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Portsmouth
CITY COUNCIL

SUPPLEMENTARY AGENDA

CABINET

TUESDAY, 5 MARCH 2024 AT 2.00 PM

COUNCIL CHAMBER - THE GUILDHALL, PORTSMOUTH

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If any member of the public wishing to attend the meeting has access requirements, please notify the contact named above.

Membership

Councillor Steve Pitt (Chair)
Councillor Suzy Horton (Vice-Chair)

Councillor Dave Ashmore
Councillor Kimberly Barrett
Councillor Ian Holder
Councillor Lee Hunt
Councillor Hugh Mason
Councillor Darren Sanders
Councillor Gerald Vernon-Jackson CBE
Councillor Matthew Winnington

(NB This supplementary agenda should be retained for future reference with the main agenda and minutes of this meeting).

SUPPLEMENTARY AGENDA

15 Capital Strategy 2024/25 to 2033/34 (Pages 3 - 34)

The enclosed report originally marked on the agenda "to follow" was published on 27 February 2024.

Purpose
1. Enable the City Council to adopt a long term Capital Strategy from 2024/25 onwards
2. Inform members and the wider community of the Council's Capital Strategy
3. Ensure that Members are aware of the overall strategy, governance procedures and risk appetite
4. Highlight the inter-relationship between business planning the Capital Strategy, Capital Programme, the Revenue budget, the Medium Term

Financial Strategy and Treasury Management

5. Ensure the council has sufficient liquidity to meet the cashflow arising from the capital programme.

Recommendation

That the Cabinet recommends that Full Council:

1.That Part I of the Capital Strategy (Capital Expenditure and Aspirations) be approved including:

a) The aspirations set out in section 6.

2.That Part II of the Capital Strategy (Borrowing and Investing) be approved including:

a) The Minimum Revenue Provision (MRP) for Debt Repayment Policy (Part II, (paragraphs 3.5 to 3.7)

b) The investment indicators in Part II - Appendix 1 (Part II, paragraphs 4.15 to 4.21)

c) That the Director of Finance and Resources (Section 151 Officer) will bring a report to the next Cabinet and City Council if (Part II, paragraph 4.11):

(i) The Council's gross General Fund (GF) debt exceeds 400% of GF net service expenditure or

(ii) Overall investment income and long term treasury management investments exceeds 14% of GF net service expenditure.

Portsmouth
CITY COUNCIL

Title of meeting:	Cabinet City Council
Date of meeting:	Tuesday 05 March 2024 (Cabinet) Tuesday 19 March 2024 (City Council)
Subject:	Capital Strategy 2024/25 - 2033/34
Report by:	Chris Ward, Director of Finance and Resources (Section 151 Officer)
Wards affected:	All
Key decision:	Yes
Full Council decision:	Yes

1. Executive Summary

1.1. The Capital Strategy sets out the overarching capital aspirations and how both capital expenditure and investment decisions are made, whilst taking into consideration risks and rewards. There are 2 parts to the Capital Strategy.

Part I - Capital Strategy

1.2. The Chartered Institute of Public Finance and Accountancy (CIPFA) describes the capital strategy as "the long-term strategy for investment in assets and for obtaining the resources required for that investment". When Members approve a capital scheme, it is at that point in time that a decision is made how to finance the scheme. If the scheme generates either sufficient income or savings, it can be financed from borrowing so long as either the income or savings can be predicted with a high degree of certainty to adequately service the debt.

1.3. At the time of scheme approval, the Council may choose to fund capital expenditure financed by borrowing from its surplus cash in the short-term, thereby delaying the need to borrow and using existing cash flow funds in lieu of borrowing instead. Prior to a scheme funded by borrowing being approved, a full business case and financial appraisal is prepared that can satisfactorily demonstrate with good certainty that cost savings / additional income or value uplift of the development, which will accrue directly to the Council, will at least cover the cost of that borrowing on a sustained basis over the lifetime of the borrowing undertaken.

1.4. Whether to take long term borrowing or use surplus cash in the short-term and delay a decision to take longer term borrowing forms part of the Treasury Management Policy and is not considered here.

Part II - Borrowing and Investing

1.5. Part II considers the implications of the Council's future capital expenditure plans on borrowing and investing.

Making Provision for the Repayment of Debt

1.6. Repayment of borrowing must be provided for upon completion of General Fund schemes financed by borrowing, it is the Council's policy to provide for the repayment of the debt over the asset's useful economic life not exceeding 50 years. This is known as the **Minimum Revenue Provision (MRP)** and is based on an annuity method of calculation. This methodology results in a lower MRP for new assets in the early years presenting the council with the opportunity to build income streams and build savings over this period. However, MRP will increase year on year, but not necessarily in real terms after inflation is taken into account.

Timing of Borrowing

1.7. When the Council has surplus cash, instead of investing that surplus cash through the Treasury Management Policy, it can use it in the short term as a source of finance for capital expenditure. The resulting loss of interest earnt on investments can be more cost effective than borrowing the required funds straight away. However, this only delays the need for external borrowing rather than avoiding the need to borrow completely.

Investments in Property

1.8. According to the CIPFA Treasury Management Code, **Investment in Commercial Properties Acquired through the Capital Programme** are regarded as investments.

- However, the Government issued revised statutory guidance on local government investments early in 2018 coming into effect from 01 April 2018, requiring Councils to not borrow purely for financial gain either within, or outside its area. Prior to this guidance coming into effect, the Council had acquired commercial properties outside the Portsmouth economic area that were acquired solely to generate income to support the services that the Council provides. There are no further commercial property acquisitions outside the Portsmouth economic area included within the Capital Programme.

1.9. To ensure that the Council does not become over reliant on Investment income, several indicators are calculated in accordance with government guidance. These are included in the Appendix of Part II.

Skills and Knowledge of Staff

1.10. Treasury Management and Capital accounting requirements are complex and heavily regulated. Consequently, professionally qualified staff are provided with adequate training so that they have sufficient **skills and knowledge**, assisted by Link Asset Services, to undertake the treasury management function in house.

