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:

Prudence

- *Prudential Indicator 13 (General Fund)* (Paragraph 8.1.2) – Proportion of Financing Costs to Net Revenue Stream (Local Indicator) – 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) – HRA Interest Cover – 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.

Annex 1

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.