capital de minimis threshold of £10,000, are also charged as a revenue expense.

Project officers are provided with guidance that outlines the requirement for expenditure being treated as capital. The below table demonstrates how the council typically treats expenditure that are related to capital projects:

Table A3.1: Accounting Treatment of Project Expenditure*

Expenditure Type	Accounting Treatment
Feasibility Studies	Revenue Expense
Options Appraisal	Revenue Expense - expenditure incurred on the option that is proceeded with *may* be capitalised e.g., if three options are appraised, 1/3 of the cost may be capitalised
Internal Staff Costs	Revenue unless a direct contribution is made to the progressing of the creation, acquisition, or enhancement of an asset e.g., a project manager. Officers are required to provide timesheets and other written documentation as justification for capitalising a staff member's cost for audit purposes.
Interest Costs on Prudential Borrowing	Revenue Expense
Design, Architect and Engineer Costs	Capital Expense
Contractors Costs	Capital Expense
Legal Fees	Capital Expense (except in relation to conveying the sale of an asset)

**This is not an exhaustive list of expenditure types*

It is therefore vital that project officers correctly classify spend for revenue and capital purposes to avoid unforeseen budget pressures. Aborted projects which no longer meet capitalisation requirements are subsequently charged to revenue.

Capital Programme

The council has a sizeable capital budget with committed spend of £40m across the programme. Projects already in the existing capital programme, prior to the inclusion of 2024/25 proposals, include:

- Transforming Bicester Market Square - £4m
- S106 Community Infrastructure Projects across the District - £2.8m
- Construction of a New Waste Services Depot - £3.9m
- Vehicle Replacement Programme - £5.7m
- Development of Castle Quay - £2.4m

All projects exist to further the council's delivery against its corporate objectives or to improve service delivery and council operations. A summary of planned capital spend in accordance with the corporate objectives is outlined in table A3.2 below:

Table A3.2: Capital Programme across Corporate Priorities in £m

Corporate Priority	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget
Healthy, resilient, and engaged communities	0.3	1.7	6.2	0.0	0.0	0.0
An enterprising economy with strong and vibrant local centres	2.3	0.9	7.3	0.0	0.0	0.0
Supporting environmental sustainability	3.7	1.2	3.9	1.1	1.1	1.5
Housing that meets your needs	8.1	21.5	4.6	1.4	1.4	1.4
Running the business - support service	0.8	4.7	9.2	0.1	0.0	0.0
Total Capital Expenditure	**15.3**	**29.9**	**31.1**	**2.5**	**2.6**	**2.9**

As part of the 2024/25 budget setting process, Full Council is requested to approve additions to the capital programme to further progress against corporate objectives. These projects are mostly funded by capital grants and S106 receipts, keeping borrowing levels at to a minimum. Proposed projects include:

- £1.6m of S106 spend on development of a 3G pitch at North Oxfordshire Academy
- £0.7m of debt financed Carbon Net Zero Capital Projects (subject to business cases prior to spend)
- £0.6m of S106 spend on development of Activity Play Zones

The council also has projects in the pipeline which are being planned, but for which capital funding has not yet been fully identified or received.

This includes the development of a New Learner Pool at Bicester Leisure Centre (£5.2m) and the BMX Pump Track (£0.2m). It is expected that future S106 receipts will be received to fully fund these projects and enable progress to Gateway 2. These items are included in the capital programme but are not able to proceed until all funding has been identified for them.

A4. Capital Financing and Affordability

Financing the Capital Programme

Capital expenditure included in the capital programme is financed from various sources – these sources can either be external (from third party contributions such as grants and Section 106 contributions) or internal (making use of reserves and capital receipts). Borrowing may be used as a temporary source of finance – as such the council may borrow externally within the prudential framework to acquire and enhance assets, including finance lease arrangements. Alternatively, it can borrow internally, making use of cash balances it holds in advance of expenditure to temporarily finance its capital spend. Internal borrowing is usually the preferred route - where possible - as interest payable on external borrowing is typically higher than interest receivable on surplus cash balances. A reduction in interest receivable will therefore be outweighed by the cost avoidance benefit in not borrowing externally. More information on this can be found in the Council's Treasury Management Strategy.

Borrowing results in an increase to the Council's Capital Financing Requirement (CFR) which needs to be carefully managed. Table A4.1 shows the expected use of receipts and the effects on the council's need to utilise borrowing as a temporary source of finance:

Table A4.1: Sources of Capital Finance

Financing Source	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget	2027/28 Budget
Capital Expenditure	**15.3**	**29.9**	**31.1**	**2.5**	**2.6**	**2.9**
Capital Receipts	(7.9)	(15.0)	(0.4)	(5.3)	0.0	0.0
S106 Receipts	(1.1)	(0.7)	(5.1)	0.0	0.0	0.0
Capital Grants	(5.3)	(3.0)	(6.5)	(1.2)	(1.2)	(1.2)
Total Financing	**(14.3)**	**(18.7)**	**(12.0)**	**(6.5)**	**(1.2)**	**(1.2)**
Increase/(Decrease) in CFR*	**1.0**	**11.2**	**19.1**	**(4.0)**	**1.4**	**1.7**

**Figures may not cross-cast between tables due to rounding*

Capital receipts are a permanent source of finance i.e., it is funding the council controls and does not have to repay. Capital receipts typically arise from the disposal of a non-current asset. Examples of capital receipts include:

- Proceeds from the sale of land or a building
- Repayment of a capital loan from a borrowing entity
- Disposal of a financial interest in a capital asset, such as a re-sale covenant on a house

Once received, capital receipts can be used to finance new capital expenditure or applied to existing expenditure to reduce the council's need to borrow. Application of capital receipts to new or historical spend will be a decision taken by the S151 Officer. Capital loan receipts are applied to the unfinanced capital spend incurred in making the original loan advancement.

Capital grants are generally received for a specific expenditure purpose and are recognised as a council resource when reasonable assurance has been received that the council will meet any conditions attached to the use of the funds. Capital grants are used for financing in the financial year the spend is incurred, with unspent balances transferred to capital reserves which can be used to finance spend in future years.

To finance capital expenditure that has no permanent source of finance such as capital receipts or grants, and that has utilised borrowing as a temporary source of finance, revenue resource must be provided for over the lifetime of the underlying asset or enhancement made. This is known as the Minimum Revenue Provision (MRP) and is a statutory requirement for councils that have utilised prudential borrowing. MRP is provided for annually and acts to reduce the council's need to borrow money, i.e., its CFR. The MRP charge must demonstrate prudence and be made with due regard to statutory guidance published by central government. The Council's MRP statement can be found in Annex A to this document. The Council's MRP forecast is outlined in table A4.2.

Table A4.2: Minimum Revenue Provision Forecast

MRP (£m)	2022/23 Actual	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Minimum Revenue Provision (MRP)	(4.9)	(3.7)	(5.5)	(4.7)	(4.9)	(5.0)

Capital Financing Requirement

The level of capital expenditure not yet permanently financed is measured through the Capital Financing Requirement (CFR). The CFR indicates the extent to which the council has needed to borrow (incur debt) and is calculated by taking the Council's total spend for capital purposes and deducting capital grants, receipts and revenue resource applied against the expenditure. Forecasting the CFR is a vital part of revenue budget management as it determines the level of prudent MRP.

