Supplementary Committee Agenda

Epping Forest District Council

Audit & Governance Committee
Thursday 15th February 2024

Place:	Council Chamber - Civic Offices
Time:	7.00 pm
Democratic Services:	Laura Kirman Tel: 01992 564243 Email: democraticservices@eppingforestdc.gov.uk

12. TREASURY MANAGEMENT STRATEGY 2024/25 - INCLUDING INVESTMENT STRATEGY (Pages 114 - 138)

(Section 151 Officer) To consider the attached report to agree and recommend the Treasury Management Strategy and Investment Strategy for 2024/25 to Council for approval.

13. CAPITAL STRATEGY 2024/25 - 2026/27 (Pages 139 - 160)

(Section 151 Officer) To consider the attached report to agree and recommend the Capital Strategy for 2024/25 to 2026/27 to Council for approval.

Report to the Audit & Governance Committee

Date of meeting: 15th February 2024

Epping Forest District Council

Portfolio:	**Finance and Economic Development**	
Subject:	**Treasury Management Strategy (including Investment Strategy) 2024/25**	
Responsible Officer:	**Andrew Small**	**(01992 564278)**
Democratic Services:	**Laura Kirman**	**(01992 564243)**

Recommendations/Decisions Required

(1) To consider and recommend for approval by full Council, the draft Treasury Management Strategy 2024/25 (attached at ***Appendix A***); and

(2) To consider and recommend for approval by full Council, the draft Investment Strategy 2024/25 (attached at ***Appendix B***).

Executive Summary

The preparation of an annual Treasury Management Strategy is a requirement of CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) and generally accepted good practice. It covers planned treasury activity for the financial year 2024/25 and is attached at ***Appendix A***.

In addition, following the issue of (MHCLG) statutory guidance on Local Government Investments in 2018, the Council is also recommended to produce an annual Investment Strategy, covering the Council's wider investment activities. The 2024/25 Strategy is attached at ***Appendix B.***

This report presents a slightly different picture to more recent iterations of the Treasury Management Strategy, with the most notable feature being the availability of resources to Invest following the recent land disposal at North Weald Airfield, which resulted in a material capital receipt. This also helps the Council minimise its need to Borrow, with a number of short-term loans also being repaid from available cash balances.

Both borrowing and investing is taking place against a backdrop of significantly higher interest rates than have been seen for many years; although there are strong indications that interest rates have now peaked, with rate reductions anticipated in the medium-term.

The purpose of this report is to allow the Audit and Governance Committee to consider and comment on both strategies, before making appropriate recommendations to full Council on 20th February 2024.

Reasons for Proposed Decision

To provide assurance to full Council that the risks associated with treasury management and investments are being appropriately managed.

Legal and Governance Implications

The Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) requires the Council to prepare for approval by full Council, an annual Treasury Management Strategy. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The Government (MHCLG) issued Investment Guidance in 2018, recommending the preparation (at least annually) of an Investment Strategy for approval by full Council.

The role of the Audit and Governance Committee is to consider this report – covering both the Treasury Management and Investment strategies – and make recommendations to full Council.

Safer, Cleaner and Greener (SCG) Implications

None.

Background Papers

Treasury Management in the Public Services: Code of Practice (2021 Edition) published by CIPFA December 2021.

(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 inherent financial risks associated with Treasury Management activity; not least the potential for loss of interest and/or deposits. The Council therefore engages the services of external Treasury Management advisors, Arlingclose Ltd.

Borrowing and Investment decisions are made in accordance with the Council's formally adopted Treasury Management Strategy. The Strategy includes several Risk Management features, including – for example – the overriding priority that security of deposit takes precedence over return on investment.

Appendix A

Treasury Management Strategy 2024/25 (DRAFT)

Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires the Council to approve a Treasury Management Strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy ***(Appendix B).***

External Context

The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming General Election, together with war in Ukraine and the Middle East, will be major influences on the Council's Treasury Management Strategy for 2024/25.

Office for National Statistics (ONS) figures showed CPI inflation was 3.9% in November 2023, down from a 4.6% rate in the previous month and, in line with the recent trend, lower than expected. The core CPI inflation rate declined to 5.1% from the previous month's 5.7%, again lower than predictions. Looking ahead, using the interest rate path implied by financial markets the Bank of England (BoE) expects CPI inflation to continue falling slowly, but taking until early 2025 to reach the 2% target before dropping below target during the second half 2025 and into 2026.

ONS figures also show that the UK economy contracted by 0.1% between July and September 2023. The BoE forecasts GDP will likely stagnate through 2024. The BoE forecasts that higher interest rates will constrain GDP growth, which will remain weak over the entire forecast horizon.

Moody's revised its outlook on the UK sovereign to stable from negative to reflect its view of restored political predictability following the volatility after the 2022 mini-budget and also affirmed the "Aa3" rating in recognition of the UK's economic resilience and strong institutional framework.

Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to "stable" from "negative" and then followed this by the same action on five rated local authorities. However, within the same update the long-term ratings of those five local authorities were downgraded.
However, the institutions on the Arlingclose Counterparty List remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

The BoE decided to hold the Bank Rate at 5.25% at its February 2024 meeting. They are expected to cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering ‘second-round effects’. Arlingclose are forecasting cuts in the Bank Rate from around July to September 2024, reducing thereafter to a low of around 3.0% by late 2025.

Local Context

At close of business on 31st December 2023, the Council held £293.5 million Borrowing and £93.4 million in Treasury Investments (excluding Qualis Working Capital Loan). This is set out in further detail in Table 5 below. Forecast changes in these sums are shown in the Balance Sheet analysis in Table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31/03/23 Actual £m’s	31/03/24 Estimate £m’s	31/03/25 Forecast £m’s	31/03/26 Forecast £m’s	31/03/27 Forecast £m’s
General Fund CFR	159.1	200.9	227.1	240.2	236.1
HRA CFR	154.5	161.9	177.0	191.2	192.6
Total CFR	**313.6**	**362.8**	**404.1**	**431.4**	**428.7**
Less: Other debt liabilities*	0	0	0	0	0
Less: External borrowing	(282.7)**	(270.8)	(266.2)	(261.5)	(256.9)
Internal borrowing	**30.9**	**92.1**	**137.9**	**169.9**	**171.8**
Less: Balance Sheet Resources	(43.7)	(143.4)	(143.4)	(143.4)	(143.4)
(Investments)/ New Borrowing	**(12.8)**	**(51.3)**	**(5.5)**	**26.5**	**28.4**

** Leases and PFI liabilities that form part of the Council’s total debt*
***Includes accrued interest of £1.1 million (principal element = £281.6 million)*

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while Balance Sheet resources are the underlying sums available for investment. The Council’s current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Council has an increasing CFR due to the Capital Programme (including Qualis Investments) and will therefore be required to take out further (new) borrowing up to £28.4 million over the forecast period (2024/25 to 2026/27). In the short-term (up to 31st March 2025), external borrowing is assumed to decline following a capital receipt of £88.215 million, received following a land disposal at North Weald Airfield in December 2023.

CIPFA’s Prudential Code for Capital Finance in Local Authorities recommends that the Council’s total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2024/25.