Treasury Management Reporting

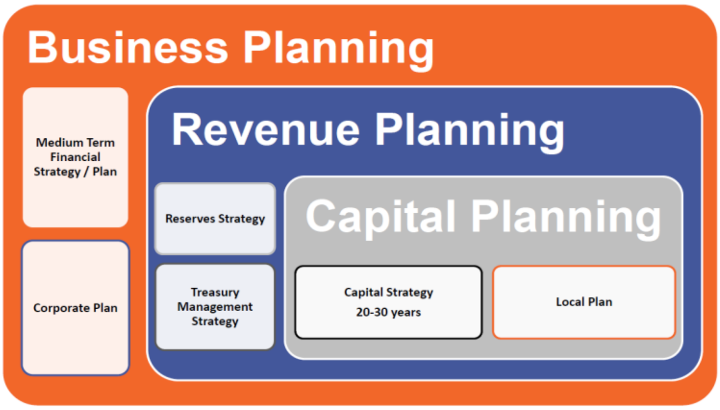
1.11. The Council's strategy for borrowing and investing surplus cash is contained within the Treasury Management Policy included elsewhere on this agenda. All **Treasury Management Policies** are considered by the Cabinet and approved by the City Council on an annual basis. All reports on treasury management including monitoring reports are scrutinised by the Governance and Audit and Standards Committee.

2. Purpose of report

2.1. The purpose of this report is to:

- Enable the City Council to adopt a long term Capital Strategy from 2024/25 onwards
- Inform members and the wider community of the Council's Capital Strategy
- Ensure that Members are aware of the overall strategy, governance procedures and risk appetite
- Highlight the inter-relationship between business planning the Capital Strategy, Capital Programme, the Revenue budget, the Medium Term Financial Strategy and Treasury Management

Simple Business Planning Model



Link Asset

- Ensure the council has sufficient liquidity to meet the cashflow arising from the capital programme.

3. Recommendations

<u>**Recommendation**</u>

That the Cabinet recommends that Full Council:

3.1. That Part I of the Capital Strategy (Capital Expenditure and Aspirations) be approved including:

a) The aspirations set out in section 6.

3.2. That Part II of the Capital Strategy (Borrowing and Investing) be approved including:

a) The Minimum Revenue Provision (MRP) for Debt Repayment Policy (Part II, (paragraphs 3.5 to 3.7)

b) The investment indicators in Part II - Appendix 1 (Part II, paragraphs 4.15 to 4.21)

c) That the Director of Finance and Resources (Section 151 Officer) will bring a report to the next Cabinet and City Council if (Part II, paragraph 4.11):

   (i) The Council's gross General Fund (GF) debt exceeds 400% of GF net service expenditure or

   (ii) Overall investment income and long term treasury management investments exceeds 14% of GF net service expenditure.

4. Background

4.1. The Capital Strategy establishes the approach to both capital expenditure and investment decisions.

4.2. This report outlines the Council's Capital Strategy and aspirations for the next 10 years, starting from 2024/25. The Capital Strategy is dynamic and will be updated annually as capital investment plans mature. The Capital Programme and "new starts" (including the Housing Investment Capital Programme) is approved each year by Full Council, in accordance with the Capital Strategy.

4.3. The Capital Strategy fulfils the requirements of the revised Prudential Code for Capital Finance in Local Authorities 2021.

5. Reasons for recommendations

5.1. Adopting a Capital Strategy will enable a longer term view to be taken of capital expenditure, borrowing and investment. The Capital Strategy is also intended to facilitate integration between the Council's aspirations, its Capital Programme and its Treasury Management Strategy.

6. Integrated Impact Assessment

6.1. This Capital Strategy identifies capital schemes that may be included in future capital programmes. Sums are not earmarked for capital schemes until they are included in the capital programme. Prior to the commencement of any capital scheme, a report and financial appraisal on that scheme will be approved either by the Portfolio Holder, the Cabinet or the City Council and at that time, an Integrated Impact Assessment will be undertaken.

7. Legal Implications

7.1. The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2011 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

8. Director of Finance's comments

8.1. All financial considerations are contained within the body of the report and the attached appendix.

………………………………………………
Signed by: Director of Finance and Resources (Section 151 Officer)

Appendices:

Part I Capital Strategy

Part II Borrowing and Investment including Investment Indicators
Sub Appendices:
Appendix 1 Investment Indicators

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

Title of document	Location
1 Information pertaining to the Capital Strategy	Financial Services

The recommendation(s) set out above were approved/ approved as amended/ deferred/ rejected by ……………………………… on ………………………………

………………………………………………
Signed by:

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Portsmouth
CITY COUNCIL

CAPITAL STRATEGY
2024/25 - 2033/34

PART I

PART I Capital Expenditure and Aspirations

CONTENTS

1. Definition, Purpose & Scope

Definition

1.1. Capital expenditure is the expenditure that is incurred primarily on buying, constructing or improving physical assets, such as:

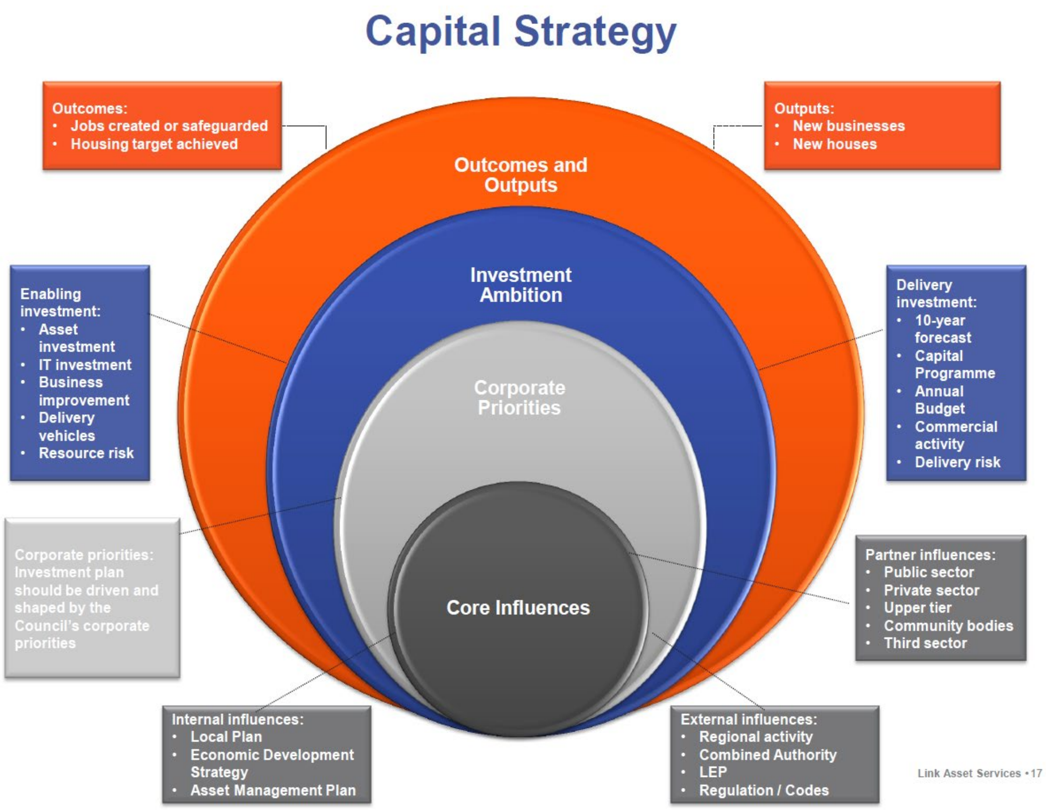
- Buildings (including schools, houses, libraries and museums)
- Land for development, roads, playing fields; and
- Vehicles, plant and machinery (including street lighting and road signs).