Table A4.3: Capital Financing Requirement Actuals and Estimates

CFR (£m)	2022/23 Actual	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
CFR	238.6	246.1	259.6	250.9	247.4	244.0

A5. Treasury Management and Prudential Borrowing

Prudential Borrowing

The council as a local authority can borrow for purposes that comply with the CIPFA Prudential Code for Capital Finance. As part of this capital strategy a series of indicators are provided to help demonstrate that borrowing is incurred in-line with the Prudential Code. Prudential indicators are provided in section A6 of this strategy.

Under the revised code, the council *cannot* borrow for commercial purposes i.e., make capital investments primarily for financial return. The council takes decisions on its capital programme with the fundamental principle that the capital project must deliver against corporate priorities as its primary objective. The council will therefore comply with this requirement.

Treasury Management

Treasury management is concerned with the management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

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 typically has surplus cash in the short-term as revenue income is received before it is spent, but insufficient cash 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. At 31 December 2023 the Council had borrowings of £166m at an average interest rate of 2.18%, and £27m of investments at an average interest rate of 5.58%. The borrowing position is reported regularly to Accounts, Audit & Risk Committee as part of the Treasury Management reports.

Borrowing Strategy

The Council's main objective when borrowing is to achieve a low but certain cost of finance while retaining flexibility should plans change in future. To meet this objective the Council must review the current market conditions alongside the long-term forecasts from Link to determine how to structure borrowings. Short term loans, which usually have lower interest rates and offer excellent flexibility, are suitable for stable market conditions or when interest rates are forecast to fall. Medium to long term loans offer a certain cost of finance but are generally more expensive and inflexible. The Council must therefore seek to strike a balance between short and medium to long term loans, to meet its objectives, by anticipating both its borrowing need and the forecast interest rates.

A6. Prudential Indicators

Under the Prudential Code, the council is required to ensure that all capital expenditure, investments and borrowing decisions are prudent and sustainable. In doing so the council must take into account arrangements for the repayment of debt (including through MRP) and consideration of risk, and the impact and potential impact on the council's overall fiscal sustainability.

A series of prudential indicators are set each year as part of the Capital Strategy to demonstrate that the council has due consideration of these factors when determining its capital programme.

A6.1 Debt and the CFR

The council can only borrow to support a capital purpose, and borrowing should not be undertaken for revenue or speculative purposes. The council should ensure that gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and the next two financial years.

Projected levels of the Council's total outstanding debt (which comprises borrowing and leases) are shown below, compared with the capital financing requirement (see table A4.3)

Table A6.1: *Debt vs CFR (£m)*	2022/23 actual	2023/24 forecast	2024/25 forecast	2025/26 forecast	2026/27 forecast
Gross Borrowing (incl. PFI & leases)	188.0	181.0	180.0	180.0	175.0
Capital Financing Requirement	238.6	246.1	259.6	250.9	247.4

As per the table, the council expects that its gross borrowing will not exceed its CFR across the MTFS period.

A6.2 Borrowing Boundaries and Limits

The council is legally obliged to determine and keep under review 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 A6.2: *Operational Boundary vs Authorised Limit (£m)*	2023/24 limit	2024/25 limit	2025/26 limit	2026/27 limit
Operational boundary	290.0	290.0	290.0	280.0
Authorised limit	310.0	310.0	310.0	300.0

There are no changes to the 2024/25 boundary and limit, indicating that the council is effectively managing its debt and cashflows.

A6.3 Financing Cost to Net Revenue Stream

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue. Together these are referred to as financing costs and it is useful to compare this to the net revenue stream, i.e., the amount funded from Council Tax, business rates and general Government grants, to determine that capital financing costs are proportionate and affordable.

Table A6.3: *Financing Costs to Net Revenue Stream (£m)*	2022/23 Actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
Interest Payable	3.6	4.0	4.5	4.8	5.0
Minimum Revenue Provision	4.9	3.7	5.5	4.7	4.9
Total Financing Costs	**8.4**	**7.7**	**10.0**	**9.5**	**9.9**
Net Revenue Stream	22.6	28.1	26.2	21.1	18.1
Total Funding	**22.6**	**28.1**	**26.2**	**21.1**	**18.1**
Proportion of Net Revenue Stream	**37.3%**	**27.4%**	**38.2%**	**45.3%**	**54.7%**

This indicator shows that the ratio of financing costs to net revenue streams is high, however it doesn't consider is that a large proportion of the council's financing costs are offset by the interest from on-lending to the Council's subsidiaries, and income generated by assets acquired as part of the Council's regeneration programme. **This "non-treasury investment" income is not included in the net revenue stream as it does not form part of the council's core funding but is nonetheless a key resource for the council.**

A6.4 Net Income from Service Investment Income to Net Revenue Stream

This Indicator shows the financial exposure of the Authority to the loss of its non-treasury investment income, i.e., income from financial investments (e.g., share and loan capital in council subsidiaries) and income from property assets:

Table A6.4: *Ratio of Service Investment Income to Net Revenue Stream (£m)*	2022/23 Actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
Net Income from Financial Investments	4.9	5.1	4.5	4.5	4.5
Net Income from Property Assets	4.2	5.1	5.8	8.2	8.3
Total Service Investment Income	**9.1**	**10.2**	**10.3**	**12.8**	**12.8**
Net Revenue Stream	22.6	28.1	26.2	21.1	18.1
Total Funding	**22.6**	**28.1**	**26.2**	**21.1**	**18.1**
Ratio of Service Investment Income	**40.4%**	**36.3%**	**39.1%**	**60.6%**	**70.7%**

Investment income represents a significant proportion of the net revenue stream and therefore the risks around loss of this income should be monitored closely. The council conducts regular reviews of projected levels of income as part of monthly budget management and provides regular updates to senior management via performance and aged debt reporting. Risks associated with income loss can therefore be identified early and plans can be implemented to mitigate the impact so the council can continue to deliver a balanced budget.

Whilst financing costs are high, the overall picture is incomplete without factoring the contribution investment income makes towards these costs. Deducting the ratio of net income from Service Investments from the Ratio of Financing costs reveals the affordability ratio, which demonstrates the net revenue impact to the taxpayer as a result of the Council's capital investment decisions.

A6.5 Affordability Ratio

There is no established Local Authorities benchmark for this ratio as activities differ widely. Interest earned on Treasury investment is not considered in either of the calculations and therefore it is not unexpected to see a positive percentage when the two are netted off against each other.

The affordability ratio shows that after taking into account the income relating to the capital expenditure that is being financed the Council has an affordable net cost of capital financing:

Table A6.5: *Affordability Ratio*	2022/23 Actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget
Ratio of Financing costs	37%	27%	38%	45%	55%
Ratio of Service Investment income	40%	36%	39%	61%	71%
Affordability ratio	**-3%**	**-9%**	**-1%**	**-15%**	**-16%**

The Section 151 Officer is satisfied that the proposed capital programme is prudent, affordable, and sustainable.