Liability Benchmark

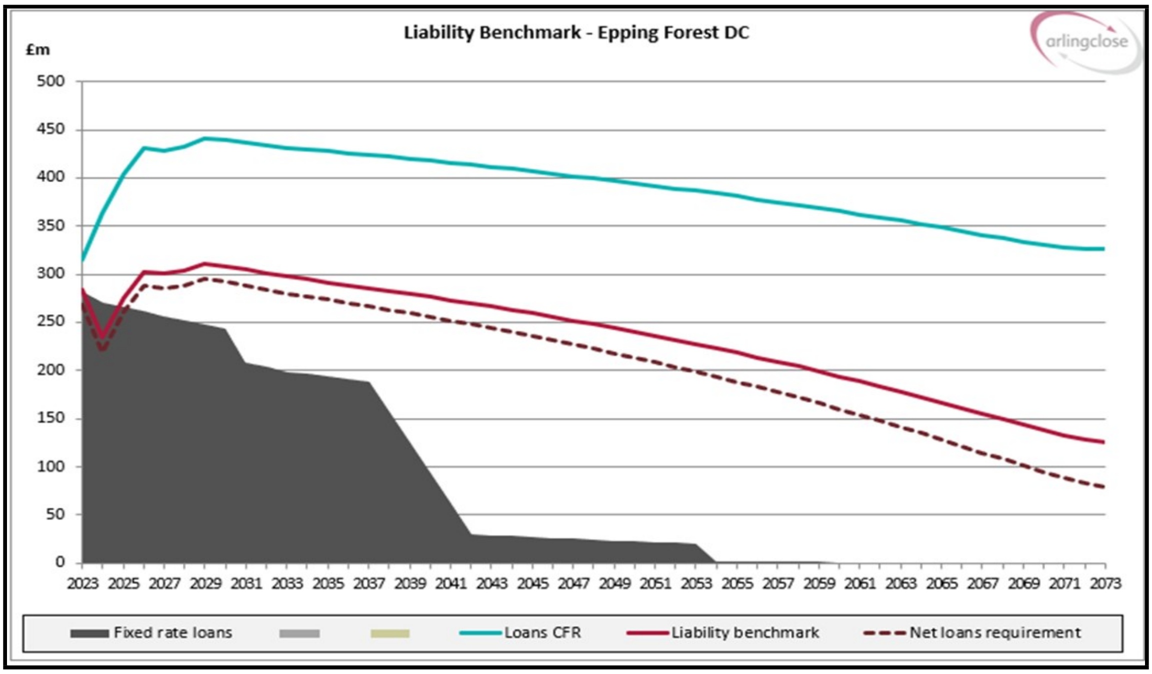
To compare the Council's actual borrowing against an alternative strategy, a Liability Benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of £15.0 million at each year-end to maintain adequate liquidity but minimise credit risk.

The Liability Benchmark is an important tool to help establish whether the Council is likely to be a Long-Term Borrower or Long-Term Investor in the future, and so shape its strategic focus and decision making. The Liability Benchmark itself represents an estimate of the cumulative amount of External Borrowing the Council must hold to fund its current Capital and Revenue plans while keeping Treasury Investments at the minimum level required to manage day-to-day cash flow.

Table 2: Prudential Indicator: Liability Benchmark

	31/03/23 Actual £m's	31/03/24 Estimate £m's	31/03/25 Forecast £m's	31/03/26 Forecast £m's	31/03/27 Forecast £m's
Loans CFR	313.6	362.9	404.1	431.4	428.7
Less: Balance Sheet Resources	(43.7)	(143.4)	(143.4)	(143.4)	(143.4)
Net Loans Requirement	**269.9**	**219.5**	**260.7**	**288.0**	**285.3**
Liquidity Allowance	15.0	15.0	15.0	15.0	15.0
Liability benchmark	**284.9**	**234.5**	**275.7**	**303.0**	**300.3**

Following on from the medium-term forecasts in table 2 above, the long-term Liability Benchmark assumes capital expenditure funded by borrowing of up to £300.3 million by 31st March 2027. Tailored Minimum Revenue Provision (MRP) contributions based on asset lives – ranging from 10 years on Equipment up to 50 years on Buildings – on new capital expenditure have been applied with an underlying inflation rate of 2.5% per annum assumed on income, expenditure, and reserves. This is shown in the Chart below, together with the Council's existing borrowing.



The Chart presented above spans 30-years and illustrates how the Council's borrowing is significantly below the Liability Benchmark.

Borrowing Strategy

The Council currently (@ 31st December 2023) holds £293.5 million in loans, an increase of £11.9 million compared to 31st March 2023, as part of its strategy for funding previous years' capital programmes. The Council's current lenders are the PWLB and other local authorities. There are total loans of £259.7 million outstanding with the PWLB as summarised in Table 3 below.

Table 3: PWLB Borrowing

PWLB Loans (@ 31st December 2023)			
Description	**Amount (£m's)**	**Interest Rate**	**Maturity Date**
Long-Term Maturities			
Fixed-Rate Maturity	30.000	2.06%	21/09/30
Fixed-Rate EIP	9.000	3.96%	15/12/32
Fixed-Rate EIP	4.750	4.23%	28/02/33
Fixed-Rate EIP	4.750	3.84%	31/03/33
Fixed-Rate EIP	3.833	4.46%	06/03/35
Fixed-Rate EIP	9.000	1.92%	28/01/37
Fixed-Rate EIP	10.633	4.02%	24/03/38
Fixed-Rate Maturity	30.000	3.46%	28/03/38
Fixed-Rate Maturity	30.000	3.47%	28/03/39
Fixed-Rate Maturity	30.000	3.48%	28/03/40
Fixed-Rate Maturity	30.000	3.49%	28/03/41
Fixed-Rate Maturity	33.656	3.50%	28/03/42
Fixed-Rate EIP	5.500	1.98%	25/03/51
Fixed-Rate EIP	5.700	2.17%	28/01/52
Fixed-Rate EIP	1.721	5.36%	26/06/53
Fixed-Rate EIP	2.000	5.32%	24/07/53
Fixed-Rate EIP	2.500	5.44%	18/08/53
Fixed-Rate EIP	1.750	5.26%	22/11/53
Fixed-Rate EIP	9.000	2.99%	03/12/59
Fixed-Rate Maturity	0.900	4.76%	18/07/73
Short-Term Maturities			
Fixed-Rate Maturity	5.00	4.39%	31/03/24
Total PWLB	**259.693**		

Local authorities are able to access preferential interest rates on PWLB loans (known as the "Certainty Rate"; currently a 0.2% discount on published rates) provided they submit a high-level description of their capital spending and financing plans (whether it is financed through PWLB borrowing or another source) for the following three years (meaning any capital spending and financing for the whole current financial year and subsequent two financial years), including their expected use of the PWLB.

The PWLB lending terms are contained in *Circular 163* (issued 21st October 2021). The updated terms now explicitly forbid borrowing for the purposes of purchasing investment assets primarily for yield. Thus Paragraph 41 requires that – before a loan can be granted – the Council's Section 151 Officer must confirm that the Council does not plan to:

- Use the PWLB to refinance any prior investment asset primarily for yield transactions which concluded after 25th November 2020; and/or
- Buy investment assets primarily for yield in the next three years.

