

## Capital Strategy 2023/24 – 2026/27

### 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.
3. The capital strategy and the supporting capital programme form part of the Medium Term Financial Strategy (MTFS) of the Council.

### Capital Expenditure and Financing

4. 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.
5. In 2023/24, the Council is planning capital expenditure of **£ 2.539 million** as summarised below:

#### **Prudential Indicator: Estimates of Capital Expenditure in £ millions**

|                     | <b>2021/22<br/>Actual</b> | <b>2022/23<br/>forecast</b> | <b>2023/24<br/>budget</b> | <b>2024/25<br/>budget</b> | <b>2025/26<br/>budget</b> | <b>2026/27<br/>budget</b> |
|---------------------|---------------------------|-----------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Capital Projects    | 2.558                     | 2.500                       | 2.539                     | 1.490                     | 0.990                     | 0.990                     |
| Capital investments | 1.932                     | 0.00                        | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| <b>TOTAL</b>        | <b>4.490</b>              | <b>2.500</b>                | <b>2.539</b>              | <b>1.490</b>              | <b>0.990</b>              | <b>0.990</b>              |

6. The full capital programme is attached at Appendices 2-1 to 2-3 to this strategy and includes:
  - Disabled facilities grants – grants for improvements to enable residents to stay in their own home;
  - Members IT Equipment
  - Upgrade of Adelante Cash Receipting System

- Esso Pipeline Environmental Projects
  - Albert Road Playground Replacement
  - Freemantle Playground Replacement (Match Funding)
  - Goalpost Replacement
  - Theatre Access Ladders and Wheelchair Access Lift
  - Replacement Flooring at Frimley Lodge Park Café
  - Replacement of Theatre Website and AV Equipment
  - Health and safety works on paths in London Road Recreation Park
  - Ashwood House Public Realm
  - Vacant units in the Square
  - London Road Block Works
  - Provision of budget for Gypsy, Traveller and Travelling Show people sites as mandated in the new Local Plan
7. The figures do not include the implications of any schemes which may be carried forward from one year to the next. These will be considered by members on the basis of the Capital Outturn report to be presented later in the year.

### **Capital Contingency**

8. A key recommendation from the Public Realm Task and Finish Group was that adequate contingency be provided in the capital programme. Rather than allocate a general contingency to every project, it is proposed that centralised contingency controlled by the Strategic Director Finance and Customer Services be created and drawdown if required.
9. Approval for drawdown of this contingency will be from the Strategic Director Finance and Customer Services in consultation with the Portfolio Holder for Finance and Customer Services. Any drawdowns will be reported to the Performance and Finance Scrutiny Committee and the Executive in the next quarterly capital budget monitoring report.
10. Certain major projects will still hold their own specific contingency based on project management principles.

### **Governance**

11. Service officers 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 capital financing cost (which can be nil if the project is fully externally financed). These bids are appraised by senior managers and the relevant portfolio holder to ensure all bids are based on their contribution to the Five Year Plan as well as a comparison of service priorities against available financing resources. The budget papers are presented to Executive who in turn will make a recommendation to Council as part of the annual budget setting process.
12. Further details of the Council's capital programme can be found in the Capital Programme which is at Appendix 2-1 to this report.

13. 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

|                  | 2021/22<br>actual | 2022/23<br>forecast | 2023/24<br>budget | 2024/25<br>budget | 2025/26<br>budget | 2026/27<br>budget |
|------------------|-------------------|---------------------|-------------------|-------------------|-------------------|-------------------|
| External sources | 0.871             | 1.450               | 0.960             | 0.780             | 0.780             | 0.780             |
| Own resources    | 1.687             | 1.050               | 1.579             | 0.710             | 0.210             | 0.210             |
| Debt finance     | 1.932             | 0                   | 0                 | 0                 | 0                 | 0                 |
| <b>TOTAL</b>     | <b>4.490</b>      | <b>2.500</b>        | <b>2.539</b>      | <b>1.490</b>      | <b>0.990</b>      | <b>0.990</b>      |

14. 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 repayments, MRP transfers and use of capital receipts to repay debt are as follows:

#### Replacement of debt finance in £ millions

|                                    | 2021/22<br>actual | 2022/23<br>forecast | 2023/24<br>budget | 2024/25<br>budget | 2025/26<br>budget | 2026/27<br>budget |
|------------------------------------|-------------------|---------------------|-------------------|-------------------|-------------------|-------------------|
| <b>Annuity principal repayment</b> | 1.4               | 1.5                 | 1.8               | 1.8               | 1.8               | 1.8               |
| <b>MRP Payment</b>                 | 0.8               | 0.8                 | 0.9               | 0.9               | 0.9               | 0.9               |
| <b>Use of Capital Receipts</b>     | 0.0               | 0.0                 | 0.0               | 0.0               | 0.0               | 0.0               |

15. The Council's full MRP statement is included within the Treasury Strategy report for 2023/24 which can be found on the February 2023 Executive agenda. The increase in the Annuity principal repayment is due to the two Phoenix loans taken out in the year.

16. 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**

|                       | <b>31.3.2023<br/>forecast</b> | <b>31.3.2024<br/>budget</b> | <b>31.3.2025<br/>budget</b> | <b>31.3.2026<br/>budget</b> | <b>31.3.2027<br/>budget</b> |
|-----------------------|-------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| General Fund services | 7                             | 7                           | 7                           | 8                           | 8                           |
| Capital investments   | 167                           | 164                         | 160                         | 156                         | 153                         |
| <b>TOTAL CFR</b>      | <b>174</b>                    | <b>171</b>                  | <b>167</b>                  | <b>164</b>                  | <b>161</b>                  |

17. **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 the four year period.

