Surrey Heath Borough Council
Executive
15 February 2022

Capital Strategy Report 2022/23

Portfolio Holder: Cllr Robin Perry – Portfolio Holder for Finance
Strategic Director: Bob Watson – Strategic Director Finance
Report Author: Bob Watson – Strategic Director Finance
Key Decision: Yes
Wards Affected: All

Summary and purpose

This Capital Strategy Report, which was introduced for the first time for the 2019/20 budget, 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 any associated risk is managed and the implications for future financial sustainability. It is provided to inform members and enhance their understanding of these technical areas.

Recommendation

The Executive is advised to RECOMMEND to Full Council the approval of the Capital Strategy and associated Capital Programme covering the period 2022/23 to 2025/26 which includes:

(i) the new capital bids for £1.139 million in Appendix 1 to Annex A for 2022/23 be approved, and that they be incorporated into the Capital Programme;

(ii) The Prudential Indicators summarised below and explained in Annex A for 2022/23 to 2025/26 in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities 2011 be approved.

Prudential Indicator	2022/23 Proposed £m	2023/24 Estimated £m	2024/25 Estimated £m	2025/26 Estimated £m
Capital Expenditure	1.139	1.428	1.428	0.928
Capital Financing Requirement	174	171	167	164
Ratio of net financing costs to net revenue stream	28.22%	27.54%	26.89%	26.30%

Financing Costs	3	3	3	3
Operational Boundary	230	230	230	230
Authorised Limit	235	235	235	235

The Executive is also advised to note that:

i. the Capital Financing Requirement (CFR) for this Council as at 31 March 2023 is estimated to be £174 million and as such a Minimum Revenue Provision of £2.32m is required

ii. the provisional financing for Capital Programme for 2022/23 to 2025/26 (Table 2 in Appendix 1 to Annex A)

iii. Potential reprofiling from 2021/22 of £8.499 million (Table 3 in Appendix 1 to Annex A)

iv. The available capital receipts forecast shown in Appendix 2 to Annex A.

1. Background and Supporting Information

1.1 The Capital Strategy was introduced as a new report in 2019/20 to give a high-level overview of how the Council's capital expenditure, capital financing and treasury management activities all contribute to the provision of local services and also provide an overview of how the associated risk is managed along with the implications for future financial sustainability of the Council. It has been written with a view to enhance members' understanding and also fully complies with the Prudential Code 2017.

2. Reasons for Recommendation

2.1 The 2017 Prudential Code stipulates that a Capital Strategy should be prepared which summarises the Council's Capital, Investment and Borrowing plans. This document fulfils those requirements. Members are also referred to the Council's Medium Term Financial Strategy (MTFS), the Revenue Budget Estimates and the Treasury Management Strategy and which are also presented on this agenda. These strategies and documents are required to be approved by Budget Council later this month.

3. Proposal and Alternative Options

3.1 It is proposed that the Executive:

3.1.1 NOTE the contents of the Capital Strategy at Annex A;
3.1.2 RECOMMEND approval of the Capital Strategy and associated Capital Programme by Budget Council

3.2 Members can accept, reject or amend the recommendations within this paper prior to recommendation to Council.

4. Contribution to the Council's Five Year Strategy

4.1 The Council's capital programme for investment in its assets is driven by the Council's Five Year Strategy and services have requested funding to deliver on the work streams with the Five Year Strategy.

5. Resource Implications

5.1 This report summarises the capital programme, treasury strategy and investment strategy. These documents set out how the Council intends to manage its £13.0m of investments, £146m of borrowing and £108m of investment property together with approval for the 2022/23 capital programme of £1.101m.

5.2 The Council has primarily acquired property for four reasons:

- 5.2.1 Regeneration of the town centre in Camberley. Due to the unique position that Council has no investors or shareholders to satisfy, it can take a longer term view of its property portfolio. Along with the access to low borrowing costs, the Council is better able to provide regeneration projects that the private sector developers would not normally carry out.
- 5.2.2 Economic development.
- 5.2.3 Sustainability of employment sites in the borough.
- 5.2.4 Preservation of the commercial and retail hub, to maintain the viability of the town centre.

5.3 Whilst the Council does not acquire property primarily and purely for investment returns there is a need for the business case for any acquisition to demonstrate viability and to show that the local tax payer is not funding these assets. Viability is assessed on the return on investment covering the cost of debt servicing and repayment provision.

5.4 In order to fund this, the Council has taken on £146 million of capital borrowing with annual budgeted interest costs of £2.9 million in the revenue budgets. The strategy for the management of this borrowing has significant revenue implications for the Council and this is explored in more detail in the strategy.

6. Section 151 Officer Comments:

6.1 The Section 151 officer comments are contained within this report and the strategy.

7. Legal and Governance Issues

7.1 The Council has to have regard to statutory guidance in respect of Local Government Investments and the Prudential Code.

