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Reference No: 6 - 2014

POLICE AND CRIME COMMISSIONER FOR CLEVELAND

# THE POLICE & CRIME COMMISSIONER FOR CLEVELAND

## DECISION RECORD FORM

**REQUEST:**

For PCC Approval

**Title:**

Capital Financing

**Executive Summary:**

The attached paper looks at options around funding the capital programme both for 2013-14 and in future years that will minimise the need to borrow any funds. This is turn will reduce the amount of the PCC budget that will then have to be set aside to pay interest and also the amount that will be needed to be set aside to meet the minimum revenue provision of the organisation

**Decision:**

The PCC is asked to:

1. Approve contributing the final under spend on the PCC's budget and the over recovery of income in 2013-14 to a capital earmarked reserve. This is currently expected to total circa £585k.
2. Approve contributing the £421k under spend from 2012-13, which is currently sat within the General Fund, to the capital earmarked reserve.
3. Approve contributing the £1,126k from the risk earmarked reserve to the capital earmarked reserve.
4. Approve changing the policy on the sale of capital assets so that, from the 1st April 2014, all proceeds from the sale of capital items, and not just those greater than £10k, are accounted for as capital receipts and therefore available to fund capital purchases in the future.
5. Approve that £200k of the recurring savings on the MRP budget, as a result of this review and the above recommendations is contributed to the capital programme on a recurring basis.
6. Approve that £250k that results from the larger than expected increase in the number of Band D properties in 2014-15 is added to the capital funding and that this becomes a permanent contribution that increases in line with future precept increases.
7. Approve that £350k of the council tax collection surplus that has arisen in 2013-14, but will be received in 2014-15, is added to the capital funding

**Implications:**

| Has consideration been taken of the following: | Yes | No | |
|---|---|---|---|
| Financial | ☒ | ☐ | |
| Legal | ☒ | ☐ | |
| Equality & Diversity | ☒ | ☐ | |
| Human Rights | ☒ | ☐ | |
| Sustainability | ☒ | ☐ | |
| Risk | ☒ | ☐ | |

**(If yes please provide further details below)**

**Decision Required – Supporting Information**

Financial Implications: (Must include comments of the PCC's CFO where the decision has financial implications)

Implementing all of the recommendations and suggestions in this report should provide sufficient financial resources within the Capital Programme to meet the known Capital needs of the Force, whilst also minimising the need for borrowing and therefore reducing the amount needed for both Interest Payable and MRP over the next 4 years.

Legal Implications: (Must include comments of the Monitoring Officer where the decision has legal implication)

There are no legal implications arising from this report

Equality and Diversity Implications

N/A

Human Rights Implications

N/A

Sustainability Implications

The aim of the proposals set out within this report is to put the Capital programme on a sustainable funding position without the need to continually borrow to do so. This should enable savings to be made on both interest payable and MRP budgets which will in turn enable reducing resources to be focussed on service delivery

Risk Management Implications

With the reducing funding available as a whole to the PCC it is possible that the principles set out within this paper might not be affordable going forward. This will then result in increased borrowing to fund capital expenditure which in turn will increase interest payments and MRP budgets which will then increase the pressures on the revenue budget

**OFFICER APPROVAL**
**Chief Executive**
I have been consulted about the decision and confirm that financial, legal, and equalities advice has been taken into account. I am satisfied that this is an appropriate request to be submitted to the Police and Crime Commissioner.

Signed: ............ Date: 20 JAN 2014

**Police and Crime Commissioner:**
The above request HAS / ~~DOES NOT HAVE~~ my approval.

Signed: ............ Date: 23/1/14

**Report of the Chief Finance Officer to the PCC**

**Status: For Approval**

**Report Title: Capital Financing**

## 1. Purpose

This paper looks at options around funding the capital programme both for 2013-14 and in future years that will minimise the need to borrow any funds. This is turn will reduce the amount of the PCC budget that will then have to be set aside to pay interest and also the amount that will be needed to be set aside to meet the minimum revenue provision of the organisation.

