Report to the Audit & Governance Committee

Date of meeting: **17 January 2022**

Epping Forest District Council

Portfolio: **Finance, Qualis Client and Economic Development – Cllr J. Philip**

Subject: **Capital Strategy 2022/23 to 2026/27**

Responsible Officer: **Andrew Small** **(07548 145665)**

Democratic Services: **Laura Kirman** **(01992 564243)**

Recommendations/Decisions Required:

(1) To consider and recommend for approval to full Council, the Capital Strategy 2022/23 to 2026/27 ***(Appendix A)***

(2) To consider and recommend for approval to full Council, the Minimum Revenue Provision Statement (MRP) 2022/23 ***(Appendix A, Annex 1)****; and*

(3) That delegated authority be given to the Section 151 Officer, in consultation with the Chairman of the Committee, to make any late adjustments to the financial information, necessitated by the finalisation of the Budget for 2022/23, prior to presentation of the final draft Strategy to full Council on 24 February 2022.

Executive Summary

The requirement to produce an overarching Capital Strategy was first introduced in CIPFA's Prudential Code for Capital Finance in Local Authorities (updated 2017) ("the Prudential Code"). Epping Forest District Council subsequently introduced its inaugural Capital Strategy in February 2019 (effective from the 2019/20 financial year). Since then, the Council has significantly changed its approach to some of the component parts of the original Strategy, especially on commercial investment and regeneration, including the introduction of Qualis, the Council's arms-length investment and service delivery vehicle.

The Strategy sets out the Council's draft five-year Capital Programme for both its General Fund and Housing Revenue Account (as presented to the Cabinet in December 2021) and explores the financial implications of that, including its impact on a range of Prudential Indicators, with the Council's Section 151 Officer concluding that the current Programme is "prudent, affordable and sustainable" as required by the Prudential Code.

Wider topics considered in the Capital Strategy include the Council's approach to Asset Management, Treasury Management, Service Investments, Commercial Investments, Financial Guarantees and the way in which professional capacity is maintained through the

development and maintenance of knowledge and skills and the selective use of professional advisors.

The Capital Strategy will be regularly updated – usually annually – in accordance with the Prudential Code.

The purpose of this report is to allow the Audit and Governance Committee to consider and comment on the Capital Strategy, before making appropriate recommendations to full Council on 24th February 2022.

Members should note that CIPFA published its revised Prudential Code on 20th December 2021 (although the supporting Guidance Notes have yet to be published at the time of preparing this report). The foreword to the new Code states that it takes immediate effect, except that authorities may defer introducing the revised reporting requirements (e.g. strategy reports) until the 2023/24 financial year.

This update to the Capital Strategy therefore achieves full compliance with the 2017 Code as well as achieving compliance with the key principles of the 2021 Code (e.g. the Council no longer undertakes debt for yield investments, as reported to this Committee in November 2021). A fully updated Strategy will be prepared for 2023/24 in full compliance with the 2021 Prudential Code.

It should further be noted that the data presented reflects draft Budget information for 2022/23 as presented to Cabinet in December 2021 (including the anticipated Capital Outturn for 2021/22 as at the end of 30th September 2021 i.e. the "Quarter 2" position). It is therefore likely that some small adjustments will be required to the financial information presented in the draft Strategy – to reflect the final Budget proposals for 2022/23 and the latest outturn projections for 2021/22 – prior to presentation for approval by full Council.

This report therefore also seeks delegated authority for any late adjustments required to be presented to, and agreed by, the Section 151 officer in consultation with the Chairman of the Audit & Governance Committee prior to presentation of the draft Strategy to full Council on 24th February 2022. In addition, any agreed amendments will be presented to this Committee on 17th March 2022.

Reasons for Proposed Decision:

To enable the robust scrutiny the Council's overarching Capital Strategy, giving special consideration to the approach to ensuring that it is prudent, affordable and sustainable.

Legal and Governance Implications:

Local authorities are required by regulation to have regard to the Prudential Code (the Code) when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003. The requirement for local authorities to produce a Capital Strategy for adoption by full Council was introduced in the 2017 (latest) edition of the Code.

Safer, Cleaner and Greener (SCG) Implications:

None.

Background Papers:

The Prudential Code for Capital Finance in Local Authorities (2017 Edition) published by CIPFA.

(MHCLG) Statutory Guidance on Local Government Investments (3rd Edition). Issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1st April 2018.

Arlingclose Technical Update (revised Prudential and Treasury Management Codes) issued 22nd December 2021.

Risk Management:

There are a range of financial risks associated with Capital Financing. Wide-ranging risk mitigation measures are therefore put in place, which are explained in detail in the report. The overall aim is to ensure that the Capital Strategy is always prudent, affordable and sustainable.

Appendix A

EPPING FOREST DISTRICT COUNCIL

Capital Strategy 2022/23 to 2026/27 (DRAFT)

1. Introduction

1.1 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council.

