APPENDIX 2

CAPITAL STRATEGY 2020/21

Introduction

This capital strategy provides a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of policing 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 Policing Body 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.

Capital Expenditure and Financing

Capital expenditure is where the Police and Crime Commissioner (PCC) spends money on assets, such as property, IT or vehicles that will be used for more than one year. The PCC has some discretion on what counts as capital expenditure, for example assets costing less than £10k are not capitalised and are charged to revenue in year.

In 2020/21, the Force is proposing capital expenditure of £10.2m as summarised below:

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

	2018/19 actual	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
Estates	4.0	3.0	3.2	0.4	1.2
IT	4.0	3.3	5.0	1.5	1.0
Fleet	1.1	1.4	1.7	1.3	1.3
Operational Equipment	0.7	-	-	-	
ESN	-	-	-	3.5	
Corporate Projects		1.1	0.3	-	
TOTAL	**9.8**	**8.8**	**10.2**	**6.7**	**3.5**

The capital projects included in the expenditure above are detailed later in this report on page 6.

Governance: The Estates, IT and Transport Departmental Heads in conjunction with the business, bid annually during November for projects to be included in the Force's capital programme. Bids are collated by Corporate Finance who calculate the financing cost (which can be nil if the project is fully funded from other resources). The proposed capital programme has been reviewed by Chief Officers and the PCC's office. The final capital programme is then presented to the Strategic Assurance Board in January for approval.

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, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
External sources	2.3	0.9	1.8	0.2	0.2
Own resources	4.3	0.5	0.4	0.1	0.1
Debt	3.2	7.4	8.0	6.4	3.2
TOTAL	**9.8**	**8.8**	**10.2**	**6.7**	**3.5**

Where the commissioner finances capital expenditure through borrowing (debt) resources must be set aside to repay that debt from the revenue account. The amount charged to revenue account for the repayment of borrowing is known as the Minimum Revenue Provision (MRP). Planned MRP is as follows:

Table 3: Replacement of debt finance in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Own resources	1.9	1.6	2.2	3.3	4.5

The Statutory Guidance issued by the DCLG sets out the 4 options for calculating the MRP. The recommended MRP policy is:

- For capital expenditure incurred before the 1st April 2008 (which was supported capital expenditure) the policy will be based on 4% of the Capital Financing requirement.

- From the 1st April 2008 for all unsupported borrowing the MRP policy will be the Asset Life Method (Equal instalment approach) – the MRP will be based on the estimated life of the assets.

The Commissioner's policy is to finance shorter life assets from capital receipts, grants and revenue contributions. Borrowing reserved generally for Land and Buildings with an expected life of 25 years and IT projects that cannot be financed from the PCC's own resources.

The PCC's cumulative outstanding 'debt finance' is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP repayments and capital receipts used to replace debt. The CFR is expected to increase by £5.8m during 2020/21. Based on the figures above for expenditure and financing, the PCC's estimated CFR is as follows:

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

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
TOTAL CFR	**24.5**	**30.3**	**36.1**	**39.1**	**37.8**

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. No capital receipts are expected to be received during 2019/20.

Treasury Management

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the PCC's / Force'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. 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, the PCC currently has £12.9m borrowing at an average interest rate of 5.29% and £32m treasury investments at an average rate of 0.57%.

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 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0% to 3.0%).

Projected levels of the PCC's total outstanding debt (which comprises borrowing, PFI liabilities and leases) are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
Debt (incl. PFI & leases)	12.4	19.8	26.1	32.4	33.6
Capital Financing Requirement	24.5	30.3	36.1	39.1	37.8

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.

Liability benchmark: To compare the PCC'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 at each year-end. This benchmark is currently £28.5m and is forecast to rise to £44.3m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
Outstanding borrowing	12.4	19.8	26.1	32.4	33.6
Liability benchmark	20.8	28.5	33.1	39.0	44.3

The table shows that the PCC expects to remain borrowed below its liability benchmark.

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 in £m

	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit – borrowing	26.4	31.1	37.4	38.7
Authorised limit – Long Term Liabilities	0.5	2.5	2.5	2.5
Authorised limit – total external debt	26.9	33.6	39.9	41.2
Operational boundary – borrowing	24.9	28.6	34.9	36.2
Operational boundary – Long Term Liabilities	0.5	1.5	1.5	1.5
Operational boundary – total external debt	25.4	30.1	36.4	37.7

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 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. Surplus cash is invested securely, for example with the government, other local authorities, selected high-quality banks and pooled funds, to minimise the risk of loss.

Table 9: Treasury management investments in £millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
Near-term investments	11.9	10.0	10.0	10.0	10.0
Longer-term investments	-	-	-	-	-
TOTAL	**11.9**	**10.0**	**10.0**	**10.0**	**10.0**

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

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Force's ACO (Resources) and staff, who must act in line with the treasury management strategy approved by the PCC. Quarterly reports on treasury management activity are presented to the Strategic Assurance Board.