The Council also has further outstanding loans of £33.8 million with other local authorities as summarised in Table 4 below.

Table 4: Local Authority Borrowing

Local Authority Short-Term Loans (@ 31st December 2023)*			
Lender	**Amount (£m's)**	**Interest Rate**	**Maturity Date**
Caerphilly County BC	5.0	5.50%	31/01/24
Cyngor Gwynedd	5.0	5.60%	25/01/24
Derry City & Strabane DC	2.0	5.40%	31/01/24
East Suffolk Council	2.0	5.50%	01/02/24
East Suffolk Council	2.0	5.50%	16/02/24
Fermanagh & Omagh DC	2.0	5.50%	25/01/24
Horsham DC	1.75	5.60%	25/01/24
Knowsley Metropolitan BC	3.0	5.40%	31/01/24
Northern Ireland Housing Executive	5.0	5.60%	26/01/24
Northern Ireland Housing Executive	5.0	5.60%	31/01/24
Salford City	1.0	5.60%	25/01/24
Total Local Authority	**33.75**		

**Exclusively fixed rate Maturity Loans*

The Council *expects* to borrow up to £275.7 million in 2024/25 (if the minimum Investment balance of £15.0 million illustrated in Table 2 is achieved). The Council may also borrow additional sums to pre-fund future years' requirements, providing the Authorised Limit for Borrowing of £425.621 million is not exceeded.

<u>*Objectives*</u>

The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Strategy

Given the significant cuts to local government funding in recent years, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Interest rates are currently at a 15-year high but are expected to fall in the coming years and it is therefore likely to be more cost effective over the medium-term to (preferably) use internal resources, or to borrow short-term loans instead.

By doing so, the Council reduces its net borrowing costs (despite foregone investment income) and reduces overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2023/24 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Council has previously raised all of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pension funds and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may take out further short-term loans to cover unplanned cash flow shortages.

Sources of Borrowing

The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- Any other UK public sector body
- UK public and private sector pension funds (except Essex County Pension Fund)
- Capital market bond investors; and
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

Other sources of Debt Finance

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase; and
- Sale and leaseback.

Municipal Bonds Agency

UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency would therefore be the subject of a separate report to full Council.

Short-Term and Variable Rate Loans

These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the Treasury Management indicators below.

Debt Rescheduling

The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Treasury Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure, plus balances and reserves held. The Council's 'Cash and Cash Equivalent' balance in 2023/24 has increased significantly since December 2023 as a consequence of the North Weald Airfield capital receipt (value £88.215 million). The Strategy to include a "Liquidity Allowance" of £15.0 million is therefore easily met.

The Council currently (@ 31st December 2023) holds £88.4 million in Cash and Cash Equivalents, an increase of £74.3 million compared to 31st March 2023 (excluding an outstanding balance of £6.0 million owed by Qualis to the Council in respect of an original Cash Flow Loan). The overall position is summarised in Table 5 below.

Table 5: Treasury Management Investments

Treasury Management Investments (@ 31st December 2023)		
Counterparty	**Amount (£m's)**	**Interest Rate**
Long-Term Investments (maturity > 12 months)		
None	N/A	N/A
Short-Term Investments (maturity < 12 months)		
Local Authorities	5.0	5.70%
Cash and Cash Equivalents (instant access)		
NatWest Bank (bank deposits)	2.4	3.25%
DMADF (Government)	61.5	5.19%
Deutsche Managed (MMF)	10.0	5.24%
Goldman Sachs (MMF)	10.0	5.23%
JP Morgan (MMF)	4.5	5.19%
Total Investments	**93.4**	

Objectives

The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Council also aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

Strategy

As demonstrated by the Liability Benchmark above, the Council expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments.

ESG Policy

Environmental, Social and Governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level.

Nevertheless, the Council is mindful of its ESG responsibilities and only invests in banks and funds that have Arlingclose approval. This ensures (through an annual check) – for example – that approved banks remain signatories to the UN Principles for Responsible Banking and approved Money Market Fund managers remain signatories to the UN Principles for Responsible Investment.

Approved Counterparties

The Council may invest its surplus funds with any of the counterparty types in Table 6 below, subject to the limits shown.

Table 6: Treasury Investment Counterparties and Limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	N/A
Local authorities & other Government entities	25 years	£10 million	Unlimited
Banks (unsecured)*	13 months	£3.0 million	£20.0 million
Building Societies* (unsecured)	13 months	£2.0 million	£2.0 million
Registered Providers* (unsecured)	5 years	£3.0 million	£3.0 million
Money Market Funds*	N/A	£10.0 million	Maximum of 3 Funds (see below)

Note - this table must be read in conjunction with the notes below.

<u> Minimum Credit Rating</u>*

Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken account of.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £10 million per counterparty as part of a diversified pool (e.g., via a peer-to-peer platform).

<u>Government</u>

Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities, and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

<u>Banks and Building societies (unsecured)</u>

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

<u>Registered providers (unsecured)</u>

Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government, and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving Government support if needed.

<u>Money Market Funds</u>

Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee.

If operational need requires the use of more than three funds, the S151 officer can authorise this in consultation with the Portfolio Holder for Finance, Qualis Client and Economic Development, provided this is reported to the Chair of the Audit and Governance Committee, and a report is submitted to the next available meeting of the Audit and Governance Committee.

<u>Operational Bank Accounts</u>

The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £3.0 million per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25.0 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

<u>Risk Assessment and Credit Ratings</u>

Credit ratings are obtained and monitored by the Council’s treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- No new investments will be made
- Any existing investments that can be recalled or sold at no cost, will be; and
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “negative watch”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn [on the next working day] will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

<u>Other Information on the Security of Investments</u>

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council’s treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment Limits

The Council had £11.591 million in (General Fund + HRA) revenue reserves on its (draft) Balance Sheet as at 31st March 2023 to cover unexpected credit losses in an emergency. A reasonable level of risk to carry in a single institution would be (say) 25%. An Investment Limit for a single institution (excluding Government and Money Market Funds) of £3.0 million has therefore been applied.

Liquidity Management

The Council uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's Medium-Term Financial Plan and Cash Flow Forecast.

The Council will usually spread its liquid cash over at least three providers (e.g., Bank, DMADF and Money Market Funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Prudential Indicators

The Council measures and manages its exposures to Treasury Management risks using the following indicators.

Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit Risk Indicator	**Target**
Portfolio average credit rating	A-

Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling [three] month period, without additional borrowing.

Liquidity Risk Indicator	**Target**
Total cash available within 3 months	£15.0 million

Interest Rate Exposure

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest Rate Risk Indicator	**Limit £'s**
Upper limit on one-year revenue impact of a 1% rise in interest rates	(500,000)
Upper limit on one-year revenue impact of a 1% fall in interest rates	500,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates. However, following the receipt of the North Weald Airfield capital receipt, and the utilisation of the cash generated for the repayment of short-term loans, there are currently no anticipated loan maturities in 2024/25. The risk in this case is therefore based solely on investments i.e. if interest rates rise, the Council benefits and vice versa.

Based on an overall assumed investment balance of circa £50.0 million during 2024/25, the potential one-year revenue impact of a 1% change in interest rates would not exceed £500,000.

Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the Maturity Structure of Borrowing will be:

Refinancing Rate Risk Indicator	Upper Limit	Lower Limit
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and within 15 years	50%	0%
15 years and within 20 years	50%	0%
20 years and within 25 years	50%	0%
25 years and above	50%	0%

It should be noted that – based on Arlinclose advice – the proposed limits presented above are deliberately wide in range. This is because the indicator is only designed to cover the risk of replacement loans being unavailable, rather than interest rate risk.

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Long-Term Treasury Management Investments

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on long-term treasury management investments will be:

Price Risk Indicator	2024/25	2025/26	2026/27
Limit on principal invested beyond year end	£15.0 million	£10.0 million	£5.0 million

Related Matters

Housing Revenue Account

On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g., premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured, with interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

Markets in Financial Instruments Directive (MIFID)

The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers, and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

Financial Implications

In 2024/25, overall investment income (General Fund and HRA) is budgeted at £2,730,000.

The budgets for General Fund and HRA debt interest payable in 2024/25 are £1,637,160 (including interest payable on Qualis-related loans for on-lending) and £5,616,000 respectively.

If investment levels and borrowing, or interest rates, differ from expectations, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any specific Treasury Management Strategy for local authorities to adopt. The Section 151 Officer, having consulted the Portfolio Holder for Finance and Economic Development, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on Income and Expenditure	Impact on Risk Management
Invest in a narrower range of counterparties and/or for shorter times.	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater.
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller.
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain.
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain.
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain.

Existing Investment & Debt Portfolio

	31/12/23 Actual Portfolio £m	31/12/23 Average Rate %
External Borrowing		
Public Works Loan Board	259.7	3.34%
Local authorities	33.8	5.50%
Other loans	-	-
Total External Borrowing	**293.5**	
Other Long-Term Liabilities:		
Leases	-	-
Total Other Long-Term Liabilities	**-**	
Total Gross External Debt	**293.5**	
Treasury Investments		
The UK Government	61.5	5.19%
Local authorities	5.0	5.70%
Banks (unsecured)	2.4	3.25%
Money Market Funds	24.5	5.23%
Total Treasury Investments	**93.4**	
Net Debt	**200.1**	

Appendix B

Investment Strategy 2024/25 (DRAFT)

Introduction

The Council invests its money for three broad purposes:

- Because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **Treasury Management Investments**)
- To support local public services by lending to or buying shares in other organisations (**Service Investments**); and
- To earn investment income (known as **Commercial Investments** where this is the main purpose).

This Investment Strategy meets the requirements of statutory guidance issued by the Government in January 2018 and focuses on the second and third of these categories.

Treasury Management Investments

The Council typically receives its income in cash (e.g., from taxes and grants) before it pays for its expenditure in cash (e.g., through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and the Government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of Treasury Management investments is expected to fluctuate in 2024/25, although the aim is to maintain a liquidity balance of £15.0 million.

Contribution

The contribution that these investments make to the objectives of the Council is to support effective Treasury Management activities.

Full details of the Council's policies and its plan for 2024/25 for Treasury Management investments are covered in a separate document, the Treasury Management Strategy (***Appendix A*** of this report).

Service Investments: Loans

Contribution

The Council will sometimes make investments to support service delivery objectives where there is a strategic case for doing so. This is an approach that has been adopted by the Council for many years 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, whilst protecting the local Waste Collection service.

More recently, the Council has invested (and continues to invest) in Service Loans to Qualis in order to help enable the deliver on the creation more jobs, growth in the local economy, and the improvement of housing and public amenities in the district.

The Council also provides “Home Assistance Loans” to eligible homeowners in certain circumstances (e.g., to help achieve the ‘Decent Homes’ standard in private sector housing). The loans are funded from the General Fund Capital Programme; they are secured against the property and are repayable on disposal.

In addition, the Council is committed to providing loans to leaseholders in Council owned blocks of flats for the cost of major works, for which they are liable under Section 20 of the Landlord and Tenant Act 1985 (as amended by the Commonhold and Leasehold Reform Act 2002). The loans are funded through the Housing Revenue Account and take the form extended payment periods (subject to interest charges). It is a new scheme, recently approved by the Cabinet, and the first loans are expected to be issued in 2024/25.

Security

The Qualis Business Plan requires the approval of the Council, and forms part of a wider Governance Framework set-up to protect the interests of the Council (when lending to Qualis).

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

Table 1: Service Investments

Category of Borrower	31/03/23 Actual			Total Approved Limit
	Balance Owing	Loss Allowance	Net Figure in Accounts	
	£000’s	£000’s	£000’s	£000’s
Subsidiaries (Qualis):				
Working Capital Loan	6,000	(142)	5,858	**6,000**
Asset Purchase Loan	14,138	(465)	13,673	**16,782**
Development Loans	18,333	(297)	18,036	**68,218**
Regeneration Loans	0	0	0	**35,000**
Home Assistance Loans (General Fund)	387	(163)	224	**150***
Leaseholder Loans (HRA)	0	0	0	**250****
TOTAL	**38,858**	**(1,067)**	**37,791**	**126,400**

** Draft Capital Programme allocation 2024/25 to 2028/29 (£30,000 over five-years)*

***Based on estimates supplied by Housing officers*

Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's Statement of Accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk Assessment

The Council assesses the risk of loss before committing to, and whilst holding, service loans. The approach taken is tailored to individual circumstances and will often include the engagement of professional advisors, the undertaking of credit checks etc. In addition, the Council will – wherever possible – look to securitise loans against physical assets (Property, Plant and Equipment).

Service Investments: Shares

Contribution

The Council will sometimes invest in shares to support local public services and stimulate local economic growth. Most notably the Council has 1 Ordinary Share in, and is the sole shareholder of, the Qualis Group, which has been set up to help create more jobs, grow the local economy, and improve housing and public amenities in the district.

Security

One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. However, in the case of the Qualis Group, (other than for service purposes) the Council has invested with a view to realising a significant financial return through the receipt of dividends and, despite limited liability status, the Council carries significant risk in the event of the financial failure of Qualis (e.g., through a guarantee to the Pension Fund as part of the transfer of staff from the former in-house Housing Repairs service).

The Qualis Business Plan therefore requires the approval of the Council, and forms part of a wider Governance Framework purposely set-up to protect the interests of the Council.

Risk Assessment

The Council assesses the risk of loss before committing to, and whilst holding, shares. The approach taken is tailored to individual circumstances, although in the case of Qualis, extensive use of professional advisors was made.

Non-Specified Investments

Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in Government guidance.

Commercial Investments: Property

Contribution

The Council invests in the acquisition of commercial property in a range of locations across the district. The value of the overall portfolio declined from £162.006 million to £148.483 million in 2022/23 (due to Balance Sheet valuation losses), with net income of £8.447 million achieved (up £0.957 million compared to 2021/22). Shops and 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 (currently the lowest district Council Tax in Essex) as well as helping to shape the district through the protection and promotion of local business and employment opportunities.

