
Capital Strategy

2023/24

Report of the Treasurer

Introduction

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.

Decisions made this year on capital and treasury management will have financial consequences for West Mercia Police for many years into the future. 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.

Safer West Mercia Plan



All capital investment decisions must demonstrate that they are contributing to the Safer West Mercia 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
- 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.

The capital strategy also ensures that the investments made by the Commissioner are affordable, deliverable and meet the objectives of the Police and Crime Commissioner and the Chief Constable.

Governance for Capital investment decisions

A capital bidding process was implemented for the 2022/23 budget setting and further refined to align more closely with PCC and Force strategic objectives for 2023/24 budget setting.

- Every department that would like to incur capital expenditure in the following financial year must complete a capital bid document.
- Each capital bid must set out the reason for, benefits of, and costs of the capital project along with how the project meets PCC and Force strategic objectives and the cost profile over the life of the project.
- Business leads must consult with business partners in Change, Estates, Digital Services and Finance when preparing their capital bids to ensure the feasibility of the project and subsequent implications on other departments are fully considered.
- The Head of Estates and Digital Services along with the Fleet Manager must also prepare capital bids for the Estates Planned Programme, ICT replacement Programme and Fleet Replacement Programme.
- Financial Accounting collate the capital bids being submitted by business leads and a review is done to ensure the reasonableness of the costs included. Financial Accounting also then calculate the financing costs of the project (which can be nil if the project is externally funded).
- Financial Accounting prepare a summary of the capital bids along with the total cost, including financing costs for review by the Chief Constable and her management team.
- The Chief Constable and her management team review the capital bids to ensure it meets the 'Plan on a Page' priorities, but also is within the financial constraints of West Mercia Police.
- The principals for which the project will be included in the capital budget are:-
 - Investment should provide an economic return, reducing revenue expenditure over the life of the asset; 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 Chief Constable presents the capital plan to the Police and Crime Commissioner, Treasurer and Chief Executive in November, which then receives final approval prior to the commencement of the financial 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 using the HM Treasury 5 case model principles.

- 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 and subsequently a decision notice to be issued before a project can be implemented.

Details of the Police and Crime Commissioner's capital programme are included in the 2023/24 Revenue Budget and Medium Term Financial Plan. This is published on the West Mercia PCC's website

Capital Expenditure

Capital expenditure is where the Police and Crime Commissioner spends money on assets, such as property or vehicles, which will be used for more than one year. 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 2023/24, West Mercia Police are planning capital expenditure of £28.624m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Digital Services Transformation	£4,586,000	£7,109,000	£11,490,000	£0	£0
Other Change Programmes	£1,377,000	£954,000	£3,050,000	£350,000	£1,520,000
ICT Replacement Programmes	£996,000	£2,094,000	£2,230,000	£1,330,000	£1,330,000
Estates Strategy Programme	£2,737,000	£3,159,000	£8,567,000	£14,100,000	£4,000,000
Vehicle Replacement Programme	£771,000	£3,502,000	£2,500,000	£2,500,000	£2,500,000
Plant & Equipment	£393,000	£23,000	£786,000	£1,120,000	£0
TOTAL	£10,860,000	£16,841,000	£28,623,000	£19,400,000	£9,350,000

The main capital projects for 2023/24 include investment in the:

- Construction of Redditch Joint Police & Fire Station
- Feasibility and Planning for a new Firearms Range & Training school
- Digital Services Transformation Programme
- Digital Forensics Transformation
- Investment in HR Systems
- Investment in Fleet

The Medium Term Capital Programme includes investment in the:

- Construction of Firearms Range & Training school
- Construction of a new Sexual Abuse Referral Clinic (SARC)
- Emergency Services Network
- Investment in electrification of fleet & associated infrastructure

