Appendix 6

Capital Programme 2024/25 to 2026/27 and Capital Strategy for 2024/25

1. Executive Summary

1.1. The financial position of the Council is critical given the Council has extremely low revenue reserves and is unable to balance the 2024/25 budget without recourse to DLUHC approval of Exceptional Financial Support in the form of capitalisation of revenue expenditure funded from borrowing. The position on reserves has been depleted over several years as these amounts have been utilised, they are unavailable to fund the transformation that is required to redesign services to operate from a lower cost base over the medium term. As a result, the Council has made an application to DLUHC for Exceptional Financial Support to balance its 2024/25 revenue budget and to underpin the reserves position in the context of financial risks within the Council's operating environment.

1.2. Capital Expenditure relates to spending on longer-term assets and infrastructure (such as property, equipment, vehicles, roads etc.). The Council's capital programme is therefore an important element of the Council's overall financial planning arrangements as appropriate investment can enable the transformation of service delivery and improve the quality of services to the local community. The schemes included in the programme need to be appropriate in meeting the Council's objectives, be affordable and represent value for money.

1.3. The Council must consider how capital expenditure is paid for and what the long-term financial implications are of undertaking this investment. The Council is permitted to borrow funds to finance the capital programme under the Local Government Act 2003. It needs to consider the impact on the revenue budget in relation to repayment of borrowing proposed, how it funds the repayment of this debt and the period over which it is repaid. This is particularly important in the context of the significant pressures on the revenue budget and the potential continuing risk of a Section 114 notice being issued if the budget cannot be maintained in balance during 2024/25 and future years.

1.4. A review and prioritisation of capital expenditure has been undertaken in order to reduce the programme to an affordable and deliverable level taking account of the revenue budget constraints upon the level of borrowing and delivery resources across Service Directorates. The proposed programme has been finalised between LMT and Portfolio Holders in formulating the proposed programme.

1.5. This report sets the proposed capital programme for 2024/25 of **£88.549m**, with a total of **£174.980m** for the period 2024/25 to 2026/27, together with the financing statement as summarised in **Table 1**.

1.6. The Council's Capital Financing Requirement (CFR) is the underlying need to borrow in relation to historical borrowing plus future planned borrowing to fund the Council's capital investment in assets. This is expected to increase to **£355.426m** by 2025/26 before starting to reduce again in 2026/27. Further details can be found in the Prudential Indicator and Treasury Management Strategy 2024/25 elsewhere on this agenda. A summary of the CFR, borrowing limits and planned borrowing together with the revenue cost of borrowing is summarised in **Table 2.**

1.7. More details on the prudential indicators which regulate the Council’s capital financing activities are included in the Prudential Indicators and Annual Treasury Management Strategy report elsewhere on this agenda. This is an integral part of setting a balanced revenue budget and MTFP for the Council.

1.8. Given the Council’s fragile financial position, the capital programme detailed in **Annex 1**, whilst affordable, must be managed strictly within budget in order to manage the revenue costs of servicing the historic external debt from previous financing decisions and future plans that are to be funded by borrowing.

1.9. The capital programme has been reprioritised to reduce previously planned expenditure to contain levels within affordable resources as follows:

- Funding Exceptional Financial Support to enable a lawful and balanced revenue budget to be set in 2024/25
- Meeting statutory duties for example health and safety requirements
- In flight schemes that cannot be stopped
- Funding transformation that will deliver ongoing revenue expenditure savings on the basis of invest to save, for which an appropriate rate of return will be determined within the transformation programme.
- Partially externally funded schemes that require council to match resources where there is a robust business case that meets Council Plan objectives and is approved in accordance with constitutional delegations.
- Repayment of borrowing to reduce revenue capital financing costs.

1.10. The governance arrangements for managing and monitoring the delivery of the programme to plan and to budget will be strengthened during 2024/25. Future budget planning rounds will be subject to improved programme governance to ensure that new projects align to the priorities of the Council plan and available resources to ensure value for money and affordability.

