SURREY HEATH BOROUGH COUNCIL

APPENDIX 2

CAPITAL STRATEGY 2024/25 – 2027/28

(APPENDIX 2 TO THE MEDIUM TERM FINANCIAL STRATEGY 2024/25 TO 2027/28)

February 2024

Surrey Heath Borough Council
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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 technical financial issues.

2. Decisions made on capital and treasury management can have financial consequences for the Council for many years into 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 the same financial year.

5. In 2024/25, the Council is planning capital expenditure of **£ 10.871 million** inclusive of slippage of **£1.118 million** as summarised below:

Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2022/23 actual	**2023/24 forecast**	**2024/25 budget**	**2025/26 budget**	**2026/27 budget**	**2027/28 budget**
Capital Projects	1.952	5.440	10.871	4.291	2.280	2.450
Capital investments	0.000	0.000	0.000	0.000	0.000	0.000
TOTAL	**1.952**	**5.440**	**10.871**	**4.291**	**2.280**	**2.450**

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;
   - Major refurbishment and improvements to the Council's car parks
   - Esso Pipeline Environmental Projects
   - Climate change initiatives (Solar photo-voltaic on Places Leisure)
   - Public Realm improvements within Camberley town centre
   - Works around the provision of Suitable Alternative Natural Greenspace (SANG)
   - Works in our country parks and recreation areas.
   - Works to remove asbestos contamination, surveying and roof replacement for the old House of Fraser building
   - Roof maintenance and repairs to the Square shopping centre
   - London Road Block (LRB) continued site assembly and preparation
   - 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

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8. A key recommendation from the Public Realm Task and Finish Group was that adequate contingency be provided in the capital programme. Subsequently in the previous programme a centralised contingency controlled by the Strategic Director Finance and Customer Services was created and drawn down if required. This will be the same for the current programme, and totals £0.200 million.

9. Approval for draw-down of this contingency will be from the Strategic Director Finance and Customer Services in consultation with the Portfolio Holder for Performance and Finance. 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 have their own element of specific contingency based on project management principles and this is managed in accordance with the terms of reference for that project.

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 officers 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 new Council Strategy,as well as a comparison of service priorities against available financing resources. The budget papers are presented to the 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 is shown 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

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget	2027/28 budget
External sources	1.286	2.503	2.853	1.023	0.961	0.961
Own resources	0.578	0.000	0.032	0.000	0.000	0.000
Debt finance	0.088	2.937	7.986	3.259	1.319	1.489
TOTAL	**1.952**	**5.440**	**10.871**	**4.292**	**2.280**	**2.450**

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 that have taken on debt 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 revenue 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

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget	2027/28 budget
Annuity principal repayment	1.800	1.800	1.800	1.800	1.800	1.800
MRP Payment	0.879	0.940	1.174	1.356	1.518	1.644
Use of Capital Receipts	0.000	0.000	0.000	0.000	0.000	0.000

15. The Council's full MRP statement is included within the Treasury Strategy report for 2024/25 which is on the February 2024 Executive agenda.

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 increase during 2024/25 and in later years. 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

	31.3.2024 forecast	31.3.2025 budget	31.3.2026 budget	31.3.2027 budget	31.3.2028 budget
Gross External Debt	174.000	178.690	182.408	186.177	190.141
Capital Financing Requirement	207.951	209.667	210.229	210.680	211.200

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

	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget	2027/28 budget
Asset sales	0.000	0.000	0.000	0.000	0.000	0.000
TOTAL	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**

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 5.0%, but bearing no cost of carry) and long-term fixed rate loans where the future cost is known but higher (currently 5.25%).

20. The advice from the Council's Treasury advisors has been for the Council to retain the bulk of its borrowing in short term loan so as to take advantage of low interest rates. However, this approach is being reviewed, with the intention of locking into longer loans when rates available come back down. The rates are expected to fall in Autumn 2024.

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

	31.3.2024 forecast	31.3.2025 budget	31.3.2026 budget	31.3.2027 budget	31.3.2028 budget
Gross External Debt	174.000	178.690	182.408	186.177	190.141
Capital Financing Requirement	207.951	209.667	210.229	210.680	211.200

22. External debt will increase over the period of the Medium Term Financial Strategy as more internal borrowing is converted into external debt as the Council requires funds for liquidity and expends more of its reserves, which is the primary source of internal debt financing.

23. 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 invest in regeneration or other major capital expenditure, then these will be funded by debt and the CFR will be rise accordingly.

24. **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

	2023/24 limit	2024/25 limit	2025/26 limit	2026/27 limit	2027/28 limit
Authorised limit – total external debt	235.000	237.000	237.000	237.000	237.000
Provision for IFRS 16 Leases Changes	0.000	2.000	2.000	2.000	2.000
Operational boundary – total external debt	230.000	230.000	230.000	230.000	230.000

25. 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. These are reflected in the numbers for 2024/25 and beyond.

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

27. 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.

28. 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

	31.3.2023 actual	31.3.2024 forecast	31.3.2025 budget	31.3.2026 budget	31.3.2027 budget
Near-term investments	**9.344**	**13.800**	**11.000**	**11.000**	**11.000**
Longer-term investments	**2.053**	**2.000**	**2.200**	**2.200**	**2.200**
TOTAL	**11.397**	**15.800**	**13.200**	**13.200**	**13.200**

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

30. **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

31. 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.

32. 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 risk based on service demand reducing due to the cost of living crisis and also increased demand for support from the Council in other areas. This risk could remain significant for 2024/25 depending on the ongoing impact of the international and the national economic position.

Liabilities

33. In addition to debt of £165 million (31 December 2023) 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 £0.5 million to cover risks of business rates appeals and revaluations and £0.1 million for business rate bad debts. These provisions will be reviewed as part of the accounts closure process for 2022/23 and 2023/24.

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

Revenue Budget Implications

35. 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

	2023/24 forecast	2024/25 budget	2025/26 budget	2026/27 budget	2027/28 budget
Financing costs (£m)	7.37	8.42	8.50	8.52	8.54
Net revenue stream (£m)	13.68	14.70	13.65	13.96	13.81
Proportion of net revenue stream	0.54	0.57	0.62	0.61	0.62

36. **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 although ambitious for a Council of the size of Surrey Heath 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.

37. **Knowledge and Skills**: 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 and the senior officers in the Finance team are experienced and qualified accountants, the property department has qualified surveyors with investment experience and the legal department has lawyers experienced in property matters.

38. 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 Real Estate Management as property consultants and management and Addleshaw Goddard as external lawyers for its property matters. This approach is more cost effective than employing such staff directly and permanently, and ensures that the Council has access to appropriate knowledge and skills commensurate with any potential risks involved

Investment and Development

39. The Council has a dedicated Property and Economic Development team responsible for:

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

40. This team is developing a 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

41. 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.

42. 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