Appendix 1 Capital Strategy Report 2025/26

INTRODUCTION

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.

Decisions made this year on capital and treasury management will have financial consequences for the Authority for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

CAPITAL EXPENDITURE AND FINANCING

Capital expenditure is where the Authority spends money on assets, such as property or vehicles, that 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.

In 2025/26, the Authority is planning capital expenditure of £51.3m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2023/24 actual £m	**2024/25 forecast £m**	**2025/26 budget £m**	**2026/27 budget £m**	**2027/28 budget £m**
General Fund services	5.3	9.0	25.4	10.8	14.1
Council housing (HRA)	12.6	7.8	20.1	14.0	13.0
Capital investments	10.6	10.5	5.8	2.2	2.2
TOTAL	28.5	27.3	51.3	27.0	29.3

The main General Fund capital projects include Folkestone – A Brighter Future (£16.4m) mostly funded by Levelling Up Fund grant, Otterpool Park LLP (£4.5m) FOLCA 2 (£4m), Private Sector Housing Improvement initiatives (£1.4), Coastal Drive Seafront Development (£1m), Coast Protection works (0.7m) Leisure Centre development (£0.5m), Coastal Park Play Area Refurbishment (£0.5m) and Cliff Stabilisation works (£0.3m).

The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately. A new 30-year HRA Business Plan was approved by Cabinet on 13 December 2023 and Council on 28 February 2024. From this, a rolling five-year medium term capital programme for the HRA (currently to 29/30) has been prepared which focuses on maintaining and improving the existing stock to meet both the Decent Homes Standard Plus and the EPC C energy efficiency rating and provides for investment to increase the supply of affordable homes for rent. Cabinet considers the updated HRA medium term capital programme before it being submitted to full Council for approval on 19 February 2025, as part of the current budget process.

Governance: Service managers bid annually in September through a formal project appraisal process for growth proposals to include projects in the Council's capital programme. Bids are initially evaluated by the Finance Team against a series of criteria to determine their business need against the Council's existing corporate priorities and the financial impact of the proposal. The Finance Team submit a summary of the evaluated growth bids to the Corporate Leadership Team (CLT) to consider against the funding available (including external funding). CLT then makes recommendations to Cabinet for consideration initially through the Budget Strategy in December. The final draft capital programme is then presented to Cabinet in January/February and to Full Council in February each year.

Details of the Authority's capital programme, including the project appraisals undertaken can be found in the Medium-Term Capital Programme report as presented to Cabinet on 13 February 2025.

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Authority's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2023/24 actual £m	**2024/25 forecast £m**	**2025/26 budget £m**	**2026/27 budget £m**	**2027/28 budget £m**
External sources	7.1	6.6	19.8	2.9	2.1
Own resources	12.1	10.1	11.7	12.5	6.7
Debt	9.3	10.6	19.8	11.6	20.5
TOTAL	**28.5**	**27.3**	**51.3**	**27.0**	**29.3**

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. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of prior years' debt finance in £ millions

	2023/24 actual £m	**2024/25 forecast £m**	**2025/26 budget £m**	**2026/27 budget £m**	**2027/28 budget £m**
Minimum revenue provision (MRP)	1.9	2.3	2.5	2.7	3.0
Capital receipts	0	1.2	0	0	0
TOTAL	**1.9**	**3.5**	**2.5**	**2.7**	**3.0**

The Council's minimum revenue provision statement can be found in appendix 2 of the Capital Strategy 25/26 report as presented to Cabinet on 13 February 2025.

The Authority'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 be £174.4m during 2025/26. Based on the above figures for expenditure and financing, the Authority's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	2023/24 actual £m	2024/25 forecast £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m
General Fund services	16.0	15.5	18.7	21.3	31.7
Council housing (HRA)	47.4	50.4	60.8	66.1	72.9
Capital investments	85.2	91.9	94.9	95.8	96.0
TOTAL CFR	**148.6**	**157.7**	**174.4**	**183.1**	**200.6**

In line with the existing approved HRA Business Plan, no provision is made to reduce the HRA CFR in the future. This helps to support the HRA's financial position over the life of the business plan.