Table 2: Commercial Property Investments

Portfolio Category	Actuals				Expected		
	Balance Sheet Value 01/04/14	**Net Additions/ (Disposals)**	**Gains/ (Losses)**	**Balance Sheet Value 31/03/23**	**Net Additions/ (Disposals)**	**Gains/ (Losses)**	**Balance Sheet Value 31/03/24**
	£000's	**£000's**	**£000's**	**£000's**	**£000's**	**£000's**	**£000's**
Shops	**17,201**	58,524	17,754	**93,479**	22	0	**93,501**
Industrial Units	**12,997**	11,025	14,092	**38,114**	(44)	(23)	**38,047**
Other	**9,556**	320	7,014	**16,890**	(87,690)	87,620	**16,820**
Total Portfolio	**39,754**	**69,869**	**38,860**	**148,483**	**(87,712)**	**87,597**	**148,368***

**31/03/24 valuation estimates not available*

Security

In accordance with Government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs, a fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment.

The Council's Commercial Property Portfolio has been acquired over many years and, within reporting deadlines, it has not been possible to identify the purchase cost of some of the older assets. Instead, the Balance Sheet value as at 1st April 2014 has been used as a proxy for purchase cost. The table above quite clearly shows a substantial gain in the value of the Portfolio over the last decade.

Risk Assessment

The Council assesses the risk of loss before committing to commercial property acquisitions; the 'strength of covenant' is of primary interest. Thus, checks on tenants, purchasers or sellers are done through Dunn & Bradstreet, with reports reviewed by property and finance teams within Qualis. Where financial strength is low/higher risk, rent deposits or guarantors may be required. For major transactions, Qualis may advise the Council not to engage with the other party if they are deemed to be high risk. Depending on the opportunity, in some instances, Qualis may look at insurance options in order to mitigate risk.

Liquidity

Compared with other investment types, commercial property is relatively difficult to sell and convert to cash at short notice and can take a considerable period of time to sell in certain market conditions.

However, the Council's liquidity risk is very low, which reflects the financing structure of the portfolio; underlying borrowing is minimal, having been purchased historically during a period when the Council's General Fund was debt free.

Commercial Investments: Loans

Contribution

The Council also provided an Investment Loan of £30.0 million to Qualis in September 2020. This was a key part of the Qualis Business Plan and was important part of helping to establish the company in its infancy.

The loan was utilised for the acquisition of commercial property outside the district, providing a key income stream to Qualis, which in turn enables the company to service the interest payments on a 10-Year maturity loan; the Council makes a margin on the interest payments.

Table 2: Commercial Loans

Category of Borrower	31/03/23 Actual			Total Approved Limit
	Balance Owing	Loss Allowance	Net Figure in Accounts	
	£000's	£000's	£000's	£000's
Subsidiaries (Qualis):				
Investment Loan	30,000	(714)	29,286	30,000
TOTAL	**30,000**	**(714)**	**(29,286)**	**(30,000)**

Security

In order to protect the Council's interests, both "floating" and "fixed" charges were included in the legal agreement for the Investment Loan, which would be activated in the event of a payment default by Qualis.

Risk Assessment

As with Service Loans, the Council assesses the risk of loss before committing to, and whilst holding, Commercial Loans. In this instance, given that Qualis was a fledgling company in September 2020, detailed consideration was also given to the Business Plan before the Council committed to granting the Investment Loan.

Loan Commitments and Financial Guarantees

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

The Council 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).

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 2023 was £154.475 million.

The Council 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. The same guarantee was also provided for a further 25 employees who were transferred to Qualis on 1st May 2023, as part of the transfer of the Grounds Maintenance 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.

Proportionality

Table 4 below shows the extent to which the expenditure planned to meet the service delivery objectives of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the MTFP. Should it fail to achieve the expected net profit, the Council's ongoing financial planning process includes short-term measures such as budget contingencies where required (e.g., a contingency to cover for potential slippage in the forecast drawdown profile for Qualis Service Loans was included in the 2023/24 budget). The rolling MTFP also acts as an early warning sign, which enables the Cabinet and senior officers to be both proactive and reactive as financial circumstances dictate. This includes making suitable adjustments to spending priorities and targeting efficiency savings in order to reduce net expenditure.

Table 4: Proportionality of Investments

Description	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 MTFP	2026/27 MTFP
	£000's	£000's	£000's	£000's	£000's
Investment Income	10,428	11,057	11,921	12,481	12,702
Gross Service Expenditure	74,537	70,179	69,367	71,716	72,362
Proportion	14%	16%	17%	17%	18%

Borrowing in Advance of Need

Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the extra sums borrowed. The Council follows this guidance and does not borrow more than or in advance of need.

Capacity, Skills, and Culture

Statutory Officers and Elected Members

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making investment decisions. In particular, 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 including Treasury Management.

The Section 151 Officer maintains personal oversight on the negotiation of all major commercial deals and achieves oversight and control of all other commercial deals through the governance process; this extends to personally signing off significant financial commitments.

The Council also 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.

Investment Indicators

The Council has set the following quantitative indicators to allow Members and the public to assess the Council's total risk exposure as a result of its investment decisions.

Total Risk Exposure

The first indicator shows the Council's total exposure to potential investment losses. This includes the amounts that the Council is committed to lend but have yet to be drawn down.

Table 5: Total Investment Exposure

Total Investment Exposure	**31/03/2023 Actual**	**31/03/2024 Forecast**	**31/03/2025 Forecast**
	£000's	**£000's**	**£000's**
Treasury Management Investments	14,100	50,000	20,500
Service Investments: Loans	38,858	69,358	87,079
Service Investments: Shares	0*	0*	0*
Commercial Investments: Property	148,483	148,368	148,368
Commercial Investments: Loans	30,000	30,000	30,000
TOTAL INVESTMENTS	**231,441**	**297,726**	**285,947**
Commitments to Lend	62,110	21,930	2,030
Guarantees Issued on Loans	0	0	0
TOTAL EXPOSURE	**293,551**	**319,656**	**287,977**

**De minimis (single share in Qualis) – loss allowances excluded*

How Investments are Funded

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

Table 6: Investments Funded by Borrowing

Investments Funded by Borrowing	31/03/2023 Actual	31/03/2024 Forecast	31/03/2025 Forecast
	£000's	£000's	£000's
Treasury Management Investments	0	0	0
Service Investments: Loans	38,858	69,358	87,079
Service Investments: Shares	0	0	0
Commercial Investments: Property	29,117	31,712	31,712
Commercial Investments: Loans	30,000	30,000	30,000
TOTAL FUNDED BY BORROWING	**97,975**	**131,070**	**148,791**

Rate of Return

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

Table 7: Investment Rate of Return

Investments Net Rate of Return	31/03/2023 Actual	31/03/2024 Forecast	31/03/2025 Forecast
	£000's	£000's	£000's
Treasury Management Investments	3.85%	5.18%	4.30%
Service Investments: Loans	4.57%	3.63%	3.39%
Service Investments: Shares	0	0	0
Commercial Investments: Property	5.91%	5.76%	5.76%
Commercial Investments: Loans	1.94%	1.94%	1.94%
ALL INVESTMENTS	**5.04%**	**4.78%**	**4.53%**

Report to the Audit & Governance Committee

Date of meeting: **15th February 2024**

Epping Forest District Council

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

Subject: **Capital Strategy 2024/25 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 2024/25 to 2026/27 ***(Appendix A),*** including reconfirming the draft Minimum Revenue Provision (MRP) Statement 2024/25 ***(Annex 1)***.