With increases in interest rates in the past year, the Council will continue to monitor this ratio and report to senior management via its regular Treasury Management review. Should the affordability ratio move adversely, the council will need to review whether this is sustainable and what actions may be required to mitigate the impact to the taxpayer as part of its budget monitoring and Medium-Term Financial Strategy.

A7. Capital Health

To get an indication of the Council's overall capital health, it is useful to examine the ratio of the CFR to the Council's total long-term asset value to determine the extent to which the council's assets could clear its debt through asset disposals, if necessary.

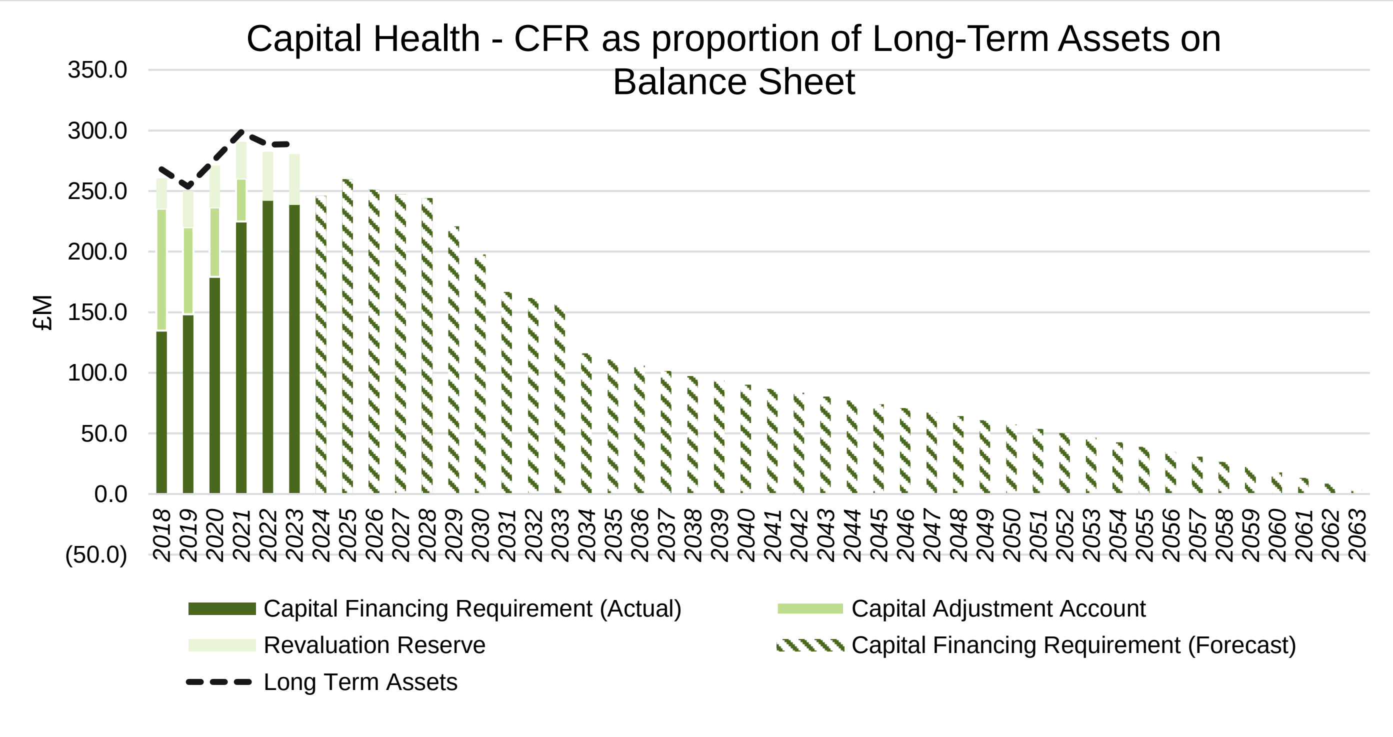
Table A7.1 – Capital Health in £ millions

Capital Health (£m)	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Capital Financing Requirement	134.9	148.2	179.2	224.8	242.1	238.6
Long-Term Assets *(as per statement of accounts)*	267.8	253.6	275.8	298.6	288.2	288.8
CFR to Long-Term Asset Ratio	**50%**	**58%**	**65%**	**75%**	**84%**	**83%**

As of 31st March 2023, the Council's CFR amounted to 83 percent of the value of its total capital worth (Long-term asset value), demonstrating that the Council's total capital worth exceeds its borrowing requirement.

Figure A7.2 demonstrates how this has changed since the Council began borrowing to fund its capital programme and includes a forecast of the Council's CFR up to 2063 based on the current 5-year capital programme and no future additions to this.

Figure A7.2– Capital Health: CFR as proportion of Long-Term Assets



The Council's capital assets are comprised of fixed assets, such as property, and financial assets, such as loan and share capital. Fixed assets and long-term financial assets are less liquid than treasury management investments, as loans and share capital have contractual arrangements and agreed repayment profiles in place, whilst property is utilised in the delivery of corporate priorities. It is important that the council continues to monitor the repayment profiles of loans and valuation of its property assets to ensure that the council can cover its debt obligations through asset sales if required to do so (e.g. in the unlikely event that PWLB refinancing of loans becomes unavailable).

Based on current forecasts, the CFR is expected to reduce by 30% by 2031 and be cleared by 2064. This is mainly due to the effects of the annual minimum revenue provision set aside by the council and principal repayment of capital loans and share capital investments by the Council's subsidiary company Graven Hill.

The council continues to ensure that wherever possible, new capital projects are fully funded by capital grants, capital receipts or S106 receipts, keeping additional borrowing requirements to a minimum level and on projects whether there is a demonstrable business need or statutory duty.

A8. Asset Management and Commercial Risk

Asset Management

To ensure that capital assets continue to be of long-term use, the Council is in the process of preparing a revised Asset Review, where the purpose of each asset held, is challenged, and these properties will be underpinned by a series of policy documents which detail how each category of property is managed. This is a multi-level approach structured as follows:

- At a property level this will comprise of the preparation of an asset management plan which are then subject to periodic review and updating. This process is ongoing and informs the portfolio strategy as a whole.

- At a tenancy level the Comprehensive Asset Register (a database of key lease events) is being updated and used to identify forthcoming lease events such as expiries, rent reviews and breaks. These are allocated to specific Property Managers to progress whose work schedules are reviewed periodically.

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. Receipts from capital grants, loan repayments and investments also generate capital receipts

Commercial Risk

To drive leadership of place within Cherwell, stimulate growth, pursue economic regeneration and to generate income to support the revenue activity, the council holds commercial property assets that are subject to commercial risks. The council continues to make investments in enhancing and adapting these assets to ensure they remain fit for purpose and to maximise their service and economic potential in a what has been a turbulent financial environment for commercial property nationwide.