## 2. Recommendations

**The PCC is asked to:**

2.1 Approve contributing the final under spend on the PCC's budget and the over recovery of income in 2013-14 to a capital earmarked reserve. This is currently expected to total circa £585k.

2.2 Approve contributing the £421k under spend from 2012-13, which is currently sat within the General Fund, to the capital earmarked reserve.

2.3 Approve contributing the £1,126k from the risk earmarked reserve to the capital earmarked reserve.

2.4 Approve changing the policy on the sale of capital assets so that, from the 1st April 2014, all proceeds from the sale of capital items, and not just those greater than £10k, are accounted for as capital receipts and therefore available to fund capital purchases in the future.

2.5 Approve that £200k of the recurring savings on the MRP budget, as a result of this review and the above recommendations is contributed to the capital programme on a recurring basis.

2.6 Approve that £250k that results from the larger than expected increase in the number of Band D properties in 2014-15 is added to the capital funding and that this becomes a permanent contribution that increases in line with future precept increases.

2.7 Approve that £350k of the council tax collection surplus that has arisen in 2013-14, but will be received in 2014-15, is added to the capital funding.

## 3. Reasons

3.1 In addition to the revenue budget the PCC will also need to consider and set the Capital Plans for the organisation for 2014/15 in February 2014. The PCC currently has to set aside £2.4m within their revenue budget each year for 'Asset Management' Costs. These are predominantly made up from Interest Payable on the loans the PCC has and the Annual Revenue Provision that the PCC must set aside in respect of these loans. This £2.4m is the equivalent of 1.75% of the total budget set by the PCC.

3.2 The decisions therefore made in relation to the Capital Programme will have a direct impact on the revenue budget and it is therefore important that the PCC takes these revenue implications into account when making future decisions around the capital programme.

**Capital Grant**

3.3 The PCC is expected to receive £1,225k in terms of Capital Grant in 2014/15 and therefore if the PCC wants, or needs, to spend more on Capital Expenditure than this Grant provides then the options are as follows:

- Borrowing money (either through loans or from current cash balances) to fund Capital Purchases.
- The sale of Capital Assets resulting in a Capital Receipt.
- A contribution from the Revenue Budget.

3.4 **Long Term Capital Plan**

The PCC approved the capital plan for 2013/14 and received indicative information for the following 3 years in February 2013. Having taken into account the carry forwards from the 2012/13 schemes that were not delivered in 2012/13, and have therefore been carried forward into 2013/14, the summary position at the start of the year was as set out below:

| CAPITAL PLAN 2013/17 | 2013/14 £000s | 2014/15 £000s | 2015/16 £000s | 2016/17 £000s |
|---|---|---|---|---|
| **FUNDING** | | | | |
| Capital Grant | 1,188 | 1,240 | 1,240 | 1,240 |
| Supported Capital Borrowing | 760 | 872 | 872 | 0 |
| Prudential Borrowing | 2,389 | 492 | 118 | 0 |
| Capital Reserves | 380 | | | |
| Capital Receipts | 40 | 0 | 0 | 0 |
| Revenue Contribution | 75 | 0 | 0 | 0 |
| **TOTAL FUNDING** | **4,832** | **2,604** | **2,230** | **1,240** |
| | | | | |
| EXPENDITURE | | | | |
| Facilities Schemes | 387 | 178 | 108 | 50 |
| Equipment Schemes | 107 | 195 | 44 | 0 |
| ICT Schemes | 3,412 | 1,491 | 1,400 | 0 |
| Fleet Replacement Programme | 765 | 1,211 | 1,235 | 1,371 |
| Provision for Business Cases | 161 | 0 | 0 | 0 |
| **TOTAL PLANNED EXPENDITURE** | **4,832** | **3,075** | **2,786** | **1,421** |
| | | | | |
| **(UNDER)/OVER COMMITMENT** | **(0)** | **471** | **556** | **181** |

3.5 The 2013/14 plan showed the need to take out prudential borrowing of £2,389k to fund the current programme. This is predominantly as a result of schemes being carried forward from 2012/13. The delays in delivering the 2012/13 programme is also one of the reasons why there is a £280k under spend on the MRP budget for 2013/14.

