REPORT REFERENCE NO.	**RC/21/2**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**10 FEBRUARY 2021**
SUBJECT OF REPORT	**CAPITAL STRATEGY**
LEAD OFFICER	**Director of Finance & Resourcing (Treasurer)**
RECOMMENDATION	***That the Authority be recommended to endorse the Capital Strategy as set out in this report.***
EXECUTIVE SUMMARY	The 2017 Prudential Code included the requirement for all Local Authorities to produce an annual capital strategy that is agreed by the Members. The capital strategy is a key document for the Authority and forms part of the financial planning arrangements, reflecting the priorities set out in the Fire & Rescue Plan and the Medium-Term Financial Strategy. It provides a high level overview of how capital expenditure, and the way it is financed, contribute to the provision of services. It also provides an overview of how associated risk is managed and the implications for future financial sustainability and sets out the governance process for approval and monitoring of capital expenditure.
RESOURCE IMPLICATIONS	As indicated in the report.
EQUALITY IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Nil.
BACKGROUND PAPERS	The Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code 2017

1. INTRODUCTION

1.1. The Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code 2017 included a new requirement for local authorities to produce a capital strategy to demonstrate that capital expenditure and investment decisions are taken in line with the Service objectives and take account of stewardship, value for money, prudence, sustainability and affordability.

1.2. The capital strategy is a key document for the Authority and forms part of the financial planning arrangements, reflecting the priorities set out in the Fire & Rescue Plan and the Medium-Term Financial Strategy. It provides a high level overview of how capital expenditure, and the way it is financed, contribute to the provision of services. It also provides an overview of how associated risk is managed and the implications for future financial sustainability and sets out the governance process for approval and monitoring of capital expenditure.

2. CAPITAL EXPENDITURE

2.1. Capital expenditure is incurred on the acquisition or creation of assets that yield benefits for a period of more than one year and carry significant cost; for this Authority the capital de minimis level is set as £20,000. It includes land, new buildings, enhancement to existing buildings within the estate and the acquisition of vehicles and major items of equipment. Intangible assets such as software can also be classed as capital expenditure this is in contrast to revenue expenditure which represents spending on day to day running costs such as salaries, heat and light.

3. CAPITAL EXPENDITURE COMPARED TO TREASURY MANAGEMENT INVESTMENTS

3.1. Treasury Management investments arise from the organisation's cash flows and debt management activity, and ultimately represent balances which can be invested until the cash is required for use in the course of business. As an example, the Authority set-a-side an amount each year to reflect the usage of an asset (Minimum Revenue Provision – see Section 17 below). This amount is invested but cannot be used to fund future capital expenditure as it is required to pay off a loan on maturity.

3.2. For Treasury Management investments the security and liquidity of funds are placed ahead of the investment return. The management of associated risk is set out in the Treasury Management Policy and the annual Treasury Management Strategy Statement.

3.3. Performance of the Treasury Management investments is reported to the Resources Committee at the end of each quarter.

4. CAPITAL REQUIREMENTS

4.1. This Authority has experienced significant revenue grant reductions since 2010 and no longer receives any capital grant. With further revenue grant reductions a possibility and increasing cost pressures, new ways of working are being implemented so that the Service can address the risks within our communities and balance the budget. The Integrated Risk management Plan 2018-2022 identified those risks and the Service determined the resources needed in terms of premises and vehicles that are needed in each location through the Safer Together programme. The National Risk Register, identifies emerging challenges such as the continued threat of terrorism, the impacts of climate change and impacts of an ageing population. These will be considered through the Community Risk Management Plan (CRMP), which replaces the Integrated Riskk Management Plan, along with the requirements of the Fire and Rescue National Framework and local risks to Devon and Somerset.

4.2. The Authority currently has 83 fire stations across the counties of Devon and Somerset. During 2020/21 one was closed and one relocated to Service Headquarters as part of the Safer Together Programme.