**Capital receipts in £ millions**

|              | <b>2021/22<br/>actual</b> | <b>2022/23<br/>forecast</b> | <b>2023/24<br/>budget</b> | <b>2024/25<br/>budget</b> | <b>2025/26<br/>budget</b> | <b>2026/27<br/>budget</b> |
|--------------|---------------------------|-----------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Asset sales  | 0                         | 0                           | 0                         | 0                         | 0                         | 0                         |
| <b>TOTAL</b> | <b>0</b>                  | <b>0</b>                    | <b>0</b>                  | <b>0</b>                  | <b>0</b>                  | <b>0</b>                  |

**Treasury Management**

18. 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.

19. **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 4.25%) and long-term fixed rate loans where the future cost is known but higher (currently 4.71%).

20. 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.
21. 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**

|                               | 31.3.203<br>forecast | 31.3.2024<br>budget | 31.3.2025<br>budget | 31.3.2026<br>budget | 31.3.2027<br>budget |
|-------------------------------|----------------------|---------------------|---------------------|---------------------|---------------------|
| Gross External Debt           | 164                  | 165                 | 158                 | 155                 | 152                 |
| Capital Financing Requirement | 174                  | 176                 | 167                 | 164                 | 161                 |

22. 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.

23. **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 £ millions**

|  | 2022/23<br>limit | 2023/24<br>limit | 2024/25<br>limit | 2025/26<br>limit | 2026/27<br>limit |
|--|------------------|------------------|------------------|------------------|------------------|
| Authorised limit – total external debt     | 235              | 235              | 235              | 235              | 235              |
| Operational boundary – total external debt | 230              | 230              | 230              | 230              | 230              |

24. The authorised and operational boundaries have not been increased in 2023/24 to reflect the changes due to the change in the accounting treatment for leases as the amount is not material.

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

26. 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.

27. 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

|                                | 31.3.2022<br>actual | 31.3.2023<br>forecast | 31.3.2024<br>budget | 31.3.2025<br>budget | 31.3.2026<br>budget |
|--------------------------------|---------------------|-----------------------|---------------------|---------------------|---------------------|
| <b>Near-term investments</b>   | 36.8                | 11.00                 | 11.00               | 11.00               | 11.00               |
| <b>Longer-term investments</b> | 2.1                 | 2.2                   | 2.2                 | 2.2                 | 2.2                 |
| <b>TOTAL</b>                   | <b>38.9</b>         | <b>13.2</b>           | <b>13.2</b>         | <b>13.2</b>         | <b>13.2</b>         |

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

29. **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

30. 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.

31. 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

32. In addition to debt of £165 million detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £6.3m). The Council also set aside last year £0.5m to cover risks of business rates appeals and revaluations and £1.4m for bad debts. These provisions will be reviewed as part of the accounts closure process for 2022/23.
33. **Governance:** The risk of liabilities crystallising and requiring payment is monitored by finance and reported within the annual financial statements.

### **Revenue Budget Implications**

34. 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**

|   | 2022/23<br>forecast | 2023/24<br>budget | 2024/25<br>budget | 2025/26<br>budget | 2026/27<br>budget |
|---|---------------------|-------------------|-------------------|-------------------|-------------------|
| <b>Financing costs (£m)</b>             | 6.7                 | 6.8               | 6.8               | 6.8               | 6.8               |
| <b>Proportion of net revenue stream</b> | 0.56                | 0.50              | 0.49              | 0.58              | 0.56              |

35. **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**

36. 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.
37. 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 Link Group as treasury management advisers, Praxis Retail as property consultants and management 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.

## **Investment and Development**

38. The Council has a dedicated Investment and Development team responsible for:

- Property lettings,
- Major regeneration and development projects.
- Maintaining the Council's property estate.
- Acquisition of new assets.
- Economic Development team

39. This team is developing an proposed programme of capital works to be implemented over the next few years, some of which may stretch beyond the current Medium Term Financial Strategy. Each individual project will be the subject of a full report to Executive and Council (if required) and will contain as a minimum:

- Full business case
- Option(s) appraisal
- Benefits identification and realisation plan
- Risk management register
- Summary of whole life costs
- Summary of annual revenue costs/incomes (annual cost of ownership)
- Funding summary including debt financing and repayment.

## **Property acquisition**

40. Any property acquisition must be within the Borough boundary and fulfil at least one of the below criteria:

- Supports regeneration within the Borough
- Supports economic development within the Borough
- Supports the protection of employment within the Borough
- Provides civic amenity within the Borough
- Supports the Council's social and affordable housing objectives.

41. In addition to the criteria above, the acquisition should be at least cost-neutral to the local tax account in that it must pass the hurdle rate below in terms of income generated versus the total cost of the acquisition. The net income should equal or exceed the sum of the following:



- Current PWLB certainty rate for a maturity loan whose duration is based the life of the asset at the time of approval to acquire.
- An assessment of a repayment provision based on the life/holding of the asset.
- A contingency of 50 basis points (bps) [0.5%] rate
- A 100 bps [1%] overage. *NB: the overage can be foregone if the social benefit case is made for the acquisition*