Manchester City Council
Report for Information

Report to:	Resources and Governance Scrutiny Committee - 5 September 2024
Subject:	Review of Capital Investment Programme
Report of:	City Treasurer

Summary

To provide members with an update on the capital investment programme in the context of current forecast spend and market conditions.

Recommendations

The Committee is recommended to:

- Note the contents of the report.

Wards Affected:
(All Wards)

Environmental Impact Assessment - the impact of the issues addressed in this report on achieving the zero-carbon target for the city	None
Equality, Diversity and Inclusion - the impact of the issues addressed in this report in meeting our Public Sector Equality Duty and broader equality commitments	None.

Manchester Strategy outcomes	Summary of how this report aligns to the Our Manchester Strategy/Contribution to the Strategy
A thriving and sustainable city: supporting a diverse and distinctive economy that creates jobs and opportunities	The capital programme contributes to various areas of the economy including investment in public and private sector housing, education and children's social care, transport infrastructure, major regeneration activities, and environmental, cultural and leisure services.
A highly skilled city: world class and home grown talent sustaining the city's economic success	The capital programme includes substantial investment in education and also provides opportunities for the construction industry to bid for schemes that could provide employment opportunities at least for the duration of contracts.
A progressive and equitable city: making a positive contribution by unlocking the potential of our communities	The capital programme includes investment in adult and children's social care, education, housing and the environment, cultural and leisure services, all of which contribute towards the strategy.
A liveable and low carbon city: a destination of choice to live, visit, work	Investment in all areas of the capital programme contributes towards this community strategy, notably the investment in sustainable and affordable housing, building schools, transport, environmental and major regeneration programmes.
A connected city: world class infrastructure and connectivity to drive growth	The capital programme includes investment in highways infrastructure.

Full details are in the body of the report, along with any implications for:

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

Financial Consequences – Revenue

Subject of the report

Financial Consequences – Capital

Subject of the report

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Background documents (available for public inspection):

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report. Copies of the background documents are available up to 4 years after the date of the meeting. If you would like a copy, please contact one of the contact officers above.

Report to the Executive 14th February 2024 – Capital Strategy and Budget 2023/24 to 2026/27

1. Introduction

1.1. The purpose of the report is to provide members of the Committee with an update on the capital investment programme in the context of the current forecast spend and market conditions.

2. Context

2.1. The Council's current approved capital programme contains over 400 distinct projects or work programmes, across a wide variety of disciplines, including new build, refurbishment, highways and infrastructure. The programme represents significant investment in assets over multiple years, which contribute to the delivery of services to residents. By its nature the programme evolves over time and includes schemes which were approved a number of years ago and are now coming to maturity. Typically, capital planning is done over a broad time horizon and is built up over different project phases including planning permission, design and construction and completed over several years.

2.2. The programme is therefore always exposed to changes in the prices of materials and labour. In times of relatively low inflation price increases are typically managed through project contingency budgets, however the Department for Business and Trade estimate that since June 2020 construction costs have risen by 38.3%. By way of contrast, in the 4 years prior to this construction costs rose by 12.3%.

2.3. The capital programme can be funded in a number of ways, including applying the proceeds from asset sales, government grants, contributions from developers and through the council taking on long-term borrowing and repaid over the useful life of the capital asset being created. Borrowing has been a key feature of the Council's capital financing strategy. The Council budgets for the interest and repayment costs (measured through the Minimum Revenue Provision – MRP) of this borrowing as part of its revenue budget.

2.4. Since June 2020 interest rates have risen. The Bank of England base rate has increased from 0.1% to 5%, and the rate on a 25-year loan from the Public Works Loan Board (PWLB) has increased from 2.67% to 5.39%. This has diminished the amount of financing capacity available to the Council for future schemes, as a construction project now is more expensive than a similar scheme in 2020. The capital financing costs are higher by virtue of both higher construction costs and higher interest rates.