The council recognises that the investments made in commercial property are higher risk than treasury investments. The principal risk exposures are listed below together with an outline of how those risks are managed:

Table A8.1 – Commercial Risk Management

Illiquidity	The council acknowledges illiquidity as a risk in property and whilst it cannot be avoided the risk is mitigated by the following strategies: a) The council invests across a range of sectors and its assets are diversified in terms of lot size. b) Some of the Council's investments are not what is termed 'Investment Grade', but they are fundable – i.e., if sold they could be suitable for debt backed investors. c) The Council's assets are uncharged. It is often lenders who require assets to be sold and whilst gearing does not increase illiquidity per se, it can expose an owner to greater risk of selling an illiquid asset at an inopportune time.

Tenant default	The council's portfolio includes both large national concerns and small local businesses (mainly retail or industrial type tenants). Tenant default risk is managed in two ways: a) Tenants are vetted when entering the portfolio either as new tenants when property is let or as replacement tenants when existing tenants assign their leases. It must be acknowledged that there is less control when a tenant applies for consent to assign, though guarantees may be sought. b) Risk is managed by diversification as only a small proportion of tenants will fail in any given year. c) A policy contingency budget is held within the Council's annual revenue budget alongside a market risk earmarked reserve which can meet a shortfall in income that may arise in year due to tenant defaults.
Obsolescence	A significant proportion of the Council's portfolio comprises industrial / warehouse buildings and retail assets which have relatively low obsolescence compared to office premises. This is because offices in general require significant investment to maintain the landlords fit out specification in line with market demands. Where matters of council policy override commercial concerns, the Council's portfolio is more vulnerable. E.g., where significant outlay may be required on plant and machinery at the end of their useful economic lives. This will be considered in the Asset Management plan for each asset.
Capital expenditure	Please see above but also note that the council aims to let space on Full Repairing terms which makes the tenant either explicitly responsible for maintaining the asset or allows CDC to recover the cost of repairs through the service charge provisions of the relevant lease.
Market risk	Two key market risks are falling rents in response to declining economic conditions and extended marketing voids when leases end or tenants fail. These risks are mitigated in three main ways: 1. Lease lengths should be 3 – 5 years + which obviates most market risks during the period of the tenancy. 2. Longer leases which contain regular rent review provisions normally require the rents to be reviewed in an upwards only direction. 3. Tenant failure – see above under Tenant Default, re: vetting and diversification policies plus earmarked reserves held. An additional risk is over-exposure to town centre retailing as the portfolio's largest assets are the Castle Quay Centre and Retail Complex in Banbury as well as Pioneer Square in Bicester. The risks arising from these investments will be managed as part of the Strategic Asset Management plan and Asset Actions Plans for each asset.
Returns eroded by inflation	Most properties are let on lease terms which contain upwards only rent reviews and some are indexed linked guaranteeing rental growth. Although in general rental levels lag against inflation (both when rising and falling due to reviews or renewals being generally every 3-5 years) rents are historically considered to be more stable with less fluctuations.
Rising interest rates	Interest rate risks are managed by the Council's Treasury Management function which is supported by professional advisers. The council publishes its approach to interest rate management in its quarterly Treasury Management Report and annual Treasury Management Strategy which should be read in conjunction with this strategy.

Commercial Governance

Decisions on investment in assets with commercial risk are made by Members and Statutory Officers in line with the criteria and limits approved by Council in the Investment Strategy. Acquisitions of property are made in-line with strategic priorities of the council, are capital in nature and will therefore form part of the council's capital programme.

The Council also has commercial activities in trading companies, exposing it to normal commercial risks. These risks are managed by the governance structure in place. The Shareholder Committee is regularly informed of the progress of each company. The Shareholder representative meets with the directors both formally and informally to ensure there is a consistent dialog between the companies and the council.

Further details on commercial investments and limits on their use can be found in the Investment Strategy (Section B of this report).

A9. Knowledge and Skills

The council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Section 151 Officer is a qualified accountant with many years of experience and several other members of the Finance team are CIPFA members and fully qualified accountants. Senior members of the Property team are registered surveyors with the Royal Institute of Chartered Surveyors (RICS). The council also pays for junior staff to study towards relevant professional qualifications, including CIPFA, to support professional development and team resilience.

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.

B. Investment strategy

B1. Introduction

The CIPFA Prudential Code for Capital Finance outlines that in the Investment Strategy presented to Full Council each year, it should report on all financial investments of the authority, together with other non-financial investments such as those held for service purposes or for financial return.

Local authority investments (including commercial property) may be categorised in accordance
With the primary purpose of the investment. The chief financial officer makes a judgement as to the primary purpose of the investment. For the purposes of this strategy, all investments and investment income must be attributed to the following purposes as per the prudential code:

- 'Investments for **treasury management** purposes' (or treasury management investments) are those investments that arise from the organisation's cash flows or treasury risk management activity, and ultimately represent balances that need to be invested until the cash is required for use in the course of business.

- 'Investments for **service** purposes' (or service investments) are taken or held primarily and directly for the delivery of public services (including housing, regeneration and local infrastructure) or in support of joint working with others to deliver such services.

- 'Investments for **commercial** purposes' (or commercial investments) are taken or held primarily for financial return and are not linked to treasury management activity or directly part of delivering services.

In line with the above definitions, the council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),

- to support local public services by lending to or buying shares in other organisations, such as subsidiaries and local community groups (**service investments**) and

- to deliver against corporate priorities as detailed in the council's annual business plan (**service investments**)

The council does not invest *primarily* for financial return (commercial purposes) – for the council to do so, it is likely the council would need to incur borrowing. The prudential code does not permit borrowing for commercial purposes.

The council realises the benefits of its investments either through direct delivery towards corporate priorities, or by generating additional income that supports service delivery and the revenue budget.

The below table summarises how each type of investment benefits the council and its residents:

Table B1.1: Investment types and Benefits

Investment	Purpose	Examples	Strategic and Service Benefits	Economic Benefits

Treasury Investments	To manage surplus cash balances held in advance of expenditure	Money Market Funds, DMADF, other Local Authorities & fixed deposits with banks	Effective treasury management – i.e. deposit cash in facilities that are secure, liquid and generate a financial return	Interest received can be used to support day-to-day revenue spend the council incurs in delivering its services.
Service Investment: *Purchasing of Share Capital*	To enable subsidiary companies such as Graven Hill to deliver service objectives and be commercially viable enterprises	Graven Hill, Crown House	The subsidiary is provided financial resource to deliver housing for the district	Investing in subsidiaries can help deliver service objectives that impact the local economy and help to stimulate economic growth e.g., in providing housing, attracting businesses, encouraging private investment in the district. The council may receive a dividend payment from the profits generated that can support revenue spend.
Service Investment: *Advancing of Capital Loans*	Loans are advanced to organisations such as its subsidiaries, local parishes and local charities to support local public services and stimulate local economic growth	Graven Hill, Crown House, Local Charities and other organisations	To enable continual delivery of housing and infrastructure to the local community. To enable local groups to deliver objectives and priorities which align with the Council's.	Advancing loans can enable local organisations to facilitate economic growth. The council receives interest on the loan advances. Loans are repaid to the council on maturity.
Service Investments: *Property*	To help the council to deliver services, meet its corporate priorities and generate income to support its revenue activity	Bicester Depot, Castle Quay, Tramway Industrial Estate	A direct impact is made on the district through strategic place shaping, regeneration, and other forms of service delivery	Property investments support public services and help to attract for local and national businesses, driving economic prosperity. The council can generate income from lettings of space that it does not occupy, e.g., retail, and industrial space.

