West Mercia Police and Crime Commissioner

Capital Strategy Report 2022/23

Introduction

This capital strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services. It also sets out how associated risk is managed and the implications for future financial sustainability. The Capital strategy is updated annually.

The aims of the Capital Strategy are:

- To take a long term perspective on capital investment and to ensure this contributes to the achievement of the Safer West Mercia Plan
- To ensure investment is prudent, affordable, and sustainable over the medium term and adheres to the Prudential Code, Treasury Management Code and other regulatory conditions.
- To set out the governance arrangements for capital investment decision-making.
- To make the most effective and appropriate use of the funds available in long term planning and using the most optimal annual financing solutions.
- To establish a clear methodology to approve capital proposals.

Organisational Objectives

Over the last 12 months there has been the Police and Crime Commissioner (PCC) elections, the management of the estate service has been brought in-house, and following the end of the Alliance with Warwickshire there was a Hosted Services agreement established defining what services, particularly in relation to digital, West Mercia would provide.

External factors have seen the continued impact of COVID-19 on society and also on how the organisation operates, particularly flexible working. Brexit and the economy have seen pressure grow on public finances, whilst locally West Mercia has undergone a period of significant and sustained growth.

These changes have provided an opportunity to re-focus on what the strategic objectives are for the PCC and how the Capital Strategy supports and enables these. The key strategic commitments are set out in the Safer West Mercia Plan

All capital investment decisions must demonstrate that they are contributing to this plan. To facilitate this there are a number of supporting strategies that have been approved which provide further detail on the key priorities for capital investment. These include

- Force 'Plan on a Page' and Target Operating Model
- Estates Strategy 2021 – 2026 (approved subject to public consultation)
- Digital Services Strategy 2020 - 2025
- Fleet Strategy

The Capital Strategy has regard to these when setting out how capital expenditure, financing and treasury management will contribute to the delivery of services.

Planned Capital Investment

Capital expenditure is where the PCC spends money on assets, such as property or vehicles, which will be used for more than one year. Spend can be on additions, replacements or enhancements of assets; this can include spending on assets owned by other bodies. The PCC 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. In 2022/23, the PCC is planning capital expenditure of £30.542m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2020/21 actual £m	**2021/22 forecast £m**	**2022/23 budget £m**	**2023/24 budget £m**	**2024/25 budget £m**
Estates Strategy	1.341	3.255	8.000	8.600	8.500
ICT Programme	2.339	2.118	4.005	2.317	2.404
Digital Transformation & Change	7.080	6.314	15.377	12.843	1.426
Vehicle Replacement	1.992	1.544	2.250	2.250	2.250
Plant and Equipment	0.243	0.400	0.910	0.000	0.000
TOTAL	**12.995**	**13.631**	**30.542**	**26.010**	**22.080**

The main capital projects for 2022/23 include investment in the:

- construction of Redditch Joint Police & Fire Station
- Digital Services Transformation Programme
- Digital Forensics Transformation
- Investment in HR Systems
- Investment in Fleet

The Medium Term Capital Programme includes investment in the:

- Force Firearms Range
- Northern Hub (at Shrewsbury/Telford)
- Emergency Services Network
- Final stages of the Digital services transformation programme

<u>Governance for Capital investment decisions</u>

A capital bidding process was implemented for the 2022/23 budget setting.

- A capital bid document has been produced for services to complete for all projects that will need to be included in the following years capital programme.
- These forms set out the reasons for the project and benefits to be delivered. It includes estimated costs and timescales for delivery and how they project contributes to the key objectives, specifically the Safer West Mercia Plan.
- Business Leads will consult with the Head of Estates, the Head of Digital Services and the Head of Transport Services when preparing their bids to

ensure that the relevant estates / ICT and transport implications are fully considered.

- The Head of Estates, the Head of Digital Services and the Head of Transport Services will also prepare bids for centrally managed projects eg the fleet replacement programme
- Force Finance will collated the bids, review the financial business case for reasonableness and also calculate the financing cost (which can be nil if the project is fully externally financed). Force Finance will prepare a summary of all the capital bids received and the total cost.
- The Chief Constable and Chief Executive, advised by the Treasurer and Force Chief Finance Officer will review all bids based on a comparison of service priorities against financing costs and make recommendations to the PCC.
- The principals for which the project will be included in the capital budget are:-
    - Investment should provide an economic return; or
    - The investment provides an improvement to the function of that asset or is required to maintain effectiveness of that asset, enabling service delivery to the public of West Mercia
    - The investment reduces environmental or social impact
- The final capital programme is then presented to the PCC in November and then approved by him in February each year.

Inclusion of projects in the capital budget is to ensure sound financial management over the medium term. It ensures that all reasonably expected costs are identified and are affordable. To provide proper governance all projects included within the capital programme require a separate detailed business case to be developed.

