ANNEX 3

CAPITAL STRATEGY 2023/24

June 2023

1. Introduction

This capital strategy report sets out 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.

Decisions made this year on capital and treasury management will have financial consequences for the Council 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.

2. Capital Expenditure and Financing

Capital expenditure is where the Council 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 2023/24, the Council is planning capital expenditure of £10.77 million as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure	2021/22 Actual	2022/23 Forecast	2023/24 Budget	2024/25 Budget [1]	2025/26 Budget
	£000	£000	£000	£000	£000
Capital Programme 2023/24 to 2027/28	35,683	21,156	4,338	4,322	3,805
Other fully-funded schemes[1]	-	-	6,434	5,807	2,727
TOTAL	**35,683**	**21,156**	**10,772**	**10,129**	**6,532**

Notes:
1. Council capital schemes approved by Executive in March 2023 that are to be funded through the Community Infrastructure Levy (CIL).

Setting the Capital programme: Service Teams bid to include projects in the Capital Programme as part of the service & financial planning process in preparation for setting the Revenue Budget and Capital Programme and refreshing the Medium-Term Financial Plan each year.

The officer Management Team appraises all bids and makes recommendations to the Executive. The final Capital Programme is then presented to Executive in January and to Council for approval in February each year. Additional capital requirements and opportunities identified through the year are considered on their merits in line with the above governance controls. Any in year changes to the capital budget will be made in accordance with the constitution, including appropriate approval by Executive and Council.

All capital expenditure must be financed, either from external sources (such as government grants, section 106, community infrastructure levy and other contributions), the Council's own resources (revenue contributions, reserves and capital receipts) or borrowing.

The planned financing of the above expenditure is as follows:

Table 2: Capital financing	**2021/22 Actual**	**2022/23 Forecast**	**2023/24 Budget**	**2024/25 Budget**	**2025/26 Budget**
	£000	**£000**	**£000**	**£000**	**£000**
Grants & Contributions	2,346	4,628	7,931	7,311	4,231
Capital Receipts	11,764	503	-	-	-
Debt	21,573	16,024	2,841	2,818	2,301
TOTAL	**35,683**	**21,156**	**10,772**	**10,129**	**6,532**

The Council's total outstanding borrowing is measured by the capital financing requirement (CFR). This increases with any new capital expenditure financed by borrowing and reduces with any minimum revenue provision (MRP) payments or any use of capital receipts to replace borrowing.

The Council approves the MRP policy each year as part of the Annual Treasury Management Strategy.

Table 3: Replacement of prior years' debt finance	**2021/22 Actual**	**2022/23 Forecast**	**2023/24 Budget**	**2024/25 Budget**	**2025/26 Budget**
	£000	**£000**	**£000**	**£000**	**£000**
Minimum revenue provision (MRP)	556	583	587	588	602
Capital receipts	-	-	35,824	-	-
TOTAL	**556**	**583**	**36,411**	**588**	**602**

The Minimum Revenue Provision Statement is set out at Appendix 1.

The CFR is expected to reduce by £36.4 million during 2023/24. Based on the above figures for expenditure and financing, the Council's forecast CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement	31.3.2022 Actual	31.3.2023 Forecast	31.3.2024 Budget	31.3.2025 Budget	31.3.2026 Budget
	£000	£000	£000	£000	£000
TOTAL CFR	**76,400**	**89,500**	**53,900**	**53,400**	**52,800**

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 forecasts to receive £35.8 million of capital receipts in the coming 2023/24 financial year.

Actual capital receipts received were £0.503 million in 2022/23 and £8.8 million in 2021/22.

There are currently no plans for significant additional capital receipts to be received in 2024/25 or 2025/26.

The Council's Flexible Use of Capital Receipts Strategy is set out at Appendix 2.

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 is used to identify opportunities to expand the Council's property assets or dispose of surplus assets where appropriate.

It also allows for a review of the state of repair of assets and provides the basis for recommending a rolling investment programme in property assets to maintain and enhance the income derived from them.

The Council's Asset Management Strategy is summarised at Appendix 3.