Capital expenditure also includes grants and advances made to the public or private sector for capital purposes, such as advances to Registered Social Landlords to provide adaptions to houses that meet the needs of vulnerable people.

1.2. The Capital Strategy is a high-level plan that sets out the Council's approach to Capital expenditure over the short, medium and long term.

1.3. The Capital Strategy takes both a "bottom up" and "top down" approach to the identification of the Council's Capital expenditure requirements. It takes a 10-year time horizon and considers:

- What are the short-term **needs** of the existing capital assets of the City Council, which of them will be required for future service delivery and what capital expenditure will be needed to sustain them both now and in the future ("Bottom Up" approach)
- What are the Council's medium-term **priorities** for service delivery and what capital expenditure will be needed to help deliver those priorities ("Top Down" and "Bottom Up" approach)
- What are the Council's long-term **aspirations** for the City of Portsmouth and what capital expenditure will be needed to deliver those aspirations ("Top Down" approach)



Purpose

1.4. The purpose of the Capital Strategy is to set out a plan and a supporting financial framework to assist in the delivery of the Council's needs, priorities and aspirations. That plan describes what will be achieved, by when with key milestones and how it could be funded.

1.5. The Capital Strategy is intended to be a robust vehicle with sufficient guiding principles to achieve the Council's stated vision and priorities but flexible enough to be able to respond to the emerging local priorities that will inevitably arise.

1.6. The Capital Strategy is not intended to be static; it is a dynamic plan that will change and evolve continually over time. The Capital Strategy needs to be flexible to respond to emerging national and local priorities. In particular, the nature of the Central Government Capital Financing system is such that many national priorities for Capital expenditure will be cascaded and "drip fed" to Local Authorities over time and will be accompanied by the external funding to support them. These will be incorporated into the Council's Capital expenditure Plans as they arise. The Strategy will, however, be robust and will include local priorities and aspirations that the Council aims to fund from the Council's own capital resources.

1.7. Following the December 2021 publication of the CIPFA Prudential Code for Capital Finance in Local Authorities', there is a requirement for Full Council to approve an annual Capital Strategy linking with the Council's asset management plans and its Treasury Management Strategy. Being aligned with one another, they will generate and create value for the Council by optimising the Council's liquidity; having a framework in place to prioritise capital expenditure and safeguarding against risk of either project overspend or non-delivery and by limiting the uncertainty of its returns.

Scope

1.8. The City Council's Capital Strategy encompasses all areas of the Council's activities including some of the traditionally more autonomous service areas such as Housing Revenue Account and the Commercial Port.

1.9. The body that approves the budget for PCC is the Full Council. The responsibility for decision-making and ongoing monitoring in respect of capital expenditure, investment and borrowing, including prudential indicators, remains with the Full Council.

1.10. New Capital Expenditure will be targeted towards those schemes that meet the Council's statutory responsibilities and that are most likely to drive cost reduction for the Council, innovation and clean economic growth and productivity for the City.

1.11. Based on the 2023 Budget Consultation with residents, the top 3 priorities at present are, in order of popularity:

i. Ensure people have access to the health and care services they need
ii. Making sure people feel safe and supported in their homes and communities
iii. Regenerate major sites to create homes, jobs and economic opportunities in the city.

1.12. Additionally, for future investment of the Council's capital budget, the most popular project areas selected by respondents are, in order of popularity:

i. Building new homes in the city, including flats offering special care for elderly residents
ii. Invest in greening projects across the city
iii. Creating better facilities for sustainable transport such as cycling and walking
iv. Build more classrooms and specialist provision for children with additional needs
v. Invest in facilities as part of the new sea defences
vi. Investing in new sport and leisure facilities and maintaining existing ones
vii. Improving facilities at Portsmouth International Port to increase the money it generates to help protect local services
viii. Buying or developing new technology to help the council work more efficiently.

2. Strategic Fit

2.1. The Medium-Term Financial Strategy (MTFS) and the Capital Strategy (CS) set out the Revenue Spending plans and the Capital expenditure plans respectively that deliver the longer-term aspirational Vision for Portsmouth and the medium term Priorities for the City Council. Both strategies set out the financial frameworks that exist to support the achievement of the vision and priorities.

2.2. Whilst there is a technical distinction between Revenue and Capital, the focus of attention for the Council is not whether it is Capital or Revenue, but whether the desired outcome is achieved. In this respect, the strategy for capital expenditure is of equal importance to the strategy for revenue spending.

2.3. Whilst the MTFS and CS are designed to support the delivery of the day-to-day revenue and ongoing capital expenditure needs, priorities and aspirations of the Council, those needs, priorities and aspirations are also constrained by the revenue and capital resources available. These strategies therefore introduce criteria-based processes to assist the Council in making informed spending decisions that will optimise the outcomes from the resources available.