3.6 As mentioned earlier there are 2 elements to the costs that make up Asset Management, these are interest payable, which as you would expect are the interest payments on the loans that the organisation has. The second element is the annual amount that has to be set aside as a result of funding capital via borrowing/loans.

3.7 Borrowing and Loans

The reason that I use the terms borrowing and loans as separate items is that it is possible to fund capital expenditure by 'borrowing' money from the cash balances that the organisation has (for which there is no interest payable) or the organisation can physically take out a loan which it will repay on an agreed date and on which it will pay interest at an agreed rate during the life of the loan. While it is 'cheaper' to borrow money internally there is obviously a limit to which this can take place before the organisation has no money available with which to do this.

3.8 As at the 1st April 2014 the PCC will have £20.6m of outstanding loans, assuming that no loans are taken out during the remainder of the current financial year. These loans will incur interest charges of £852k during 2014/15. This is £78k less than the interest charges in 2013/14 given the repayment of £3.76m worth of loans during 2013/14.

3.9 The table below profiles the repayment of these loans over the next 5 years:

**Repayment Profile of current loans and corresponding interest paid on those loans**

| | 2013/14 £000s | 2014/15 £000s | 2015/16 £000s | 2016/17 £000s | 2017/18 £000s | 2018/19 £000s |
|---|---|---|---|---|---|---|
| Loans at start of year | 24,360 | 20,600 | 19,260 | 18,160 | 16,416 | 16,416 |
| Loan Repayments | (3,760) | (1,340) | (1,100) | (1,744) | 0 | (872) |
| **Loans at Year End** | **20,600** | **19,260** | **18,160** | **16,416** | **16,416** | **15,544** |
| Interest to be paid on above Loans | 930 | 852 | 794 | 749 | 686 | 667 |

3.10 As can be seen from the above table **IF** no additional loans are taken out for the next 5 years then it will be possible to reduce the interest paid budget by £260k. **It is recommended therefore that to free up funds to spend on frontline services, and to help meet the financial challenges of the organisation, that the PCC does not take out any further loans and continues to repay those that are due for repayment over the next 5 years.**

3.11 As with any recommendation the above should not be followed at all costs. It would be prudent for the PCC to follow the above approach but with the ability to take out additional loans in the following situations:

- Any loans that may be needed in relation to any new HQ to bridge the timing between expenditure and the receipt of the sales proceeds from the sale of the current HQ.
- Any loans that may be needed to enable a reduction in the costs of the PFI's that the organisation has.
- Where there is an invest to save business case, provided that the savings are transferred into the Capital Programme until the initial capital investment has been repaid and the interest on any loans has been met.

3.12 The 'cash' available to repay these loans will come from the funds that will be set aside in each of the next 5 years for MRP and therefore repaying the loans will not be an issue for the PCC.

3.13 The challenge comes in having enough cash to support the current plans of the organisation otherwise new loans will need to be taken out which will mean that the reductions in interest payable will not be achievable.

3.14 In addition to the interest payments required on these loans the PCC must also set aside an annual revenue provision in respect of these debts and any other credit liabilities they have. Based on current plans this charge in 2014/15, know as MRP, it estimated to be £1.4m.

3.15 For each £1m of capital spend that is funded by borrowing, either using current cash balances or taking out loans, then the PCC will need to set aside further funds for MRP. The amount to be set aside depends on the asset life of the asset being funded, but the likelihood is that these assets will be IT related with a life of between 5 and 10 years. As such between £100k and £200k will need to be set aside, for the life of the asset, for MRP for each £1m over and above the Capital Grant that is spent.