- The business case will identify the detailed full life costings associated with the project and the benefits that will be delivered as a result of the investment.
- All business cases require a risk assessment of the project and confirmation that risks are managed to an acceptable level as defined in the Risk Management strategy.
- Where a business case has an additional financial impact on the capital budget and therefore its affordability over the long term, this will be considered as part of the decision to approve the project
- The business case requires formal approval by the PCC before a project can be implemented

Details of the PCC's capital programme are included in the 2022/23 Revenue Budget and Medium Term Financial Plan. This is published on the West Mercia PCC's website.

Capital Financing

All capital expenditure must be financed, either from external sources (government grants and other contributions), the PCC's own resources (revenue, reserves and capital receipts) or debt (borrowing and / or leasing). The planned financing of the above expenditure is as follows:

Table 2: Capital financing

	2020/21 actual £m	**2021/22 forecast £m**	**2022/23 budget £m**	**2023/24 budget £m**	**2024/25 budget £m**
External sources	1.534	0.810	1.257	0.500	0.500
Own resources	0.241	0.400	1.060	1.100	1.200
Debt	11.220	12.421	28.225	24.410	20.380
TOTAL	**12.995**	**13.631**	**30.542**	**26.010**	**22.080**

1) External Sources

The principal source of external funding comes from sale of assets to third parties. 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 PCC plans to receive £0.5m of capital receipts in the coming financial year.

Table 3: Capital receipts

	2020/21 actual £m	**2021/22 forecast £m**	**2022/23 budget £m**	**2023/24 budget £m**	**2024/25 budget £m**
Asset sales	0.5	0.5	0.5	0.5	0.5
Loans repaid	0.4	1.6	1.6	6.6	1.6
TOTAL	**0.9**	**2.1**	**2.1**	**7.1**	**2.1**

An alternative source of external funding is from capital grants from third parties. There has been very limited funding made available from central government or other government/voluntary sector providers for capital projects over the last 3 years. The assumption is that over the medium term there will be no capital grant funding made available to the PCC. However the Office of the PCC (OPCC) and Force will explore opportunities to access funding from other providers and where possible work with partners on joint projects to share costs.

2) Internal Sources

The PCC has allocated £1m of funding from the revenue budget in 2022/23 to pay for capital expenditure. Over the medium term the PCC is keen to identify further revenue funding that can be utilised to fund capital projects. Reducing the need to pay revenue interest costs. The strategy is to fund expenditure on assets with short useful economic lives from revenue, such as ICT replacement programme. This strategy is balanced against the competing revenue needs of service delivery.

3) Debt

Debt is only a temporary source of finance, since loans and leases must be repaid. The debt must therefore be replaced over time by other financing, usually from revenue. This is known as minimum revenue provision (MRP). Effectively MRP is a charge to revenue for the repayment of the principal element of borrowing. Whilst proceeds from selling capital assets may be used to replace debt finance, the limited asset disposal programme highlighted above means that this is not a viable source of debt replacement. The planned MRP over the medium term is as follows:

Table 4: Replacement of debt finance

	2020/21 actual £m	2021/22 forecast £m	2022/23 budget £m	2023/24 budget £m	2024/25 budget £m
MRP requirement	2.3	3.6	4.9	7.5	9.5

The PCC's full minimum revenue provision statement is included in the Treasury Management & Investment Strategy and is available on the PCC's website.

The PCC's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). 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 by £52.5m over the next 3 years. Based on the above figures for expenditure and financing, the PCC's estimated CFR is as follows:

Table 5: Prudential Indicator: Estimates of Capital Financing Requirement

	31.3.2021 actual £m	31.3.2022 forecast £m	31.3.2023 budget £m	31.3.2024 budget £m	31.3.2024 budget £m
TOTAL CFR	**57.865**	**66.708**	**90.225**	**107.362**	**119.248**

<u>Treasury Management</u>

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the PCC's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing. The PCC is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

Due to decisions taken in the past, at 28/2/2022 the PCC had £35.2m long term borrowing at an average interest rate of 2.25%, short-term temporary borrowing of £5m at an interest rate of 0.11% and £4.9m treasury investments at an average rate of 0.5%. No new PWLB borrowing has been taken out in 2021/22 due to better than anticipated cash flow, partly due to slippage on the capital programme.

Borrowing strategy: The PCC'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 PCC therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.3%) and long-term fixed rate loans where the future cost is known but higher (currently 1.0% to 2.3%).

Projected levels of the PCC's total outstanding debt are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing

	2020/21 actual £m	**2021/22 forecast £m**	**2022/23 budget £m**	**2023/24 budget £m**	**2024/25 budget £m**
Debt	45.5	39.6	73.5	97.6	117.8
Capital Financing Requirement	57.9	66.7	90.2	107.4	119.3

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the PCC expects to comply with this in the medium term. Table 6 assumes that the capital spend set out in Table 1 occurs in the year that it is forecast, whereas in practice there is likely to be slippage. It also assumes that the requirement for new borrowing set out in Table 2 is met by external borrowing, rather than financed from surplus cash ("internal borrowing"). Due to the low level of cash currently held by the PCC it is likely that any new borrowing will be external (from PWLB).