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).

However, a decade of austerity in the public sector, and especially local government, has led to an increasing emphasis on commercialisation in order to protect – rather than cut – public services. Commercial property investments financed by cheap borrowing available to local authorities (through the PWLB) especially has seen a sharp increase; such activity has become increasingly controversial.

In response to a recommendation from the Public Accounts Committee, CIPFA launched an initial (principles-based) consultation in February 2021 on proposals to strengthen the provisions within the 2017 Code (and the Treasury Management Code that complements it). The consultation process eventually led to the publication of CIPFA's updated Prudential Code in December 2021; it is a legal requirement for local authorities to "have regard" – with effect from 2023/24 – to the 2021 Code when carrying out its duties.

This report presents a draft Capital Strategy (2024/25 to 2026/27) (***Appendix A***) –incorporating the updated requirements of the 2021 Code – for consideration and comment by the Audit and Governance Committee, before making appropriate recommendations to full Council on 20th February 2024.

The Strategy sets out the Council’s draft Capital Programme for its General Fund and Housing Revenue Account (as recommended by Cabinet on 5th February 2024) 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 Programme is “prudent, affordable and sustainable” as required by the Code.

Wider topics considered in the Capital Strategy also 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.

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 first introduced in the 2017 edition of the Code. The updated 2021 edition includes a number of revisions to the Code and its adoption was required with effect from the 2023/24 financial year.

Safer, Cleaner and Greener (SCG) Implications

None.

Background Papers

CIPFA’s Prudential Code for Capital Finance in Local Authorities (2021 Edition).

(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 2024/25 to 2026/27 (DRAFT)

1. Introduction

1.1 This Capital Strategy report gives a high-level overview of how Capital Expenditure, Capital Financing and Treasury Management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance Members' understanding of these – sometimes technical – areas.

1.2 Decisions made this year on Capital and Treasury Management will have financial consequences for the Council for many years into the future. Such decisions are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

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.

2.1.2 In 2024/25, Epping Forest District Council is planning capital expenditure of £65.265 million (and £142.493 million over the next three years) as summarised in Table 1 below.

Table 1: Prudential Indicator: Estimates of Capital Expenditure

Description	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000's	£000's	£000's	£000's	£000's
General Fund Services	3,949	**12,164**	12,278	19,013	2,389
Qualis Investments (GF)	8,000	**31,625**	19,900	2,030	0
Housing Revenue Account	14,975	**29,883**	33,087	34,576	19,220
TOTALS	**26,924**	**73,672**	**65,265**	**55,619**	**21,609**

2.1.3 The most significant General Fund capital scheme in the Programme is the development of the new Epping Leisure Facility (£33.1 million). The wider 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 £19.900 million draft budget allocated to Qualis Investments in 2024/25, with a further allocation of £2.030 million in 2025/26. See Section 5 of this report below 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 £40.413 million allocated to the Housing Development Programme over a five-year period commencing 2024/25 through to 2028/29.

Governance

2.1.6 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.

2.1.7 The draft Capital Programme is then subjected to formal Scrutiny prior to setting the budget (followed by Cabinet and full Council approval). The draft Capital Programme for 2024/25 to 2028/29 was considered by Cabinet on 5th February 2024.

2.2 Financing

2.2.1 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	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000's	£000's	£000's	£000's	£000's
Internal: Capital Resources	15,914	19,709	16,026	16,207	13,267
Internal: Revenue Resources	0	1,364	2,499	2,667	3,098
External Sources	1,377	3,301	1,218	3,329	3,281
Debt	9,633	49,298	45,522	33,416	1,963
TOTALS	**26,924**	**73,672**	**65,265**	**55,619**	**21,609**

2.2.2 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	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000's	£000's	£000's	£000's	£000's
Capital Resources	4,614	2,223	5,326	5,293	2,135
Revenue Resources (MRP)	1,125	1,164	1,306	1,900	2,426
TOTALS	**5,739**	**3,387**	**6,632**	**7,193**	**4,561**

2.2.3 The Council's adopted MRP statement (considered by the Audit & Governance Committee in November 2022 and approved by full Council in February 2023), which can be found at ***Annex 1*** below, has been reviewed by the Section 151 Officer and is recommended for re-adoption for 2024/25 without amendment.

2.2.4 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 £41.3 million in 2024/25. 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	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£m's	£m's	£m's	£m's	£m's
General Fund	159.1	200.9	227.1	240.2	236.1
Housing Revenue Account	154.5	161.9	177.0	191.2	192.6
TOTALS	**313.6**	**362.8**	**404.1**	**431.4**	**428.7**

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 2024) 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	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000’s	**£000’s**	**£000’s**	**£000’s**	**£000’s**
Asset Sales	4,122	1,711	4,744	4,673	1,481
Loans Repaid	492	512	582	620	654
TOTALS	**4,614**	**2,223**	**5,326**	**5,293**	**2,135**

3.2.2 The sale (at market value) of a number of key regeneration sites within the district to Qualis occurred in October 2021, which included the Cottis Lane site (valued at £3.470 million) as part of the development of the new Leisure Facility and Multi-Storey Car Park in Epping (overall scheme scheduled for completion in 2025/26). A further sale (at market value) took place in November 2023 of the Cartersfield Road site (valued at £2.375 million). Loans were granted by the Council to Qualis to enable the purchases. 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 2023) has borrowing of £293.5 million at an average interest rate of 3.6% and £93.4 million in Treasury Investments at an average interest rate of 5.1%.

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 (current local authority rates typically in the range 4.4% to 5.7%) and long-term fixed rate loans where the future cost is known but higher (current PWLB rates typically in the range 4.9% to 5.6%, excluding a 0.2% discount on General Fund loans and currently, a 0.6% discount on HRA loans).

4.2.2 The Council no longer borrows to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board.

4.2.3 Projected levels of the Council's outstanding/current 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	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£M's	£M's	£M's	£M's	£M's
Outstanding Debt (including leases)	281.6	270.8	266.2	261.5	256.9
Capital Financing Requirement (CFR)	313.6	362.9	404.1	431.4	428.7

4.2.4 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

4.2.5 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 £15.0 million at each year-end. The actual Liability Benchmark was £284.9 million as at 31st March 2023 and is expected to increase to £300.3 million over the four-year period.

Table 7: Borrowing and the Liability Benchmark

Description	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£M's	£M's	£M's	£M's	£M's
Outstanding Borrowing	281.6	270.8	266.2	261.5	256.9
Liability Benchmark	284.9	234.5	275.7	303.0	300.3

4.2.6 Table 7 above shows that the Council is expected to be above its Liability Benchmark on 31st March 2024; this is a short-term position and latest projections above show that the Council is on course to be increasingly below its Liability Benchmark from 2024/25 onwards.