1.2 The Capital Strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services in the district of Epping Forest, along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been purposely written in an accessible style to enhance understanding of what can be very technical areas.

1.3 Epping Forest District Council introduced its first Capital Strategy in February 2019 (effective from 2019/20). An updated Strategy (effective from 2021/22) was presented to this Committee in March 2021 (and subsequently adopted by full Council).

1.4 This update – which reflects the Council's latest updated capital needs, including the newly emerging HRA Business Plan – will be effective from 2022/23 and, subject to the recommendation of the Audit & Governance Committee, will go forward for adoption by full Council on 24th February 2022.

1.5 It should be noted that CIPFA published its revised Prudential Code on 20th December 2021 (although the supporting Guidance Notes have yet to be published at the time of preparing this document). The foreword to the new Code states that it takes immediate effect, except that authorities may defer introducing the revised reporting requirements (e.g. strategy reports) until the 2023/24 financial year.

1.6 This update to the Capital Strategy therefore achieves full compliance with the 2017 Code as well as achieving compliance with the key principles of the 2021 Code (e.g. the Council no longer undertakes debt for yield investments, as reported to this Committee in November 2021). A fully updated Strategy will be prepared for 2023/24 in full compliance with the 2021 Prudential Code.

1.7 It should further be noted that the data presented reflects draft Budget information for 2022/23 as presented to Cabinet in December 2021 (including the anticipated Capital Outturn for 2021/22 as at the end of 30th September 2021 i.e. the "Quarter 2" position).

2. Capital Expenditure and Financing

2.1 Expenditure

2.1.1 Capital expenditure occurs when the Council spends money on assets such as property or vehicles, which will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not capitalised and are charged to revenue in year.

2.1.2 In 2022/23, Epping Forest District Council is planning capital expenditure of £93.580 million (and £293.049 million over the next five years) as summarised in Table 1 below.

Table 1: Prudential Indicator: Estimates of Capital Expenditure

Description	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000's	**£000's**	**£000's**	**£000's**	**£000's**	**£000's**
General Fund Services	6,866	21,563	16,608	2,525	2,750	2,470
Qualis Investments (GF)	46,000	25,000	37,000	0	0	0
Housing Revenue Account	30,429	47,017	56,950	38,649	26,955	15,562
TOTALS	**83,295**	**93,580**	**110,558**	**41,174**	**29,705**	**18,032**

2.1.3 The most significant General Fund capital scheme in the Programme is the development of the new Epping Leisure Facility (£24.282 million). The scheme will see the development of a replacement leisure facility for the existing (and aging) leisure facility as well as the construction of a multi-story car park. Cabinet approved the addition of this scheme to the draft Capital Programme at its meeting on 21st January 2021.

2.1.4 As noted above in Table 1, the Council also has a £25.0 million draft budget allocated to Qualis Investments in 2022/23, with a further allocation of £37.0 million in 2023/24. See Section 6.2 of this report for further detail.

2.1.5 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that the Council's housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately and includes £74.808 million allocated to the Housing Development Programme over a four-year period commencing 2022/23 through to 2025/26, which is expected to deliver 291 new homes (including 10 Qualis acquisitions).

2.2 Governance

2.2.1 The evaluation, prioritisation and acceptance of capital schemes onto the Capital Programme is carried out within a new governance framework that is being progressively rolled out by the Council at the time of preparing this Strategy. The approach ensures that Council priorities are reflected in schemes accepted onto the Programme, and that deliverability is also given due consideration in terms of available capacity and capability. Proposals are shaped by senior managers in consultation with councillors.

2.2.2 The draft Capital Programme is then subjected to formal Scrutiny prior to setting the budget (followed by Cabinet and full Council approval).

2.3 Financing

2.3.1 All capital expenditure must be financed, either from external sources (Government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing and leasing). The planned financing of the above expenditure is presented in Table 2 below.

Table 2: Capital Financing

Description	2021/22 Estimate	2022/23 Budget	2023/24 Budget	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000's	£000's	£000's	£000's	£000's	£000's
Internal: Capital Resources	29,539	16,300	17,205	12,651	13,103	11,269
Internal: Revenue Resources	783	4,994	3,579	5,292	5,805	5,222
External Sources	1,500	1,438	3,143	2,033	1,800	1,541
Debt	51,473	70,848	86,631	21,198	8,997	0
TOTALS	**83,295**	**93,580**	**110,558**	**41,174**	**29,705**	**18,032**

2.3.2 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as "Minimum Revenue Provision" (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and the use of capital receipts are presented in Table 3 below.

Table 3: Replacement of Debt Finance

Description	2021/22 Estimate	2022/23 Budget	2023/24 Budget	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000's	£000's	£000's	£000's	£000's	£000's
Capital Resources	4,694	7,342	8,068	3,331	3,597	1,573
Revenue Resources (MRP)	1,020	1,368	2,406	2,266	2,316	2,373
TOTALS	**5,714**	**8,710**	**10,474**	**5,597**	**5,913**	**3,946**

2.3.3 The Council's annual MRP statement can be found at ***Annex 1*** below.

2.3.4 The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £42.9 million in 2022/23. Based on the above figures for expenditure and financing, the Council's estimated CFR is presented in Table 4 below.