Asset management: To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place. This strategy was adopted in July 2017 by Cabinet and sets out how property asset management is delivered for the Council to meet its long-term objectives and goals. It outlines how the long-term objectives for managing the asset portfolio are met, including statutory obligations, stakeholder needs and the overall performance of property within the context of any constraints such as funding. A new updated asset management strategy is planned to be submitted to Cabinet during 2025.

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Authority is currently also permitted to spend capital receipts "flexibly" on service transformation projects up until and including 2029/30. Repayments of capital grants, loans and investments also generate capital receipts. The Authority expects to receive £2m of capital receipts in the coming financial year as follows:

Table 5: Capital receipts receivable

	2023/24 actual £m	2024/25 forecast £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m
Asset sales	1.9	8.9	1.5	6.0	1.5
Loans etc repaid	0.7	0.5	0.5	0.5	0.5
TOTAL	**2.6**	**9.4**	**2.0**	**6.5**	**2.0**

The asset sales forecast for 2024/25 includes the sale of land at Biggins Wood.

No capital receipts from Otterpool Park development are anticipated to be received over the three-year period to 2027/28.

TREASURY MANAGEMENT

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Authority'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 Authority 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.

Due to decisions taken in the past, the Authority as at 31 December 2024 has £98.8m borrowing at an average interest rate of 4.51% and £20m treasury investments at an average rate of 4.6%.

Borrowing strategy: The Authority's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Authority therefore seeks to strike a balance between cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher.

The Authority does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board.

Projected levels of the Authority's total outstanding debt (which comprises borrowing, PFI liabilities, leases and transferred debt) are shown below, compared with the capital financing requirement (see above).

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

	2023/24 actual £m	2024/25 forecast £m	2025/26 budget £m	2026/27 budget £m	2027/28 budget £m
Debt (incl. PFI & leases)	107.8	115.6	120.4	123.3	127.6
Capital Financing Requirement	148.6	157.8	174.4	183.2	200.6

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Authority expects to comply with this in the medium term.

Liability benchmark: To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £14m at each year-end. This benchmark is currently £124.9m and is forecast to rise to £160.5m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	2023/24 actual £m	2024/25 forecast £m	2025/26 budget £m	2026/27 budget £m	31.3.2028 budget £m
Existing borrowing	107.8	115.6	120.4	123.3	127.6
Liability benchmark	107.8	119.9	137.0	145.6	163.0

The table shows that the Authority expects to remain borrowed below its liability benchmark. This is because cash outflows to date have been below the assumptions made when the loans were borrowed.

Affordable borrowing limit: The Authority is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. 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: Authorised limit and operational boundary for external debt in £m

	2024/25 limit £m	**2025/26 limit £m**	**2026/27 limit £m**	**2027/28 limit £m**
Authorised limit – borrowing	181.0	189.0	208.0	214.0
Operational boundary – borrowing	159.0	176.0	184.0	202.0

Further details on borrowing can be found in section 4 of the 25/26 treasury management strategy report as presented to Cabinet on 13 February 2025.

Treasury investment strategy: 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.

The Authority’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 or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Authority may request its money back at short notice.

Table 9: Treasury management investments in £millions

	2023/24 Actual £m	**2024/25 Forecast £m**	**2025/26 Budget £m**	**2026/27 Budget £m**	**2027/28 Budget £m**
Near-term investments	6.1	0	0	0	0
Longer-term investments	14.1	14.0	14.0	14.0	14.0
TOTAL	**20.2**	**14.0**	**14.0**	**14.0**	**14.0**

Further details on treasury investments can be found in section 5 the 25/26 treasury management strategy report presented to Cabinet on 13 February 2025.

Risk management: The effective management and control of risk are prime objectives of the Authority’s treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

The treasury management prudential indicators can be found in Section 6 of the treasury management strategy report as presented to Cabinet on 13 February 2025.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Interim Director of Finance and Governance and staff, who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity are presented to Cabinet. The Finance and Performance Scrutiny Sub-Committee are responsible for scrutinising treasury management decisions.