2. Introduction

2.1. The Council Plan for Middlesbrough acknowledges that a sustainable capital programme, and the strategy and controls to shape and manage it, is a critical contributor to the future ambitions, overall service delivery, and financial position of the Council going forwards.

2.2. The implementation of the Capital Strategy will assist in the Council meeting its '*Recover, Rest and Deliver'* approach by ensuring:

- Capital investment is strictly prioritised and meets the Council's objectives within a set funding limits from within its revenue budget and MTFP.
- Investment meets the CIPFA criteria of being prudent, sustainable, affordable and value for money.
- The Council is appropriately responding to the statutory recommendations raised by its external auditor.
- The Capital Programme does not include any schemes that are not permitted under the HM Treasury's definition of commercial activity and using external debt to solely generate ongoing revenue income.
- Capital projects are delivered within budget and in a timely manner and meet the objectives of their business cases.
- Members and Senior Officers have a common understanding of the financial context the Council is operating in and the capital principles underpinning capital decisions within the Council.

3. Capital Programme 2024/25 to 2026/27

3.1. **Table 1** summarises the Capital Programme by Directorate, EFS and an upper financial limit within which Transformation and redundancy costs will need to be delivered. It should be noted that the Transformation Programme is in development and will be presented to the Executive and Council in March together with the Flexible Use of Receipts Strategy to fund the programme and redundancies arising from the 2024/25 budget process. It is necessary to incorporate the financial provision at budget setting to ensure the overall budget and MTFP is complete, robust and affordable. Detailed development of plans will be subsequently approved through governance arrangements to be presented for approval in March.

Table 1: Summary of Capital Programme 2024/25 to 2026/27

	2024/25 £m	2025/26 £m	2026/27 £m	TOTAL		Council Funding £m	External Funding £m
Regeneration	21.582	36.935	2.670	61.187		25.684	35.503
Environment & Community Services	17.396	19.781	2.398	39.575		26.660	12.915
Public Health	0.043	-	-	0.043		-	0.043
Education & Partnerships	12.040	3.597	-	15.637		0.646	14.991
Childrens Care	2.035	2.360	-	4.395		4.395	-
Adult Social Care	1.213	0.660	0.660	2.533		2.064	0.469
Legal & Governance Services	2.350	2.185	2.185	6.720		6.720	-
Finance	4.790	-	-	4.790		4.790	-
Total All Directorates	**61.449**	**65.518**	**7.913**	**134.880**		**70.959**	**63.921**
Transformation							
Programme Costs	5.500	4.800	3.300	13.600		13.600	-
Redundancies	6.500	-	-	6.500		6.500	-
Contingencies	1.700	2.900	2.000	6.600		6.600	-
Total Transformation	**13.700**	**7.700**	**5.300**	**26.700**		**26.700**	-
Exceptional Financial Support (EFS)							
Budget Gap	4.700	-	-	4.700		4.700	-
Contingency on Budget Gap	0.600	-	-	0.600		0.600	-
Savings Delivery	3.500	-	-	3.500		3.500	-
Receipts Delivery	4.600	-	-	4.600		4.600	-
Total EFS	**13.400**	-	-	**13.400**		**13.400**	-
TOTAL CAPITAL EXPENDITURE	**88.549**	**73.218**	**13.213**	**174.980**		**111.059**	**63.921**

	2024/25 £m	2025/26 £m	2026/27 £m	TOTAL		Council Funding £m	External Funding £m
FUNDED BY							
Prudential Borrowing	23.037	28.009	1.913	52.959		52.959	-
EFS Borrowing	13.400	-	-	13.400		13.400	-
Capital Receipts	6.000	6.000	6.000	18.000		18.000	-
Flexible Receipts	13.700	7.700	5.300	26.700		26.700	-
Grants	29.897	27.931	-	57.828		-	57.828
Contributions	2.515	3.578	-	6.093		-	6.093
TOTAL FUNDING	**88.549**	**73.218**	**13.213**	**174.980**		**111.059**	**63.921**

