

Capital Strategy 2025/26

Background and Introduction

This capital strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services. It also sets out 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 West Mercia 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.

Interest and inflation rates are currently high compared to the previous 20 years

The impact of inflation on West Mercia's revenue budget has been significant. The costs of providing policing services over the past 3 years has outstripped the additional resources provided from government funding settlements. The continued focus on police officer numbers has also meant West Mercia has limited flexibility on how these cost pressures are managed.

The high interest rates have made the cost of borrowing significantly higher. West Mercia were able to borrow £10m at a rate of 0.98% in December 2020, as opposed to the current rate of 5.0% in February 2025. The interest payments on this £10m have increased from £98,000 to £500,000. West Mercia currently have £80.23m of long-term debt, costing £3.78m a year to service.

The impact of higher costs comes at a time when West Mercia are continuing to invest heavily in our assets. The construction of Joint Police and Fire Station in Redditch has been completed during 2024/25 and the Digital Services Transformation programme is being finalised. There is still more that needs to be done, including requirements for an operational firearms range, modernisation of outdated buildings and investment in key police digital systems.

West Mercia has the combined issues of reliance on borrowing to fund previous capital programmes, at higher interest rates than previously incurred, and the potential of a large future capital programme. As a result there is an increasing amount of revenue that would be directed to servicing interest and debt payments. This has the potential to be financially unsustainable against the need to provide effective policing services.

In response to this the PCC has directed West Mercia to put a greater emphasis of funding of capital projects to come from the revenue budget in 2025/26 and beyond. Therefore, reducing the capital programme cost and subsequently the amount borrowed to fund the expenditure and associated interest costs. The aim is to ensure that those assets which typically have a shorter life and are based on a replacement cycle, such as laptops and mobile phones, are funded when purchased. An additional £2.8m of revenue has been applied in the 2025/26 budget to fund this. The PCC also made a commitment in the MTFS to increasing the revenue contribution to fund capital projects, increasing from the £1.5m in 2024/25 to £2.7m in 2025/26 with the expectation of reaching £7.9m by 2027/28.

The aims of this Capital Strategy are:

- To take a long term perspective on capital investment and to ensure this contributes to the achievement of the West Mercia Safer Communities Plan.
- To ensure investment is prudent, affordable, and sustainable over the medium term and adheres to the Prudential Code, Treasury Management Code and other regulatory conditions.
- To make the most effective and appropriate use of the funds available in long term planning and using the most optimal annual financing solutions.

The principles of capital investment

In March 2024 the PCC agreed a set of principles for how the capital programme is managed and how capital decisions are made to help ensure that it is financially sustainable over the short, medium and long-term. The aim is to ensure that when making capital investment decisions it includes an understanding of the wider long term financial impact. The principles are not definitive but should be reflected in all business cases and decision making.

Principle 1 - That short life assets are financed through revenue resources. Consideration of short life should be applied to assets with a life expectancy under 10 years.

Principle 2 – That request for funding for assets with a useful life of 10 – 15 years are clear on the return on investment (RoI), to offset the associated revenue costs of any borrowing, ensuring there is no overall increase in the revenue budget.

Principle 3 – For assets with a useful life of 10 – 15 years which do not have a clear RoI, then it should be funded from revenue resources. Where a project has a partial RoI identified, a mix of revenue and capital funding may be required. A clear business case should be made that sets out the appropriate financing for the project with clear assessment of life cycle costs.

Principle 4 – That capital receipts from the sale of buildings held by the PCC, will be used to fund future investment in buildings.

Principle 5 – That the revenue impact of the full capital programme over the medium term is capped at 4.5% of the Net Revenue Budget as an indicator of being financially sustainable.

Principle 6 – That the required level of revenue resources is reviewed as part of the Medium-Term Financial strategy, Business planning and the annual revenue budget to ensure that it remains at an appropriate level to be fund short life assets.

Governance for Capital investment decisions

A capital bidding process has been established since 2022/23 budget setting and is aligned to PCC and Force strategic objectives and built alongside the revenue budget setting process;

- Every department that would seek to incur capital expenditure in the following financial year must complete a capital bid document, setting out the reason for, benefits of, and costs of the capital project along with how the project meets PCC and Force strategic objectives and the cost profile over the life of the project.
- Business leads must consult with business partners in Change, Estates, Digital Services and Finance when preparing their capital bids to ensure the feasibility of the project and subsequent implications on other departments are fully considered.
- Force projects will be sent to Financial Accounting, who collate the capital bids being submitted by business leads and a review is done to ensure the reasonableness of the costs included. Financial Accounting also calculate the

financing costs of the project (which can be nil if the project is externally funded).

