Peter McCall
POLICE, FIRE & CRIME COMMISSIONER

Office of the Police, Fire and Crime Commissioner Report

Public Accountability Conference 15 February 2024

Title: Capital Strategy 2024/25

Report of the PFCC Chief Finance Officer and Constabulary Chief Finance Officer

Originating Officers: **Lorraine Holme, Group Accountant**

1. Purpose of the Report

1.1. This capital strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

1.2. The aim of this report is to provide enough detail to allow non-financial decision makers to understand how stewardship, value for money, prudence, sustainability and affordability will be secured without repeating in detail the information that is contained in other documents presented as part of this suite of capital and treasury management reports (agenda items 08b & 08c).

1.3. These reports meet the reporting requirements of the Charted Institute of Public Finance and Accounting (CIPFA) Prudential Code for capital finance in Local Authorities 2021 updated guidance.

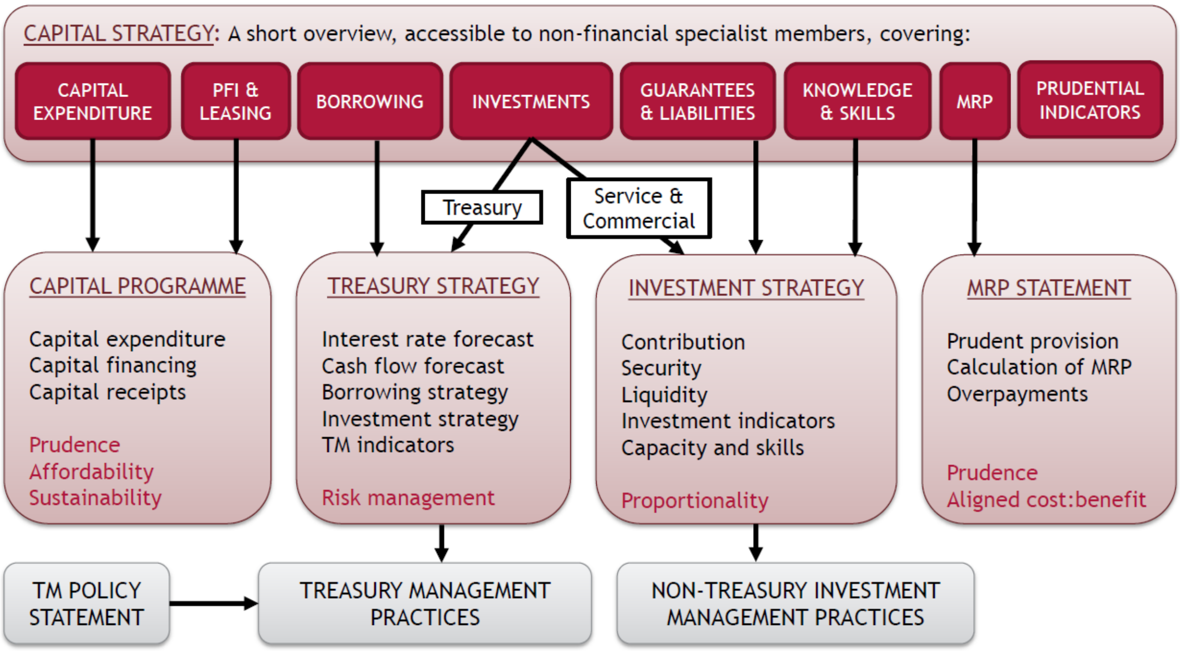
2. Recommendation

2.1. The Commissioner is asked to approve the contents of the report.

3. Introduction

3.1. The CIPFA Prudential Code (the code) and guidance notes were originally issued in 2002 and were later fully revised in 2009, 2011, 2017 and again in 2021. This code requires the Commissioner to look at capital expenditure and investment plans in light of the overall strategy and resources and ensure that the decisions are being made with sufficient regard to the long run implications and potential risks to the Commissioner.

3.2. This capital strategy report summarises the purpose and governance over a range of activities associated with capital investment and financing, which are reported on in detail elsewhere on this agenda item. The diagram below provides an overview of the scope of these activities, their inter-dependencies and reporting structures:



*The MRP Statement, Investment Strategy and the Prudential Indicators of the Commissioner are encompassed into the Treasury Management Strategy.

4. Capital Expenditure and Financing

4.1. Capital expenditure is the term used to describe expenditure on assets, such as property, vehicles and ICT equipment, that will be used (or have a life) of more than 1 year. There is some limited discretion on what is to be treated as capital expenditure and assets costing less than £25k will be charged to the revenue account in accordance with the Financial Rules and Regulations (this is known as the deminimis level).