Capital Receipts memo	2024/25 £m	2025/26 £m	2026/27 £m
Total Capital Receipts expected	24.512	13.240	9.709
Capital Receipts to finance above programme	(6.000)	(6.000)	(6.000)
Flexible Receipts to finance transformation	(13.700)	(7.700)	(5.300)
Capital Receipts to carry forward	**4.812**	**4.352**	**2.761**

3.2. **Annex 1** details the capital programme for approval, incorporating the capital budgets for 2024/25 to 2026/27. The capital budget is aligned to the Capital

Strategy. It presents in financial terms, the Council's plan for meeting the costs of EFS, Transformation and Redundancies together with investment related to the purchasing, building and improvement of capital assets, together with the implications of any major capital projects or investments within the Middlesbrough boundary. It also provides a framework for ensuring the programme is affordable within the current medium term financial plan.

3.3. The Capital Programme has been reviewed during January 2024 by the Council's LMT to ensure that any schemes delivered continue to be in line with the priorities identified in the Council Plan and that schemes included are based on robust estimates and profiles. The review has also considered that given the Council's fragile revenue and reserves position and the reliance upon borrowing under EFS, that borrowing to fund capital expenditure must be tightly controlled and maintained within medium to long term affordability levels as set out in the MTFP.

3.4. **Table 2** below sets out the Prudential Indicators in terms of Council indebtedness and debt levels over the medium term. Further information is set out in the Prudential Indicator and Treasury Management Strategy Report elsewhere on this agenda.

Table 2: Prudential Indicators

Prudential Indicator	**2024/25 (£m)**	**2025/26 (£m)**	**2026/27 (£m)**
Capital Financing Requirement (underlying need to borrow)	**331.863**	**355.426**	**352.332**
External Borrowing	310.535	333.294	329.910
Internal Borrowing	21.328	22.132	22.422
Authorised limit for External Debt	**372.000**	**396.000**	**393.000**
Annual Capital Financing Cost	11.154	12.814	14.496
% of Net Revenue Budget on debt costs	7.8%	8.6%	9.8%

Figure 1: Total Debt as a % of core spending power for all English unitary authorities

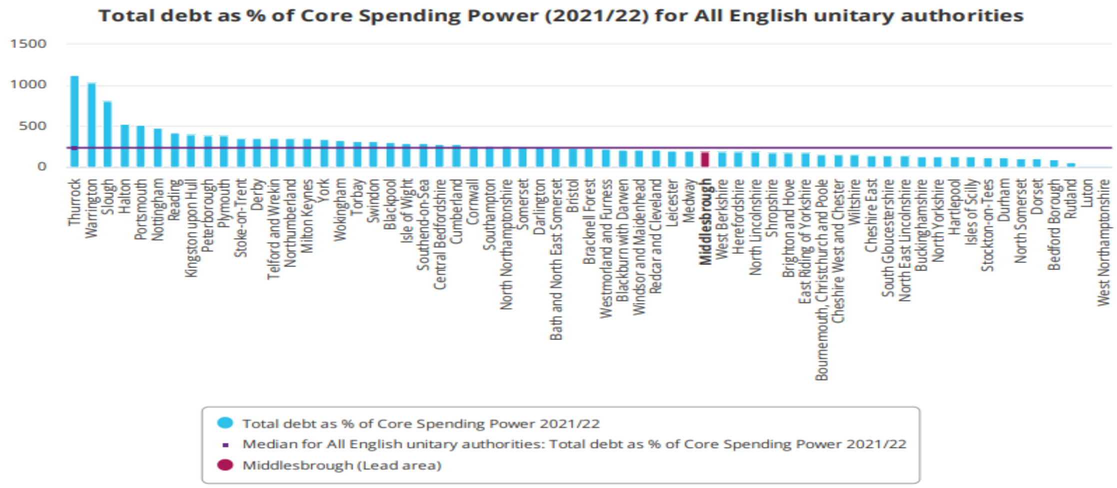
Total debt as percentage of core spending power