In both the Capital Strategy and the Treasury Management Strategy, the PCC is assuming that the cash and investment balances will be kept as low as possible. The PCC will consider alternative strategies during the course of the financial year.

Affordable borrowing limit: The PCC 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

	2021/22 Limit £m	2022/23 limit £m	2023/24 limit £m	2024/25 limit £m
Authorised limit				
Borrowing	77.000	105.000	120.000	130.000
PFI and leases	0.000	0.000	0.000	0.000
Total debt	**77.000**	**105.000**	**120.000**	**130.000**
Operational boundary				
Borrowing	67.000	95.000	110.000	120.000
PFI and leases	0.000	0.000	0.000	0.000
Total debt	**67.000**	**95.000**	**110.000**	**120.000**

Further details on borrowing are in Section 8 of the treasury management strategy.

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 PCC'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 banks, to minimise the risk of loss. 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 PCC may request its money back at short notice.

Table 8: Treasury management investments

	31.3.2021 actual £m	31.3.2022 forecast £m	31.3.2023 budget £m	31.3.2024 budget £m	31.3.2024 budget £m
Short-term investments	8.9	2.5	3.7	5.0	5.0

Further details on treasury investments are in Section 8 of the treasury management strategy.

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Treasurer, the Chief Finance Officer and staff, who must act in line with the treasury management strategy approved by the PCC. Regular reports on treasury management activity are presented to the Joint Audit and Standards Committee. The Joint Audit and Standards Committee is responsible for scrutinising treasury management decisions.

Investments for Service Purposes

The PCC can make investments to assist local public services, including making loans to and buying shares in local service providers.

The PCC holds a £1 share in Place Partnership Limited, which is in the process of being wound-up as a company following the decision by Worcestershire County Council to withdraw from this arrangement. All partners agreed to put new arrangements to provide and/or procure Estates Services from 1 April 2021. Once the administrators have been appointed and the company formally wound up the PCC will not hold any investments in local service providers.

Governance: Decisions on service investments are made by the PCC in consultation with the Chief Constable, Chief Executive, Treasurer and Force Chief Finance Officer and must meet the criteria and limits laid down in the Treasury Management Strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

Commercial Activities

With central government financial support for local public services declining, the PCC can invest in commercial property purely or mainly for financial gain and can lend to joint venture companies and partners in formal collaboration agreements. The PCC holds one commercial investment property, Evesham Contact Centre. This was valued at £345,000 in the Statement of Accounts 2020/21, however this will reduce as at 31/03/22 as the property is currently vacant. The PCC received rental income of £42,000 in 2020/21. There are no restrictions in his ability to realise the value inherent in this property or on his right to the remittance of income and proceeds of disposal. The PCC has no contractual obligations to purchase, construct or develop the investment property or undertake repairs, maintenance or enhancement.

Governance: Decisions on commercial investments are made by the PCC. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme. With financial return being the main objective, the PCC accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include vacant properties following termination or a fall in the capital value. These risks are managed by the Head of Estates

Further details on commercial investments and limits on their use are in Section 8 of the Treasury Management Strategy.

Annual Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP (effectively principal repayments) 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.

Table 9: Prudential Indicator: Proportion of financing costs to net revenue stream

	2020/21 actual	**2021/22 forecast**	**2022/23 budget**	**2023/24 budget**	**2024/25 budget**
Financing costs (£m)	3.1m	4.5m	5.8m	8.8m	10.5m
Proportion of net revenue stream	1.31%	1.82%	2.22%	3.29%	3.72%

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 Treasurer is satisfied that the proposed capital programme is prudent, affordable and sustainable because of the historically and comparatively low levels of investment and borrowing. The current mix of short term borrowing and fixed rate long term borrowing is considered to be affordable and is delivering Value for Money from the assets held and being invested in.

The Treasurer for the PCC utilises the expertise of external advisors who provide quarterly updates on the expected future trends in interest rates. This provides regular opportunities to review the current borrowing profile and to weigh up the risks of future changes in interest rates and the length of time over which borrowing is fixed for.

Knowledge and Skills

The PCC employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Treasurer is a qualified accountant with 20 years' experience. The day to day management of treasury management is provided by the Force Financial Accounting Manager who has a similar level of experience.

Where PCC staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The PCC currently employs Arlingclose Ltd as treasury management advisers. This approach is more cost effective than employing such staff directly, and ensures that the PCC has access to knowledge and skills commensurate with its risk appetite.

In ensuring delivery of the capital programme the Strategic Estates Manager has gained an MBA, IRPM2 qualification and is a Prince 2 Project Manager and a member of the Institute of Workplace Facility Management.