4.2. Capital expenditure plans are under-pinned by asset strategies, which are developed by respective service leads linked to delivery of the Commissioner's Police and Crime Plan and the Constabulary's Vision 25. The principal asset strategies and their objectives are:

- The Digital, Data and Technology Strategy, which has six key themes
  - Actively supporting the delivery of the Constabulary Vision and Target Operating Model
  - On-going provision of reliable and trusted DDAT services.
  - A cost effective and affordable DDAT enabling services
  - To implement national DDAT projects
  - To meet local demand to renew and replace Core Systems and Applications
  - Collaboration and Partnership
- The Estates Strategy, which aims to maintain an Estate which is fit for purpose whilst reducing overhead expenditure and maximising and exploiting existing assets.
- The Fleet Strategy, which aims to satisfy the Constabulary's vehicle needs within a sustainable financial model.

4.3. A workplan is developed annually to support delivery of each strategy. The updated financial implications are distilled early in the financial planning process and subsequently consolidated to produce a ten-year capital programme. The overall capital programme is then subject to a process of financial scrutiny in the context of both available capital funding resources and the overall revenue budget position. The final capital programme and associated asset strategies are subject to approval by both the Constabulary Chief Officer Group and the Commissioner at his Public Accountability Conference.

4.4. The capital expenditure estimates for the current year and five year medium term are shown below:

Capital Expenditure	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Capital Expenditure	4.09	5.89	6.55	3.48	6.52

4.5. The profile of capital expenditure fluctuates annually. Across the current five-year programme, annual average expenditure typically comprises £1.7m to replace fleet vehicles, £0.8m on estate schemes (although by their nature these investments tend to be more lumpy) and around £3.3m for replacement of ICT systems and equipment.

4.6. The 2024/25 capital programme includes ICT expenditure on development and roll out of mobile technology and smartphones, consideration of options for ICT infrastructure and a move to more cloud based systems. In addition, preparatory work on the national programme to replace the Police Radio System (Airwave) with an Emergency Services Network (ESN) will continue, in advance of significant expenditure to implement the system in future years. Investment in the on-going replacement of vehicles in accordance with the Fleet Strategy will continue. Expenditure on Estates schemes over the 5 years is dominated by the need to evaluate options and provide a BCU deployment centre in the west of the County upon the expiry of the existing PFI arrangement in 2026.

4.7. Before the commencement of each financial year the schemes for that year are revisited to be assigned an approval category. Large schemes which have previously been approved by the Commissioner following submission of a business case and the smaller rolling replacement schemes are approved on a firm basis, meaning that they can be progressed without further scrutiny. Schemes which have been approved in principle but need some detailed work may be delegated to the Constabulary Chief Finance Office for future approval. Schemes requiring business cases, option appraisals and financial appraisals are given the status of indicative until they have been thoroughly scrutinised by all relevant business leads before being passed to the Constabulary Chief Officer Group and the Office of the Police, Fire and Crime Commissioner for final approval.

4.8. The capital programme must be financed from a combination of capital grants, capital receipts, reserves, direct support from the revenue budget and, unlike the revenue budget, borrowing is permitted. Whilst it is a statutory requirement that the Commissioner agrees a balanced revenue budget, the Prudential Code requires the capital programme to be demonstrated as ‘Affordable, Prudent and Sustainable’’, it is up to each authority how it determines these criteria. Cumbria has previously defined an ‘Affordable, Prudent and Sustainable’ programme as being fully funded (from the sources outlined above) for the medium term financial forecast (MTFF) period of 5 years. The estimates for 5-10 years are built on a number of assumptions, which, particularly in rapidly changing sectors such as ICT, are difficult to accurately predict. This means that projected costs in the later years of the capital programme become increasingly indicative and should be treated with caution. As the capital programme is fully funded over ten years, it meets the test of being Affordable, Prudent and Sustainable. The revenue budget and MTFF must also fully reflect any revenue implications of the capital programme including servicing costs of borrowing.

4.9. The difficulty facing Cumbria is that capital grants have been reduced to zero, the potential to generate future capital receipts is low and capital reserves are likely to have been fully utilised by 2026/27. This means that the only viable options in future to fund capital expenditure are directly from the revenue budget or through borrowing, which itself has implications for the revenue budget. The challenge for the PFCC and Constabulary will be the need to find an appropriate balance between capital and revenue expenditure, which is sustainable.