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement (CFR)

Description	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000's	£000's	£000's	£000's	£000's	£000's
General Fund	195,664	238,515	285,229	282,963	280,647	278,274
Housing Revenue Account	157,552	184,181	221,692	242,890	251,887	251,887
TOTALS	**353,216**	**422,696**	**506,921**	**525,853**	**532,534**	**530,161**

3. Asset Management

3.1 Asset Management Strategy

3.1.1 The Council recognises the importance of ensuring that capital assets continue to be of long-term use and, especially in a post pandemic world, where there has been a step change increase in the speed of legislative (especially Building Control regulations), technological and operational change. Consequently, at the time of preparing this Capital Strategy, a new Asset Management Strategy (AMS) for General Fund assets is under development. Backed by a comprehensive review of Council assets, the AMS takes a longer-term view comprising:

- 'Good' information about existing assets
- The optimal asset base for the efficient delivery of Council objectives
- The gap between existing assets and optimal assets
- Strategies for purchasing and constructing new assets, investments in existing assets, transferring of assets to other organisations and the disposal of surplus assets; and
- Plans for individual assets.

3.1.2 The Council is also committed to rapidly achieving Zero Carbon status for all its buildings; it is an ambition that will be embedded within the new Asset Management Strategy.

3.1.3 The Council's housing assets are managed as part of a separate strategy based on professionally prepared rolling stock condition surveys (with effect from 2022) and evolving housing demand (by type), with routine repairs and maintenance funded through the annual Housing Revenue Account and major works phased within the HRA Capital Programme.

3.2 Asset Disposals

3.2.1 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 used to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. Table 5 below summarises the overall projections for capital receipts.

Table 5: Capital Receipts

Description	2021/22 Forecast	2022/23 Budget	2023/24 Budget	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000's	£000's	£000's	£000's	£000's	£000's
Asset Sales	4,272	5,970	4,551	1,777	1,818	74
Loans Repaid	422	1,372	3,517	1,554	1,779	1,499
TOTALS	**4,694**	**7,342**	**8,068**	**3,331**	**3,597**	**1,573**

3.2.2 The transfer (at market value) of a number of key regeneration sites within the district to Qualis occurred in October 2021; this included sites at Cottis Lane (valued at £3.470 million) and Hemnall Street (valued at £2.030 million) as part of the development of a new Leisure Facility and Multi-Storey Car Park in Epping (due for completion in 2023/24). However, a loan was granted by the Council to Qualis to enable the purchase. In accordance with the capital accounting rules, the associated capital receipt is recognised by the Council gradually over the period of the loan (categorised as "Loans Repaid" in Table 5 above).

3.2.3 Asset sales include receipts from Council tenants for the purchase of their properties under the "Right to Buy" (RTB) scheme; an average of 12 disposals per annum are assumed within current projections. A proportion of the capital receipts must be used to provide additional homes within a five-year time scale or be remitted to the Government.

4. Treasury Management

4.1 Introduction

4.1.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. 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 is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor 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.

4.1.2 Due to decisions taken in the past, the Council currently (@ 31st December 2021) has borrowing of £265.606 million at an average interest rate of 2.47% and £24.978 million in treasury investments at an average interest rate of 0.711%.

4.2 Borrowing

4.2.1 The Council's main objectives when borrowing is to achieve a low but certain cost of finance while retaining flexibility should plans change in the future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available typically in the range 0.10% to 0.20%) and long-term fixed rate loans where the future cost is known but higher (typically available from the PWLB in the range 1.2% to 2.0% as at 31st December 2021).

4.2.2 Projected levels of the Council's outstanding debt are shown in Table 6 below, compared with the Capital Financing Requirement (Table 4 above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement

Description	31/03/21 Actual	31/03/22 Estimate	31/03/23 Budget	31/03/24 Budget	31/03/25 Budget
	£000's	£000's	£000's	£000's	£000's
Debt (including leases)	261,706	261,756	261,306	260,856	260,406
Capital Financing Requirement (CFR)	302,763	353,216	422,696	506,921	525,853

4.2.3 Statutory guidance requires debt to remain below the Capital Financing Requirement, except in the short-term. As can be seen from Table 6 (which provides a view on how much debt the Council needs to take on to bring it up to the CFR), the Council expects to comply with this in the medium-term.

Liability Benchmark

4.2.4 To compare the Council's *actual* borrowing against an alternative strategy, a liability benchmark has been calculated showing the minimum amount of borrowing required to keep investments at a minimum liquidity level. This assumes that cash and investment balances are kept to a minimum level of £12.0 million at each year-end. The actual Liability Benchmark was £263.2 million as at 31st March 2021 and is expected to increase to £487.7 million over the four-year period.