4.3. At the commencement of the 2021-22 year, the Service will have 112 front-line fire engines (down from 121 at the start of 2020-21), of which 49 have surpassed their recommended economic life, and 19 Special Appliances. Ensuring prioritisation over where capital resources are used to best utilise our Estate and Fleet of vehicles is paramount.

5. PROJECT INITIATION

5.1. Capital projects are subject to a robust justification process, bringing together a clear business case with sufficient detailed costings to ensure transparent decisions can be taken.

5.2. Proposals are commissioned by the Executive Board and then monitored through regular meetings between capital leads, procurement and finance officers. The Programme Board considers variations to plan and monitors milestones.

5.3. A formal process of project management is followed with a project manager or building surveyor assigned to each Capital scheme to ensure they are subject to thorough oversight for the duration of the project. The project manager will oversee planning, delivery, management, skills assessment and governance of capital projects.

5.4. Capital projects will be assessed for:

- Strategic fit – corporate objectives are being met by the expenditure.
- Identified need – e.g. vital repairs and maintenance to existing assets.

- Achievability – this may include alternatives to direct expenditure such as partnerships.
- Affordability and resource use – to ensure investment remains within sustainable limits.
- Practicality and deliverability.
- Resource time is assessed when considering projects to ensure both delivery of projects and day-to-day work is covered.

5.5. To support a robust governance process, for larger capital investment projects, the Service uses the "Five Case" model to develop the business case as recommended by HM Treasury. The model provides a discipline and structure to arrive at the best possible decision and considers; The strategic case (the case for change), the economic case (value for money), the commercial case (it is commercially viable and attractive to the market), the financial case (to ensure the proposed spend is viable) and finally the management case (that the requirement is achievable).

6. THE SERVICE CAPITAL PROGRAMME 2021-22 – 2025-26

6.1. The Service capital programme for 2021-22 – 2025-26 is considered annually and is set out in the table below.

TABLE 1

Capital Programme 2021/22 to 2025/26								
2020/21 £000 Budget	2020/21 £000 Forecast Outturn	Item	PROJECT	2021/22 £000 Budget	2022/23 £000 Budget	2023/24 £000 Budget	2024/25 £000 Indicative Budget	2025/26 £000 Indicative Budget
			Estate Development					
3,557	1,907	1	Site re/new build	2,150	0	0	0	0
5,591	1,437	2	Improvements & structural maintenance	5,089	3,600	1,300	3,500	3,700
9,148	**3,344**		**Estates Sub Total**	**7,239**	**3,600**	**1,300**	**3,500**	**3,700**
			Fleet & Equipment					
5,034	2,839	3	Appliance replacement	5,157	2,300	2,800	2,800	2,000
710	370	4	Specialist Operational Vehicles	440	5,100	1,900	700	700
0	0	5	Equipment	0	0	0	0	0
159	9	6	ICT Department	400	0	0	0	0
46	46	7	Water Rescue Boats	0	0	0	0	0
5,949	**3,264**		**Fleet & Equipment Sub Total**	**5,997**	**7,400**	**4,700**	**3,500**	**2,700**
(3,800)	**0**	**9**	**Optimism bias Sub Total**	**(2,600)**	**400**	**1,000**	**1,200**	**0**
11,297	**6,608**		**Overall Capital Totals**	**10,636**	**11,400**	**7,000**	**8,200**	**6,400**
			Programme funding					
7,672	2,663	15	Earmarked Reserves:	6,575	7,998	3,417	1,667	0
2,037	2,037	16	Revenue funds:	2,037	2,037	2,300	2,300	2,300
60	380	17	Capital receipts:	0	0	0	0	0
1,528	1,528	18	Borrowing - internal	2,024	1,365	1,283	1,352	1,918
		19	Borrowing - external	0	0	0	2,881	2,182
11,297	**6,608**		**Total Funding**	**10,636**	**11,400**	**7,000**	**8,200**	**6,400**

7. FUNDING THE CAPITAL PROGRAMME

7.1. There are several funding sources available to meet the Authority's capital expenditure requirements. These are explored in more detail.