- Financial Accounting prepare a summary of the capital bids along with the total cost, including financing costs for review by the Chief Constable and management team. Which is then reviewed to ensure the bids meet the 'Plan on a Page' priorities, but also are within the financial constraints of West Mercia Police.
- The Chief Constable presents the force capital plan to the PCC for consideration.
- OPCC projects will be presented to the PCC by the Head of Estates in consultation with the Treasurer.
- The OPCC and Chief Constable capital programmes are brought together into a single programme for consideration alongside revenue proposals.

Inclusion of projects in the capital budget is to ensure sound financial management over the medium term. That all reasonably expected costs are identified and are affordable. To provide proper governance all projects included within the capital programme require a business case to be developed using the HM Treasury 5 case model principles. Each business case will;

- Identify the full life costings associated with the project and the benefits that will be delivered as a result of the investment.
- Require a risk assessment of the project and confirmation that risks are managed to an acceptable level as defined in the relevant risk management strategies.
- Identify the revenue impact of capital investment, over the life of the asset and the implications on the Medium-Term Financial Strategy. This covers the annual running and operating costs associated with the assets and any costs related to borrowing to fund the asset.
- The PCC will set out in the capital budget which schemes require formal approval of a business case by the PCC (in compliance with the arrangements set out in the corporate governance framework) before a project can be implemented and those which are delegated to other forums for decision making.

Details of the PCC's capital programme are included in the 2025/26 Revenue Budget and Medium Term Financial Plan. This is published on the West Mercia PCC's website.

Capital Expenditure

Capital expenditure is where the PCC spends money on assets, such as property or vehicles, which will be used for more than one year, and costs greater than £10,000.

In 2025/26, West Mercia Police are planning capital expenditure of £32.734m as summarised below;

Table 1: Prudential Indicator: Estimates of Capital Expenditure;

	2023/24 Actual	2024/25 Forecast	2025/26 budget	2026/27 budget	2026/27 budget
Digital Services Transformation*	£8,883,000	£8,020,000	£0	£0	£0
ICT & Change Programmes**	£3,781,000	£4,445,000	£10,989,000	£14,622,000	£6,563,000
Estates Strategy Programme**	£14,651,000	£7,146,000	£18,742,000	£26,556,000	£17,820,000
Vehicle Replacement Programme	£2,289,000	£5,988,000	£3,003,000	£3,125,000	£3,157,000
TOTAL	£29,604,000	£25,599,000	£32,734,000	£44,303,000	£27,540,000

* Digital Services Transformation will end 31/3/25

** ICT & Change programmes is large in 25/26 and 26/27 due to migration of SAAB to Greenfield and ESN rollout

Moving forwards in 2025/26 and 2026/27, large scale capital projects such as the construction of a new firearms range facility, modernisation of the northern and Hereford DHQ's and custody blocks mean our capital programme continues to be significant.

The main capital projects for 2025/26 include investment in;

- Construction of a firearms range
- Modernisation of Northern and Hereford DHQ's
- Construction of sexual abuse referral clinic (SARC) in the Telford area.
- Migration of SAAB and Telephony systems to Greenfield
- Fleet Replacement & Electrification

Capital Financing

All capital expenditure must be financed, either from

- external sources (government grants and other contributions),
- West Mercia Police's own resources (revenue contributions, reserves and capital receipts)
- Internal borrowing (use of cash resources available to fund the capital expenditure, which are then replenished over time through the MRP)
- financed from borrowing (debt to be repaid at a future date).

The current policy is that revenue contributions and any available capital resources, such as capital receipts are used to fund the proportionally high impact that short term assets have on the level of revenue contributions required in future years. This means that the longer life capital investments are financed from borrowing.