2.4. The MTFS and CS are driven by the Corporate Plan both directly in terms of medium to longer term priorities and ambitions of the Council and via Service Business Plans and the Council's asset management plans in terms of the short and medium term needs and priorities of the Council.

2.5. Service Business Plans and asset management plans are the more immediate “needs analysis” and “bottom up” drivers that feed the MTFS and Capital Strategy. Service Business Plans set out all spending plans of the service to deliver priority outcomes. Service Business Plans also feed into asset management plans which seeks to align the Council's asset base with our corporate plans and objectives. Asset management plans identify current and future needs and priorities of services and seeks to provide a series of actions to ensure the Council has the right assets, in the right condition and in the right location.

2.6. A core feature of this Capital Strategy is to assist in the delivery of the Corporate Plan. There is a presumption that Capital expenditure will be targeted towards income generation and economic growth whilst ensuring the Council's statutory obligations are also met. The emphasis is therefore on cost reduction, innovation and clean economic growth and productivity for the City.

3. Key Capital Expenditure Principles

3.1 In order to determine which current, or future assets, should be either maintained or invested in, the following principles will be adopted when consideration is given to capital expenditure decisions:

3.2 **Principle 1 – Contribution to Council Plan / Priorities**

For the Council’s non-commercial activities, Capital expenditure will be made where there is a clear and demonstrable contribution to the priorities and aspirations contained within the Corporate Plan.

For the Council’s commercial activities (such as the Port and Investment Property Portfolio), Capital expenditure will be based on the commercial principles of achieving security of the investment with a specified rate of return and payback through surpluses over a reasonable timeframe.

Principle 2 - Statutory Obligations

There must be clarity about the details of immediate obligations and the extent to which the current statutory obligation is being met.

Principle 3 – Financial Appraisal

The City Council will only embark on new capital expenditure where that capital expenditure is fully funded and the source of funding in terms of both timing and value can be relied upon with a high degree of confidence. The timing and accessibility of funds to PCC must be considered.

Prior to any Capital expenditure decision being made, the whole life cost of the proposal will be estimated, and the Council will satisfy itself that those costs can be accommodated with the council's overall budget. Capital Expenditure must also take into consideration the impact on both existing revenue and capital budgets and future forecasts. This will include both the maintenance and any lifecycle replacement of components required over the estimated useful life of the asset.

Principle 4 – Option Appraisal

Any new capital expenditure decision is to follow a full and proper options appraisal that considers the following for each reasonable alternative:

- Suitability – the extent to which each option contributes to the needs, priorities and aspirations of the Council as defined within asset management plans and Corporate Plan
- Feasibility – the capital cost and whole lifecycle cost plus the practical ease of implementing the scheme
- Acceptability – the extent to which the scheme is acceptable to Members of the City Council and the residents of Portsmouth.

Principle 5 - Risk

The Capital expenditure should neither place the Council in a position where the risks associated with the Capital expenditure exceed the benefits of undertaking that investment, nor should the Council enter any Capital expenditure where the risks associated with that investment cannot be managed effectively. Such risks may include (but will not be exclusive to) having insufficient resources generally or project management resources to be able to effectively deliver a capital scheme.

Principle 6 – Approved Schemes in Progress (overspends)

The first concern before any new Capital Expenditure is considered, is to ensure that the existing approved capital programme is fully and properly funded. Except in exceptional circumstances, the first call on available capital resources will be to fund any overspendings on approved schemes which are contractually committed. An approved scheme that is in progress will only be cancelled when the Value for Money of that scheme becomes unviable. (i.e. the additional costs and risks outweigh the potential future benefits).

4. Capital Resources

4.1 The financial framework governing the allocation of Capital Resources offers Members greater choice and transparency with the overall aim of delivering better outcomes from the resources available. It seeks to strike the correct balance of allocating capital resources between short and medium term needs and priorities and longer-term aspirations, to support the delivery of the long-term Capital Strategy.

4.2 Allocation of corporate capital resources (i.e. non passported sources of finance) available to the City Council for new capital schemes comprise the following:

- Contributions to the “Corporate Pool” of all non-ring-fenced capital grants from Government, commonly referred to as the “Single Capital Pot” allocations
- The anticipated balance on the Revenue Reserve for Capital
- Changes to the existing Capital Programme - additions or deductions for any changes in the costs or funding requirements associated with the existing capital programme
- Any allowances for Prudential Borrowing
- Other Corporate Capital Grants & Contributions e.g. Community Infrastructure Levy
- Any Revenue Contributions to Capital
- The forecast value of additional capital receipts taking into account:
    - New assets declared surplus to requirements
    - Any increase or decrease in the estimated value of existing assets to be disposed of
    - Any requirements to provide for affordable housing, parking or any other conditions which could have a significant impact on the disposal value and other costs associated with disposal.

4.3 Unless there is a compelling case in the wider public interest, any capital receipts received from assets previously appropriated between the General Fund and the Housing Revenue Account be used in any way to relieve the Council (HRA or General Fund) of its associated ongoing debt burden. Such uses will include:

- A voluntary contribution to the repayment of debt (i.e. Voluntary Minimum Revenue Provision)
- The funding of (or contribution to) a capital scheme that will generate long term income streams that exceed the ongoing debt burden
- The funding of a capital scheme that will reduce expenditure or avoid costs at a level that exceeds the ongoing debt burden
- Any combination of the above.

5. Short & Medium Term Capital Expenditure Needs & Priorities

5.1 The short and medium term Capital expenditure needs of the Council will be driven by the Corporate Plan and be identified in Service Business Plans and asset management plans.

5.2 The Corporate Plan, Service Asset Management Plans and Service Business Plans is both a “bottom up approach” (i.e. needs led - drawing upon changing demographics, changing demand and changing expectations of residents) as well as a “top down” approach (i.e. priority led - based on the future direction of the Council set out in the Corporate Plan).

5.3 Asset management plans will identify:

- The assets needed to deliver current and future services
- The condition and sufficiency of those assets
- The capital expenditure required to maintain and / or adapt those assets to ensure that they are “fit for purpose”
- Unsuitable and surplus assets that are not required for the delivery of the Council’s services and could either be:
    - Re-used for another purpose
    - Re-developed or “mothballed” for future re-development
    - Transferred for Community or other Public Use
    - Disposed of via sale.