B2. Treasury Management Investments

The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and Central Government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to be an average of £14m during the 2024/25 financial year.

Full details of the Council's policies and its plan for 2024/25 for treasury management investments are covered in a separate document, the treasury management strategy.

B3. Service Investments: Loans

Contribution
The Council lends money to third parties (e.g., its subsidiaries, local parishes, local charities) to support local public services and stimulate local economic growth. The main loans issued are to the council's subsidiaries – the Graven Hill Village companies and Crown House Banbury Ltd. Graven Hill is a housing development providing significant housing in Bicester. Crown House is a redeveloped derelict office building in the centre of Banbury which is providing significant rental opportunities in the town centre.

Security
The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. To limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table B3.1: Fair Value of Loans

Category of borrower (£m)	31st March 2023 actual			
	Balance	Loss allowance	Net figure in accounts	Approved Limit
Subsidiaries	71.2	1.3	69.9	71.2
Parishes	0.1	0.0	0.1	0.1
Local charities	0.1	0.0	0.1	0.1
Other	1.3	0.1	1.2	1.3
TOTAL	**72.7**	**1.4**	**71.3**	**72.7**

Accounting standards (IFRS 9) require the council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts are shown net of this loss allowance. The council, however, makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk Assessment
The Council assesses the risk of loss before entering into and whilst holding service loans by approaching each loan request individually. The bulk of the council's loans are to its subsidiaries. When the council considers whether or not to create or acquire a subsidiary a full business case is prepared which sets out the optimal financing of the company. This will include an assessment of the market in which it will be competing, the nature and level of competition, how that market may evolve over time, exit strategy and any ongoing investment requirements. External advisors are used where appropriate to complement officer expertise and second opinions from alternate advisors is sought in order to monitor and maintain the quality of advice provided by external advisors.

Other service loans are evaluated against a set of criteria designed to demonstrate:

- Evidence of project objectives and needs analysis is provided
- The loan must have a demonstrable community impact
- The loan would provide up to 50% of the whole project cost

- Such a loan can only be applied for by constituted voluntary organisations with their own bank account; Town or Parish councils; charitable organisations

- The loan cannot be applied retrospectively

- The applicant has provided evidence of its financial stability and of its ability to manage the proposed scheme.

- Appropriate checks have been carried out on the owners of the organisations to be satisfied as to their integrity and to avoid any potential embarrassment to the Council.

- The applicant has demonstrated that the proposed scheme has been developed following good practice in terms of planning, procurement, and financial appraisal.

- The applicant has provided evidence the affordability of their proposed scheme and the loan repayments

- That the project furthers the council's priorities as reflected in its Business Plan

B4. Service Investments: Share Capital

The council invests in the shares of its subsidiaries to support local public services and stimulate local economic and housing growth. The council currently holds shares in Graven Hill Holding Company Ltd, Graven Hill Development Company Ltd and Crown House Banbury Ltd.

One of the risks of investing in shares is that the initial outlay may not be recovered. To limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table B4.1: Fair Value of Share Capital Investments

Category of company	31st March 2023 actual			
	Amounts invested	Gains or losses	Value in accounts	Approved Limit
Subsidiaries	35.7	0.0	35.7	35.7
TOTAL	**35.7**	**0.0**	**35.7**	**35.7**

The Council assesses the risk of loss before entering into entering and whilst holding shares by maintaining close links with the Boards of Directors of the companies through an established Shareholder Committee. Risk is assessed as above in Service Loans.

The maximum periods for which funds may prudently be committed are assessed on a project-by-project basis. The decision will balance both the long-term viability of the subsidiary and the revenue and capital requirements of the Council.

Shares are the only investment type that the council has identified that meets the definition of a non-specified investment in the Government guidance. The limits above on share investments are therefore also the Council's upper limits on non-specified investments. The council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

B5. Service Investments: Property

The council invests in local property in two ways: by acquiring new assets and by enhancing existing assets to help provide and meet the needs of its residents and businesses. For example, the council has recently acquired land to relocate and expand its Waste Collection Depot in Bicester to accommodate growth across the district. The Capital Programme includes significant investment over the next five years, which includes:

- Development of the new Bicester Depot
- Transforming Bicester Market Square
- Investing in Solar Panels and Solar Photovoltaic car ports at the Council's leisure and community centres
- Acquiring and making capital improvements to Town Centre House to return the building to use, to help rehouse Ukrainian Refugees, and to provide safe, secure and affordable housing
- Commitment of funding to net zero carbon projects

The Council also continues to hold strategic assets that have received significant investment in recent years to regenerate town centres and generate income for the council, the largest of which include,

- Castle Quay Centre and Waterfront, Banbury;
- Pioneer Square, Bicester;
- Tramway Industrial Estate; Banbury.

Security

Under the statutory guidance on investments published by Central Government, the council should evaluate the security of its investments by conducting a fair value assessment against the capital invested. A fair value assessment is possible for assets held at fair value, I.e. properties valued annually as investment property (IAS 40 as adapted by the CIPFA code) or operational assets valued under Existing Use Value (EUV) where there is an active market for these types of assets.

In 2023, the council undertook a review of properties held under IAS 40 and determined that most of the assets classified as investment property up to 2021/22 were done so incorrectly. The CIPFA code defines Investment Properties as assets held *solely* for financial return, either through rental income or capital appreciation.

Assets like Castle Quay, Tramway and Pioneer Square that were originally classed as investment properties, were investments made for the purpose of meeting the strategic regeneration objectives of the council, and *not* solely for financial return. Regeneration is, and has been, a key service objective for the council and whilst the assets are partly commercial in their day-to-day use as retail, leisure and industrial operations by tenants and generate rental income, the council continues to hold the assets as part of its wider regeneration strategy.

The council has therefore reclassified these assets as Property, Plant and Equipment (operational assets) and made prior year adjustments to its accounts to correct erroneous classification made in prior years' financial statements.

Under the CIPFA code, operational assets are valued under the Existing Use Value approach. Existing Use valuations are conducted on assets that have service benefits, such as in provision of housing or in the delivery of regeneration objectives. Existing Use (EUV) valuations may in some circumstances be lower than Market Value due to EUV disregarding potential alternative uses of the asset, known as 'hope value'. An assessment of the security of these assets is therefore made against valuations in Existing Use where Market Value is unavailable. Table B5.1 shows the latest fair value assessments of the council's high value strategic investments made in recent years:

Table B5.1: Fair Value of High Value Investments in the Council's Strategic Assets

Asset Name	Investment Cost (£m)	Fair Value 31/03/2022 (£m)	Movement in Fair Value (£m)	Fair Value 31/03/2023 (£m)	Gains/(Losses) in Book Value Recognised in Accounts (£m)
Castle Quay Waterfront, Hotel and Supermarket	68.3	32.0	(2.6)	29.4	(38.9)
Castle Quay Centre	64.7	15.4	(1.6)	13.8	(50.9)
Tramway Industrial Estate	9.6	10.7	(1.6)	9.1	(0.5)
Pioneer Square	8.2	4.1	0.3	4.4	(3.8)
Totals	**150.8**	**62.2**	**(5.5)**	**56.7**	**(94.1)**

The decline in book values have been driven by multiple factors, namely:

- The decline of high street retail, accelerated by the Covid-19 pandemic
- Performance of retail assets nationally, affecting property yields and therefore asset valuations
- National economic conditions, such as interest rates and inflation

Book gains and losses are recognised in the Council's statutory accounts to reflect fluctuations in asset values and represent a snapshot of the Council's financial position as at a balance sheet date. Cash movements against the original capital investment are therefore not realised until an asset is disposed of.