8. REVENUE FUNDING

8.1. The Authority agreed on the 24th February 2014 that an element within the Revenue budget for each year will go towards funding the capital programme and this has continued into each subsequent financial year. The amount awarded to assist with the capital programme is based on affordability and is specific to that year. Table 1 identifies the amount the Authority is hoping to fund from Revenue each year.

9. PRUDENTIAL BORROWING

9.1. The Authority is permitted to take out regulated external borrowing. The Local Government Act 2003 refers to affordability and the requirement that the local authorities in England and Wales keep under review the amount of money they borrow for capital investment.

9.2. The Code requires that "The local authority shall ensure all of its capital and investment plans and borrowing are prudent and sustainable. In doing so, it will take into account its arrangements for the repayment of debt (including Minimum Revenue Provision) and consideration of risk and the impact on the overall fiscal sustainability". The impact of borrowing is outlined within the Treasury Management Strategy Statement and monitored by the Resources Committee on a quarterly basis.

10. RESERVES

10.1. It has been the strategy of the Authority to utilise revenue contribution to fund capital expenditure. Following approval by the Authority, an amount of the in-year revenue budget underspend has been set-a-side and moved in to a Reserve to fund the future capital programme. The amount of Earmarked Reserve funding identified to fund the Capital programme is shown above. No additional external borrowing has been taken out - the last loan the Authority took out was in 2012. Depending on the size of the Capital programme, there could be a requirement for new borrowing within financial year 2024-25 if the quantity and type of assets remain the same.

11. MONITORING CAPITAL EXPENDITURE

11.1. The performance of the capital programme is reported to Officers each month and to Members each quarter and forms part of the Financial Performance report. Any timing differences are also identified within the report.

12. RISK MANAGEMENT

12.1. The Prudential Code recognises that in making its capital investment decisions, the authority must have explicit regards to option appraisal and risk:

> “The 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 sustainability.”

12.2. Each Capital scheme project will have its own risk register and options appraisal to manage the operational risk arising from the project, however this section of the strategy focuses on strategic risks arising from capital investment activity.

12.3. Every item will go through a rigorous justification process so that a greater scrutiny can be achieved over what is included within the capital programme. This will become even more critical if collated bids exceed the available funding. All investment will be aligned to the Integrated Risk Management Plan (this plan will soon be redesigned as the Community Risk Management Plan) and the Fire & Rescue Plan to ensure that the Service is replacing the right assets, at the right location to address the risk and at the same time reducing our revenue costs to help balance the budget.

12.4. The Capital budget requirement is determined on an annual basis. The process starts at the end of the summer with relevant departments determining their requirements. Once formalised, the requirements are discussed and scrutinised with the relevant Director. Following that, they are presented to the Executive Board in December before being presented to the Authority in February for approval in advance of the financial year to which it relates.

13. CREDIT RISK

13.1. There is a risk that a supplier becomes insolvent and cannot complete the agreed contract. Appropriate due diligence is carried out before a contract is placed as part of the procurement process.

14. LIQUIDITY RISK

14.1. This is the risk that the timing of cash inflows from a project will be delayed. In the main, the Authority’s capital projects are self- funded and therefore don’t rely on other organisations contributing or failing to make their contributions when agreed. Under the collaboration agenda it is possible that an increasing number of Capital projects will be shared across organisations. Liquidity risk and the impact on cash flows is monitored on a daily basis by the Treasury Management function.

15. FRAUD, ERROR AND CORRUPTION

15.1. This is the risk that financial losses will occur due to error, fraudulent or corrupt activities. The Authority has procedures in place to minimise the risk of fraud especially regarding changing of bank details for suppliers. There are also policies in place to address some of the risk such as the Whistleblowing Code, the Strategy on Protection and Detection of Fraud and the Declaration of Interests.

