Appendix F

Capital and Investment Strategy 2022/23 to 2024/25

1. Introduction

1.1 This Strategy gives a high-level overview of how capital expenditure, capital financing, and treasury management and investment 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.

1.2 This Strategy covers:

- Governance arrangements for capital investment
- Capital expenditure forecasts and financing
- Prudential indicators for capital expenditure, external debt and affordability
- Minimum Revenue Provision (MRP) statement
- Treasury Management definition and governance arrangements
- Pooled fund investments
- Utilising property assets
- Opportunities to work with partners and contractors to generate a return
- Knowledge and skills
- Chief Financial Officer's conclusion on the affordability and risk associated with the Capital and Investment Strategy
- Links to the statutory guidance and other information

2. Governance

2.1 The Authority's Medium Term Financial Plan (MTFP) ensures that it continues to invest wisely in existing assets and the delivery of a programme of new ones in line with overall priorities and need. Capital investment priorities are kept under review by the Executive Team, chaired by the Chief Fire Officer. Identified priorities are reported to the Authority and the capital programme is presented to the Authority in February each year. Any in year changes must be reported to the Authority and approval obtained for any increases to the plans.

2.2 The Authority is aware of the need for a sustained reduction in its impact on the environment. This is partly driven by the Government Climate Change Act but is predominantly due to the need to protect local communities and reduce the consequences of inaction, given that the Fire and Rescue Service acts as a first responder to extreme weather events. The Carbon Reduction Pathway was approved by the Authority in July 2021, setting the strategic direction for alignment with the UK National Target of being Net Zero by 2050. Key opportunities for carbon reduction relate to the electrification of the fleet; building fabric and heating works within the estate; carbon reduction by design; and behavioural change and staff engagement.

3. Capital Expenditure and Financing

3.1 Capital expenditure is spending by the Authority on assets that will be used for more than one year, such as land, property or vehicles. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy or enhance 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 considered in determining the funding available for the capital programme.

3.3 Capital expenditure may be funded from capital receipts, capital grants and contributions from other bodies. It may also be funded directly from revenue and the Authority makes a regular annual contribution to capital from the revenue budget. General pressures on the Authority’s revenue budget and council tax levels, however, limit the extent to which this can be used as a source of capital funding.

3.4 Prudential borrowing provides another option for funding additional capital development and the Authority has agreed to use this source of funding for the Station Investment Programme. Prudential borrowing results in ongoing revenue costs and given anticipated future pressures on the revenue budget, the Authority will only use prudential borrowing where there are clear service or financial benefits. The Authority will not borrow to invest primarily for financial return.

3.5 Expenditure flows in 2021/22 and the following three years will result from works in progress (schemes started in 2021/22 and earlier years) plus those arising from the proposed programme for 2022/23 to 2024/25. Estimated capital expenditure flows are shown in Table 1:

Table 1: Estimates of capital expenditure (Prudential Indicator 1)

	2021/22 £’000	**2022/23 £’000**	**2023/24 £’000**	**2024/25 £’000**
Estimates of capital expenditure flows	3,743	41,893	26,752	12,101

3.6 The most significant elements of the Authority’s capital programme relate to the Station Investment Programme, other developments to the estate, and the investment in vehicles. Further details can be found in Appendix C to the Budget and Precept report.

3.7 All capital expenditure must be financed, either from external sources, the Authority's own resources, or debt. Debt is only a temporary source of funding and is replaced over time by other financing, usually from revenue through annual Minimum Revenue Provision (MRP) charges. External debt will also incur interest costs. The Authority's borrowing strategy is summarised in Section 6 and forms part of its Treasury Management Strategy.

3.8 The resources to fund the capital expenditure flows set out in Table 1 are shown in Table 2.

Table 2 - Resources to Fund Capital Expenditure

	2021/22 £'000	2022/23 £'000	2023/24 £'000	2024/25 £'000
Prudential borrowing	1,500	21,619	15,230	5,920
Capital receipts	0	0	0	350
Contributions from other bodies	100	0	0	0
New Resources in the Year	**1,600**	**21,619**	**15,230**	**6,270**
Draw From / (Contribution to) the Capital Payments Reserve:	2,143	20,274	11,522	5,831
Total Resources Available	**3,743**	**41,893**	**26,752**	**12,101**

3.9 In addition to the draws from the Capital Payments Reserve above, there are forecast further draws to fund major revenue investments of £2.866m in 2021/22.

4. Prudential Indicators

4.1 The Authority is required to set and monitor against Prudential Indicators in accordance with the Prudential Code. These indicators cover capital expenditure, external debt and affordability and are presented in Tables 1, 3, 4 and 5. Further indicators on treasury management are contained within the Treasury Management Strategy.