Table 7: Borrowing and the Liability Benchmark

Description	31/03/21 Actual	31/03/22 Estimate	31/03/23 Forecast	31/03/24 Forecast	31/03/25 Forecast
	£M's	£M's	£M's	£M's	£M's
Outstanding Borrowing	261.7	315.0	384.5	468.7	487.7
Liability Benchmark	263.2	315.0	384.5	468.7	487.7

4.2.5 Table 7 above shows that the Council was below its Liability Benchmark on 31st March 2021. Borrowing from 2021/22 onwards is expected to be in line with the Liability Benchmark.

Affordable Borrowing Limit

4.2.6 The Council is legally obliged to set 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 8: Prudential Indicators: Operational Boundary and Authorised Limit for External Debt

Description	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
	£000's	**£000's**	**£000's**	**£000's**
Operational Boundary – borrowing	353,663	433,025	517,646	536,992
Operational Boundary – other long-term liabilities	0	0	0	0
Operational Boundary – total external debt	**353,663**	**433,025**	**517,646**	**546,992**
Authorised Limit – borrowing	363,663	443,025	527,646	546,992
Authorised Limit – other long-term liabilities	0	0	0	0
Authorised Limit – total external debt	**363,663**	**443,025**	**527,646**	**546,992**

HRA Borrowing: Local Indicator

4.2.7 The requirement to borrow and the risk associated with HRA borrowing can be distinguished from that of the General Fund. The HRA is underpinned by a very large property portfolio (6,437 properties, with a Balance Sheet value of £717.4 million as at 31st March 2021). Accordingly, the different risk profile is reflected within the capital financing rules e.g. the Local Government Act 2003 established the requirement for councils to put aside resources (through making a "Minimum Revenue Provision") to repay debt in later years; it was (still is) a legal requirement that only applies to General Fund borrowing.

4.2.8 Nevertheless, HRA borrowing is not risk free; HRA capital investment plans must be just as prudent, affordable and sustainable as General Fund capital investment plans. Two local indicators have therefore been developed, which are used to gauge, and provide assurance, around the Council's HRA borrowing plans:

- *'Loan to Value'* – LTV is an easy to understand Borrowing indicator that is widely used as a measure of default risk by lenders in Housing finance. It is a determined by calculating the year-end outstanding debt as a proportion of the total value of assets. Table 9 below shows that the total LTV on the HRA is expected to rise from 0.20 in 2021/22 to 0.27 by 2024/25; and

- *HRA Interest Cover* – Again a relatively simple indicator that reflects how able the HRA is to meet interest costs from its Net Cost of Services. This is a Financing Indicator (refer to Sections 8.1 and 8.2 below for presentation and discussion).

4.2.9 Both indicators form a key part of the Council's emerging HRA Business Plan with target levels (both minimum and maximum) reflecting generally accepted industry good practice across the wider social housing sector.

Table 9: Local Indicator: 'Loan to Value' (HRA)

Description	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
	Ratio	**Ratio**	**Ratio**	**Ratio**	**Ratio**
Loan to Value	0.20	0.22	0.25	0.27	0.27
Target Maximum (LTV)	**0.70**	**0.70**	**0.70**	**0.70**	**0.70**

4.2.10 It can be seen from Table 9 above, that – based on current projections – HRA borrowing plans are well within acceptable Loan to Value limits.

4.2.11 Further details on borrowing are contained in the Treasury Management Strategy 2022/23.

4.3 Investments

4.3.1 Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

(Treasury Management) Investment Strategy

4.3.2 The Council's Investment Strategy is to prioritise security and liquidity over yield; focussing on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with other local authorities, Money Market Funds or selected high-quality banks, to minimise the risk of loss.

4.3.3 The availability of cash for the purposes of longer-term investment is currently limited by the Council's need to fund the expanding Capital Programme. Treasury Management advice in recent years (in the context of a low interest rate environment) has also been to 'keep investments short' (in the expectation that interest rates will rise in the future).

4.3.4 Table 10 below summarises the Council's current and forecast treasury investments.

Table 10: Treasury Management Investments

Description	31/03/21 Actual	31/03/22 Forecast	31/03/23 Budget	31/03/24 Budget	31/03/25 Budget
	£000's	**£000's**	**£000's**	**£000's**	**£000's**
Long-Term Investments*	4,050	2,850	1,650	450	0
Short-Term Investments*	11,674	14,200	14,200	14,200	12,450
TOTALS	**15,724**	**17,050**	**15,850**	**14,650**	**12,450**

**Includes Qualis Working Capital Loan*

4.4 Governance

4.4.1 Treasury Management decisions are made every day and are therefore delegated to the Section 151 Officer, who must act in line with the Treasury Management Strategy approved by the Council. Annual outturn reports on Treasury Management are also approved by the Council (following recommendation from the Audit and Governance Committee), whereas mid-year updates are reported exclusively to the Audit and Governance Committee.

