Capital and Investment Strategy 2019/20 to 2021/22

1 Introduction

1.1 This 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. Hampshire Fire & Rescue Authority has previously reported these matters in separate reports of the revenue budget, capital programme and the medium term financial plan (MTFP). In line with the latest statutory guidance, these inter-related issues are brought together in this one Capital and Investment Strategy.

1.2 This strategy covers:

- Governance arrangements for capital investment;
- Capital expenditure forecasts and financing;
- Prudential indicators;
- Minimum revenue provision;
- Treasury Management definition and governance arrangements;
- Investments for service purposes, linked to the Authority's commercial strategy;
- Links to the statutory guidance and other information.

2 Governance

2.1 The Authority's medium term financial plan (MTFP) ensures that we continue to invest wisely in our existing assets and deliver a programme of new ones in line with overall priorities and need. This is kept under review by the Authority, with updates being provided on an annual basis for the MTFP.

2.2 The final capital programme is presented to the Authority in February each year. Any in year changes must be reported to the Authority and approval obtain for any increases to the plans.

3 Capital expenditure and financing

3.1 Capital expenditure is where the Authority spends money on assets, such as land, property, or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

3.2 The estimated level of capital expenditure (or ‘payment’) flows each year, together with forecasts of financing resources, are two of the factors taken into account in determining the funding available within the capital programme.

3.3 Capital expenditure may be funded directly from revenue, with a regular, annual contribution to capital currently being made from the revenue budget. However, the general pressures on the Authority’s revenue budget and council tax levels limit the extent to which this may be exercised as a source of capital funding in future.

3.4 Prudential borrowing does provide an option for funding additional capital development but one which then results in costs that have to be funded each year from within the revenue budget or from generating additional ongoing income streams.

3.5 Given the pressure on the Authority’s revenue budget in future years, prudent use could be made of this discretion to progress schemes in cases where there are clear service or financial benefits. Such schemes focus on clear priorities for investment in new or existing assets, and those that generate revenue benefits in future financial years, in the form of clear and measurable revenue savings or longer term income generation either directly or through council tax or business rate yield.

3.6 Expenditure flows in 2018/19 and the following three years will result from works in progress (schemes started in 2018/19 and earlier years) plus those arising from the proposed programme for 2019/20 to 2021/22, as Table 1 below shows.

Table 1 – Forecast capital expenditure flows

	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000
Works in progress at 31 March 2018 and schemes starting in 2018/19	5,257	5,332	0	0
Programmes starting in 2019/20, 2020/21 and 2021/22		1,022	14,202	6,756
Total expenditure flows	5,257	6,354	14,202	6,756

3.7 In practice, expenditure flows in the years after 2018/19 may vary from those shown in Table 1 if further external contributions become available to fund additional capital schemes, or if prudential borrowing is used to fund the Station Investment Programme.

Table 2 - Resources to fund capital expenditure

	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000
Contributions from other bodies including developers	500	0	0	0
Capital receipts	1,500	0	0	0
Contributions from reserves				
Revenue contributions to capital	3,699	3,905	3,905	3,905
New resources in the year	5,699	3,905	3,905	3,905
Use of the capital reserve:				
added to the reserve (-), or	-442			
taken from the reserve (+)		2,449	10,297	2,851
Total resources available	5,257	6,354	14,202	6,756

4 Prudential Indicators

4.1 Prudential borrowing is only used by the Authority on a case by case basis as such there is no specific prudential framework in existence for HFRA. The current capital programme does not rely on prudential borrowing for funding and it is many years since the Authority took out any new borrowing.

4.2 As the loan repayments and interest charges have to be financed by the Authority from its own resources, it is important that the use of prudential borrowing is very closely controlled and monitored. Any decision to take out any new borrowing to fund capital expenditure (for example for the Station Investment Programme) will have to be considered and approved by the full Authority itself and would include an assessment of the impact and affordability on the revenue budget.