Capital Financing

All capital expenditure must be financed, either from external sources (government grants and other contributions), West Mercia Police's own resources (revenue, reserves and capital receipts) or debt (borrowing or leasing). 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
External sources	£440,000	£0	£40,000	£100,000	£0
Capital receipts	£204,000	£500,000	£500,000	£500,000	£500,000
Revenue resources	£3,653,000	£1,360,000	£1,500,000	£1,100,000	£1,200,000
Use of Reserves	£737,000	£97,000	£30,000	£770,000	£0
Debt	£5,826,000	£14,884,000	£26,554,000	£16,930,000	£7,650,000
TOTAL	£10,860,000	£16,841,000	£28,624,000	£19,400,000	£9,350,000

Borrowing

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). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of prior years' debt finance in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Minimum revenue provision	£3,578,000	£4,052,000	£5,767,000	£7,844,000	£8,891,000
Capital receipts	£0	£0	£0	£0	£0
TOTAL	£3,578,000	£4,052,000	£5,767,000	£7,844,000	£8,891,000

The Police and Crime Commissioners full minimum revenue provision statement is included within the Treasury Management & Investment Strategy and is available on the Police and Crime Commissioner's website.

The Police and Crime Commissioners cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR).

The CFR 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 £10.65m during 2023/24. Based on the above figures for expenditure and financing, West Mercia Police's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
TOTAL CFR	£60,114,000	£70,761,000	£92,265,000	£101,449,000	£100,401,000

Capital Receipts

Capital receipts are generated from the sale of existing capital assets. Proceeds from the sale of assets are either used to fund capital expenditure in the year of receipt or set aside in a Useable Capital Receipts Reserve to fund capital expenditure arising in future years.

Capital Receipts are not automatically written off in year to offset borrowing. As borrowing costs in the future could be higher the best strategy is for the use of receipts is considered on a case by case basis, this may include holding them to avoid future higher borrowing costs rather than reducing what are lower interest borrowing now.

Capital grant

Direct funding from government capital grants has in the past been the principal source of funding. However, these have now ceased as the government has looked to reduce direct capital funding. Where relevant and appropriate the PCC will aim to secure specific grant opportunities, either from Central Government or through collaboration with public sector or other partnership bodies.

Revenue & Reserves

Reserves - Income surpluses that has been set aside from previous years and transferred to reserves can be used to fund capital expenditure. As reserves have been consumed in recent years, the level of reserves now available to fund future capital expenditure has reduced, and other sources of funding are required going forward to sustain the short-life capital programme.

Revenue – The PCC has been increasing the allocation of funding direct from revenue for capital projects. The principal of using revenue is to fund short life assets directly when purchased, avoiding the need to borrow and therefore pay interest on top of MRP. With limited sources of other funding then West Mercia has to ensure that it is financial sustainable in being able to invest in capital assets with a short life span.

Treasury Management

As highlighted in the Financing section above the principal source of funding for capital projects is from Borrowing. Therefore Treasury Management is an important principal in ensuring the ongoing affordability of the capital programme.

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the West Mercia Police's spending requirements, 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. West Mercia Police 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, as at 11/1/2023, West Mercia Police currently has £42.6m of long term borrowing at an average interest rate of 2.71% and £5.1m treasury investments at an average rate of 3.13%.

Borrowing strategy

The Police and Crime Commissioners 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 Police and Crime Commissioner therefore seeks to strike a balance between cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher.

West Mercia Police does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board. We also complete a PWLB certainty return each year to receive a discounted interest rate when taking out PWLB loans.

The Commissioner has not had to borrow to fund the full capital programme at present as some capital expenditure has been internally financed from internal balances available in the Police Fund (reserves/working capital). As not all PCC reserves are cash-backed and if reserves are utilised then this will likely create a need to finance the expenditure using further external borrowing

Projected levels of the Police and Crime Commissioner'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 Requirement in £ millions

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
Debt (incl. PFI & leases)	£39,243,000	£44,134,000	£66,227,000	£83,257,000	£80,907,000
Capital Financing Requirement	£60,114,000	£70,946,000	£92,705,000	£101,164,000	£98,769,000

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, West Mercia Police expects to comply with this in the medium term. Table 6 assumes that capital spend set out in Table 1 occurs in the year that it is forecast. In practice, there is likely to be capital slippage and additional capital projects approved.