'Total debt' is Capital Financing Requirement, a measure of capital indebtedness that the council has built up over many years of capital financing decisions, but based on a methodology. (It is perhaps more accurate to describe this as the amount of capital expenditure that has not yet been funded by capital receipts, capital grants or revenue contributions and which therefore will need to be funded in future years. As such is some kind of measure of capital indebtedness, but arguably not a perfect one.

Core Spending Power is a measure of the funding the government makes available to councils for service delivery but it excludes several important elements that may be contributing to the servicing of debt including schools grants, investment income, service income and housing rents.

In 2021/22, the total debt as a percentage of Core Spending Power for Middlesbrough was 190.1%, which was below the All English unitary authorities median percentage of 229.4%.

Note the metric on total debt as a percentage of core spending power used by Oflog uses different financial years for the denominator and numerator, whereas LG Inform uses the same financial year so the numbers will differ slightly.



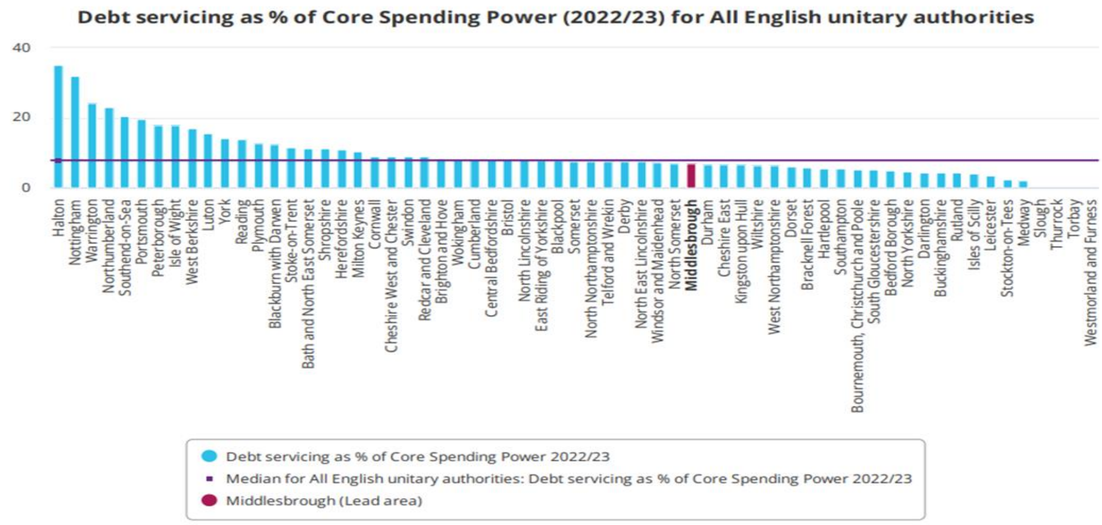
Source:
Calculated by LG Inform, N/A, Total debt as % of Core Spending Power , **Data updated:** 22 Nov 2023

Figure 2: Debt Servicing as a % of core spending power for all English unitary authorities