INVESTMENTS FOR SERVICE PURPOSES

The Authority makes investments to assist local public services, including making loans to its subsidiaries, its charities where the Council is the trustee, its external service providers, local residents and its employees to support local public services and to stimulate local economic growth. In the future the authority may also lend money to joint ventures it decides to enter into to help deliver its major corporate objectives. Total investments for service purposes are currently valued at £34m with the largest being Otterpool Park LLP.

Risk management: In light of the public service objective, the Authority is willing to take more risk than with treasury investments, however it still plans for such investments to generate a profit after all costs. The risk of incurring unexpected losses is managed by accessing the long term financial viability of the entity, it's ability to meet loan repayment term and also the internal governance arrangements in place to support its operations. A limit of £79.1m is placed on total investments for service purposes to ensure that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services.

Governance: Decisions on service investments are made by the relevant service manager in consultation with the Section 151 Officer and must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure, and purchases will therefore also be approved as part of the capital programme. The relevant service director is responsible for ensuring that adequate due diligence is carried out before investment is made. Further details on service investments can be found in Appendix 1, sections 3 and 4 of the Non-Treasury Investment Strategy as presented to Cabinet on 13 February 2025.

COMMERCIAL ACTIVITIES

With central government financial support for local public services declining, the Authority previously invested in commercial property and land with the intention of making capital gains or generating new revenue streams to spend on local public services. Total commercial investments are currently valued at £30.3m with the largest being the Connect 38 Offices in Ashford (£18.3m) and land and property held for the Otterpool Park development (£9.6m).

Risk management: With financial return being the main objective, the Authority accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include fluctuations in future demand of the market including competition, risk of void tenancies, fall in capital values etc. These risks are managed by the project lead as well as assessed through the corporate risk register. The authority has an established proactive risk management framework, which incorporates key projects, and reports quarterly to the Audit & Governance Committee as well as annually to the Cabinet.

Governance: Decisions on commercial investments are made by Cabinet and/ or full Council in line with the criteria and limits outlined within the Constitution, in specific circumstances the Executive have delegated authority to progress certain projects to the Director of Strategy and Resources and the Director of Housing and Operations in consultation with the relevant Portfolio holders. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

Further details on commercial investments and limits on their use are in section 5 of the investment strategy 2025/26.

Table 10: Prudential indicator: Net income from commercial and service investments to net revenue stream

	2023/24 actual £m	**2024/25 forecast £m**	**2025/26 budget £m**	**2026/27 budget £m**	**2027/28 budget £m**

Total net income from service and commercial investments	1.3	1.7	2.1	2.7	3.7
Proportion of net revenue stream	7.4%	10.0%	12.0%	14.0%	19.0%

OTHER LIABILITIES

In addition to debt of £120.4m as at 31 March 2026, the Authority is committed to making future payments to cover its pension fund deficit (valued at £9m), and its impact to 2028/29 is factored into the MTFS. The Council has also allowed for prudent provisions in its business rates budget to cover risks of the business rates appeals.

Governance: Decisions on incurring new discretional liabilities are taken by the Interim Director Governance and Finance in liaison with service managers. The risk of liabilities crystallising and requiring payment is monitored by Accountancy and reported through the regular budget monitoring/projected outturn cycle to Cabinet if identified or through the Statement of Accounts process to the Audit & Governance Committee. New liabilities exceeding the auditors materiality threshold would be reported to full council for approval/notification as appropriate.

REVENUE BUDGET IMPLICATIONS

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 11: Prudential Indicator: Proportion of financing costs to net revenue stream

	2023/24 actual £m	**2024/25 forecast £m**	**2025/26 budget £m**	**2026/27 budget £m**	**2027/28 budget £m**
General Fund Financing costs (£m)	4.8	5.1	5.6	6.0	6.3
Proportion of net revenue stream	28.5%	29.1%	31.1%	32.1%	33.0%
HRA Financing costs (£m)	1.8	1.9	2.4	2.7	3.1
Proportion of net revenue stream	8.7%	9.4%	11.5%	12.4%	13.6%

Sustainability: 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 up to 50 years into the future. The Section 151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because it has been evaluated and risk assessed, it is considered to be a balanced portfolio with minimal risks.