3. Treasury Management

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

This Council is typically cash rich in the short-term as revenue income is received before it is used. Revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

At 31 March 2023 the Council had £7.0 million borrowing at an average interest rate of 4% which has since been repaid.

Borrowing strategy: The Council's main objectives when borrowing is to achieve a low but certain cost of finance while retaining flexibility should plans change in future.

The Council has historically been largely debt free but has borrowed on a temporary basis to fund short term cash flow shortfalls. As the Council has a modest and relatively short-lived expected future borrowing requirement short term borrowing is expected to continue to be the most cost-effective option.

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

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

Table 5: Prudential Indicator: Gross Debt and the Capital Financing Requirement	31.3.2022 Actual	31.3.2023 Forecast	31.3.2024 Budget	31.3.2025 Budget	31.3.2026 Budget
	£000	£000	£000	£000	£000
Debt	-	7,000	-	-	-
Capital Financing Requirement	76,400	89,500	53,900	53,400	52,800

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 5, the Council expects to comply with this in the medium term.

Liability Benchmark: To compare the Council'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 £15.0 million at each year-end.

The benchmark is currently £6.0 million for 2022/23 and is forecast to increase to £10.4 million by 31 March 2024.

The Council plans to borrow at or as near as possible to the Liability Benchmark in future as is illustrated by the table below.

Table 6: Borrowing and the Liability Benchmark	31.3.2022 Actual	31.3.2023 Actual	31.3.2024 Budget	31.3.2025 Budget	31.3.2026 Budget
	£000	£000	£000	£000	£000
Outstanding/ estimated borrowing	0	7,000	10,400	19,400	22,000
Liability benchmark	(10,900)	6,000	10,400	19,400	22,000

Affordable Borrowing Limit: The Council is legally 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.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt	2022/23 Limit	2023/24 Limit	2024/25 Limit	2025/26 Limit
	£000	£000	£000	£000
Authorised limit – borrowing	79,000	40,000	41,000	42,000
Operational boundary – borrowing	69,000	35,000	36,000	37,000

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 Council'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 money market funds and banks, to minimise the risk of loss, the Council may request its money back at short notice.

Table 8: Treasury management investments	31.3.2022 Actual	31.3.2023 Forecast	31.3.2024 Budget	31.3.2025 Budget	31.3.2026 Budget
	£000	£000	£000	£000	£000
Near-term investments	15,900	6,000	5,000	5,000	5,000
Longer-term investments	10,000	10,000	10,000	10,000	10,000
TOTAL	**25,900**	**16,000**	**15,000**	**15,000**	**15,000**

The Council is required to have at least £10 million in investments at all times to retain a desired professional status when working with financial intermediaries: as this is a constant requirement that remains indefinitely it is considered a long-term investment balance, although it may be invested in short-term products.

Risk management: The effective management and control of risk are prime objectives of the Council'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.

In managing the overall programme of investment there are inherent risks associated such as changes in interest rates, credit risk of counter parties.

Accordingly, the Council will ensure that robust due diligence procedures cover all external capital investment. Where possible contingency plans will be identified at the outset and enacted when appropriate.

No project or investment will be approved where the level of risk - determined by the Council or Chief Finance Officer as appropriate - is unacceptable.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Chief Finance Officer and Finance staff, who must act in line with the Treasury Management Strategy approved by Council.

Quarterly reports on treasury management activity are presented to the Overview & Scrutiny Committee, Executive and full Council.

4. Investments for Service Purposes

The Council makes investments to assist local public services, to stimulate local economic growth.

The largest loan currently is to a Council subsidiary to provide a vehicle for both the delivery of housing and infrastructure to seek to meet the corporate objectives of the Council.

Total property investments are currently valued at £37.7 million with the largest being the Redhill Distribution Centre which provides a net return after costs of 5.58%.

Risk management: The Council is exposed to a range of risks with regard to the continued affordability and delivery of it's the Capital Programme including:

- Financial risks related to the investment of the Council's assets, cash flow and market volatility;
- Macroeconomic risks related to the growth or decline of the local economy, interest rates, inflation and the wider national and global economy;
- Reputational risks related to the Council's dealings and interests, and the impact of adverse outcomes on the Council's reputation and public perception; and

- Governance risks related to ensuring that prudence and careful consideration are prominent in the Council’s decision-making.