The council recognises that property valuations are important. The book value losses recognised to date, whilst significant, are temporary and are expected to improve in the medium to long-term which will ensure the authority remains in a healthy long-term financial position. The investment benefits will continue be realised through non-financial factors such as regeneration and place shaping and through revenue receipts which will help finance the capital investment.

Whilst strategically important, property valuations do not have a direct impact on the council's day-to-day financial standing. The council has prudently budgeted for the debt servicing costs on these investments and continues to receive income from the assets to support the financing of the investments. Many of the assets are long-term for the council, with current and future service benefits that also need to be taken into consideration in evaluation of the investment. As detailed in section A6 of the capital strategy, the council deems its capital investment plans to be affordable, prudent, and sustainable.

To improve the economic and service potential of its property investments and ensure they remain fit for purpose, the council intends to undertake a strategic review of its property within the next 12 months. A strategic review on one of the Council's largest assets, the Castle Quay Centre, is already underway. As part of this review, the council has already assessed the viability of moving council offices to the centre, for which a business case has been approved. Further work is now being undertaken to progress the project.

Once the move to Castle Quay completes, a capital receipt may be generated from the sale of the current council headquarters, Bodicote House.

It should be noted that the security of investment is not only considered through annual fair value assessment. Asset valuations fluctuate in accordance with the market, which has been on a downward trend in recent years. Assets that generate income to the council contribute to the overall business case and therefore whilst capital values may fluctuate, income generated from property assets may be considered secure in accordance with the lease terms granted, tenant performance, and asset obsolescence.

Risk assessment

The council assesses the risk of loss before entering and whilst holding property investments by cash flow modelling the income and expenditure profile of each investment and interrogating that model across a range of scenarios to test the robustness of the investment. The modelling exercise is informed by the likelihood of tenant default and the chances that individual units will become empty during the hold period.

The property investment market is dynamic, and the council is kept abreast of developments by frequent communication and established relationships with local and national agents, supplemented by in-house investigations and reading of published research. The Council's focus is on assets that are local and help to deliver the strategic aims of the council.

In all acquisitions the council takes external advice from acknowledged experts in the field and sense-check their input against our in-house knowledge, experience, and expertise. The advice sourced covers market value but also, letting risk, marketability and occupational demand, and likely expenditure over the hold period.

The council uses a number of local and national advisors and cross reference their views periodically. There is no single party who expects to be instructed by the council without competition.

Credit ratings are used on acquisitions, new lettings and when tenants request consent to assign their leases. The council uses D&B ratings as well as reviewing the published accounts of tenants or potential tenants.

A number of other strategies are used to mitigate risk:

- Tenant rent payment histories are analysed on any acquisition.
- Tenant rent payment patterns and arrears are examined in the existing portfolio.
- Introducing agents advise the council throughout the acquisition process and their advice includes market commentary at a national and a local level and commentary on perceived risks to the investment.
- In tandem with the above every acquisition is subject to a third-party RICS Red Book valuation by qualified surveyors who are independent i.e., not acting for the council or the vendor on the acquisition.

Liquidity

Compared with other investment types, property is relatively difficult to sell to convert to cash at short notice and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the council acknowledges illiquidity as a risk in property and whilst it cannot be avoided the risk is mitigated by the following strategies:

- The council invests across a diverse range of sectors and lot sizes. This affords the council the ability to access a range of purchaser types e.g., small local investors, listed property companies or institutions.

- The council does not invest in high-risk assets which can be the most illiquid of all other than for the purposes of delivering regeneration which has a different investment objective from pure revenue or capital return.

- Some of the Council's investments are not what is termed 'Investment Grade', but they are fundable – i.e., if sold they could be suitable for debt backed investors

- The council does not invest in specialist properties, where the market tends to be most illiquid.

- The Council's assets are uncharged. It is often lenders who require assets to be sold and whilst gearing does not increase illiquidity per se, it can expose an owner to greater risk of selling an illiquid asset at an inopportune time.

B6. Loan Commitments and Financial Guarantees

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the council and are included here for completeness.

The council has contractually committed to the following loan, bond, and guarantee amounts:

Table B5: Loan Commitments, Bonds and Guarantees

Borrower	Purpose	£m Contractually Available
Graven Hill Village Development Company Ltd	Revolving Credit Facility available to the council's subsidiary until 2026	£17.0m
Graven Hill Village Development Company Ltd	Bonds and Guarantees in place	£22.4m
Graven Hill Village Development Company Ltd	Bond and Guarantees agreed in principle	£14.4m
TOTAL		**£53.8m**

B7. Capacity, Skills and Culture

Elected members and statutory officers

The majority of senior statutory officers are qualified to degree level and have appropriate professional qualifications. Their shared business experience encompasses both the public and private sectors.

Training and guidance are provided to support members in delivering their roles and support effective decision making.

Investments
Negotiations are either undertaken directly by Assistant Directors or at a senior level with Assistant Director direct involvement and oversight, alongside input from Directors and Lead Members where required. Assistant Directors are aware of the regulatory regime and convey that to all junior staff.

Corporate governance
There are appropriate corporate governance measures in place which comprise end to end decision making procedures. These include risk assessments within the organisation; presentation to relevant committees including Members, statutory officers' approvals, and relevant project boards.

B8. Investment Indicators

The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure resulting from its investment decisions.

Total risk exposure
The first indicator shows the council's total exposure to losses in investment book value (i.e. losses not already recognised on balance sheet) which includes amounts the council is contractually committed to lend but have yet to be drawn down and guarantees the council has issued over third-party loans and the council's high value property assets. These risks are managed by the council operating within the Treasury Management, Capital and Investment Strategies and strict governance arrangements around the council subsidiary Companies.