4.10. In the context of requiring significant revenue savings to balance the revenue budget in 2024/25 and beyond primarily due to increased inflation, the decision has been taken reduce the revenue budget support to the capital programme to around £500k per annum with the balance being financed through an increased use of borrowing requirement that will be repaid over the life of assets bought. The revenue effects of borrowing decisions have been reflected in the MTFF.

4.11. 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 debts. Capital financing assumes that all capital receipts will be used to finance new assets rather than reduce existing debt.

4.12. Full details of the 10 year programme and associated financing can be found in the separate report 'Capital Programme 2024/25 to 2033/34 (item 08b on this agenda).

5. Treasury Management

5.1. Treasury management is concerned with keeping sufficient but not excessive cash available to meet 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. The Police, Fire and Crime Commissioner is generally cash rich in the short term due to the level of reserves currently held and revenue grants being received in advance of spend, but cash poor in the long term due to capital expenditure being incurred in advance of being financed.

5.2. Treasury Management involves the management of large sums of money and is therefore inherently risky. Accordingly, treasury activities are strictly controlled and managed in accordance with CIPFA's Prudential Code. The Treasury Management Strategy is approved annually by the Commissioner at his Public Accountability Conference, with activities being reported upon a periodic basis through the same meeting. The Joint Audit Committee also provides scrutiny of treasury management activities. Responsibility for treasury activities is delegated to the PFCCs Chief Finance Officer, who delegates responsibility for day to day management to the Constabulary Chief Finance Officer. The Treasury Management Strategy incorporates subsidiary investment and borrowing strategies, which are summarised below.

5.3. **Investment strategy** - Treasury investments arise from receiving cash before it is paid out again. The Commissioner makes investments because he has a cash surplus as a result of his day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments). The Commissioner does not make investments to support local public services by lending to or buying shares in other organisations (service investments), or to earn investment income (known as commercial investments where investment income is the main purpose).

The Commissioner's policy on treasury investments is to prioritise **security** and **liquidity** over **yield**; that is to focus on minimising risk rather than maximising returns. The risk that an investment counter-party defaults is very real as illustrated by the BCCI and, more recently, Icelandic Banks scandals, which impacted on public sector bodies. The investment strategy seeks to mitigate this risk by only investing in high quality, trusted counter-parties and spreading the investment portfolio across organisations. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy (subject to strict criteria) and the Commissioner may request his money back at short notice.

Whilst the Commissioner has historically held significant investments, these balances are being reduced as the Commissioner has undertaken internal borrowing to support the capital programme (see below) and reserves are drawn down to support the revenue budget.

Further details on treasury investment strategy are on pages 10 to 13 of the treasury management strategy (agenda item 08c).

5.4. **The Borrowing Strategy** – As indicated the Commissioner currently holds no external debts, other than a PFI arrangement described in section 6 of this report, with all external borrowing with the PWLB (Public Works Loans Board) having been repaid during 2012/13. However, there is an underlying need to borrow, known as the Capital Financing Requirement (CFR), arising from historical decisions to finance capital expenditure from borrowing within prudent limits. To date this has been met from internal borrowing.

5.5. The capital financing requirement (CFR) is a measure of the amount of capital spending that has not yet been financed by capital receipts, grants or contributions, it is in essence the amount of internal debt finance of the Police, Fire and Crime Commissioner. The CFR increases each time there is new capital expenditure financed by debt and decreases with MRP repayments, capital receipts assigned to repay debt or by making additional voluntary contributions. The CFR for the 31 March 2024 is forecast to be £20.8m.

Internal Borrowing – the practice of using reserves and provisions that have been set aside for future use to fund capital expenditure plans now. External borrowing comes with interest payments of currently around 5% where investments are currently making around 5.25% return, rates are forecast to fall during 2024/25 and as such, there is an incremental cost to borrow in advance of need (known as cost of carry). This is therefore discouraged if there are cash reserves available that can be drawn down as an alternative to borrowing.

5.6. The main objectives when borrowing is to achieve a low but certain cost of finance, while retaining flexibility should plans change in future. These objectives are often conflicting, and the Commissioner would therefore have to strike a balance between low cost short-term loans (currently available at around 4.5%) and long-term fixed rate loans where the future cost is known but higher (currently 5%). Current forecasts show that a small amount of short term borrowing, probably from other local authorities, may be required at the start of 2024/25 to bridge a shortfall in cash in advance of receipt of the new financial year's revenue grants.

Given the current spike in borrowing costs it is unlikely that the Commissioner will actually exercise long-term external borrowing until these reduce. As such financing decisions have long term consequences and should be taken in this context, long term interest rates will be carefully monitored with the aim of deciding the most advantageous time to take on long-term liabilities.