4.3 The Authority's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). In order to ensure that, over the medium term, debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

Table 3 – Ensuring borrowing is only for capital purposes

	31/03/19 Revised £m	31/03/20 Estimate £m	31/03/21 Estimate £m	31/03/22 Estimate £m
CFR	**11.2**	**10.8**	**10.3**	**9.9**
Debt				
Borrowing	8.4	8.3	7.1	6.7
Total Debt	**8.4**	**8.3**	**7.1**	**6.7**

4.4 Total debt is expected to remain below the CFR during the forecast period.

Affordable borrowing limit

4.5 The Authority is legally obliged to set an authorised limit for the maximum affordable amount of external debt. In line with statutory guidance, a lower 'operational boundary' is also set as a warning level should debt approach the limit. The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring.

Table 4 – Affordable borrowing limits

	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Authorised limit:				
Borrowing	18.7	18.2	17.8	17.4
Other Long-term Liabilities	5.0	5.0	5.0	5.0
Total Authorised limit	23.7	23.2	22.8	22.4
Operational boundary:				
Borrowing	15.0	14.5	14.1	13.7
Other Long-term Liabilities	5.0	5.0	5.0	5.0
Total operational boundary	20.0	19.5	19.1	18.7

Ratio of Financing Costs to Net Revenue Stream

4.6 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Table 5 – Ratio of Financing costs to Revenue Budget Requirement

	2018/19 Revised	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	%	%	%	%
Ratio	1.03	1.00	0.95	0.90

Incremental Impact of Capital Investment Decisions

4.7 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed for the next three years.

Table 6 - Incremental Impact of Capital Investment Decisions

	2019/20 Estimate	**2020/21 Estimate**	**2021/22 Estimate**
	£	**£**	**£**
General Fund - increase in annual band D Authority Tax	0.33	0	0

5 Minimum Revenue Provision for debt repayment

5.1 Where the Fire & Rescue Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Fire & Rescue Authority to have regard to guidance issued by the Ministry of Housing, Communities and Local Government on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2017.

5.2 The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

5.3 The MHCLG Guidance requires the Fire & Rescue Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The four MRP options available are:

- Option 1: Regulatory Method;
- Option 2: CFR Method;
- Option 3: Asset Life Method;
- Option 4: Depreciation Method.

6 MRP in 2019/20

6.1 Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) capital expenditure funded from borrowing. Methods of making prudent provision for unsupported capital expenditure include Options 3 and 4 (which may also be used for unsupported capital expenditure if the Fire & Rescue Authority chooses).

6.2 The Fire & Rescue Authority will apply Option 1/Option 2 in respect of supported capital expenditure funded from borrowing and Option 3/Option 4 in respect of unsupported capital expenditure funded from borrowing.

6.3 MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

6.4 Capital expenditure incurred during 2019/20 will not be subject to a MRP charge until 2020/21.

6.5 Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2018, the budget for MRP has been set as follows:

	31.03.2019 Estimated CFR £'000	**2019/20 Estimated MRP £'000**
Supported capital expenditure before 01.04.2008	11,081	443
Unsupported capital expenditure after 31.03.2008	131	3
Total General Fund	**11,211**	**446**

7 Treasury Management

7.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Authority'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 Authority 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.

7.2 The Authority's Treasury Management Strategy (contained at Appendix F of this report) is scrutinised and approved by the Authority each year. Actual performance is reviewed by the Authority on a six monthly basis.

8 Investments for Service Purposes

Utilising Property Assets

8.1 The Authority's Strategic Property & Estates Plan (SPEP) was approved by the Finance & General Purposes Committee of Hampshire Fire Authority in November 2016. The document sets the strategic direction for the estate until 2020. The strategy sets out seven core principles which are used to govern the management of the estate.

8.2 The principles are:

1. All our properties are recognised as HFRS corporate assets. This approach allows decisions to be made centrally with strategic overview.

2. The prime 'customer' of our properties are our operational and support teams which deliver our services. As far as possible, decisions are made recognising these primary users of our buildings.

3. We have a strategy to retain the current service provision across Hampshire. This may result in retaining and/or re-providing fire stations to meet the changing needs of the organisation and of the communities we service.

4. We will seek to wholly own our estate.

5. We will ensure our estate remains fit for the organisation's purposes, through continued investment in maintenance, improvements and replacement where this is deemed necessary.

6. The estate needs to work harder for the Service and be cost effective to maintain and operate. Where possible, we should maximise the potential use of land and buildings, generating income and implementing cost recovery.

7. Our environmental and energy strategies will set out approach to reduce risks, increase resilience and take advantage of opportunities presented by a changing climate in Hampshire.