5. Investments for Service Purposes

5.1 The Council will sometimes make investments for service delivery purposes where there is a strategic case for doing so. This is an approach that has been adopted for the delivery of a package of services including Refuse Collection and Leisure. For example, the Council has previously invested in contractor loans for the procurement of Refuse Vehicles, which has realised a return for the Council in the form of lower contract payments. Similarly, the Council's investment of £1.3 million in 2020/21 on the refurbishment of Ongar Leisure Centre formed part of the agreed terms within the 20-year leisure contract and is reflected in the Management Fee that the Council receives.

5.2 Looking forwards, the capital investment in the new Epping Leisure Centre (highlighted above in Paragraph 2.1.3) is expected to increase the Management Fee that the Council receives as part of the net return from the wider development, which include a swimming pool and multi-storey car park.

Governance

5.3 Decisions on service investments are made by the Council's Cabinet and require the support of a full business case.

6. Commercial Investments

6.1 Direct Investments: Commercial Property Portfolio

6.1.1 The Council has pursued an expansive commercial investment strategy in recent years through the direct acquisition of commercial property in a range of locations across the district. The value of the overall portfolio rose from £136.418 million to £147.305 million in 2020/21, with net income of £6.798 million achieved. Shops and (more recently) Industrial Units have been two areas of emphasis and the returns achieved have been a key enabler in maintaining a low Council Tax charge in the district (now the lowest district Council Tax in Essex).

Table 11: Commercial Property Portfolio

Portfolio Category	Balance Sheet Value	
	31/03/20	31/03/21
	£000's	£000's
Shops	93,451	92,363
Industrial Units	31,818	35,996
Other	11,149	18,946
Total Portfolio	**136,418**	**147,305**

6.1.2 The Council continues to invest in its directly owned Commercial Property Portfolio and in Industrial Units in particular. Since 2020/21 there has been a focus on Waltham Abbey, with the Council purchasing long leases on directly owned Units, which is enabling greater long-term financial returns as well as direct capital investment.

6.2 Arms-Length Investments: "Qualis"

6.2.1 Building on the commercial success of its directly owned commercial property portfolio, the Council established a wholly owned Local Authority Trading Company ("LATCO") in October 2019 with the trading name of "Qualis".

6.2.2 Qualis comprises a holding company ("Qualis Group") with three operating subsidiaries. The primary aim of the Group is to help create more jobs, grow the local economy, and improve housing and public amenities in the district. The subsidiary companies are as follows:

- Qualis Commercial – a development company
- Qualis Living – an investment company; and
- Qualis Management – a services company.

6.2.3 Qualis is required to act commercially to maximise profits within Qualis and deliver sustainable returns to the Council as the shareholder. Therefore, the Council will benefit from the receipt of a dividend on future profits. Qualis operations are rapidly expanding with activity so far (in 2020/21) predominantly focused on Qualis Living (with the acquisition of Commercial Property Investments in November 2020) and Qualis Management (following the transfer of the Council's Housing Repairs service in October 2020).

6.2.4 The Council also makes a margin on the loans that it has made to Qualis as well as the supply of various services that are supplied at market rates. Table 12 below summarises the Council's planned capital investment position with Qualis.

Table 12: Qualis Capital Investments

Description	Type/Terms	2020/21	2021/22	2022/23	2023/24	Totals
		£000's	**£000's**	**£000's**	**£000's**	**£000's**
Investment Loan	10-Year Maturity/4.0%	30,000	0	0	0	**30,000**
Asset Purchase Loan	30-Year EIP/4.94%	0	16,000	0	0	**16,000**
Regeneration Finance Loans	Various EIP/TBC	6,000	30,000	25,000	37,000	**98,000**
Totals		**36,000**	**46,000**	**25,000**	**37,000**	**144,000**

6.2.5 In addition to the capital loans presented above, the Council has also provided Qualis with a Working Capital Loan totalling £6.0 million in a series of seven tranches as follows:

- 2019/20 (Tranche 1) - £500,000 (5-Year EIP @ 7.80%); and
- 2020/21 (Tranches 2 - 7) - £5,500,000 (5-Year EIP @ 3.80%).

6.3 Governance

6.3.1 It is important that Qualis have freedom and act 'commercially', within the boundaries of its Business Plan (approved by the Council). However, it is also important that this is balanced against the need for the Council to exercise the necessary oversight so that its risk exposure as the sole shareholder is minimised.

6.3.2 The Qualis Board includes two nominated (Epping Forest District Council) councillors and the Council's Chief Executive, although all Board members are required to act in the interests of Qualis. Consequently, additional oversight is exercised through the Council's Section 151 Officer in the role of "Shareholder's Representative", acting as the official conduit from the Council to Qualis.