Table B8.1: Total investment exposure in £ millions

Total investment exposure	31/03/2023 Actual	31/03/2024 Forecast	31/03/2025 Forecast
Treasury management investments*	43.5	13.3	14
Service investments: Loans*	63.4	57.4	57.4
Service investments: Shares	35.7	35.7	35.7
Service investments: Property***	56.7	65.9	80.3
TOTAL INVESTMENTS	**199.3**	**172.3**	**187.4**
Commitments to lend	11.0	17.0	17.0
Bonds & Guarantees in place and agreed in principle	45.4	17.9	11.8
TOTAL INVESTMENT EXPOSURE	**255.7**	**207.2**	**216.2**

**The investment forecast for 2024/25 is as per the MTFS budget and includes a forecast loan necessary for the Council to maintain its professional client status with its providers of financial services. This figure will differ from table 1.3 in the Treasury Management Strategy, as that only takes loans already committed to, into account.*
***Loans as per the investment funded by borrowing (excluding interest income) as per Table B8.2*
****As per the net book value in Table B5.1 for 2022/23 on high value property investments*

How investments are funded
Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate specific assets with specific liabilities, this guidance is difficult to comply with. However, the following investments could be described as funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

Table B8.2: Investments funded by borrowing in £ millions

Investments funded by borrowing	31/03/2023 Actual	31/03/2024 Forecast	31/03/2025 Forecast
Service investments: Loans	63.4	57.4	57.4
Service investments: Shares	35.6	35.7	35.7
Service investments: Property	156.3	163.7	178.8
Total Funded by Borrowing*	**255.3**	**256.8**	**271.9**

**The total funded by borrowing represents the gross expenditure incurred on these types of investments which form part of the Council's CFR. MRP (see Annex A) made to date on these investments has not been included in this total.*

Rate of return received

This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred

Table B8.3: Investment rate of return (net of all costs)

Investments net rate of return	2022/23 Actual	2023/24 Forecast	2024/25 Forecast
Treasury management investments	2.1%	5.1%	4.9%
Service investments: Loans	6.3%	6.9%	6.0%
Service investments: Property	1.0%	0.9%	0.9%

The rate of return on property assets represents the return across property service investments in housing, car parks, property bought with regeneration objectives and other property. The rate is lower than the return on loans and treasury investments as the council has invested in properties to meet corporate priorities in which financial return is not the primary objective. The council has invested in local housing projects which generate income at a below market rate, e.g., Affordable Housing, for which the gross capital costs (i.e. not including capital grants and receipts received to finance the spend) on the construction and development have been included in this calculation.

Annex A – Annual Minimum Revenue Provision (MRP) Statement

MRP Summary

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). The council is required by statute to charge an amount of MRP to the General Fund Revenue account each year for the repayment of debt. The MRP charge is how capital expenditure which has been funded by borrowing is paid for by council taxpayers. Legislation requires local authorities to draw up a statement of their policy on the annual MRP, for full approval by Council before the start of the financial year to which the provision will relate.

The statutory guidance [1] on MRP outlines 4 ready-made options for calculating prudent provision:

- Option 1 – Regulatory Method
- Option 2 – CFR Method
- Option 3 – Asset Life method a and b
    - Option 3a –*Straight Line*
    - Option 3b –*Annuity*
- Option 4 – Depreciation Method

Options 1 and 2 can only be used for capital expenditure incurred prior to 1 April 2008 (supported capital expenditure). These options are therefore unavailable to the council as it has no supported capital balances within its Capital Financing Requirement (CFR).

MRP Statement

The Council is recommended to approve the following statement:

- For unsupported capital expenditure incurred on fixed assets after 31st March 2008 and not acquired under a finance leasing arrangement, MRP will be determined using **option 3b (Annuity method)** of the statutory guidance on MRP starting in the *year after* the asset becomes operational.

- MRP on the acquisition of share capital in a subsidiary company will also be calculated using **option 3b** of the statutory guidance.

- For capital expenditure incurred in the advancing of loans to third parties that are delivering service objectives on behalf of the Council, such as subsidiary companies, MRP will be charged at an amount equal to any expected credit losses on the loans recognised in the financial year in accordance with IFRS 9. For service loans with historical credit losses incurred in prior financial years, the council will make a one-off MRP charge in the current financial year to ensure prudent provision is made for the IFRS 9 accounting losses.

- Repayments of loan principal on capital loans will be treated as capital receipts and applied to the capital adjustment account to clear any unfinanced capital spend and reduce the council's capital financing requirement.

- Capital expenditure incurred on acquiring assets under finance leases will have an MRP charge made equal to the capital rent payment made to reduce the lease liability in year.

- Capital expenditure incurred in 2024/25 will not be subject to an MRP charge until 2025/26 at the earliest.

For **option 3b,** under statutory guidance:

- "*MRP is the principal element for the year of the annuity required to repay over the asset's useful life the amount of capital expenditure financed by borrowing or credit arrangements, using an appropriate rate of interest."* In simpler terms, this is equivalent to the MRP charge matching the capital repayment profile of a mortgage or a finance lease arrangement, with payments taking place over the life of the asset and using an appropriate rate of interest to determine the annual amount.

- Adjustments to the calculation to take account of repayment by other methods during repayment period (e.g., by the application of capital receipts) will be made as necessary.

As external debt balances cannot be directly linked to specific capital expenditure (external debt is a Treasury Management function) the Council has determined an *appropriate* interest rate to be the Public Works Loans Board (PWLB) rate available for an annuity-based loan, with a repayment lifetime that matches the estimated useful life of the underlying asset. The PWLB rate used is taken from on the PWLB website [2] and will be the rate available on the first working day of the financial year in which the expenditure is incurred.

Indicative annuity rates used in the Council's MRP calculation are shown below which are then further reduced by 0.2% for use in the MRP calculation, in accordance with the borrowing discount available to Local Authorities:

PWLB Borrowing Rates		Loan Term/Asset Life				
Publication Date/Time	***Year***	***10***	***20***	***30***	***40***	***50***
03/04/2023 09:15:48	2023/24	4.49%	4.60%	4.86%	4.89%	4.82%
01/04/2022 12:19:13	2022/23	2.50%	2.69%	2.85%	2.86%	2.80%
01/04/2021 09:08:50	2021/22	1.43%	1.97%	2.28%	2.41%	2.42%
01/04/2020 12:28:08	2020/21	2.13%	2.32%	2.60%	2.76%	2.77%
01/04/2019 12:13:33	2019/20	1.74%	2.09%	2.44%	2.60%	2.59%
03/04/2018 12:15:35	2018/19	2.07%	2.46%	2.67%	2.75%	2.72%
03/04/2017 12:15:31	2017/18	1.49%	2.18%	2.62%	2.80%	2.78%
01/04/2016 12:15:18	2016/17	1.86%	2.59%	3.08%	3.31%	3.32%
01/04/2015 12:15:49	2015/16	2.13%	2.72%	3.08%	3.29%	3.34%
01/04/2014 12:15:51	2014/15	2.96%	3.95%	4.34%	4.47%	4.50%