16. LEGAL AND REGULATORY RISK

16.1. This is the risk that changes to laws or regulation make a capital project more expensive or time consuming to complete, make it no longer cost effective or make it illegal or not advisable to complete. Before entering into a capital project, officers will determine the powers under which any investment is made with input from our Treasury Management advisors.

16.2. Capital schemes must comply with legislation (Disability and Discrimination Act as an example) and also consider Authority Regulations, Service plans and Policies such as:

- Fire & Rescue Plan;
- Integrated Risk Management Plan;
- Contract Standing Orders; and
- Financial Regulations.

17. MINIMUM REVENUE PROVISION

17.1. Within the Local Government Act 2003, local authorities are required to have regard to the statutory guidance on Minimum Revenue Provision. The Ministry of Housing, Communities and Local Government has produced statutory guidance which local authorities must have regard to.

17.2. Minimum Revenue Provision represents the minimum amount that must be charged to an authority's revenue budget each year for financing capital expenditure, where it has initially been funded from borrowing. The Minimum Revenue Provision accounting practice allows the Authority to set aside an amount of money each year to ensure that it can pay off the debts it has from buying capital assets.

17.3. The Minimum Revenue Provision Policy is reviewed annually and is outlined within the Authority's Treasury Management Strategy Statement.

18. AFFORDABILITY OF THE CAPITAL PROGRAMME

18.1. A variety of factors are taken into account when determining the affordability of the Capital programme, including the impact on revenue budgets and reserves:

- Minimum revenue provision

- Interest payable
- Interest receivable
- Revenue contribution to capital
- The Authority's affordability indicator, that debt charges must be <5% of net revenue budget in each financial year

18.2. The cheapest and most sustainable method to fund a Capital Programme is to set aside an amount from revenue each year to purchase assets, with any variations to the programme being smoothed out using an Earmarked Reserve for Capital.

18.3. The strategic objective within the medium term financial plan is to ensure that revenue funds of at least £2m are included in the annual budget, which will increase as other capital costs fall as a result of reduced borrowing.

18.4. Historically, the Authority received a Central Government Capital Grant of up to £2m per year and also supported its capital programme using borrowing where required. However, it became apparent that the 5% indicator of affordability for borrowing would be breached and this with the cessation of Government Grant meant that alternative ways of addressing the Capital programme needed to be explored.

18.5. Several years ago the Service engaged staff and developed a range of smaller fire engines that whilst able to make better progress through congested cities as well as narrow country lanes, were also cheaper to procure. By ensuring that we have the right balance between large traditional fire engines and smaller, lighter fire engines we have been able to reduce the capital costs for the Service without compromising public safety. Not only is this a more efficient use of the financial resources we have available to us, it is also better for the environment.

The Authority's strategy is to reduce borrowing

18.6. As at 31 March 2021 external debt will be £24.9m, down from £26.3m ten years ago.

18.7. Due to the introduction of a baselined revenue contribution to capital, budget and in year savings a healthy capital reserve has been built up, meaning that the Authority could spend £39m over the next five years replacing and improving its assets without needing to borrow any more.

18.8. Recognising that we needed to take a fundamental review of our Service Delivery Operating Model (completed in 2020), major decisions relating to fire station locations and number/type and location of some fire engines had been deferred. There are now a considerable number of assets needing replacement or enhancement and the proposed programme totals £43.6m over the next five years. As only £39m of funding is available, officers will need to develop further plans to prioritise expenditure and avoid borrowing in the future.

18.9. The Safer Together programme has delivered a new Service Delivery Operating Model and provided a focus on the way Vehicles and Equipment are managed. Both of these work streams have presented reductions to the asset base which have fed into this iteration of the Capital Programme and Medium Term Financial Plan.

AMY WEBB
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