Liability Benchmark - The 2021 code requires Authorities to define their own 'Liability Benchmark' which will provide a future basis for developing a strategy for managing interest rate risk. This has been included in the TMSS for the first time.

As an assurance that borrowing is only undertaken for capital purposes and is sustainable, the Commissioner is required to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with the statutory guidance a lower 'operational boundary' is also set as a warning level should debt approach the limit.

Further details on the borrowing strategy are on pages 8 to 9 of the treasury management strategy (agenda item 08c).

6. Other Liabilities

6.1. In relation to other external liabilities the Commissioner's balance sheet currently shows debt of £3.965m in relation to a private finance initiative (PFI) scheme for the provision of the Basic Command Unit deployment centre in West Cumbria. This debt is scheduled to reduce gradually through annual unitary charge payments met from the revenue account, until 2026 when the primary arrangement comes to an end. At this point a decision on the provision of future policing facilities in West Cumbria will need to be made. Options are currently being evaluated.

6.2. The Commissioner's balance sheet also shows long term liabilities totalling £1.066bn in respect of the Local Government and Police Officer Pension Scheme deficits. These will be met through a combination of payments from the revenue budget over a long period and support from central Government. A sum of £1.707m has been set aside to cover risks from legal claims and insurance liabilities. The Commissioner is also at risk of having to pay for an unlawful discrimination claim arising from the transitional provisions in the Police Pension Regulations 2015 but has not put aside any money because there is no clarity of the scale of the claim and no certainty over who will bear the costs at this time.

6.3. The risk of these pension liabilities crystallising and requiring payment is monitored by the Financial Services team. Further details on liabilities and guarantees are on page 98 of the 2022/23 statement of accounts.

7. Prudential Indicators

7.1. Both capital expenditure plans and treasury management are supported by a range of Prudential Indicators, whose purpose is to act as an early warning system that these activities are falling outside prescribed limits and may no longer be affordable, prudent or sustainable. Prudential Indicators, other than those using actual expenditure taken from audited statements of accounts must be set prior to the commencement of the financial year to which they relate. Indicators may be revised at any time, and must, in any case, be revised for the year of account when preparing indicators for the following year. The PFCCs Chief Finance Officer has a prescribed responsibility under the Code to ensure that relevant procedures exist for monitoring and reporting of performance against the indicators. The Prudential Indicators when initially set and whenever revised, must be approved by the body which approves the budget, i.e. The Commissioner at his Public Accountability Conference. Details of Prudential indicators are set out on pages 15-21 of the treasury management strategy (agenda item 08c).

8. Revenue Budget Implications

8.1. Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable.

8.2. The Commissioner is also required to set aside a sum each year from the revenue budget to repay borrowing, which is linked to the life of the asset being financed. This is known as the minimum revenue payment (MRP) and can be likened to the minimum repayment on a credit card debt. The estimates for the repayment of internal borrowing from the revenue budget is shown below:

Minimum Revenue Provision	2022/23 Actual £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Minimum revenue provision for the financial year	0.65	0.68	0.71	1.46	1.85

8.3. The net annual charges to the revenue account are collectively known as financing costs; which are compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants as a key prudential indicator of the affordability, prudence and sustainability of capital expenditure plans see below.

Ratio of Financing Costs to Net Revenue Stream	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m
Investment income	0.44	0.40	0.40	0.40	0.40
MRP	0.65	0.68	0.71	1.46	1.85
Financing Costs	**0.22**	**0.28**	**0.31**	**1.06**	**1.45**
Net Revenue Stream	129.62	136.75	145.38	145.38	145.49
Ratio	0.17%	0.21%	0.22%	0.73%	1.00%

The financing costs are forecast to increase from 2022/23, reflecting the decision to make increased use of borrowing over the MTFF period in lieu of direct revenue contributions highlighted earlier in the report. Nonetheless, the ratios of financing costs to the revenue budget above are considered sustainable.

Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred over the MTFF period may extend for up to 50 years into the future. The PFCC Chief Finance Officer is satisfied that the proposed capital programme is **prudent, affordable and sustainable.**

9. Knowledge and Skills

9.1. The Commissioner employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions.

9.2. Where employees do not have the knowledge and skills required, use is made of suitably qualified external advisers. The Commissioner currently employs Link Asset Services Limited as treasury management advisers. This approach is more cost effective than employing such staff directly and ensures that the Commissioner has access to knowledge and skills commensurate with his risk appetite.