8.3 These principles aim to ensure that a fit for purpose estate is maintained at all times in the most cost-effective way. Principles 4 and 6 specifically relate to the Capital and Investment Strategy, with the aim of using assets to reduce the annual revenue cost of the estate and to maximise the potential for income generation, where appropriate.

8.4 This is a deliberate outcome of the overall strategy and has been achieved through the pursuit of a range of initiatives targeting increased income generation but without over exposing the Authority to excessive risk or considering radical changes that take the Authority into areas that are not its core business or indeed pursuing more niche opportunities that simply do not offer with any confidence anything like the scale of income to merit the effort and upfront investment.

Pooled Funds

8.5 Higher yields can be accessed through investments in assets other than cash, such as equities and property. The Fire & Rescue Authority has made investments in pooled property and equities funds.

8.6 The principle mitigation for risk is ensuring that investments in non-cash assets are held as long-term investments. This will enable the initial costs of any investment and any periods of falling capital values to be overcome. In order to be managed as long-term investments the amounts invested need to be taken from the Fire & Rescue Authority's most stable cash balances, and the proposed target allocation of £7.0m forms part of the Fire & Rescue Authority's forecast future minimum balance.

8.7 The selection of investments to target higher yields is carefully managed with the assistance of Arlingclose, the Fire & Rescue Authority's treasury management advisor, who recommend that the Fire & Rescue Authority diversifies its investments targeting a higher return between asset classes. This is in order to mitigate the loss of capital value, so that there is no over exposure to an event that impacts the value of investments in a particular asset class, such as a fall in property prices.

8.8 The Fire & Rescue Authority utilises pooled investment vehicles as the most appropriate means to access asset classes such as property or equities. Pooled funds are managed by external specialist investment managers who are best placed to select the particular investments and then manage them, for example for property investments managing the relationship with tenants and maintenance of the building.

Developing joint ventures that yield additional income or generate a return

8.9 The Authority is pursuing a number of opportunities either through its land holdings or through the relationship it has with partners or contractors that look at new and innovative ways of generating a financial return. To date the Authority has formed partnerships with other emergency services, both by sharing building space and through operational changes.

9 Knowledge and skills

9.1 Through the Hampshire Shared Services Partnership, the Authority is advised by professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions in accordance with the approved strategies. Performance against targets and learning and development needs are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

9.2 Staff attend training courses, seminars and conferences provided by CIPFA, Arlingclose and other providers. Relevant staff are also encouraged to study professional qualifications from CIPFA, and other appropriate organisations.

9.3 CIPFA's Code of Practice requires that the Authority ensures that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. All members were invited to a workshop presented by Arlingclose in November 2018, which gave an update of treasury matters. A further Arlingclose workshop has been planned for November 2019.

Investment Advisers

9.4 As part of the Hampshire Shared Services Partnership, the County Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with the County Council's Deputy Chief Executive and Director of Corporate Resources, her staff and Arlingclose.

10 Chief Finance Officers conclusion on the affordability and risk associated with the Capital and Investment Strategy

10.1 This Capital and Investment Strategy has been developed alongside the Treasury Management Strategy (Appendix F) and the Reserves forecast (Appendix B). Together, they form an integrated approach adopted by the Authority to balance the need for capital investment to support service priorities with consideration of affordability and the consequent impact on the revenue budget whilst recognising and managing risk to an acceptable level.

11 The forward planning of capital funding, including being in a position to maximise the use of external grants, contributions and capital receipts, together with the process of regular monitoring of actual income, expenditure, and project progress, provides assurance to the Chief Financial Officer that the proposed capital programme is prudent, affordable and sustainable.

12 Links to statutory guidance and other information

12.1 The Local Government Act 2003, section 15(1) and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146] require Local Authorities to have regard to the following guidance:

- MHCLG - Local Government Investment* MHCLG Investment
- CIPFA's Prudential Code 2017
- CIPFA's Treasury Management Code 2017

* Where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, a Treasury Management Strategy in line with the requirements of the Treasury Management Code, the Investment Strategy can be published in those documents instead of a separate document.

12.2 The Authority's Strategic Property & Estates Plan can be found at the following the link *Full SPEP*.

12.3 Details of the 7 Core Principles can be found at *Core Principles* .

12.4 The proposed capital programme is included at Appendix C within this report.