7.2 Council is required to approve the Capital Strategy and Programme.

8. Other Considerations and Impacts

Risk Management

8.1 The Council does not invest in property assets primarily for revenue return.

8.2 Investing in property and Treasury Management activities are not without an element of financial risk. Rents and investment returns can fall and the capital asset value of investments can also fluctuate. The Council actively minimises these risks by the use of professional advisors and appropriate due diligence, however this cannot always guarantee the security of an investment.

8.3 The Council maintains reserves to enable it to deal with a level of risk and in terms of property purchases the intention is to hold assets for the longer term. The Council is not immune to the wider economic pressures and thus services could be put at risk if the anticipated income and returns are not delivered. This risk however should considered against the very real risk of services being cut completely due to the reduction in Government funding had the Council opted not to acquire property at all.

Annexes

A. Capital Strategy 2022/23

Appendices

1. Capital Programme 2022/23 - 2025/26
2. Capital reserve balances 2022/23 -2025/26

Background Papers
Insert text

Annex A

Capital Strategy 2022/23 – 2025/26

Introduction

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 with the intention of enhancing members' understanding of these sometimes technical areas.

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

Capital Expenditure and Financing

3. Capital expenditure is where the Council spends money on assets, such as property or vehicles that will deliver an economic benefit for more than one year. In local government this could include expenditure on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not capitalised and are charged to revenue in year.

4. In 2022/23, the Council is planning capital expenditure of £1.139 million as summarised below:

Prudential Indicator: Estimates of Capital Expenditure in £ million*s*

	2020/21 Actual	**2021/22 forecast**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**	**2025/26 budget**
Capital Projects	23.552	13.433	1.139	1.428	1.428	0.928
Capital investments	0.5	0.5	0.0	0.0	0.0	0.0
TOTAL	**24.052**	**13.933**	**1.139**	**1.428**	**1.428**	**0.928**

5. The main General Fund capital projects include:

   - Disabled facilities grants – grants for improvements to enable residents to stay in their own home;
   - Replacement of Electrical Distribution boards at Surrey Heath House.
   - Refurbishment of Unit 5 Albany Park, Frimley
   - Rebuild of SHBC, Theatre and Building Control Websites and CRM System.
   - Restoration fund for Camberley Theatre (formerly revenue funded)

- Creation of a capital property maintenance programme (formerly revenue funded)
- Provision of budget for Gypsy, Traveller and Travelling Show people sites as mandated in the new Local Plan

6. The figures do not include the implications of any schemes which may be carried forward from one year to the next. Currently (as at 31 December 2021, there is a proposed reprofiling of capital schemes to 2022/23 totalling £8.499 million (£9.732 million was reprofiled into 2021/22); this will be considered by members on the basis of the Capital Outturn report to be presented later in the year. Some of these projects may no longer proceed subject to a viability and affordability review following the recent hyper-inflation in costs of labour and materials, and again this will be reported to Executive for agreement. Indicative reprofiling numbers are shown within the Capital Programme (Appendix 1, Table 3) for completeness.

Governance

7. Service Heads will bid annually in October to include projects in the Council's capital programme. Bids, which include business cases, are collated by finance who calculate the financing cost (which can be nil if the project is fully externally financed). The Corporate Management Team (CMT) appraises all bids based on their contribution to the Five Year Plan as well as a comparison of service priorities against available financing resources. CMT will make recommendations to Executive through the budget papers in February; Executive will in turn make a recommendation to Council as part of the annual budget setting process.

8. Further details of the Council's capital programme can be found in the Capital Programme which is at Appendix 1 to this report.

9. 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 (prudential borrowing, leasing and/or Private Finance Initiatives). The planned financing of the above expenditure is as follows:

Capital financing in £ millions

	2020/21 actual	**2021/22 forecast**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**	**2024/25 budget**
External sources	4.180	1.535	0.780	0.780	0.780	0.78
Own resources	2.992	0	0.359	0.648	0.648	0.148
Debt finance	16.880	12.398	0	0	0	0
TOTAL	**24.052**	**13.933**	**1.139**	**1.428**	**1.428**	**0.928**

10. 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)” . Councils are required by statute to make revenue provision transfers over the life of a loan to ensure that they have sufficient resources to repay debt. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance, but councils are not allowed to offset provisions against future or anticipated receipts. Planned MRP transfers and use of capital receipts to repay debt are as follows:

Replacement of debt finance in £ millions

	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget	2025/26 budget
MRP Payment	**2.2**	**2.3**	**2.3**	**2.4**	**2.4**	**2.4**
Use of Capital Receipts	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

11. The Council’s full MRP statement is included within the Treasury Strategy report for 2022/23 which can be found on the February 2022 Executive agenda

12. The Council’s cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR) – its underlying need to borrow. This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to fall by £3m during 2022/23. Based on the above figures for expenditure and financing, the Council’s estimated CFR is as follows:

Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.2022 forecast	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
General Fund services	7	7	7	8	8
Capital investments	170	167	164	159	156
TOTAL CFR	**177**	**174**	**171**	**167**	**164**

13. **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. Repayments of capital grants, loans and investments also generate capital receipts. The Council does not plan to receive any capital receipts from asset sales in future years.