5.4 The City Council has a wide range of service responsibilities, both statutory and non-statutory. In determining the needs and priorities for new Capital expenditure, a balanced approach will be taken to ensure that the needs and priorities of all service areas are considered including taking into account, the capital intensive nature of some services.

5.5 The Capital Strategy is dynamic and whilst the priorities and aspirations of the Council will remain broadly constant, the Capital expenditure to achieve those priorities may change. The Capital expenditure plans of the Council will be updated continuously and added to the Council’s Capital Programme following the proper approvals in accordance with the Council’s Constitution and Financial Rules. The Capital Planning process is described as part of the Financial Framework supporting the Delivery of the Capital Strategy in Section 7.

6. Long Term Capital Expenditure Aspirations

6.1 In accordance with the Council's Capital Strategy and Medium Term Financial Strategy, in developing capital investment plans for 2024-25, (which were approved by Full Council on 13 February 2024) the Cabinet prioritised those schemes that:

1) Provide for statutory requirements including School Places, Transport Safety, Homelessness and necessary Health and Safety obligations
2) Ensure that the Council's services to residents continue to operate from safe "fit for purpose" buildings
3) Support the renewal of the Council's aging Leisure Estate and end of life sports and play facilities across the City
4) Continue the Council's environmental agenda, including the downsizing of the Civic Offices and further greening initiatives
5) Continue with the Council's key regeneration opportunity for the City Centre North, aiming to stimulate housing and employment in the Council's most deprived area.

6.2 As described earlier in this report the key responses arising from the Budget Consultation for the future investment of the Council's Capital Programme selected by respondents are, in order of popularity:

- Building new homes in the city, including flats offering special care for elderly residents (49%)
- Invest in greening projects across the city (37%)
- Create better facilities for sustainable transport such as cycling and walking (37%)
- Build more classrooms and specialist provisions for children with additional needs (37%).

6.3 The longer term aspirations that the Council has for the City are ambitious and rely on the Council applying the resources at its disposal in ways which deliver the greatest impact. Known obligations and aspirations, in line with the Medium Term Financial Strategy, for future capital investment once further capital resources become available include:

Statutory Obligations:

- Additional extensions / additions to schools in respect of pupils with complex educational needs in order to provide for additional school places
- Provision of additional disabled facilities grants
- Requirements to improve road safety, disabled access and air quality
- Landlords Repairs & Maintenance.

Improving the City Economy:

- Further development of key employment, housing and regeneration sites
- Anti-Poverty projects
- Coastal protection schemes to protect homes and businesses
- Improvements to road transport infrastructure as a means of supporting new business growth and productivity generally as well as the protection of the tourism economy.

Enhancing the Environment:

- Greening the City
- Creating space and access.

Public Service Transformation:

- Developing the Digital Council
- Use of technology to provide greater personal independence for those with care needs.

6.4 Accordingly, the Cabinet has identified some further specific priority and aspirational capital schemes to be pursued as further capital funding becomes available:

- Investing in a rolling programme of investment into council assets subject to the outcome of the Asset Management Strategy
- Enabling works and land assembly associated with the City Centre North scheme
- The Civic Offices regeneration / replacement scheme
- Greening and environmental improvement schemes
- Investing in replacing play park equipment across the City based on the strategy prepared by the Parks team
- Investing in refurbishing outside sports courts based on the strategy prepared by the Parks team
- Investing into schemes delayed due to inflationary pressures and higher than anticipated interest rates
- Completing the East-West cycle corridor
- Delivering future stages of the Eastern Road cycle lane scheme
- Enhancing the Southsea Sea Defences.

6.5 It is recommended that the City Council endorses the short to medium and long-term aspirations of the Capital Strategy, as set out above.

7. Summary

7.1 This strategy sets out the key capital expenditure priorities over the short, medium and longer term.

7.2 Whilst the capital resources available are currently insufficient to meet all the capital expenditure Priorities of the Council, the financial framework set out in this strategy will provide the best opportunity for maximising resources and the best opportunity for applying those resources to that Capital expenditure which will make the greatest contribution to the Council's needs, priorities and aspirations.

7.3 Inevitably plans to achieve the Council’s objectives over the short, medium and long term will change as will the capital resources available. This strategy has been designed to be flexible enough to accommodate any such changes whilst being robust enough to enable the Council’s core objectives to be achieved.

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Portsmouth
CITY COUNCIL

CAPITAL STRATEGY 2024/25- 2033/34

PART II

PART II Borrowing and Investing

CONTENTS

1. Definition

1.1 A key activity is to know when and how much to borrow when the Council requires more cash and investing when the Council has surplus cash. In this way, it manages the Council's cashflows. This activity is known as Treasury Management.

2. Net Debt

2.1 Borrowings increase when capital schemes are financed from borrowing and decrease when debt is repaid.

2.2 The Council's reserves and working capital are invested until the money is required to finance expenditure. The Council's forecast net debt, i.e. its borrowings less its investments are summarised in the table below. This forecast is based on the Council using its reserves to finance capital expenditure in the medium term, rather than undertaking new external borrowing for as long as possible. This is beneficial to the Council's revenue budget as the interest on borrowings normally exceeds the return on the Council's investments. However, this position cannot be maintained in the long term with the Council's net debt increasing year on year. It is expected that the Council will have to undertake further external borrowing in 2025/26 or alternatively sell its Investment Properties.

	2023/24	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**
	£m	£m	£m	£m	£m	£m
Borrowings	734	721	751	812	796	780
Less Investments	(244)	(145)	(71)	(86)	(103)	(122)
Net Debt	**490**	**576**	**680**	**726**	**693**	**658**

3. Borrowing

3.1 In the past, the principal source of borrowing has been the Public Works Loan Board, (PWLB) which is operated by HM Treasury. The PWLB can still be used to replace existing debt or to reschedule debt. However, a recent change in the PWLB's lending terms requires Local Authorities to confirm that they do not plan to purchase investment assets primarily for yield or use incidental income from the development of commercial properties for regeneration purposes to fund wider services.