Debt servicing as percentage of core spending power

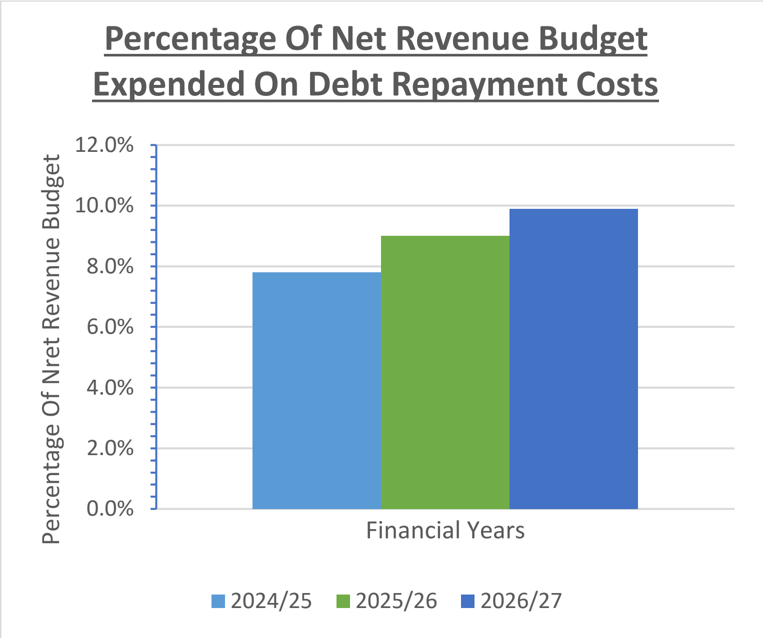
Capital expenditure is expenditure which has an impact over more than one year – for example building a road or a community centre which is going to last many years. Where a council finances capital spending by borrowing or credit, it will incur costs on its budget over the period of the loan or credit arrangement. These figures demonstrate how much the council is currently paying in relation to servicing its debt compared with its Core Spending Power, recognising the fact that current residents are getting the benefit of investments in assets made several years ago.

In 2022/23, the level of debt servicing as a percentage of Core Spending Power for Middlesbrough was 6.8%, which was below the All English unitary authorities median of 7.9%.



Source:
Calculated by LG Inform, N/A, Debt servicing as % of Core Spending Power , **Data updated:** 14 Dec 2023

Table 3: % of Net Revenue Budget expended on debt repayment costs



3.5. As illustrated in **Figures 1 and 2 and Table 3** above, although Middlesbrough's debt related indicators are increasing over the medium term, it is not an outlier in terms of its levels of debt when compared against all the other English unitary authorities.

3.6. In total the programme sets out investment of **£174.980m** from 2024/25 to 2026/27, in support of delivering the Council's objectives and priorities.

3.7. The Capital programme was reviewed and revised during Quarter 3 of 2023/24, given the financial position of the Council and to ensure that the Council's capital ambitions remain affordable and sustainable. This review reduced capital expenditure during 2023/24 and proposed expenditure for 2024/25 to 2026/27 as follows:

Table 4: Review of capital programme undertaken at Quarter 3 2023/24

Council Capital Programme			
	2024/25 £m	2025/26 £m	Total £m
Total Planned Spend at Q2	**110.543**	**23.039**	**133.582**
Council Funded	52.680	14.956	67.636
Grants / Contributions / Other	57.863	8.083	65.946
Total Planned Spend at Q3	**61.449**	**65.518**	**126.967**
Council Funded	29.037	34.009	63.046
Grants / Contributions / Other	32.412	31.509	63.921
Total Difference	**(49.094)**	**42.479**	**(6.615)**
Council Funded	(23.643)	19.053	(4.590)
Grants / Contributions / Other	(25.451)	23.426	(2.025)

3.8. This resulted in the following major schemes being removed from the programme:

- Removal of Tees Amp 2 - £8.820m of Council resources
- Removal of Brownfield Housing Fund grant - £6.076m of grant funding
- Removal of £1.521m of Council resources & replacing with grant funding / other contributions on the following schemes
    - £1.250m relating to Traffic Signals
    - £0.163m relating to Parking Ticket Machines
    - £0.108m relating to Bridges.