Due diligence is undertaken on acquisitions and external advice is sought wherever necessary.

When making decisions - particularly around assets which generate a return - due diligence processes include second opinion on asset values, site visits, surveys and market intelligence. They also include risk analysis and sensitivity analysis in order to model how affordability is impacted by stress testing key underlying assumptions. Consideration is also made to the profile of the Council’s asset base - and how effectively risk is spread across different asset types and sectors.

Governance: The Overview & Scrutiny Committee is responsible for scrutiny and governance of Treasury Management. It reviews the Treasury Management Strategy, and all Treasury Management reports. The Capital Programme is monitored by the Overview & Scrutiny Committee and the Executive as well as receiving all Treasury Management reports. Council approves the Treasury Management Strategy each year along with quarterly performance updates. The Chief Finance Officer is responsible for ensuring that adequate due diligence is carried out before investment is made.

Service teams bid to include projects in the Capital Programme as part of the service & financial planning process in preparation for setting the Revenue Budget and Capital Programme and updating the Medium-Term Financial Plan each year.

The officer Management Team appraises all bids and makes recommendations to the Executive. The recommended Capital Programme is then presented to Executive in January and to Council for approval in February each year.

Additional capital requirements and opportunities identified through the year are considered on their merits in line with the above governance controls. Any in year changes to the capital budget will be made in accordance with the constitution, including appropriate approval by Executive and/or Council. Due diligence is undertaken on acquisitions and external advice is sought wherever necessary.

Table 9: Prudential indicator: Net income from commercial and service investments to net revenue stream	**2021/22 Actual**	**2022/23 Forecast**	**2023/24 Budget**	**2024/25 Budget**	**2025/26 Budget**
Total net income from service and commercial investments - in £000	1,955	2,013	2,085	2,397	2,757
Proportion of net revenue stream	10.42%	13.52%	9.39%	10.80%	12.42%

5. Liabilities

In addition to debt of £7.0 million detailed above, the Council is committed to making future payments to cover its pension fund deficit valued at £1.89 million and has made provisions to cover risks such as insurance claims.

Governance: Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Chief Finance Officer.

The risk of liabilities crystallising and requiring payment is monitored by the Corporate Governance Group and reported quarterly to the Audit Committee and the Executive.

6. Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are. 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 10: Prudential Indicator: Proportion of financing costs to net revenue stream	2021/22 Actual	2022/23 Actual	2023/24 Budget	2024/25 Budget	2025/26 Budget
Financing costs – in £000	620	606	631	720	736
Proportion of net revenue stream	3.30%	4.07%	2.84%	3.24%	3.32%

Sustainability: The Chief Finance Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because only modest amount of short-term borrowing is expected over a short-term period, and only modest MRP costs are expected over a more extended period.

7. Knowledge and Skills

The Finance Team has responsibility for preparing and on-going management of the capital and treasury management strategies and Capital Programme. The team is staffed by professionally qualified accountants with extensive local government finance experience. Team members attend all relevant training courses, workshops and events to ensure that their knowledge and skills are up to date and the Council is in a position to address all new technical developments.

Overall responsibility for capital and treasury activities lies with the Council's Chief Finance Officer who, in accordance with statue, is professionally qualified and is suitably experienced to hold the post.

The Council provides training to Members on an annual basis, which is delivered by Council Officers and external advisors. Members are updated on developments and any issues of significance throughout the year with information presented to the Overview & Scrutiny Committee, Audit Committee, Executive and at Member briefings.

The Council uses Arlingclose Limited, as its external Treasury Management advisors and recognises that that it is essential to engage with external providers of expertise in order to acquire access to specialist skills and resources. When looking at commercial activity transactions, officers from relevant professional disciplines from across the Council are involved in conducting due diligence exercises.

Alongside the internal resources the Council also uses, where appropriate, external advisors to complete the due diligence process.

APPENDIX 1

Minimum Revenue Provision (MRP) Policy

1. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the MRP). It is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP).