3.2 There are alternative types of borrowing available including:

- Local Authority
- Market Forward Borrowing (for transactions greater than £30m)
- Bond Issue (for transactions greater than £100m)
- UK Municipal Bond Agency (UKMBA)
- UK Infrastructure Bank (UKIB) specially for infrastructure investments such as Transport, waste etc

- Other such as leasing or local bonds

3.3 This Capital Strategy identifies capital aspirations that may be included in future capital programmes. Prudential Borrowing is only available for a Council's "Primary Purpose for Investment", this means that it must be directly and primarily related to the functions of the authority. Also any Prudential Borrowing must meet the "Invest to Save" criteria where those savings accrue directly to the Council on a sustained basis and meet the Prudential Code's tests of affordability, sustainability, and prudence over the lifetime of the borrowing undertaken. Prior to any borrowing, a full business case and financial appraisal is prepared that can satisfactorily demonstrate that borrowing is affordable by the services existing cash limits and must satisfy the S151 Officer.

3.4 Outstanding long-term debt is reviewed regularly with a view to early redemption and rescheduling; although premiums would be payable to the lender and consequently early redemption and rescheduling are rarely financially beneficial to the Council.

Affordability of Borrowing

3.5 To ensure future budgets remain affordable, the Council needs to be aware that capital expenditure financed from Prudential Borrowing incurs both **interest costs** and a **Minimum Revenue Provision (MRP)** for the repayment of debt. The MRP is a revenue charge within the budget which reduces the Capital Financing requirement over time.

3.6 The Council has a policy of calculating MRP on an annuity basis. This means that MRP will start at a relatively low level but require increasing amounts of MRP to be set aside year on year, especially for assets with long useful economic lives. This creates a period of low MRP during the early years as income builds, or savings start to accrue. The distribution of MRP over the life of a capital scheme is determined by the prevailing interest rate. The lower the interest rate, the higher the MRP is in the early years.

3.7 It is estimated that MRP will amount to £9.9m in 2024/25. The inclusion of further schemes in the capital programme financed by Prudential Borrowing will further increase the MRP.

Key Risks

3.8 There are risks with borrowing more than the Council can afford. To mitigate these risks, the Chartered Institute of Public Finance and Accountancy (CIPFA) has produced the Prudential Code for Capital Finance in Local Authorities, which is a statutory code governing local authority borrowing. The Prudential Code requires the Council to establish various indicators over a minimum of 3 years to demonstrate that its capital programme is both affordable and prudent. The Council publishes its Prudential Indicators, over a 5-year period, within its capital programme and the Council then reports its position against the prudential indicators at the end of each financial year.

3.9 To ensure that the borrowing required to finance the capital programme is affordable, the Council:

- Estimates the ratio of its financing costs to its net revenue stream
- Estimates the ratio of net income from commercial and service investments to its net revenue stream.

3.10 To ensure that the Council's capital programme is prudent, the Council:

- Publishes a capital programme which includes estimates of its underlying need to borrow as measured by its Capital Financing Requirement
- Is required to approve an Authorised Limit for external debt and an Operational Boundary when it approves its capital programme.

3.11 The **Authorised Limit** for external debt, as set by the City Council, is the maximum amount of debt which the authority may legally have outstanding at any time. The authorised limit includes headroom to enable the Council to undertake borrowing to take advantage of unexpected movements in interest rates and to accommodate any short-term debt or unusual cash movements that could arise during the year.

3.12 Whilst the Authorised Limit cannot be breached, the **Operational Boundary** is based on the probable external debt during the year. It is not a limit but acts as a warning mechanism to prevent the authorised limit (above) being breached.

<u>Sensitivity Analysis</u>

3.13 The Council's gross debt on 31 March 2023 was as follows:

	£m	**£m**
Fixed Rate Borrowing	**627**	
Finance Leases	1	
Private Finance Initiative (PFI) Schemes	45	
Sub Total - Fixed Rate Debt		**673**
Lenders Option Borrowers Option (LOBO) Loan	11	
Retail Price Index (RPI) linked loan	63	
Sub Total - Variable Rate Debt		**74**
Total Gross Borrowing		**747**

3.14 90% of the Council's borrowing has a fixed interest rate, but the Council does have two variable rate loans.

- The lender of the LOBO loan has an option to increase the interest rate every two years. The lenders next option is on 19 March 2025. If the lender does increase the interest rate the Council, then has the option to repay the loan.
- The Council has £63m outstanding on a loan which links the instalments payable by the Council to the RPI. The Council has leased the Isle of Wight Ferry Terminal in White Heart Road to Wightlink on an RPI linked rent that mirrors the instalments payable on this loan mitigating the consequences of increases in RPI.

Minimum Revenue Provision (MRP) for Debt Repayment

3.15 Early in 2018 the Government issued revised statutory guidance on MRP requiring the repayment of General Fund Prudential Borrowing to be provided for within 50 years.

3.16 The following MRP policies (applied to calculating the MRP) are set out in the table below and are fully compliant with this policy. It is recommended the City Council approves the Annual Minimum Revenue Provision (MRP) for Debt Repayment Policies set out in the table below (Recommendation 3.2a).

Borrowing	**MRP Methodology**
General Fund Borrowing:	
Supported borrowing other than finance leases and service concessions including private finance initiative schemes #	50-year annuity
Finance leases and service concessions including private finance initiative schemes *	MRP equals the principal repayments made to lessors and PFI operators
Prudential borrowing excluding borrowing to fund long term debtors (including finance leases), investment properties and equity shares purchased in pursuit of policy objectives	Annuity over life of asset
Prudential Borrowing to fund long term debtors	The principal set aside to finance the borrowing used in the original transaction
Prudential Borrowing to fund finance leases	The principal element of the rent receivable be set aside to repay the borrowing that financed these assets
Prudential Borrowing to fund investment properties with an expected holding period of under 50 years	The repayment of Prudential Borrowing will be provided for by setting aside the capital receipt when the property is disposed of including any surplus over the cost of acquisition unless the carrying (market) value of the property falls below that part of the purchase price financed from Prudential Borrowing. If this happens MRP will be made for the shortfall over the residual life of the property. Any uplifts in rental income beyond that in the budget will be used to make MRP.
Prudential Borrowing to fund investment properties with an expected holding period of over 50 years	Annuity over life of asset
Prudential Borrowing to fund equity shares purchased in pursuit of policy objectives	25-year annuity
Housing Revenue Account (HRA)	No MRP is currently provided for. It is currently anticipated that from 2028/29 it will be provided again for the HRA Self Financing Payment in equal instalments over 30 years. MRP is not provided for other HRA debt.