Table 2: Capital financing

	2023/24 Actual	2024/25 Forecast	2025/26 budget	2026/27 budget	2026/27 budget
External sources	£16,000	£0	£600,000	£0	£0
Capital receipts	£1,430,000	£0	£1,595,000	£1,567,000	£1,000,000
Revenue resources	£1,544,000	£1,500,000	£2,885,000	£4,800,000	£7,900,000
Use of Reserves	£242,000	£4,000	£34,000	£0	£0
Debt	£26,372,000	£24,095,000	£27,620,000	£37,936,000	£18,640,000
TOTAL	£29,604,000	£25,599,000	£32,734,000	£44,303,000	£27,540,000

Borrowing

Internal borrowing is an effective way of financing capital expenditure as it avoids having to pay interest associated with external borrowing. However, it is reliant on having a healthy and sustainable level of reserves. In the past 10 years revenue reserves have decreased as they have been allocated to fund specific activities. Since 2017/18, West Mercia have internally borrowed £34.8m to fund the capital programme. Over the same period, we have seen reserve balances reduce as they are utilised to fund certain projects. West Mercia therefore no longer has significant cash balances available to meet our revenue expenditure. Over the last 2 years there has

been a need to externalise some of this borrowing to replenish cash resources, which has further increased the pressure on revenue budgets.

At the end of the 2023/24 financial year there was a total external borrowing of £62.8m. In 2024/25 £17.5m has been borrowed, and a further £7.5m is expected to be required before the year end. There has been £7.1m of principle repayments on loans, bringing total expected external debt held to £80.7m.

The borrowing in year has been taken out as EIP Loans, and for period of between 9 and 10 years. The aim is to balance the whole of the borrowing portfolio to provide manage the risk of:-

- the likelihood of future changes in interest rates,
- cash flow implications of repayment dates of principal and
- the long-term profile of debt to ensure that it remains affordable.

Given the low levels of reserves and operating cash flow forecasts to support internal borrowing, it is likely that the 2025/26 capital programme will require a further £27m of borrowing during the year to ensure there is sufficient cash balances within West Mercia Police meaning that our external debt will go above £100m.

Debt is only a temporary source of finance, since loans must be repaid, and this is therefore replaced over time by other financing, usually from revenue through a minimum revenue provision (MRP). In addition to this, we must pay interest on the loans we hold each year. Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts to replace debt are as follows;

Table 3: Replacement of prior years' debt finance in £ millions

	2023/24 Actual	2024/25 Forecast	2025/26 budget	2026/27 budget	2027/28 budget
Minimum revenue provision	£5,431,000	£6,730,000	£8,870,000	£9,995,000	£11,608,000
Interest Payable	£1,574,000	£2,940,000	£3,780,000	£5,108,000	£5,670,000
Capital receipts	£1,430,000	£0	£1,595,000	£1,568,000	£1,000,000
TOTAL	£8,435,000	£9,670,000	£14,245,000	£16,671,000	£18,278,000

The PCCs full MRP statement is included within the Treasury Management & Investment Strategy and is available on the PCC's website.

The PCCs cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). The CFR increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to repay or replace debt. The CFR is expected to increase by £18.75m during 2025/26 (£27,620m borrowing indicated in table 2, less £8.87m MRP in table 3). Based on the above figures for expenditure and financing, West Mercia Police's estimated CFR is as follows:

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

	31.3.2024 actual	31.3.2025 forecast	31.3.2026 budget	31.3.2027 budget	31.3.2028 budget
TOTAL CFR	£90,554,000	£107,919,000	£126,669,000	£154,610,000	£161,642,000

Capital Receipts

Capital receipts are generated from the sale of existing capital assets. Proceeds from the sale of assets are either used to fund capital expenditure in the year of receipt or set aside in a Useable Capital Receipts Reserve to fund capital expenditure arising in future years.

Capital Receipts are not automatically written off in year to offset borrowing. As borrowing costs in the future could be higher the best strategy for the use of these receipts is considered on a case-by-case basis. This may include holding them to avoid future higher borrowing costs rather than reducing what are lower interest borrowing now.

West Mercia are currently conducting a comprehensive review into our existing property assets to identify how we use our assets and how to maximise the use of our estate, whilst minimising the cost. Whilst the review is at an early stage, it has identified options to rationalise the estate which could generate in the region of £4m in capital receipts over the next 3 years.