Capital receipts in £ millions

	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget	2025/26 budget
Asset sales	0	0	0	0	0	0
TOTAL	**0**	**0**	**0**	**0**	**0**	**0**

Treasury Management

14. Treasury management is concerned with keeping sufficient but not excessive cash balances available to meet the Council's short-term spending needs, whilst managing the risks involved. Surplus cash balances are invested until required, while a temporary shortage of cash will be met by short-term borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash solvent in the short-term as revenue income streams are generally received before they are required to be expended, but generally cash poor in the longer-term as capital expenditure is often incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall external borrowing.

15. **Borrowing strategy**: The Council'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 Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.15%) and long-term fixed rate loans where the future cost is known but higher (currently 1.87%).

16. Following advice from the Council's Treasury advisors the Council has retained the bulk of its borrowing in short term loan so as to take advantage of low interest rates.

17. Projected levels of the Council's total outstanding debt (which comprises borrowing, leases are shown below, compared with the capital financing requirement (see above).

Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2022 forecast	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget	31.3.2025 budget
Gross External Debt	**146**	**143**	**140**	**137**	**134**
Capital Financing Requirement	**177**	**174**	**171**	**167**	**164**

18. Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table above, the Council expects to comply with this in the medium term. If the Council decides to acquire more regeneration properties, then these will be funded by debt and the CFR will be rise accordingly.

19. **Affordable borrowing limit:** The Council is statutorily 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.

Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2021/22 limit	2022/23 limit	2023/24 limit	2024/25 limit	2025/26 limit
Authorised limit – total external debt	235	235	235	235	235
Operational boundary – total external debt	230	230	230	230	230

20. The authorised and operational boundaries have not been increased in 2022/23 to reflect the changes due to the change in the accounting treatment for leases as the amount is not material.

21. Further details on borrowing are included in the treasury management strategy which can be found within the February Executive agenda

22. 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.

23. The Council's policy on treasury investments is to prioritise security and liquidity over yield which focuses 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 Council may request its money back at short notice.

Treasury management investments in £millions

	31.3.2021 actual	31.3.2022 forecast	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget
Near-term investments	**20.3**	**10.0**	**11.0**	**11.0**	**11.0**
Longer-term investments	**2.1**	**2.2**	**2.2**	**2.2**	**2.2**
TOTAL	**22.4**	**12.2**	**13.2**	**13.2**	**13.2**

24. Further details on treasury investments are included within the treasury management strategy which is included within the February executive agenda

25. **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Strategic Director Finance and Customer Services who ensures that staff act in line with the treasury management strategy approved by Executive and Council. Half yearly reports on treasury management activity are presented to Executive and the Performance and Finance Scrutiny Committee which is responsible for scrutinising treasury management decisions.

Commercial Activities

26. With Government financial support for local public services declining, the Council will use its capital balances to save on ongoing revenue costs ('invest to save' or 'invest to spend less'). The Council will not however borrow to invest in commercial property for purely investment reasons.

27. The Council has limited commercial activities such as the Theatre, community services etc. which are primarily operated for community benefit, however they will expose the Council to some commercial risk. This risk could be significant for 2022/23 depending on the ongoing impact of the Covid-19 pandemic.

Liabilities

28. In addition to debt of £146m detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £6.3m) It also set aside last year £0.5m to cover risks of business rates appeals and revaluations and £1.8m for bad debts. These provisions will be reviewed as part of the accounts closure process for 2021/22**.**

29. **Governance**: The risk of liabilities crystallising and requiring payment is monitored by finance and reported within the annual financial statements.

Revenue Budget Implications

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

Prudential Indicator: Proportion of financing costs to net revenue stream

	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget	2024/25 budget
Financing costs (£m)	**3**	**3**	**3**	**3**	**3**
Proportion of net revenue stream	**30.6%**	**28.2%**	**27.5%**	**26.9%**	**26.9%**

31. **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 Strategic Director Finance and Customer Service is satisfied that the proposed capital programme is prudent, affordable and sustainable because it is either funded by external grant or there is sufficient capital reserves to cover the costs of the current programme.

Knowledge and Skills

32. The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Strategic Director Finance and Customer Service is an experienced and qualified accountant, the property department has a qualified surveyor with investment experience and the legal department has lawyers experienced in property matters.

33. 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, Montagu Evans as property consultants and Addleshaw Goddard as external lawyers. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to appropriate knowledge and skills commensurate with its risk appetite.