 # The Council applied the last of its supported borrowing 2011/12

** If transactions that take the legal form of finance leases but in substance amount to borrowing, the MRP policy relating to self - financed borrowing will be adopted. An example of when this could happen would be when the Council grants a head lease to an institution in return for an upfront premium and leases the asset back from the same institution in return for a rent.*

3.17 The Council had a review of its MRP policy in 2016/17. Consequently, it highlighted that the previous methods used in the past have resulted in over provisions of MRP from 2008/09 to 2015/16 of £22.6m. The Director of Finance and Resources (Section 151 Officer) will release the over provision of MRP back into General Fund balances over a prudent period by reducing the MRP in future years under delegated authority. This overprovision is forecast to expire in 2026/27.

3.18 Currently there is an open MRP Consultation relating to updating regulations and statutory guidance and the outcome is expected for implementation in 2024/25.

4. Investments

Treasury Management

4.1 Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

Service Delivery

4.2 Investments held primarily and directly for the delivery of public services including housing, regeneration, and local infrastructure. Dunsbury Park, Portsmouth Retail Park, Portico and Ravelin are included in this category as income received would be used for regeneration purposes. Returns on this category of investment which are funded by borrowing are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.

Commercial Return

4.3 Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council's financial capacity – i.e., that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must no longer borrow to invest primarily for financial return.

Due Diligence

4.4 The Council initially identifies suitable Treasury Management investments using credit ratings from Fitch, Moody's, and Standard and Poor. Where possible, credit ratings are compared to insurance premiums against a counter party defaulting. Insurance premiums against a counter party defaulting can be compared to a widely used index of the market (ITRAAX). If the market has concerns about a borrower, it should be reflected in a higher insurance premium. Although credit ratings are supported by an in-depth analysis of the borrower, insurance premiums provide a more up to date indicator of a borrower's credit worthiness. Prior to making investments, any news relating to the borrower is also considered.

4.5 All property acquisitions require a business case which includes a full financial appraisal. The detailed business case and financial appraisal includes building surveys, environmental surveys and valuations in accordance with the Red Book. In addition, properties continue to be revalued on an annual basis.

4.6 Other sources of information that are relevant to particular sectors are also considered either as a substitute for credit ratings and insurance premiums in sectors where these are not available or to supplement credit ratings and insurance premiums. Examples of this are the governance and viability ratings assigned to larger registered social landlords (RSLs) by the Homes and Communities Agency (HCA), and data sets published by the Building Societies Association

4.7 For further detail on the Council's investment criteria, see the Treasury Management Policy.

Service and Commercial Investments Acquired Through the Capital Programme

4.8 According to the CIPFA Treasury Management Code, investment properties acquired through the capital programme are regarded as investments in addition to investments of surplus cash.

4.9 CIPFA has revised the Prudential Code relating to service and commercial investments so that:

1) The risks associated with service and commercial investments should be proportionate to a local authority's financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services
2) An authority must not borrow to invest for the primary purpose of commercial return
3) It is not prudent for local authorities to make any investment or spending decision that will increase the Capital Financing Requirement (CFR), and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose
4) An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt
5) A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream
6) Local authorities should create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

Statutory Guidance

4.10 The Government issued revised statutory guidance on local government investments early in 2018 coming into effect from 01 April 2018. The guidance requires Councils not to borrow purely for financial gain.

4.11 The Government's revised statutory guidance also requires local authorities to present a range of indicators to allow members and other interested parties to understand the total exposure from borrowing and investment decisions. It is recommended that the indicators contained in the Appendix be approved. The Government's statutory guidance requires the Council to consider the long-term sustainability risk implicit in becoming too dependent on commercial income or in taking out too much debt relative to net service expenditure. In particular, the Government's statutory guidance requires the City Council to set limits that cannot be exceeded for gross debt compared to net service expenditure, and for commercial income as a percentage of net service expenditure. It is recommended that if these limits are exceeded, the Director of Finance and Resources (Section 151 Officer) bring a report to the Cabinet and City Council.

Activity in the Investment Property Market

4.12 The Council has an investment property portfolio that it acquired over several years for £173m.

4.13 The Council's overall long-term strategy is to dispose of its investment property portfolio and to mitigate the risks attached to the investment property portfolio in the meantime. The Councils exit strategy is as follows:

1) To sell property when it becomes clear from a property and financial perspective that a sale will be preferable to a hold and rent (based on frequent review of forward cash flow forecasts)
2) Use all proceeds to make MRP (including any surpluses)
3) If the carrying (market) value of a property falls below that part of the purchase price financed from unsupported borrowing, MRP will be made for the shortfall over the residual life of the property
4) Any uplifts in rental income beyond that in the budget to be used to make additional MRP
5) The savings in debt costs to contribute towards the loss of rental income to the General Fund. Over time the significance of the rental income will reduce as it is eroded by inflation.

4.14 The Commercial Property Portfolio is managed by an in-house team who are qualified members of the Royal Institute of Chartered Surveyors.

Investment Indicators

Gross General Fund (GF) Debt to GF Net Service Expenditure

4.15 The Councils GF borrowing is forecast to be two times its GF net service expenditure in 2024/25. It is recommended that GF borrowing be limited to four times GF net service expenditure. This will allow further borrowing to be undertaken if it is financially advantageous.

Income from Investments for commercial and service purposes to General Fund (GF) Net Service Expenditure

4.16 The Council will depend on income from investments for commercial and service purposes to fund 9.3% of its estimated GF net service expenditure in 2024/25. To ensure that the Council does not become over dependent on income it is recommended that no more than 14% of GF net service expenditure will be funded from investment income.

Interest Cover

4.17 The Council's investment property portfolio has been financed from borrowing. There is therefore a risk that income from investment properties may be insufficient to pay the interest incurred on the associated debt. However, the net income from the investment property portfolio exceeds the cost of the associated interest 2.3 times.

Loan to Value Ratio

4.18 The Council's investment property portfolio has only recently been acquired, but the market value of the properties is thought to be sufficient to repay the borrowing that financed their acquisition.