7. Other Liabilities

7.1 Outstanding Commitments

7.1.1 The Council also has the following outstanding commitments:

- A commitment to achieve a fully funded position on the Pension Fund (over a 16-year period from 2020 to 2036). The overall deficit was valued at £69.108 million as at 31st March 2021 and back-funding payments of £0.624 million are scheduled to be made in 2022/23. The payments required in 2023/24 and beyond will be reviewed as part of the next Triennial Valuation (scheduled for 31st March 2023); and

- The Council has also set aside £2.244 million (as at 31st March 2021) to cover the financial risk associated with Business Rates Appeals lodged with the Valuation Office Agency (VOA).

7.2 Guarantees

7.2.1 The Council became "self-financing" in respect of its retained housing stock from April 2012. The self-financing regime applied to all authorities and replaced the former Housing Subsidy system whereby the Council made annual payments to the Government funded from its HRA. Its introduction entailed a one-off redistribution of 'debt' between local authorities, and locally this resulted in the Council taking on PWLB loans, which it is required to service (instead of making Housing Subsidy payments).

7.2.2 The Council's original 30-Year Business Plan for the HRA (effective from April 2012) primarily entailed a strategy of debt repayment, with a limited growth strategy based on debt re-financing and upgrading and/or expanding the stock; this comfortably complied with the Government debt cap that was in place at the time. However, the Government removed the debt cap in late 2018, and the Council has since increased its commitment towards building council houses in the district through a more expansive approach to Housing Development.

7.2.3 The Council is refining a new HRA Business Plan at the time of preparing this Strategy. This is designed to ensure adequate rental income is generated each year to run an efficient and effective housing management service (as well as delivering ambitious housing development plans) whilst at the same time servicing the debt. However, if the HRA is unable to repay the debt at any point in the future, the Council (through its General Fund) is liable to repay any remaining balance. The remaining balance on the HRA debt as 31st March 2021 was £185.456 million.

7.2.4 The Council has also provided a guarantee (to the Essex County Pension Fund) on pension costs for 38 'TUPE protected' employees that transferred to Qualis in October 2020, as part of the transfer of the Housing Repairs service. If Qualis is unable to meet its liabilities incurred, through its participation in the Local Government Pension Scheme (LGPS), the Council is obliged to meet those costs on its behalf.

7.3 Governance

7.3.1 Decisions on incurring new discretionary liabilities are taken by Service Directors in consultation with the Section 151 Officer. For example, in accordance with the Council's Financial Regulation D6, "leasing agreements or other financial facilities" can only be agreed by the Section 151 Officer or an officer nominated by them.

8. Revenue Implications

8.1 Financing Costs

8.1.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, Business Rates and general Government grants.

Table 13: Prudential Indicator: Proportion of Financing Costs to Net Revenue Stream (General Fund)

General Fund Financing Costs	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
	£000's	**£000's**	**£000's**	**£000's**
Financing Costs	2,315	3,844	4,924	5,993
Proportion of Net Revenue Stream (Standard CIPFA Indicator)	15%	25%	32%	38%
Proportion of Net Revenue Stream (Local Indicator)	13%	19%	22%	26%

8.1.2 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for many (occasionally up to 50) years into the future.

Financing: Local Indicator (HRA)

8.1.3 As noted above in Section 4.2, the Council also monitors the ability of the HRA is to meet interest costs from its Net Cost of Services. Table 14 below shows a strengthening position whereby HRA Interest Cover is expected to rise from 1.40 in 2021/22 to 1.85 by 2025/26.

Table 14: Local Indicator: Interest Cover (HRA)

Description	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
	Ratio	**Ratio**	**Ratio**	**Ratio**	**Ratio**
HRA Interest Cover	1.40	1.36	1.61	1.81	1.85
Target Minimum (IC)	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**

8.1.4 It can be seen from Table 14 above that – based on current projections – current HRA borrowing plans are comfortably in excess of Interest Cover targets.

8.2 "Prudence, Affordability and Sustainability"

8.2.1 The Section 151 Officer is satisfied that the proposed Capital Programme (Section 2) is prudent, affordable and sustainable based on the following:

Prudence

- *Prudential Indicator 13 (General Fund)* (Paragraph 8.1.1) – Proportion of Financing Costs to Net Revenue Stream – the growth in Financing Costs reflects the Council's ambitions for capital investment in its strategic priorities over the medium-term, including its ambitions for Qualis. The standard CIPFA indicator shows the impact on taxpayers should Qualis default on its loans from the Council, with all Financing Costs having to be met from Council Tax, Business Rates and general Government Grants. The standard indicator however excludes the interest that the Council receives from Qualis loans. A local indicator has therefore been prepared, including the interest received from Qualis loans. Importantly, this shows that the indicator remains under 30% for the duration of the forecast, which is within expected and controllable parameters. It should also be noted that:

  - The above forecast includes all lending contained within the Qualis Business Plan approved by full Council; there are currently no plans to extend Council lending beyond that already contained within the Business Plan

  - Qualis loans are fully secured and 'asset-backed', which greatly enhances the protection afforded to public funds in the event of any potential default

  - Future Qualis lending (especially) is planned to be predominantly in the form of repayment loans ("Equal Instalments of Principal") which means that, in the absence of further extended borrowing to Qualis, the level of outstanding debt will reduce in the longer term; and

  - If this indicator should threaten to breach the 30% threshold, the Section 151 Officer would engage with the Council.