4.2 The Authority's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). The CFR increases with new debt-funded capital expenditure and reduces through annual Minimum Revenue Provision (MRP) charges to the revenue budget and any capital receipts used to replace debt.

4.3 In order to ensure that over the medium term debt will only be for capital purposes, 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 and is shown in Table 3.

Table 3: Ensuring Borrowing is Only for Capital Purposes (Prudential Indicator 2)

	31/03/22 Revised £M	31/03/23 Estimate £M	31/03/24 Estimate £M	31/03/25 Estimate £M
CFR	**11.4**	**33.0**	**47.4**	**50.3**
External debt				
Borrowing	6.7	29.0	43.9	47.6
Lease Liabilities	n/a	0.4	0.4	0.4
Total external debt	**6.7**	**29.4**	**44.3**	**48.0**

4.4 Total external debt is expected to remain below the CFR during the forecast period. The estimates for CFR and external debt reflect the introduction of IFRS 16 (the new accounting standard for leases) from April 2022.

4.5 External debt is expected to remain below the CFR because of the Authority's borrowing strategy, whereby it has used internal borrowing (the use of internal cash balances) to fund capital expenditure in place of borrowing money from external sources on the advice of its treasury management advisors Arlingclose. The Authority is expecting to undertake new external borrowing in future to fund the Station Investment Programme and the forecasts in Table 3 assume new external borrowing from 2022/23 onwards for those projects to be funded by borrowing. The timing and source of actual borrowing will be determined in line with the Authority's borrowing strategy within its Treasury Management Strategy.

Affordable Borrowing Limit

4.6 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 the 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 (Prudential Indicators 3 and 4)

	2021/22 Revised £M	2022/23 Estimate £M	2023/24 Estimate £M	2024/25 Estimate £M
Authorised Limit:				
Borrowing	21.7	42.9	57.3	60.2
Leases	5.0	5.4	5.4	5.4
Authorised Limit	**26.7**	**48.3**	**62.7**	**65.6**
Operational boundary:				
Borrowing	16.6	37.8	52.1	55.0
Leases	5.0	5.4	5.4	5.4
Operational Boundary	**21.6**	**43.2**	**57.5**	**60.4**

Ratio of Financing Costs to Net Revenue Stream

4.7 Capital expenditure is not charged directly to the revenue budget, however the interest payable on loans and the annual MRP are charged to revenue (in aggregate known as financing costs). It is important that the revenue implications of capital projects are closely controlled and monitored. Any decision to take out new borrowing to fund capital expenditure is considered and approved by the full Authority and includes an assessment of the impact and affordability on the revenue budget.

4.8 Table 5 shows estimated financing costs for the existing and proposed capital programme. It identifies the proportion of the Authority’s net revenue stream (Council Tax, business rates and general government grants) required to meet financing costs. This is an indicator of the affordability of the Authority’s capital programme.

Table 5: Ratio of Financing Costs to Net Revenue Stream (Prudential Indicator 5)

	2021/22 Revised	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Ratio	1.1%	1.8%	2.9%	3.4%

4.9 A low proportion is forecast, demonstrating that the cost of financing is minimised and the proportion of the revenue budget available for delivering services is maximised. The estimated increase through to 2024/25 is the result of projected additional prudential borrowing related to the Station Investment Programme.

5. Minimum Revenue Provision (MRP) Statement

5.1 Where the Authority finances capital expenditure by debt, statutory guidance requires it to put aside revenue resources to repay that debt in later years, known as MRP. The Local Government Act 2003 requires the Authority to have regard to proper practice issued by Government. The Department for Levelling Up, Housing and Communities is currently consulting on proposed changes to the relevant regulations to ensure that all authorities make adequate revenue provision. Until that is concluded, the relevant guidance is that issued by the (former) Ministry of Housing Communities and Local Government (MHCLG) in 2018.

5.2 The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is reasonably commensurate with that over which the capital expenditure provides benefit 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 guidance requires the Authority to approve an Annual MRP Statement each year, and whilst it provides a range of options for the calculation of MRP, the guidance also notes that other options are permissible provided that they are fully consistent with the statutory duty to make prudent revenue provision.

5.4 The four provided options are:

- Option 1: Regulatory Method
- Option 2: CFR Method (4% of the CFR)
- Option 3: Asset Life Method
- Option 4: Depreciation Method

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

5.6 The Authority will continue to apply Option 2 in respect of supported capital expenditure funded from borrowing with an MRP charge equal to 4% of the CFR balance in respect of that expenditure.

5.7 The Authority will continue to apply Option 3 in respect of unsupported capital expenditure funded from borrowing by charging MRP over the expected useful life of the relevant asset in equal instalments.

5.8 For assets acquired by leases, MRP will be determined to be equal to the element of the rent or charge that goes to write down the balance sheet liability.