Change of MRP Approach

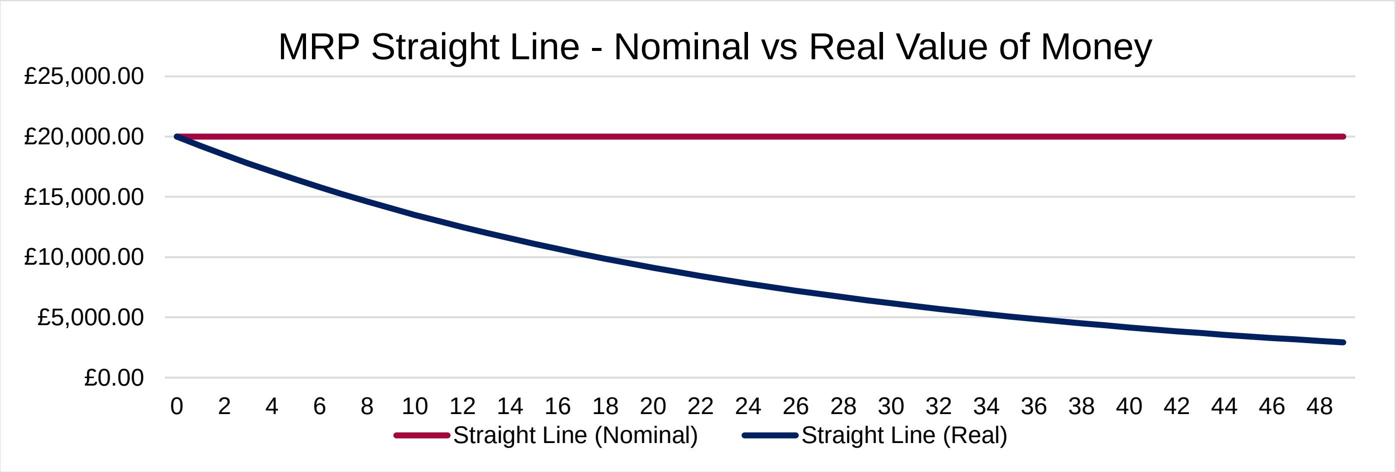
Adopting **option 3b** for fixed asset and share capital expenditure represents a change of approach for the council, having previously adopted a straight-line MRP approach in prior years (option 3a). Under the statutory guidance, where a local authority changes the method(s) that it uses to calculate MRP, it should explain in its Statement, why the change will better allow it to make prudent provision.

The change to annuity based MRP improves the council's ability to make prudent provision as it helps to distribute MRP more fairly when factoring that the value of money decreases with time due to its earning potential. The current adoption of a straight-line approach means that the real value that future revenue budgets are expected to provide for MRP can be significantly less than the current budget, whilst the assets are delivering the same benefits. The divergence in the real vs nominal value of money therefore creates a divergence in the suitability of a straight-line vs annuity-based approach to MRP, particularly over the medium to long-term. With interest rates and inflation presently much higher than when the Council began to generate a CFR (incurring capital spend without capital receipts available to finance the spend), this factor is becoming more prevalent and therefore should be considered in making prudent provision.

Much of the capital the council has outlaid which has increased its CFR has been in the purchase and enhancement of long-term assets that will have an expected lifetime of 50 years or more for the district. These assets include Castle Quay Shopping Centre, Castle Quay Waterfront development and investments in subsidiary companies, such as Graven Hill, that are set to provide long-term economic and innovative housing benefits. Factoring the time value of money into the MRP calculation helps to distribute the cost more fairly to the revenue budget over the lifetimes of the underlying assets resulting from the investments. This ensures that the current revenue budget is not unfairly burdened with costs associated with assets delivering long-term strategic objectives of the council or where economic benefits are expected to be maintained or increase over the life of the assets, benefitting the future as well as the current taxpayer.

For example, if the council spends £1m on purchasing a building with a 50-year useful life, under the straight-line approach, the council will charge £20,000 annually in MRP. However, where interest rates are expected to remain around 4% on average over that period (as an illustration), the real value of the MRP decreases across the life of the asset, meaning that future revenue budgets pay proportionally less in MRP compared to the current budget. This is depicted in the figure below:

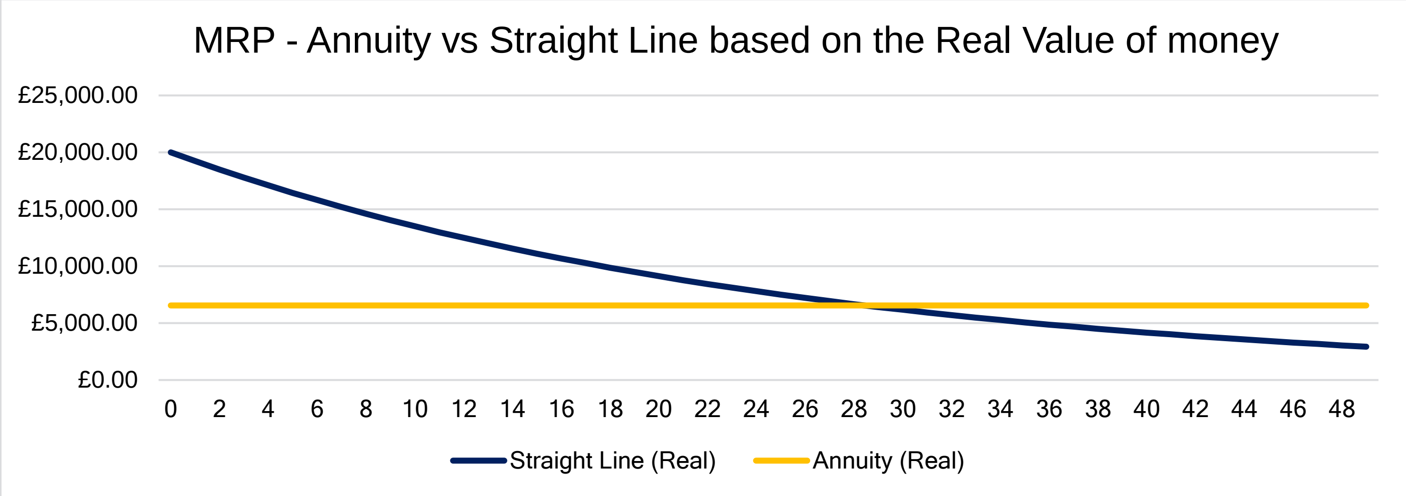
Figure M1: MRP Straight Line comparison between the real and nominal value of money



The time value of money means that an MRP charge of £20,000 in fifty years would be around £3,000 in today’s terms. The annuity method seeks to combat this effect by ensuring an even spread of MRP with the time value of money factored in. Whilst the nominal value increases with time, the real value of the MRP will remain proportionate to the value of money at the time the charge is made, essentially making the MRP charge constant in real terms.

Below is a profile of MRP on an annuity basis for the same scenario, demonstrating that using the annuity method factoring the time value of money, results in a straight-line MRP charge in real terms:

Figure M2: Annuity vs Straight Line MRP based on the real value of money



Conclusions

By adopting an annuity based MRP approach for fixed asset and share capital expenditure service benefits, the council will:

- Factor in the time value of money into its MRP calculation;
- More fairly distribute MRP across the underlying lifetime of the assets invested in, and;
- Better allow a prudent MRP charge to revenue to be made.

Future MRP Considerations

The council recognises that the interest rates and inflation determine the time value of money and are likely to fluctuate over the lifetime of MRP for long-term assets. As such, the council will review the suitability of the annuity based method annually to ensure it remains appropriate. If interest rates decrease significantly, the current annuity model may no longer be the most appropriate methodology.

[1] – Statutory Guidance on Minimum Revenue Provision
https://assets.publishing.service.gov.uk/media/5a7451d9ed915d0e8bf188f4/Statutory_guidance_on_minimum_revenue_provision.pdf

[2] – PWLB Lending Facility Rates
https://www.dmo.gov.uk/responsibilities/local-authority-lending/historical-interest-rates/