- *Local Indicator 14 (HRA)* (Paragraph 8.1.3) – HRA Interest Cover – current estimates indicate that the 1.25 minimum cover threshold is exceeded for the duration of the projection, with the indicator expected to progressively strengthen over the four-year period

- *Underlying Prudent Assumptions* – a prudent set of assumptions have been used in formulating the Capital Programme (e.g. no future asset disposals that may be identified as part of the updated Asset Management Strategy have been assumed in General Fund projections)

- *Repairs and Maintenance* – the approach to asset maintenance is professionally guided with assets maintained in a condition commensurate with usage and expected life, addressing those items that could affect ongoing and future maintenance, in the most appropriate and cost-effective manner.

Affordability

- The estimated General Fund revenue consequences of the Capital Programme (£107.916 million over the five years from 2022/23) have been included in the 2022/23 Budget and Medium-Term Financial Plan (MTFP), extending to 2026/27; and

- The MTFP is underpinned by a Reserves Strategy, which includes maintaining contingency funds in the event that projections are not as expected (further supported by Section 151 report to Council under Section 25 of the Local Government Act 2003 on the robustness of estimates and the adequacy of financial reserves and balances).

Sustainability

- Capital schemes that are expected to deliver long-term revenue savings/generate income are given due priority. For example, the recent investment in Ongar Leisure Centre underpinned an established revenue stream for the Council through its annual Management Fee. The new Leisure Facility for Epping, which includes provision for a Multi-Storey Car Park as part of the wider scheme, will increase footfall, including a range of associated revenue streams; and

- As explained in Section 3.1 above, the new Asset Management Strategy for General Fund represents an enhancement to the Council approach to asset planning through (especially) taking a longer-term view. This includes providing for future operational need, balancing the requirement to achieve optimal performance, whilst taking account of technological change and managing the risk of obsolescence.

9. Knowledge and Skills

9.1 Officers

9.1.1 The Council employs professionally qualifies and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Most notably:

- *Finance* – the Section 151 Officer, who is the strategic lead on the Council's finances, is a qualified (CIPFA) accountant with many years of experience, whereas the Deputy Section 151 Officer, who leads on operational matters, is also a qualified (ACCA) accountant, also with many years of experience. The Council is committed to the ongoing professional development of the other officers within the Finance function, which includes a commitment towards general professional development (e.g. through CIPFA, ACCA and AAT), as well focussed professional training in specialist areas such as Treasury Management and Business Partnering

- *Property* – the Head of Asset Strategy, who is leading on the development of the Asset Management Strategy, is a highly experienced senior property professional. In addition, the Council also has a dedicated Commercial Property team, resourced by two senior (“MRICS”) chartered surveyors; and

- *Housing* – the Council has a separate Housing Team that is responsible overseeing social housing developments within the district.

9.2 External Advisors

9.2.1 Where the Council does not have the relevant knowledge and skills required, judicious use is made of external advisors and consultants that are experts/specialists in their field. The Council currently engages Arlingclose Limited as Treasury Management advisers, and the Asset Management Team will appoint property advisers (e.g. development managers, valuers etc.) to support their work where required. The approach is more cost effective than employing such staff directly and ensures that the Council has access to knowledge and skills commensurate with risk.

9.3 Councillors

9.3.1 Newly elected councillors have been required to undertake induction training at the Council for some years. Council elections were most recently held in May 2021 and were immediately followed by a range of training for both newly elected councillors (induction training) and experienced councillors (refresher training). For example, a training event on “Local Authority Finance and the Budget Process” was held in July 2021.

9.3.2 For specialist training such as Treasury Management, the Council acknowledges the importance of ensuring that Members have appropriate capacity, skills and information to effectively undertake their role on the Audit and Governance Committee and have arranged training in the past from the Council’s Treasury Management advisors, Arlingclose. The most recent session took place in January 2019. A further session is to be ran following the May 2021 elections.

10. Section 151 Statement on the Capital Strategy

10.1 Prudential Code

10.1.1 Paragraph 24 of the 2017 Prudential Code requires the Section 151 Officer to report explicitly on the affordability and risk associated with the Capital Strategy.

10.1.2 Accordingly, it is the opinion of the Section 151 Officer that the Capital Strategy as presented is affordable, and the associated risk has been identified and is being adequately managed.