2.5. The total amount of borrowing the Council needs to take is measured through its Capital Finance Requirement (CFR). As noted in the Capital Strategy for 2024/25, which forms part of the suite of budget papers for the Council, the Council's CFR was forecast to be almost £2.2bn by 2025/26. This ranks as one of the highest levels of borrowing amongst local authorities in absolute terms, however at c. £4k per head it is not, and for 2023/24 the Council's CFR per head ranked as 33rd amongst authorities for which the data is available.

3. Current Approved Capital Programme

3.1. The current forecast for the approved capital programme is shown in the table below. The total forecast spend is £780.6m over the programme period.

Current Forecast Programme	2024/25	2025/26	2026/27	2027/28 onward	Total
	£'m				
Highways	44.2	26.5	18.1	1.8	**90.6**
Neighbourhoods	35.5	6.3			**41.8**
The Factory International and St John's Public Realm	8.1				**8.1**
Growth and Development	116.9	45.4	19.8	23.0	**205.1**
Town Hall Refurbishment	78.7	31.2			**109.9**
Housing – General Fund	46.8	19.3	2.4		**68.5**
Housing Revenue Account	69.1	39.9	15.2	18.6	**142.9**
Children's Services	47.5	3.3			**50.8**
ICT	4.0	0.1			**4.1**
Corporate Services	3.1	0.5	0.5		**4.1**
Total (exc. Contingent budgets)	**453.8**	**172.4**	**56.0**	**43.4**	**725.6**
Contingent Budgets	22.8	32.2			**55.0**
Total	**476.6**	**204.6**	**56.0**	**43.4**	**780.6**

3.2. The forecast funding for the programme is shown in the table below. This includes both external funding, by way of external grants and contributions, and use of Council resources including capital receipts and external borrowing.

Draft Funding	2024/25	2025/26	2026/27	2027/28 onward	Total
	£'m				
Grants	119.2	39.8			**159.0**
Contributions	20.3	8.6	5.1	1.8	**35.8**
Capital Receipts	98.7	69.6	31.1	0.6	**200.0**
Revenue Contributions to Capital	39.8	29.5	16.9	41.0	**127.3**
Capital Fund	2.4	2.4	1.3		**6.1**

Borrowing	196.2	54.7	1.6		**252.5**
Total	**476.6**	**204.6**	**56.0**	**43.4**	**780.6**

3.3. Critically, the resources available for further investment beyond that in the current approved programme is restricted by the extent to which external grants and contributions are available to fund schemes, the value of any capital receipts that the Council receives from disposing of assets, and the capacity of the revenue budget to fund capital financing costs linked to additional borrowing.

3.4. To provide some context, additional borrowing to fund the construction of a new £50m building would incur capital financing costs of around £3.5m per annum over 50 years.

4. Current Financing Position

4.1. The Council's Treasury Management Strategy sets out its approach to the management of its cash flows, investments, reserves and long term debt. Typically the costs of borrowing are higher than the interest that can be earned on investments. It is therefore prudent to minimise the level of cash investments and keep external debt as low as possible. This is reflected in the current balance sheet as at the end of 2023/24, where the Council's Capital Financing Requirement is £2.082bn compared to actual external debt owed of £1.320bn.

4.2. The difference between these two figures, known as internal (or under) borrowing, highlights the strategy to minimise the level of external debt through the use of cash backed reserves and delaying borrowing until the reserves are needed. This approach supports keeping interest costs to a minimum and has saved the Council significantly over the years.

4.3. Current forecasts for the capital and revenue budgets are that a significant amount of the Council's reserves will be needed over the coming years to deliver the capital and revenue budgets, as this cash is spent, it will need to be replaced through long term borrowing as the internal borrowing position is unwound. The table below shows the current forecast:

	2024/25	**2025/26**	**2026/27**	**2027/28**
	£'m			
Planned Capital Expenditure funded by Borrowing	196.2	54.7	1.6	0.0
Change in Capital Grants and Contributions	70.6	(4.4)	(0.1)	0.0
Change in Capital Receipts	35.6	12.9	9.1	(26.6)
Change in Reserves	100.9	83.9	61.4	41.5