Affordable Borrowing Limit

4.2.7 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	2023/24 Actual	2024/25 Proposed	2025/26 Estimate	2026/27 Estimate
	£000's	£000's	£000's	£000's
Operational Boundary – borrowing	399,973	415,621	443,512	441,326
Operational Boundary – other long-term liabilities	0	0	0	0
Operational Boundary – total external debt	**399,973**	**415,621**	**443,512**	**441,326**
Authorised Limit – borrowing	409,973	425,621	453,512	451,326
Authorised Limit – other long-term liabilities	0	0	0	0
Authorised Limit – total external debt	**409,973**	**425,621**	**453,512**	**451,326**

HRA Borrowing: Local Indicator

4.2.8 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 (6,442 properties, with a Balance Sheet value of £806.892 million as at 31st March 2023). 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.

4.2.9 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 remain constant at 0.19 in all years apart from 2025/26 when it is expected to briefly rise to 0.20; 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).

4.2.10 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	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
	Ratio	Ratio	Ratio	Ratio	Ratio
Loan to Value	0.19	0.19	0.19	0.20	0.19
Target Maximum (LTV)	**0.70**	**0.70**	**0.70**	**0.70**	**0.70**

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

4.2.12 Further details on borrowing are contained in the Treasury Management Strategy 2024/25.

4.3 Treasury Investment Strategy

4.3.1 Treasury Investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

4.3.2 The Council's policy on Treasury Investments is to prioritise security and liquidity over yield; that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the Government, 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, although there was a significant increase in cash in December 2023 due to a significant capital receipt received following a land disposal at North Weald Airfield, which is currently assumed to be available for short-term investment only.

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

Table 10: Treasury Management Investments

Description	31/03/23 Actual	31/03/24 Forecast (Q3)	31/03/25 Budget	31/03/26 Budget	31/03/27 Budget
	£M's	£M's	£M's	£M's	£M's
Long-Term Investments	0	0	0	0	0
Short-Term Investments	14.1	50.0	20.5	15.0	15.0
TOTALS	**14.1**	**50.0**	**20.5**	**15.0**	**15.0**

Risk Management

4.3.5 The effective management and control of risk are prime objectives of the Council's Treasury Management activities. The Treasury Management Strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses.

4.3.6 Further details on the Treasury Management Prudential indicators can be found in the Treasury Management Strategy.

Governance

4.3.7 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 a recommendation from the Audit and Governance Committee), whereas quarterly updates are reported exclusively to the Audit and Governance Committee (the Committee with responsibility for scrutinising Treasury Management decisions).

5. Service Investments

5.1 The Council will sometimes make investments to support service delivery objectives where there is a strategic case for doing so. This is an approach that has been adopted by the Council for many years 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, whilst protecting the local Waste Collection service.

5.2 More recently, the Council has invested (and continues to invest) in Service Loans to Qualis in order to deliver its Housing and Regeneration ambitions for the district.

5.3 The Council also provides "Home Assistance Loans" to eligible homeowners in certain circumstances (through the General Fund e.g., to help achieve the 'Decent Homes' standard in private sector housing) and Leaseholder Loans (through the HRA, enabling leaseholders to pay for major works on the communal areas of Council-owned blocks of flats).

5.4 The Council will sometimes invest in shares to support local public services and stimulate local economic growth. Most notably the Council has 1 Ordinary Share in, and is the sole shareholder of, the Qualis Group, which has been set up to help create more jobs, grow the local economy, and improve housing and public amenities in the district.

5.5 Total Investments for Service Purposes were valued at £38.858 million as at 31st March 2023. The largest category of Service Investments is Development Loans to Qualis (Net Book Value on Balance Sheet of £18.333 million as of 31st March 2023). This is enabling Qualis to develop transferred assets, including the former Conder Building site for Housing provision. The value of this Investment is rising significantly as Qualis progressively draws down further tranches of the loan as the various sites are developed.

Risk Management

5.6 In light of the public service objective, the Council is willing to take more risk than with Treasury Investments, however an overriding objective is to ensure that such investments breakeven (and usually) generate a profit after all costs.

5.7 The risk of incurring unexpected losses is tailored to individual circumstances, but is often managed by the engagement of professional advisors, the undertaking of credit checks etc. In addition, the Council will – wherever possible – look to securitise loans.

Governance

5.8 Decisions on Service Investments are made by the Council's Cabinet and require the support of a full business case. Most loans represent capital expenditure and purchases will therefore also be approved as part of the Capital Programme (which is approved by full Council).

5.9 With regard to Qualis specifically, it is important that it has the freedom to 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.

5.10 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.

6. Commercial Investments

Commercial Property

6.1 The Council invests in the acquisition of commercial property in a range of locations across the district. The value of the overall portfolio declined from £162.006 million to £148.483 million in 2022/23 (due to Balance Sheet revaluation losses), with net income of £8.774 million achieved (up £0.957 million compared to 2021/22). Shops and 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 (currently the lowest district Council Tax in Essex) as well as helping to shape the district through the protection and promotion of local business and employment opportunities.

Qualis Investment Loan

6.2 Access to affordable finance is a key enabler in the Qualis Business Plan which underpins the Council's ambition to create more jobs, grow the local economy, and improve housing and public amenities in the district. Consequently, most of the loans granted to Qualis are Service Investments (as presented above in Section 5), which are aimed at facilitating the delivery of those objectives (they are all 'district council functions'), whilst also generating a margin; the loans are *not* provided primarily for the purpose of generating a profit.

6.3 However, the Council provided an Investment Loan of £30.0 million to Qualis in September 2020. This was a key part of the Qualis Business Plan and an important part of helping to establish the company in its infancy. This was purely a 'debt-for-yield' Commercial Investment, with the loan utilised for the acquisition of commercial property outside the district, providing a key income stream to Qualis; although the Council makes a margin on the loan (and the rental income helps sustain Qualis; a wholly owned subsidiary), there is no direct service benefit, and the primary objective is to generate a financial return (for both Qualis and the Council).

6.4 It should be noted that the Prudential Code 2021 (Paragraph 51) now makes clear that "an authority must not borrow to invest primarily for financial return". This is a change to the 2017 edition of the Prudential Code, with the PWLB also making its loans to local authorities conditional on meeting the requirements of Paragraph 51. The Council no longer undertakes debt-for-yield investments and maintains full access to the PWLB borrowing facility.

Risk Management

6.5 With financial return being the main objective, the Council accepts higher risk on Commercial Investments compared to Treasury Investments. The principal risks include rental losses caused by voids and insolvencies (on Commercial Property) and payment default (on the Qualis Loan). The risks are managed as follows:

- *Commercial Property* – the Council has appointed Qualis to deliver the property and asset management service to its commercial property portfolio (comprising mostly of retail and industrial units). Qualis employs a team of qualified and experienced property professionals to maximise portfolio performance.

  Checks on tenants, purchasers or sellers are done through Dunn & Bradstreet, with reports reviewed by property and finance teams within Qualis. Where financial strength is low/higher risk, rent deposits or guarantors may be required. For major transactions, Qualis may advise the Council not to engage with the other party if they are deemed to be high risk. Depending on the opportunity, in some instances, Qualis may look at insurance options in order to mitigate risk.

- *Qualis Investment Loan* – the loan agreement was purposely drafted to protect the Council's position, with charges secured against both Qualis assets and the commercial assets acquired with the proceeds. Progress against the Qualis Business Plan is also frequently monitored and reported to Members (see further discussion on Governance arrangements below).