In 2024/25, capital receipts were used flexibly and offset the revenue costs of a management of change process as a result of work undertaken by Op Franklin. The impact of using capital receipts flexibly is that it increases West Mercia's Capital Financing Requirement and subsequently additional borrowing is required. Further

details on capital receipt flexibility and the implications can be found in the Treasury Management Strategy.

West Mercia will review whether to continue using capital receipt flexibility in 2025/26 recognising that it has a significant implication for the affordability of the capital programme. The assumption is that we will not be using capital receipts flexibility in future years.

Capital grant

Direct funding from government capital grants has in the past been the principal source of funding. However, for some years these have been reduced to funding only specific national projects, as the government has sought to provide greater flexibility through the provision of revenue grant. Where relevant and appropriate the PCC will aim to secure specific grant opportunities, either from central government or through collaboration with public sector or other partnership bodies.

Revenue & Reserves

Reserves - Income surpluses that has been set aside from previous years and transferred to reserves can be used to fund capital expenditure. As reserves have been consumed in recent years to cover revenue budget deficits, the level of reserves now available to fund future capital expenditure has reduced, and other sources of funding are required going forward to sustain the short-life capital programme.

Revenue – The PCC has been increasing the allocation of funding direct from revenue for capital projects. The principal of using revenue is to fund short life assets directly when purchased, avoiding the need to borrow and therefore pay interest. With limited sources of other funding, West Mercia must ensure that it is financial sustainable in being able to invest in capital assets with a short life span. As part of 2025/26 budget, over £2m was allocated in the revenue budget to pay for short life assets (laptops and mobile phones) along with £2.7m being ring-fenced as a revenue contribution to fund other capital spend.

Treasury Management

As highlighted in the financing section above the principal source of funding for capital projects is from borrowing. Therefore, treasury management is an important aspect in ensuring the ongoing affordability of the capital programme.

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the West Mercia Police's spending requirements, while managing

the risks involved. Surplus cash is invested until required, generating interest income while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank account. West Mercia Police 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.

West Mercia Police currently has £80.23m of long-term borrowing at an average interest rate of 3.74%.

Borrowing strategy

The PCCs main objective when borrowing is 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 cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher.

West Mercia Police does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board (PWLB). We also complete a PWLB certainty return each year to receive a discounted interest rate on PWLB loans.

External borrowing currently accounts for 69.9% of the unfunded capital programme at present as some capital expenditure has been internally financed from internal balances available in the Police Fund (reserves/working capital). The use of reserves to fund revenue expenditure during previous years has reduced the capacity for internal borrowing. The gap between the debt and capital financing requirement figures below is effectively the amount of internal borrowing West Mercia has.

Projected levels of the PCC's total outstanding debt are shown below, compared with the capital financing requirement (see above).

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

	31.3.2024 actual	31.3.2025 forecast	31.3.2026 budget	31.3.2027 budget	31.3.2028 budget
Debt (incl. PFI & leases)	£63,260,000	£80,300,000	£98,400,000	£127,058,000	£132,024,000
Capital Financing Requirement	£90,554,000	£107,919,000	£126,669,000	£154,610,000	£161,642,000

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, West Mercia Police expects to comply with this in the medium term. Table 6 assumes that capital spend set out in Table 1 occurs in the year that it is forecast. In practice, there is likely to be capital slippage and additional capital projects approved.

It also assumes that the requirement for new borrowing set out in table 2 is met by external borrowing rather than being financed from surplus cash (internal borrowing). Due to the low level of cash held by the PCC, it is likely that any external borrowing will be from PWLB.

In both the Capital Strategy and the Treasury Management Strategy, the PCC is assuming that the cash and investment balances will be kept as low as possible. The PCC will consider alternative strategies during the course of the financial year.

The focus of the current capital strategy to ensure short life assets are funded via revenue will further increase the gap between CFR and Debt ensuring we are comfortably within the statutory guidance

Affordable borrowing limit: West Mercia Police are 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

	2024/25 limit	2025/26 limit	2026/27 limit	2027/28 limit
Authorised limit – borrowing	120.0	130.0	165.0	175.0
Authorised limit – PFI and leases	0.0	0.0	0.0	0.0
Authorised limit – total external debt	120.0	130.0	165.0	175.0
Operational boundary – borrowing	110.0	120.0	155.0	165.0
Operational boundary – PFI and leases	0.0	0.0	0.0	0.0
Operational boundary – total external debt	110.0	120.0	155.0	165.0

Further details on borrowing are in appendix A of the treasury management strategy.