Minimum Revenue Provision	(39.3)	(42.8)	(43.3)	(45.7)
Refinancing of Maturing Debt	89.3	190.7	175.0	30.0
Movement in Working Capital	(100.0)	50.0	50.0	0.0
Estimated Borrowing Requirement	**353.3**	**345.0**	**253.7**	**(0.8)**
Estimated CFR	2,133.5	2,189.9	2,193.5	2,142.9
Estimated External Debt	1,610.4	1,764.7	1,843.3	1,812.5
Estimated Internal Borrowing	523.1	425.2	350.2	330.4

4.4. In 2016 when the Council embarked on the current capital programme, which include the significant refurbishments of the Leisure estate, the Town Hall, and Aviva Studios, a fixed capital financing budget of £43.2m per annum was set aside, so as to insulate the day to day revenue budget from the increasing levels of borrowing required to deliver this programme. In the early years of the programme, the capital financing budget was not needed to fund borrowing, so the underspend was transferred into a capital financing reserve, now £114.9m, to smooth the longer term capital financing costs.

4.5. The reserves will be drawn down as external borrowing peaks to support the revenue budget. It is expected that the annual capital financing costs will start to exceed the budget from 2024/25 onward, reducing the capital financing reserves. Interest rates are widely expected to fall from current levels and therefore long term borrowing is being deferred until this happens. There is sufficient funding available to deliver the current approved capital programme within current spending profiles and market conditions.

5. Risks to the Current Programme

5.1. There remain a number of risks to the delivery of the existing approved programme. Further increases in construction costs for existing schemes which cannot be contained within contingency budgets, as well as interest rates remaining higher for longer, could add stress to the capital financing position.

5.2. It is also important to consider the nature of some of the projects the Council is currently undertaking. Schemes such as the Factory, Victoria North, This City, and particularly the refurbishment of the Town Hall building are complex with intertwined and dependent workstreams, as well as significant risk of discovery once the project starts on site. This means that there may be occasions where cost increases are unavoidable.

6. Budget Strategy

6.1. Future investment capacity is limited to grants and contributions available to the Council, the ability to raise capital receipts through the sale of assets, and the affordability of capital financing costs within the revenue budget.

6.2. The Strategic Asset Management Programme (SAMP) is used to actively review the Council's asset base, to challenge the use of existing assets, and propose disposal routes where appropriate, with a view to maximising both the outcomes (financial and non-financial) from the use of current Council-owned land and achieving value for money in terms of capital receipts.

6.3. The level of capital receipts received when an asset is disposed of is also impacted by the same market conditions that affect capital spend, with land values a key part of the viability models of schemes, and different end uses impacting on the underlying land value achieved. This means that both the timing of a disposal and future use of the land/asset may impact the cash value that is received.

6.4. Additional capital expenditure funded from borrowing will incur additional revenue costs by the way of interest costs and MRP. The Council's revenue budget position is well documented with significant pressures in the coming years, as identified in the budget papers received by Council in March. As noted above, the existing capital financing capacity including reserves is fully committed to support the existing programme. Any additional financing costs for new schemes will require an increase to the capital financing revenue budget and therefore act as an additional revenue pressure within the Medium-Term Financial Plan, which informs the annual budget process to arrive at a balanced budget for the start of the forthcoming year.

6.5. It is in this context that the financing strategy set out in the Capital Strategy for 2024/25 remains, namely that if projects support corporate priorities, including both low carbon and social value, then they will be supported if:

- The project is fully funded by external grants and contributions;
- The project generates additional capital receipts to the Council, so the impact on resources is minimal; or
- The project will generate a robust net income stream or revenue savings that is sufficient to meet the associated capital financing costs and therefore be funded on an invest to save basis

6.6. Additional borrowing will only be considered if there are no other funding sources available and the project is of critical importance. The impact on the Council's revenue budget will form part of the decision making.

7. Recommendations

7.1. Members are asked to note the contents of the report.