Governance

6.6 General decisions on Commercial Investments are made by the Council's Cabinet and require a full business case, which is supported by the Section 151 Officer. Most loans represent capital expenditure and purchases will therefore also be approved as part of the Capital Programme (which itself is approved by full Council).

6.7 Commercial Property arrangements changed with effect from April 2023, with the transfer of the Council's Asset Management function to Qualis, following completion of a successful development trial of the new arrangements since October 2021. The Council retains ownership of the Asset Portfolio, with day-to-day management passing to Qualis.

6.8 The Council benefits from the additional professional expertise and agility available within Qualis, which combine with in-built safeguards to protect the interests of the Council.

6.9 Arrangements to ensure that the Council exercises appropriate oversight over Qualis and minimises the associated risks are the are the same as those described above for Service Investments (see Paragraphs 5.10 and 5.11).

Table 11: Prudential Indicator: Net Income from Commercial and Service Investments to Net Revenue Stream

Description	31/03/23 Actual	31/03/24 Forecast (Q3)	31/03/25 Budget	31/03/26 Budget	31/03/27 Budget
	£000's	£000's	£000's	£000's	£000's
Total Net Income from Service and Commercial Investments	10,428	11,058	11,921	12,481	12,702
Proportion of Net Revenue Stream	66%	65%	68%	69%	69%

6.10 The relatively high proportion of income from Service and Commercial Investments illustrated in the table above reflects the Council's commercial focus over many years as to means of protecting local public services, whilst maintaining a low Council Tax.

7. Other Liabilities

7.1 Outstanding Commitments

7.1.1 The Council 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). A funding deficit was valued by the actuary at £2.66 million as at 31st March 2022 (with the Epping share of the Essex fund liabilities 98.5% funded at that point). Back-funding payments of £0.193 million are scheduled to be made in 2024/25; and

- The Council has also set aside £1.106 million (as at 31st March 2023) 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's current HRA Business Plan 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 2023 was £154.475 million.

7.2.4 The Council 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. The same guarantee was also provided for a further 25 employees who were transferred to Qualis on 1st May 2023, as part of the transfer of the Grounds Maintenance 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; the 'standard' CIPFA Prudential Indicator compares this to "Net Revenue Stream" (the amount funded from Council Tax, Business Rates, and general Government grants).

8.1.2 However, the standard definition of Net Revenue Stream does not adequately take account of the circumstances of Epping Forest District Council, which has had – for many years – a major income stream from Commercial Property and – more recently – an additional income stream from Qualis loan margins. Factoring in those two major sources of income produces a more meaningful Prudential Indicator, tailored to the specific circumstances of this Council. The 'local' Prudential Indicator is presented in the table below, alongside the standard CIPFA Indicator (for comparison purposes only).

Table 12: Prudential Indicator: Proportion of Financing Costs to Net Revenue Stream (General Fund)

General Fund Financing Costs	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Budget	2025/26 Budget	2026/27 Budget
	£000's	**£000's**	**£000's**	**£000's**	**£000's**
Financing Costs	2,657	2,525	363	2,032	2,940
Proportion of Net Revenue Stream (Standard CIPFA Indicator)	17%	15%	2%	11%	16%
Proportion of Net Revenue Stream (Local Indicator)	**10%**	**9%**	**1%**	**7%**	**9%**

Financing: Local Indicator (HRA)

8.1.3 As noted above in Section 4.2, the Council also monitors the ability of the HRA to meet interest costs from its Net Cost of Services. Table 13 below shows a stable position whereby HRA Interest Cover is expected to remain above the Target Minimum for the duration of this Strategy.

Table 13: Local Indicator: Interest Cover (HRA)

Description	2022/23 Actual	2023/24 Forecast (Q3)	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
	Ratio	**Ratio**	**Ratio**	**Ratio**	**Ratio**
HRA Interest Cover	1.02	1.13	1.24	1.33	1.46
Target Minimum (IC)	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**

8.1.4 It can be seen from Table 13 above that – based on current projections – current HRA borrowing plans are expected to exceed the Interest Cover target from 2025/26 onwards.

8.2 “Prudence, Affordability and Sustainability”

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

<u>Prudence</u>

- *Prudential Indicator 13 (General Fund)* (Paragraph 8.1.2) – <u>Proportion of Financing Costs to Net Revenue Stream (Local Indicator)</u> – following a spell of recent increases in Financing Costs as a consequence of the Council’s ambitions for capital investment in its strategic priorities over the medium-term, including its ambitions for Qualis, combining with a sharp increase in global interest rates, the North Weald Airfield capital receipt has a major impact on the profile of this indicator, especially in the short-term. This has caused anticipated Financing Costs to plummet from a forecast of £2.525 million in 2023/24 to just £0.363 million in 2024/25 with a commensurate decrease in the indicator, although as the table demonstrates, the Proportion of Financing Costs to Net Revenue Stream is expected to begin rising again from 2025/26 onwards.

  The standard CIPFA indicator shows the impact on taxpayers should the Council lose both its income from Commercial Property and suffer a default by Qualis on its loans. The local indicator therefore recognises income from Commercial Property and interest received from Qualis loans. Importantly, both indicators remain under 20% for the duration of the forecast, which is within expected and controllable parameters. It should also be noted that:

  - The Council’s Commercial Property Portfolio (Balance Sheet value £148.483 million as at 31st March 2023) overwhelmingly debt free and not backed by Council borrowing. This gives the Council flexibility to realise substantial capital receipts through asset sales without the need to repay underlying borrowing, should the need arise.
  - 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 predominantly 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 the Local Indicator should threaten to breach threshold of 20%, the Section 151 Officer would engage with the Council.

- *Local Indicator 14 (HRA)* (Paragraph 8.1.3) – <u>HRA Interest Cover</u> – current estimates indicate that the 1.25 minimum cover threshold is to be exceeded from 2025/26 (i.e. within the lifetime of this Strategy)

- *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 (£60.488 million over the five years from 2024/25) have been included in the 2024/25 Budget and Medium-Term Financial Plan (MTFP), extending to 2028/29; 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 the recently completed 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 qualified 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 as 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 – through its arms-length arrangements with Qualis – has a dedicated Commercial Property Team, resourced by experienced and senior ("MRICS") chartered surveyors; and

- *Housing* – the Council has a separate Housing Team that is responsible for 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 Commercial Property 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. For example, a training events on "Local Authority Finance and the Budget Process" are routinely held.

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.

10. Section 151 Statement on the Capital Strategy

10.1 Prudential Code

10.1.1 Paragraph 25 of the 2021 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 2028/29 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 2028/29) 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, asset transfers 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 2024/25 in accordance with CIPFA's (updated) "Treasury Management in the Public Services: Code of Practice 2021". 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 2024/25 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 Section 6) 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 2024/25.

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. Progress/performance against relevant Prudential Indicators will be reported Quarterly alongside the Capital Programme.

Minimum Revenue Provision Statement 2024/25

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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.

MRP Policy

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.

External Loans

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.

Capitalisation Directions

For capitalisation directions on expenditure incurred after 1st April 2008 MRP will be made using the annuity method over 20 years.