5.9 The adoption of the accounting standard for leases (IFRS 16) means former operating leases have been brought onto the balance sheet on 1 April 2022. Where this is the case annual MRP charges will be set so that the total charge to revenue remains unaffected by the new accounting standard.

5.10 Capital expenditure incurred during 2022/23 will not be subject to an MRP charge until 2023/24.

5.11 Based on the Authority's latest estimate of its CFR on 31 March 2022 and the impact of the new accounting standard for leases, the budget for MRP has been set as follows:

Table 6: MRP Budget

	31/03/2022 Estimated CFR £'000	**2022/23 Estimated MRP £'000**
Supported Capital Expenditure	9,803	392
Unsupported Capital Expenditure After 31/03/2008	1,622	33
Leases	0	7
Total General Fund	**11,425**	**433**

6. Treasury Management

6.1. 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.

6.2. The Authority has potentially large exposures to financial risks through its investment and borrowing activity, including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's Treasury Management Strategy (TMS).

6.3. The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans, should the Authority's long-term plans change, is a secondary objective.

6.4. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. It therefore invests its funds prudently and has regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

6.5. The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

6.6. The Authority's TMS, included as Appendix E to this report, is and approved by the Authority each year. Actual performance is reviewed by the Authority at mid-year and the end of each financial year.

7. Pooled Fund investments

7.1. The Authority holds reserves for a number of purposes, which are explained in more detail in the Reserves Strategy (Appendix D). Where the Authority holds surplus cash, it is invested until it is required, in accordance with the Authority's Treasury Management Strategy. This includes allocating a proportion to investments in pooled funds and the Authority has made investments totalling £7m into pooled property, equity, and multi-asset funds.

7.2. These investments help the Authority to mitigate interest rate and inflation risks as part of its treasury management strategy. They also present a number of risks which must be carefully managed, including the risk of loss of capital, illiquidity, entry and exit fees, and volatility of returns.

7.3. The principal 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 Authority's most stable cash balances. The allocation of £7m forms part of the Authority's forecast future minimum balance.

7.4. The selection of investments in pooled funds is carefully managed with the assistance of Arlingclose, the Authority's treasury management advisor, who recommend that the Authority diversifies its investments in pooled funds between asset classes. This is 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.

7.5. The 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 investments and then manage them, for example for property investments managing the relationship with tenants and maintenance of the building.

8. Utilising property assets

8.1. The Authority primarily uses its property estate for the delivery of frontline services, with asset management conducted by the Property and Facilities team within the Corporate Services directorate.

8.2. Where practical and without having an operational impact, the Authority will look to use property assets to reduce the annual revenue cost of the estate and to maximise the potential for income generation, for example through the use of vacant space.

9. Opportunities to work with partners and contractors to generate a return

9.1. 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 by sharing buildings.

10. Knowledge and skills

10.1. Through the Hampshire Shared Services Partnership, the Authority is advised by professionally qualified and experienced staff in senior positions supporting 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.

10.2. Staff attend training courses, seminars and conferences provided by the Chartered Institute of Public Finance and Accountancy (CIPFA), Arlingclose and other providers. Relevant staff are also encouraged to study professional qualifications from CIPFA, and other appropriate organisations.

10.3. 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 2021, which gave an update of treasury matters. A further Arlingclose workshop has been planned for 2022.

Investment Advisers

10.4. As part of the Hampshire Shared Services Partnership, Hampshire 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 Director of Corporate Operations for Hampshire County Council, their staff and Arlingclose.

11. Chief Financial Officers Conclusion on the Affordability and Risk Associated with the Capital and Investment Strategy

11.1. This Capital and Investment Strategy has been developed alongside the TMS (Appendix E) and the Reserves Strategy (Appendix D). 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.

11.2. The forward planning of capital investment and its 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 around the forward capital programme.

11.3. The Station Investment Programme significantly increases prudential borrowing and brings with it associated annual revenue costs over the longer term. The Authority and Service are aware of the impact of this new borrowing and it has been taken into account in setting the Medium Term Financial Plan alongside the revenue budget for 2022/23 and the forward capital programme.

11.4. The Chief Financial Officer has concluded that the 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:

- Ministry of Housing, Communities & Local Government (MHCLG) - Local Government Investment* MHCLG Investment.
- CIPFA's Prudential Code
- CIPFA's Treasury Management Code

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

12.2. The Authority includes its non-treasury management Investment Strategy within this Capital Strategy. The TMS is a separate document reported to the Fire Authority (Appendix E).

12.3. The CIPFA Prudential Code was revised in December 2021 to reflect developments since it was last updated in 2017 and became applicable with immediate effect, however an exception was made to allow the deferral of revised reporting requirements until 2023/24. The revised reporting requirements relate to the capital strategy, prudential indicators and investment reporting. The Treasury Management Code was also revised at the same time.

12.4. The proposed Capital Programme is included at Appendix C within this report.