2. MHCLG regulations require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

3. Council is recommended to approve the following MRP Statement for 2023/24:

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the Minimum Revenue Policy will be the Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations and will be set aside in the year after the asset becomes operational. This will be a combination of the annuity method and straight-line method:

- Operational land and buildings - 50 years annuity method;
- Investment Properties - 50 years annuity method;
- General Fund Housing - 50 years straight line method;
- Infrastructure - 50 years straight line method;
- Plant and Equipment- 30 years straight line method;
- ICT- 5 years straight line method; and
- Vehicles - 8 years straight line method.

MRP on Capital Loans and Share Capital.

4. Under local authority capital accounting regulations loans to third parties for capital purposes and share capital are deemed to be capital expenditure of the authority. The Council has made loans to its companies (Greensand Holdings Limited, RBBC Limited, Horley Business Park Development LLP) and holds share capital in Pathway for Care Limited.

5. The Capital Financing Requirement (CFR) includes the value of the loans and investments (share capital). Funds repaid by the companies will be classed as capital receipts and offset against the CFR, which will reduce accordingly.

6. The repayments of principal will be set aside as capital receipts to finance the initial capital advance in lieu of making MRP.

MRP Overpayments.

7. MHCLG Guidance includes the provision that any MRP charges made over the statutory minimum may be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed, the MRP policy must disclose the cumulative overpayment made each year.

   At 31 March 2023 the cumulative voluntary overpayments by this Council were forecast to be £Nil.

APPENDIX 2

Flexible Use of Capital Receipts Strategy

The Department for Levelling up, Housing and Communities (DLUHC) confirmed the extension for the use of capital receipts to fund the revenue costs of transformation.

The flexible use of capital receipts is designed to offset the revenue cost of transformational projects which are expected to deliver future ongoing revenue savings for either the Council or other public sector delivery partners. In order to take advantage of the change of use to capital receipts, the Council must act in accordance with the statutory guidance issued by the Secretary of State. This guidance requires the Council to prepare, publish and maintain a Flexible Use of Capital Receipts Strategy.

Qualifying expenditure.

Qualifying expenditure is expenditure on any project that is designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that reduces costs or demand for services in future years for any of the public sector delivery partners.

Projects

There are currently no projects in place that plan to make use of the capital receipts flexibility. Should this change, details of the expected savings/service transformation will be provided to full Council alongside the impact on the Council's Prudential Indicators.

APPENDIX 3

Asset Management

Management of the Council's property maintenance programme, condition surveys and project management of small to medium size construction projects is carried out by the Property Services team. This team incorporates Facilities Management, with responsibility for the day to day running of the buildings to support and enable ongoing service delivery. The team is augmented by external consultants when specialist advice or additional resources are required.

Compliance with numerous statutory requirements relating to maintenance and management of properties are dealt with in-house, augmented by external consultants when specialist advice is required. The main legislative areas covered are:

• Disability Discrimination Act;

• Control of Asbestos Regulations;

• Health and Safety at Work Act;

• Environment Protection Act (contaminated land);

• Control of Substances Hazardous to Health Regulations (Legionella);

• The Regulatory Reform (Fire Safety) Orders;

• Gas safety and fixed wire testing;

• Fire risk assessments; and

• Lifts and Lifting Operations Lifting Equipment Regulations (LOLER).

Health and Safety schedules have been checked and updated, with all due inspections and certifications in hand.

A rolling five-year programme of condition surveys, regular inspection of the properties and liaison with service managers determines the revenue and capital budgets required over the medium term.

The objective is to reduce reliance on capital to fund planned and reactive maintenance, through continued aggregation of planned maintenance contracts and efficient re tendering of services that the Council purchases from external contractors.

Budgets for, and the cost of, repairs and maintenance are split between planned maintenance and reactive maintenance in order to monitor and measure the progress of improving the proportion of expenditure on the former at the expense of the latter.

All procurements are undertaken in accordance with the Council's Contract Procedure Rules and making use of the Council's E-Procurement system. This approach ensures both compliance with legislation governing public sector procurement and an open and competitive process for securing the most economically advantageous terms.