KNOWLEDGE AND SKILLS

The authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Interim Director Finance and Governance (Section 151 Officer) is a qualified accountant with over 25 years' experience, the Director of Housing and Operations has a degree and post graduate certificate in strategic leadership and over 20 years extensive and relevant experience in contract and project management. The Housing and Operations teams include suitably qualified and experienced professionals ranging from FRCIS through to MSc Engineering and senior project management qualifications. The authority pays for staff to study towards relevant professional qualifications including ACCA.

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers, Savills and Montague Evans as property consultants, Wilks-Head & Eve LLP as valuers and as well as other bodies on an ad hoc basis. This approach is more cost effective than employing such staff directly,and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Appendix 2 Annual Minimum Revenue Provision Statement 2025/26

Where the Authority funds capital expenditure with 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 Authority to have regard to the Ministry of Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in April 2024.

The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is aligned with that over which the capital expenditure provides benefits.

The MHCLG Guidance requires the Authority to approve an Annual MRP Statement each year and provides a number of options for calculating a prudent amount of MRP but does not preclude the use of other appropriate methods. The following statement only incorporates options recommended in the Guidance.

MRP is calculated by reference to the capital financing requirement (CFR) which is the total amount of past capital expenditure that has yet to be permanently financed, noting that debt must be repaid and therefore can only be a temporary form of funding. The CFR is calculated from the Authority's balance sheet in accordance with the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Expenditure in Local Authorities*, 2021 edition.

- For capital expenditure incurred before 1st April 2008 and for supported capital expenditure incurred on or after that date, MRP will be determined as 4% of the CFR in respect of that expenditure.

- For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments *or* as the principal repayment on an annuity with an annual interest rate *or* equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years

Capital loans

- For capital expenditure on loans to third parties which were made primarily for service purposes, the Authority will make nil MRP unless the loan is an investment for commercial purposes and no repayment was received in year or an expected credit loss was recognised or increased in-year. Instead, the Authority will apply the capital receipts arising from the repayments of the loan principal to finance the expenditure in the year they are received.

- For capital loans made on or after 7th May 2024 where an expected credit loss is recognised during the year, the MRP charge in respect of the loan will be no lower than the loss recognised. Where expected credit losses are reversed, for example on the eventual repayment of the loan, this will be treated as an overpayment.

- For capital loans made before 7th May 2024 and for loans where expected credit losses are not applicable, where a shortfall in capital receipts is anticipated, MRP will be charged to cover that shortfall over the remaining life of the assets funded by the loan.

Housing Revenue Account

- No MRP will be charged in respect of assets held within the Housing Revenue Account but depreciation on those assets will be charged instead in line with regulations.

Capital expenditure incurred during 2025/26 will not be subject to a MRP charge until 2026/27 or later.

Based on the Authority's latest estimate of its CFR on 31st March 2025, the budget for MRP has been set as follows:

	31.03.2025 Estimated CFR £m	2025/26 Estimated MRP £
Capital expenditure before 01.04.2008	7.3	0.3
Unsupported capital expenditure after 31.03.2008	72.0	1.2
Capital loans to third parties	28.0	1.0
Total General Fund	**107.3**	**2.5**
Assets in the Housing Revenue Account	23.4	0
HRA subsidy reform payment	32.0	0
Total Housing Revenue Account	**55.4**	**0**
Total	**162.7**	**2.5**

Capital receipts

Proceeds from the sale of capital assets are classed as capital receipts and are typically used to finance new capital expenditure. Where the Authority decides instead to use capital receipts to repay debt and hence reduce the CFR, the calculation of MRP will be adjusted as follows:

- Capital receipts arising on the repayment of principal on capital loans to third parties will be used to lower the MRP charge in respect of the same loans in the year of receipt, if any.
- Capital receipts arising on the repayment of principal on finance lease receivables will be used to lower the MRP charge in respect of the acquisition of the asset subject to the lease in the year of receipt, if any.
- Capital receipts arising from other assets which form an identified part of the Authority's MRP calculations will be used to reduce the MRP charge in respect of the same assets over their remaining useful lives, starting in the year after the receipt is applied.
- Any other capital receipts applied to repay debt will be used to reduce MRP in 10 equal instalments starting in the year after receipt is applied.