3.16 It is therefore suggested that the PCC looks at alternative methods to fund Capital expenditure both for 2013-14 and into the future. It is suggested that the PCC establishes a Capital Programme Earmarked Reserve and:

- Contributes the final under spend on the PCC's budget and the over recovery of income in 2013-14 to a capital earmarked reserve. This is currently expected to total circa £585k.
- Contributes the £421k revenue under spend from the 2012/13 budget, that is currently within General Reserves, into this capital Reserve.
- Transfers the funding held within the Risk Earmarked Reserve of £1,126k into the Capital Programme Earmarked Reserve.

This reserve will then become a mechanism for funding the Capital Programme in 2013/14 instead of borrowing/loans.

3.17 If the PCC implements the above recommendations it will reduce the amount needed to be set aside for MRP by £200k per annum. It is recommended that this £200k per annum becomes a regular contribution to the capital programme or capital reserve.

3.18 It is also recommended that the PCC considers the use of any annual collection surplus on precept collection and any growth in the tax base in providing funds to the Capital Programme or reserve.

3.19 When modelling the LTFP there is no assumption built into the financial plans in relation to either a collection surplus or an increase in the tax base, it would therefore be possible to commit to putting some of these unbudgeted funds into the capital programme/reserve each year.

3.20 The average annual collection fund surplus, relating to policing, over the last 10 years, has been £210k. In 2013-14 the surplus is expected to be £559k and the PCC is asked to approve that £350k of this is used to fund the Capital programme/reserve.

3.21 2014-15 has seen a significant increase in the calculated number of Band D properties within Cleveland. It has increased by over 2,500 properties when the average over the last 7 years has been 700 properties.

3.22 It is therefore proposed that the financial benefit of around half of this increase, 1,236 Band D equivalent properties, is also added to the Capital reserve and this become a recurring contribution that will increase in line with increases in Precept. This proposal will provide a recurring £250k to the capital programme from 2014-15 onwards.

3.23 Future levels of collection surplus and increases in Band D properties can be reviewed on an annual basis in line with the needs of the overall budget.

3.24 The final recommendation in relation to future capital funding relates to the income received from the sale of capital assets. The current policy is that only sales that are in excess of £10k are treated as Capital Receipts and therefore form part of the funding available for capital expenditure. The income received from sales below £10k being available for the revenue budget. It is recommended that from 2014/15 this policy is changed and that all income received from Capital Assets, no matter how small, is accounted for as a Capital Receipt and therefore available to support the capital programme in the future. This should provide around £100k per annum into the Capital Programme.

3.25 Implementing all of the recommendations and suggestions in this report should provide sufficient financial resources within the Capital Programme to meet the known Capital needs of the Force, whilst also minimising the need for borrowing and therefore reducing the amount needed for both Interest Payable and MRP over the next 4 years.

## 4. Implications

4.1 Financial
The financial implications are contained within the report

4.2 Diversity and Equal Opportunities
There are no diversity and equal opportunities implications arising from this report.

4.3 Human Rights Act Implications
There are no human rights implications arising from this report.

4.4 Sustainability
The aim of the proposals set out within this report is to put the Capital programme on a sustainable funding position without the need to continually borrow to do so. This should enable savings to be made on both interest payable and MRP budgets which will in turn enable reducing resources to be focussed on service delivery.

4.5 Risk
With the reducing funding available as a whole to the PCC it is possible that the principles set out within this paper might not be affordable going forward. This will then result in increased borrowing to fund capital expenditure which in turn will increase interest payments and MRP budgets which will then increase the pressures on the revenue budget.

## 5. Conclusions

The paper sets out recommendations that if adopted with provide the funding to enable a capital programme to be maintained that will minimise the need for borrowing in the future whilst also delivering savings on both interest payable and MRP budgets that can then be spent on front line services.

Michael Porter
Chief Finance Officer and Deputy Chief Executive