Revenue Budget Implications

Interest payable on debt and MRP are charged to revenue annually to provide the resources to repay the external borrowing required to fund the capital programme and reduce the CFR. 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 general government grants.

Table 10: Prudential Indicator: Proportion of financing costs to net revenue stream

	2023/24 actual	2024/25 forecast	2025/26 budget	2026/27 budget	2027/28 budget
Financing costs (£m)	£7.005m	£8.932m	£12.065m	£14.568m	£16.743m
Proportion of net revenue stream	2.57%	3.14%	3.99%	4.76%	5.39%

Sustainability & affordability

Due to the 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 50 years into the future. The capital strategy sets out the ambition of West Mercia to rebalance the funding of capital to ensure that it is affordable and sustainable over the long term. Significant steps have been made in 2025/26 to ensure short life assets are funded at time of purchase, however there are the historic issues of reliance on external and internal borrowing which is impacting on the current projection of the percentage of revenue funding capital. The full capital programme projection suggests that the principle that the cost of borrowing as a percentage of revenue will be above 4.5% in the short term. The medium to longer term is that this percentage should start to fall again below the 4.5% and so on that basis as we transition to a more sustainable capital financing model then it is accepted that the principle can be breached, but that it will be closely monitored.

The Treasurer is satisfied that the proposed capital programme is prudent, affordable and sustainable. In coming to this conclusion, the Treasurer has taken into account:-

- the historically and comparatively low levels of investment and borrowing,
- the need for replacement and refurbishment given the age and condition of the estates and ICT infrastructure,

- the planned programme for the disposal of assets (generating capital receipts) and the opportunities the programme presents to secure better value for money.
- that all capital projects will be subject to detailed options appraisals and business cases before final approval is given by the PCC.

The PCC has recognised the impact that the capital programme is having on the revenue budget. Whilst the revenue impact of financing costs are expected to peak in 2027/28 and then reduce, the PCC is clear that further capital projects are affordable. To ensure that future capital schemes are affordable business cases will have additional focus on demonstrating an economic return for West Mercia.

Leasing and Collaboration Activities

The PCC does not have a statutory general power of competence and so cannot hold interests in commercial property purely or mainly for financial gain. The Policing Protocol enables the PCC to work with partners and other policing bodies to improve the efficiency and effectiveness of policing. Part of this consideration is utilising the available estate held by the PCC to share or lease. The PCC has several such agreements to with other public sector bodies, The Evesham Community Contact Centre (ECC), which was valued at £261,906 as at 31st March 2024 was one such asset, which was leased to another public sector body but which was vacated at the end of 2021/22 and now remains vacant. The decision of the PCC is that given the age and condition of the asset that it is now surplus and can be sold to realise the value inherent in this property.

Risk management: Under the Policing Protocol power to improve the efficiency and effectiveness of policing, the PCC accepts a risk of being unable to identify an occupant for the property and therefore lose out on rental income as currently being experienced at the ECC and a reduction in the capital value of the property. These risks are managed by the Head of Estate Services across all leased assets and recommendations made to the PCC as to the future use and ownership.

Governance: Decisions on leasing assets are made by the PCC.

Other Liabilities

In addition to debt of £80.2m detailed above, the PCC is committed to making future payments to cover its pension fund deficits. The deficit on the funded Local

Government Pension Scheme (for police staff) was valued at Nil in 2023/24 (£1.2m deficit at 31/3/2023) and the deficit on the unfunded Police Pension scheme (for police officers) was £2,006.1m (£1,982.8m in 2023/2024).

Governance: Decisions on incurring new discretionary liabilities are made by the PCC in consultation with the Chief Constable, Chief Executive, Treasurer and Director of Commercial Services. The risk of liabilities crystallising and requiring payment is monitored by Force Finance and reported to the Chief Constable and PCC in the monthly Money Matters budget report.

Knowledge and Skills

The PCC employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Treasurer is a qualified accountant and the Head of Estates has gained an MBA, IRPM2 Qualification and is a Prince II project manager and a member of the institute of workplace facility management.

Where the PCC's 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 has access to knowledge and skills commensurate with its risk appetite.