3.9. Schemes that were reprofiled were as follows:

Table 5: Review of capital programme undertaken at Quarter 3 2023/24 – schemes reprofiled

Schemes where significant re-profiling has been undertaken						
Directorate	Scheme	Funding Source				
		Council	Grant	2023/24	2024/25	2025/26
		£m	£m	£m	£m	£m
Regeneration	Towns Fund Grant		11.415		(11.415)	11.415
Regeneration	East Middlesbrough Community Hub		0.618		(3.218)	3.218
Regeneration	Acquisition of Town Centre Properties	2.600			(1.207)	1.207
Regeneration	Town Hall Roof	1.207			(2.153)	2.153
Regeneration	De-Risking Sites	2.153			(1.066)	1.066
Regeneration	Cleveland Centre	1.066			(1.034)	1.034
Environment & Community Services	Purchase of New Vehicles	1.034		(0.500)	(1.000)	1.500
Environment & Community Services	Bridges & Structures	1.500		(1.000)	(0.500)	1.500
Environment & Community Services	Highways Infrastructure	1.500		(0.700)	(0.300)	1.000
Education	Basic Needs Grant	1.000			(1.900)	1.900
Children's Care & Prevention	Children's Services Financial Improvement Plan		1.900	(0.232)	(2.128)	2.360
		2.360				
TOTAL		14.420	13.933	(2.432)	(25.921)	28.353

3.10. In addition, amounts for the transformation programme of £26.7m for 2024/25 to 2026/27 and exceptional financial support of £13.4m in 2024/25 have been added to the capital programme. The profile of these costs are shown in **Table 1** and are funded by capital receipts and external (EFS) borrowing respectively. Further details on both these funding streams are given later in this appendix.

4. <u>Financing approach for the capital programme</u>

4.1. All capital expenditure has to be financed, from either external sources (government grants and other contributions), the Council's own resources (revenue budget, reserves or capital receipts) or debt (borrowing or leasing).

4.2. In terms of affordability, receiving capital funding from a partner organisation in the form of a contribution or from central government via an approved grant is always the Council's preferred route of financing. There is no initial cost of the capital investment, with only the ongoing revenue consequences to consider.

4.3. When the Council puts its own funding into a capital project, there is an opportunity cost of this investment. If it sells a capital asset to generate a receipt, it releases the asset and possibly revenue income that is generated. If it uses prudential borrowing, there is an ongoing revenue costs of principal and interest of between 7% - 10% per annum over the estimates useful life of the asset being financed. The final option of funding from the revenue budget has not been used in recent years due to the pressures on the revenue budget position and the low level of revenue reserves currently. The Council would therefore prioritise its own financing resource as capital receipts first, prudential borrowing last. Direct revenue financing is not recommended within the period of this MTFP.

4.4. In addition, there would be restrictions on the level of capital receipts in any financial year, based on the availability of buyers for specific assets, the need to demonstrate best value on any sale and the legal processes required for any sale. The amount of prudential borrowing will be restricted by the impact on the revenue budget of servicing the debt costs of principal (minimum revenue provision) and interest (on any loans drawn down to finance the asset).

4.5. The Council must ensure that any approach to financing the capital programme is affordable, sustainable, and prudent in line with the requirements of the CIPFA Prudential Code on Capital Finance. It does this by setting and monitoring a set of prudential indicators each year. These are key metrics for the Director of Finance and for elected members when setting a budget for each financial year and when considering any changes that may occur during the financial year.

4.6 More details on this can be seen with reference to the Council's prudential indicators and annual treasury management strategy as included elsewhere on this agenda. Some key indicator values on the current position of the Council are shown in the table below for reference purpose.

5. Flexible use of capital receipts strategy

5.1. Local authorities are ordinarily only able to utilise capital receipts from the sale of fixed assets for specific purposes. This precludes the financing of revenue expenditure under s15(1) of the Local Government Act 2003.

5.2. In 2016/17, the Department of Levelling up Housing and Communities implemented a time limited relaxation to the regulations under the Local Government Act 2003 Sections 16(2)(b) and 20. This allows capital receipts to be used to finance revenue expenditure in specific circumstances and subject to certain conditions.