Forecast Income Returns

4.19 The investment property portfolio is expected to make a net return of 2.6% against the original cost of the properties in 2024/25.

Gross and Net Income from Investment Properties

4.20 The investment property portfolio is expected to generate a retained income of £3.8m in 2024/25.

External Operating Costs

4.21 External operating costs are driven by lease events such as rent reviews and lease renewals. Some years have more lease events than others.

5. Skills and Knowledge

5.1 The issues covered by this report are in their nature complex, so all the Council's senior finance staff are chartered accountants. The Treasury Manager is a qualified Chartered Certified Accountant. Where the Council does not have the necessary in-house skills and services, it employs Link Asset Services to provide interest rate and economic forecasts, and counter party information.

5.2 On 31 March 2023, £41.16m of the Council's investments of surplus cash were being managed externally consisting of £28.66m invested in instant access money market funds, £4.8m in a multi-asset fund and £7.7m invested in corporate bonds that were being externally managed.

5.3 The City Council is also a member of Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Network which provides training events throughout the year. Some training is also provided by Link Asset Services. Additional training for investment staff is provided as required.

5.4 Councillors are offered training by an external consultant to provide them with an overview of treasury management after the local government elections.

6. Treasury Management Reporting

6.1 An integrated approach to Treasury Management gives rise to consideration in relation to:

- Borrowing
- Repaying
- Refinancing
- Investing.

6.2 Treasury management has been defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as "the management of an organisations borrowing, 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". Put simply, the Council's approach to cash flow includes:

- Borrowing when the Council requires more cash
- Investing when the Council has surplus cash.

6.3 In addition to the Capital strategy, the Council also has a Treasury Management Strategy. The Treasury Management Strategy contains:

- The Treasury Management Indicators that set the boundaries within which treasury management activities will be undertaken and
- An Annual Investment Strategy that specifies how surplus cash will be invested.

6.4 To demonstrate good governance, all treasury management reports taken to the Governance and Audit and Standards Committee and all treasury management reports requiring policy decisions are taken to the Cabinet and the City Council.

Report	Reporting of Compliance & Performance in Previous Period	Policy Changes	Audience
Treasury Management Policy	N/A	Yes	G&A&S Committee Cabinet City Council
Treasury Management Quarter 1 Monitoring	Yes		G&A&S Committee
Treasury Management Mid-Year Review	Yes	Yes	G&A&S Committee Cabinet City Council
Treasury Management Quarter 3 Monitoring	Yes		G&A&S Committee
Treasury Management Outturn	Yes		G&A&S Committee

INVESTMENT INDICATORS

Gross General Fund (GF) Debt to GF Net Service Expenditure						
This provides an indication of the Council's financial strength and its ability to repay its debts. Statutory government guidance requires a limit to be placed on the number of times gross debt can exceed net service expenditure.						
	2023/24 Estimate	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**	**2027/28 Estimate**	**2029/29 Estimate**
Forecast	194%	164%	149%	148%	135%	123%
Recommended Limit	400%	400%	400%	400%	400%	400%

Forecast Investment Income to General Fund Net Service Expenditure						
This provides an indication of how dependent the Council is on investments to fund its services.						
	2023/24 Estimate	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**	**2027/28 Estimate**	**2029/29 Estimate**
Investment Properties	4.1%	3.8%	4.5%	4.5%	4.4%	4.2%
Investments for Service Purposes	5.8%	5.3%	5.3%	5.2%	5.1%	4.9%
Long Term Treasury Management Investments	0.4%	0.2%	0.1%	0.0%	0.0%	0.0%
Overall Investment Income	**10.4%**	**9.3%**	**9.9%**	**9.7%**	**9.4%**	**9.1%**

Limit on Investment Income to General Fund Net Service Expenditure						
Statutory government guidance requires a limit to be placed on the Council's dependence on commercial income and other long term income to fund its services						
	2023/24 Estimate	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**	**2027/28 Estimate**	**2029/29 Estimate**
Investment Properties	6.2%	5.6%	6.7%	6.7%	6.5%	6.3%
Investments for Service Purposes	8.8%	8.0%	8.0%	7.8%	7.6%	7.4%
Long Term Treasury Management Investments	0.6%	0.3%	0.1%	0.0%	0.0%	0.0%
Overall Investment Income	**15.6%**	**14.0%**	**14.8%**	**14.5%**	**14.1%**	**13.7%**

Interest Cover						
This provides a measure of the risk that net income from investment properties will be insufficient to pay the interest on the debt that financed their acquisition						
	2023/24 Estimate	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**	**2027/28 Estimate**	**2029/29 Estimate**
Investment Properties	241%	228%	272%	278%	278%	278%

Loan to Value Ratio						
This indicator shows whether the market value of the investment properties is likely to be sufficient to repay the debt that financed them.						
	2023/24 Estimate	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**	**2027/28 Estimate**	**2029/29 Estimate**
Investment Properties	0.9	0.8	0.8	0.8	0.8	0.8

Forecast Income Returns						
This is a measure of the achievement of the portfolio of properties.						
	2023/24 Estimate	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**	**2027/28 Estimate**	**2029/29 Estimate**
Investment Properties	2.69%	2.57%	3.44%	3.58%	3.58%	3.59%
Long Term Treasury Management Investments	2.46%	2.35%	1.91%	4.00%	0.00%	0.00%

Gross and Net Income from Investment Properties						
This indicator shows how much of the gross income is being retained by the Council.						
	2023/24 Estimate £'000s	**2024/25 Estimate £'000s**	**2025/26 Estimate £'000s**	**2026/27 Estimate £'000s**	**2027/28 Estimate £'000s**	**2029/29 Estimate £'000s**
Gross Income	8,335	8,335	9,940	10,177	10,177	10,177
Net Income	3,993	3,812	5,106	5,306	5,317	5,329

External Operating Costs						
This indicator shows the trend in operating costs over time, as the portfolio expands.						
	2023/24 Estimate £'000s	**2024/25 Estimate £'000s**	**2025/26 Estimate £'000s**	**2026/27 Estimate £'000s**	**2027/28 Estimate £'000s**	**2029/29 Estimate £'000s**
Investment Properties	879	863	1,174	1,210	1,199	1,188