Investments for Service Purposes

The PCC does not make any investments directly into local public services i.e buying shares or investing in local businesses to promote economic growth.

Commercial Activities

The PCC does not invest in any commercial property / activities.

Liabilities

In addition to debt of £12.4m detailed above, the PCC is committed to making future payments to cover its LGPS pension fund deficit (valued at £10.7m) as set out by the scheme actuary. It has also set aside £1m to cover risks of both the self insured public and employers liability claims where the PCC's claims handlers have advised there is a high probability of economic benefits being transferred. Following the successful claims in Allard v Devon and Cornwall Police for unpaid overtime following recalls to duty by covert human intelligence handlers, Leicestershire has identified when officers were on call and provisional costings have been calculated.

The PCC is also at risk of having to pay for the legal costs of the Force and former officers regarding the Independent Inquiry into Child Sexual Abuse (IICSA), but has not put aside any money because a reliable estimate of these costs cannot be made at this time.

Governance: The risk of liabilities crystallising and requiring payment is monitored by corporate finance and reported in the quarterly Budget Monitoring Report presented to the Strategic Assurance Board (SAB), if appropriate.

- Further details on liabilities are on pages 43 and 59 of the 2018/19 statement of accounts.

Revenue Budget Implications

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. 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 and core government grants.

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

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
Financing costs (£m)	2.5	2.1	3.0	4.1	5.4
Proportion of net revenue stream	1.39%	1.13%	1.48%	2.03%	2.66%

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 25 years into the future.

Proposed Capital Programme

A summary of the proposed Capital Programme for 2020/21 is shown in the table below. The more detailed programme relating to the financial years 2019/20 to 2022/23 is shown in **Annex 3A**.

Proposed Capital Programme 2020/21

Expenditure	£000	Funding	£000
Property	3,209	Capital Grant	200
Information Technology	5,002	Specific HO grants	486
Vehicle Fleet	1,686	Borrowing Requirement	8,001
Corporate Projects	291	Revenue Contributions	385
Emergency Services Network	55	3rd Party Contributions	1,171
Total	**10,243**	Total	**10,243**

The ‘Estates’ programme is based on the approved Estates Strategy and includes the:

- Refurbishment of the Dog Section (offices and kennels) & canteen kitchen to meet the latest health and safety requirements
- alterations to the Front Enquiry desk at Loughborough
- an extension to the SARC (sexual assault referral centre) to provide additional space
- the replacement of the heating and ventilation system in the Learning and Development building.

As a result of the TOM (Target Operating Model) changes, a number of departments have approached Estates to look at the reconfiguration of their office space as a result of an increase/decrease in staff. These departments have been informed that none of the requests will be considered until after the TOM has been implemented in March. The Estates Utilisation Board will decide on the merits of the individual requests. Until all the requests are known and approved or not, it is not possible to put a budget cost to the work required.

Annex 3B provides more detail regarding the individual schemes.

The IT programme includes:

- Investment in the data network and storage to ensure network performance and support new services.
- The Force has committed to the National Enabling Programme (NEP) Office 365 cloud service and 2020/21 will see the completion of the migration and the exploitation of the office 265 productivity tools.
- The Force is developing a cloud delivery strategy for provision of information systems and services. Investment will be required to maintain the high speed internet capability as these services increase.
- Completion of the smartphone fleet to facilitate the on-going use of agile services.
- Provision for the on-going development of Pronto.
- The continuation of investment in the personal computer estate to support agile working.

Annex 3C provides more detail regarding each of the work streams.

Provision is also made for the rolling programme of Automatic Number Plate Recognition (ANPR) camera replacements (including vehicle fits), stage 2 of the Contact Management Department refurbishment (ergonomics) delayed from 2019/20 and the preparatory work in relation to the roll out of the Emergency Service Network.

Planned replacements for the existing vehicle fleet, vehicle tracking system and the cost of vehicle replacements below the insurance threshold as a result of accidents are also included.

The vehicle fleet budget is based on the replacement of the current fleet provision and does not allow for any changes in vehicle specifications as a result of changing operational requirements or the target operating model as these are currently being assessed. The national purchasing framework for vehicles has also expired and the new vehicle types and purchase prices, are not yet known.

Financing

The 2020/21 capital grant is £0.2m, a reduction of 75% compared to the previous year. After the application of revenue contributions to capital schemes and the use of Section 106 funding, the 2020/21 borrowing requirement is **£8.001m**.

The Capital Programme assumes that the 2020/21 borrowing requirement of £8.001m is financed through loans from the Public Works Loan Board (PWLB). Revenue resources are set a side over the life of the asset to repay the borrowing.

Knowledge and Skills

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

Where 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 PCC / Force has access to knowledge and skills commensurate with its risk appetite.

List of Annexes

Annex 3A: 4 Year Capital Programme 2019/20 to 2022/23
Annex 3B: Estates Capital Projects
Annex 3C: IT Capital Projects

Background Papers

Home Office Settlement Notification via the Home Office website.