5.3. The current statutory direction applies to financial years from 1 April 2022 up to and including 31 March 2025 and it is expected that the scheme will continue into future years as a tool that brings flexibility to local authorities pursuing transformation and modernisation to improve value for money. DLUHC is currently consulting on extending capital flexibilities that, if implemented, are likely to apply from 2025/26 onwards.

5.4. Eligible expenditure under the regulations relates to revenue expenditure which:

- is designed to generate ongoing expenditure savings, income generation, and/or more efficient delivery of services, and/or
- transforms service delivery to reduce costs/ reduce demand; and/or
- improves the quality-of-service delivery in future years.

5.5. The annual Flexible Use of Capital Receipts (FUoCR) Strategy is required to be approved by Full Council as part and is part of the budget and policy framework. For 2024/25, the Strategy is under development alongside the Transformation Programme and will be presented to Council for consideration and approval on 28 March 2024.

5.6. The expenditure required to deliver the Transformation Programme will be a combination of revenue and capital expenditure. The FUoCR Strategy will set out any plans for eligible revenue expenditure to be incurred during the financial year to be funded by capital receipts in accordance with statutory regulations. The Council is not permitted to apply flexible capital receipts to fund expenditure more than the sum set out in the approved Strategy. A copy of the FUOCR Strategy, once approved by Council is required to be shared with DLUHC to enable review and oversight (but not approval).

5.7. As outlined as part of the budget monitoring process for 2023/24, the Council faces a challenging overall financial position on its revenue budget and has a critically low level of usable reserves. The Council is undertaking a major transformation programme during 2024/25 to move the Council to a lower cost base for the future. It is anticipated that the amount of transformation expenditure will be significantly higher in 2024/25, than in previous years. The planning estimate is currently up to £5.5m with an estimate for redundancy costs of up to £6.5m. A contingency budget of £1.7m is provided. The value of the programme will be presented for consideration in March as referenced above.

5.8. As this expenditure can only be financed by capital receipts given the critically low level of revenue reserves held by the Council. The FUoCR strategy therefore provides the funding solution for the revenue costs of transformation work to be funded from capital receipts generated from the current review of assets as approved by the Executive in November 2023. EFS approval of £4.6m is required to underwrite the risk of slippage in the realisation of capital receipts to fund transformation and redundancy expenditure.

6. Financial Support

6.1. The Council made an application to the Department for Levelling Up Housing and Communities during January 2024 for exceptional financial support to assist with the setting of the 2024/25 revenue budget. The amount required of up to £13.4m can be analysed as follows:

- Budget Gap - £4.7m
- Contingency on Budget Gap - £0.6m
- Savings Delivery Risk - £3.5m
- Capital Receipts Delivery Risk - £4.6m

6.2. If the EFS application is approved by central government, a capitalisation direction will be issued which will allow the Council to treat the relevant costs as capital expenditure. This could then be financed by external borrowing from the Public Works Loan Board over a period of 20 years. This would be at a 1% premium above normal PWLB borrowing rates for the capital programme.

7. Risk & Governance

7.1. The proposed five-year programme will require the Council to use a higher proportion of available resources but without recourse to any more borrowing than is necessary to meet existing commitments. Investment of this nature will result in the Council being exposed to additional inherent risks as follows:

- economic risks on capital projects such as rising inflation and extended leading times for orders.
- the impact of Brexit / Covid-19 on construction costs.
- major schemes have a long pay-back period, which will require the use of reserves in the early years to fund short term deficits in business plans.
- Any unforeseen events occur which effect the overall cost or delivery times for specific schemes.

7.2. The management of risk on projects within the capital programme is managed by individual service directors as part of their own risk processes but is overseen by the Leadership Management Team as part of its corporate governance responsibilities.

7.3. It is the aim of the Council to create a capital programme board framework consisting of elected members and senior officers to oversee and support the delivery of the capital programme as part of its governance improvement ambitions. This would take the lead role for the organisation on both programme planning, scheme delivery and financing from the current arrangements once established.

Annex

1	Revised Capital Programme 2024/25 to 2026/27