It also assumes that the requirement for new borrowing set out in table 2 is met by external borrowing rather than being financed from surplus cash (internal borrowing). Due to the low level of cash held by the Police and Crime Commissioner, it is likely that any external borrowing will be 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: West Mercia Police are 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 in £m

	2022/23 limit	2023/24 limit	2024/25 limit	2025/26 limit
Authorised limit - borrowing	105.0	120.0	120.0	120.0

Authorised limit - PFI and leases	0.0	0.0	0.0	0.0
Authorised limit - total external debt	105.0	120.0	120.0	120.0
Operational boundary - borrowing	95.0	110.0	110.0	110.0
Operational boundary - PFI and leases	0.0	0.0	0.0	0.0
Operational boundary - total external debt	95.0	110.0	110.0	110.0

Further details on borrowing are in section 6 of the treasury management strategy.

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and Minimum Revenue Payments are charged to revenue. 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 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Financing costs (£m)	£4.4m	£4.6m	£6.7m	£10.0m	£11.5m
Proportion of net revenue stream	1.7%	1.76%	2.45%	3.58%	4.03%

Sustainability & affordability

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 need for replacement and refurbishment given the age and condition of the estates and ICT infrastructure, the planned programme for the disposal of assets (generating capital receipts) and the opportunities the programme presents to secure better value for money. All capital projects will be subject to detailed options appraisals and business cases before final approval is given by the Police and Crime Commissioner.

The Commissioner has recognised the impact that the capital programme is having on the revenue budget. Whilst the revenue impact of financing costs are expected to peak in 2025/26 and then reduce, the Commissioner is clear that further capital projects are affordable. To ensure that future capital schemes are affordable the business case focus on demonstrating an economic return for West Mercia.

Commercial Activities

With central government financial support for local public services declining, the Police and Crime Commissioner can invest in commercial property purely or mainly for financial gain. The Police and Crime Commissioner holds one commercial investment property, Evesham Community Contact Centre, which was valued at £277,000 as at 31st March 2022. The Police and Crime Commissioner also received £53,000 rental income from this property in 2021/22. Evesham Community Contact Centre was vacated at the end of 2021/22 and now remains vacant. There are no restrictions in the Police and Crime Commissioners ability to realise the value inherent in this property or on his right to the remittance of income and proceeds of disposal. The Police and Crime Commissioner has no contractual obligations to purchase, construct or develop the investment property or undertake repairs, maintenance or enhancement.

Risk management: With financial return being the main objective, the Police and Crime Commissioner accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include being unable to identify an occupant for the property and therefore lose out on rental income as currently being experienced and a reduction in the capital value of the property. These risks are managed by the Head of Estate Services and an options paper is being prepared to review the future use and ownership of the site.

Governance: Decisions on commercial investments are made by the Police and Crime Commissioner. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.

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	£53,000	£0	£0	£0	£0
Proportion of net revenue stream	0.02%	0.0%	0.0%	0.0%	0.0%

Other Liabilities

In addition to debt of £42.6m detailed above, the Police and Crime Commissioner is committed to making future payments to cover its pension fund deficits. The deficit on the funded Local Government Pension Scheme (for police staff) was valued at £199.6m at 31/3/2022 and the deficit on the unfunded Police Pension scheme (for police officers) was £2,895.9m.

Governance: Decisions on incurring new discretionary liabilities are made by the Police and Crime Commissioner in consultation with the Chief Constable, Chief Executive, Treasurer and Director of Commercial Services. The risk of liabilities crystallising and requiring payment is monitored by Force Finance and reported to the Chief Constable and Police and Crime Commissioner in the monthly Money Matters budget report.

Further details on liabilities and guarantees are on pages 89 and 95 of the 2021/22 Statement of Accounts

Knowledge and Skills

The Police and Crime Commissioner 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 and the Head of Estates has gained an MBA, IRPM2 Qualification and is a Prince 2 project manager and a member of the institute of workplace facility management.

Where the Police and Crime Commissioner's 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 Limited as treasury management advisers. This approach is more cost effective than employing such staff directly, and ensures that the Police and Crime Commissioner has access to knowledge and skills commensurate with its risk appetite.