10.2 Affordability

10.2.1 The Capital Strategy is affordable and there is a range of evidence to support this assertion, including:

- *Capital Programme* – the Programme as presented above (in Section 2) is supported by a robust and resilient General Fund Medium-Term Financial Plan (MTFP) extending through until 2026/27 that contains adequate revenue provision, including adequate reserves, in the event plans and assumptions do not materialise as expected

- *Asset Management* – as presented above (in Section 3), a new Asset Management Strategy for General Fund assets is under development, which is taking a strategic longer-term view (i.e. beyond 2026/27) of the Council's asset base. A fundamental aim of the Strategy is to achieve the optimum balance between future operational need and affordability, which will be reflected in its component parts including strategies for purchasing and constructing new assets, investment in existing assets, the transferring of assets to other organisations and the disposal of surplus assets; and

- *Commercial Investment* – as presented above (in Section 6), building on the success of its in-house Commercial Property Portfolio, the Council is now widening its commercial investment activities on arms-length basis through the creation of Qualis. The company is still at a relatively early stage in its evolution but is already generating financial returns for the Council through interest receipts and other 'inter-company' services and the Qualis Business Plan is progressing positively towards delivering a shareholder return to the Council in the medium-term.

10.3 Risk

10.3.1 The risk associated with the Capital Strategy has been identified and is being adequately managed. Evidence to support this assertion includes:

- *Treasury Management Strategy* – alongside this Capital Strategy, and subject to the recommendation of the Audit and Governance Committee, the Council is set to formally approved a Treasury Management Strategy for 2022/23 in accordance with CIPFA's "Treasury Management in the Public Services: Code of Practice 2017". That Strategy was developed by a professionally qualified and experienced officer within the Finance Team and informed by specialist advisors Arlingclose and other relevant and extant professional guidance

- *Investment Strategy* – the Council is also set to formally a approve an Investment Strategy for 2021/22 in accordance with MHCLG's "Statutory Guidance on Local Government Investments (3rd Edition) 2017". As with the Treasury Management Strategy, the Investment Strategy was developed by a professionally qualified and experienced officer within the Finance Team and informed by specialist advisors Arlingclose and other relevant and extant professional guidance; and

- *Commercial Activities* – as noted above (in sections 6.3 and 6.4) the Council is committed to significantly expanding its commercial activities through its arms-length delivery vehicle Qualis. It is recognised and accepted that increased commercial activity brings additional risk. The development of the Qualis initiative was therefore guided by the engagement of professional advisors on the commercial, financial and legal aspects of the project, and the preparation of full supporting business cases, prior to the commencement of trading activities. Now that the company is operational, the Council manages its risk exposure through a formally agreed governance framework, which balances the commercial freedom of Qualis with the need for oversight by the Council.

10.3.2 In addition (pending the completion of the Asset Management Strategy), the Section 151 Officer has sought, and obtained, further assurance in issuing this statement in reviewing the position and arrangements in place for maintaining the Council's current assets. Based on a high-level review (all assets with a Gross Book Value of £0.5 million+ were sampled), the Section 151 Officer is satisfied that there are no major omissions – in terms of financial liabilities – from the Capital Programme in the medium-term. The new Asset Management Strategy will extend beyond the medium-term and will therefore – once completed – provide longer-term assurance with effect from 2022/23.

10.4 Capital Strategy Updates

10.4.1 The Capital Strategy is a 'living document' and will be periodically – usually annually – updated to reflect changing local circumstances and other significant developments. However, the further development of the new HRA Business Plan – in the light of the imminent updated Stock Condition Survey results – may necessitate an in-year update to this Strategy should there be any material impact on the assertions contained herein.

Annex 1

Minimum Revenue Provision Statement 2022/23

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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), although there has been no statutory minimum since 2008.

The Local Government Act 2003 requires the Council to have regard to the Ministry of Housing, Communities and Local Government’s (MHCLG) Guidance on MRP (the MHCLG Guidance) updated in 2018.

The MHCLG Guidance requires the Council to approve an Annual MRP Statement and recommends a range of options for calculating a prudent amount of MRP.

<u>MRP Policy</u>

No MRP is required to be charged for Housing Revenue Account (HRA) assets.

No MRP is required to be charged on any General Fund Capital Financing Requirement, which was in existence prior to the HRA Subsidy Reform exercise of 2012.

For General Fund capital expenditure incurred after the HRA Subsidy Reform exercise of 2012:

- MRP will be determined by charging the expenditure over the expected useful life of the asset, to a maximum of 50 years, on an annuity basis; and

- MRP on purchases of freehold land will be charged over 50 years.

The MRP payment is financed from revenue with an option that part, or all, of the payment could be financed from capital receipts to repay debt.

MRP will commence in the financial year following the asset coming into operational use or after purchase.

<u>External Loans</u>
For capital expenditure loans to third parties that are repaid in instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement.

<u>Capitalisation Directions</u>
For capitalisation directions on expenditure incurred after 1st April 2008 MRP will be made using the annuity method over 20 years.