South Somerset District Council

2021/22 Capital Monitoring Report Period Ending 31st October 2021

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Purpose of the Report

1. To inform Members of the forecast capital spend for the year 2021/22 and how this is to be funded along with an explanation of the key differences from the original capital budget agreed by Council in February 2021.

2. To seek approval from Council for Revised Capital Estimates for 2021/22 along with revised capital funding plans including the approval to use Council earmarked reserves to fund expenditure in this financial year.

3. To seek approval from Council to cease all investment purely for yield capital expenditure from December 2021 onwards.

Forward Plan

4. This report appeared on the District Executive Forward Plan with an anticipated Committee date of November 2021.

Public Interest

5. Capital expenditure is expenditure on assets such as land, property, ICT equipment, and the refurbishment of existing assets that will prolong the useful life of the asset (such as replacing a roof). Lending to third parties is also capital expenditure in the majority of cases. This report sets out details of the expenditure estimated to be incurred by SSDC in 2021/22, how this is to be financed, and compares the expenditure to the approved capital budget, both for individual projects and for the overall programme.

6. SSDC has a large and ambitious multi million pound capital programme that is planned to deliver many of the Council's key strategic priorities as set out in the Corporate Plan. The size and funding of capital expenditure has a direct impact on the Council's revenue budget when capital expenditure is funded by borrowing as the financing costs of the borrowing are a cost to the revenue budget.

Recommendations

7. That the District Executive recommends to Council to approve: -

a) Revised Capital Estimates for the financial year 2021/22 of £41.703m (as described in paragraphs 13 to 18 and as shown in detail in Appendix A).

b) The removal of the schemes listed in Table Two from the capital programme.

c) The removal of the unspent Commercial Investment budget from the capital programme (of £8.643m) and the cessation of investment purely for yield capital expenditure from December 2021 (as described in paragraphs 32 to 41).

d) Approval to increase the capital programme by £482k to fund capital works on the Council's Commercial Property Portfolio as described in paragraph 16.

e) Revised capital funding plans as described in paragraphs 24 to 30 including the approval to use £20.2m of corporate Council earmarked reserves to fund expenditure in this financial year as follows:
   i. The allocation of £2m of the Useable Capital Receipts earmarked reserve to the Octagon Theatre Project to fund estimated expenditure for this and next financial year.
   ii. The use of the remaining amount currently in the Useable Capital Receipts earmarked reserve, of £16m, to fund the revised 2021/22 capital programme.
   iii. The use of the Capital Fund earmarked reserve of £1.167m to fund the revised 2021/22 capital programme.
   iv. The use of the Commercial Investment Risk Reserve of £482k to fund capital works required on the Council's commercial property portfolio in 2021/22.
   v. The use of the Cremator Replacement Capital Reserve of £549k to part fund the Yeovil Crematorium Project in 2021/22.

Background

8. Full Council approves the capital budget in February each year. Council has also agreed a reserve programme comprising of projects that have been agreed in principal. Monitoring of the agreed programme is delegated to District Executive and is undertaken on a quarterly basis (although a Quarter One position was not produced in 2021/22 due to a temporary lack of capacity in the Finance Team earlier this year). District Executive also agrees each quarter whether the capital budget is amended, within the overall programme approved by council, to reflect any known changes to the project or its funding or whether reserve projects can be added to the capital budget.

9. The Chief Finance Officer along with Senior Leadership Team (SLT) colleagues have undertaken an enhanced review of the 2021/22 capital programme, i.e. a more in-depth review than is normally the case for the quarterly budget monitoring process. SLT has reviewed the programme in terms of priority of the expenditure, when the expenditure is likely to take place, and the officer capacity to deliver the projects. SLT recommends that some of the current projects within the programme

should be removed – the proposed schemes and their budgets are shown in Table Two. A further iteration of this review process will be undertaken with outcomes reported in the Capital Budget Report going to District Executive and Council in February 2022.

10. It is proposed to change the previous methodology of agreeing reserved schemes “in principle”. Given that that Local Government Reorganisation will mean a new unitary authority will be in existence in April 2023 it is important for SSDC to now fully agree and “fix” its capital programme for this and the next financial year. The reserved schemes shown in the February 2021 Capital Budget Report have therefore either been incorporated into the Revised Estimate proposals for 2021/22 shown in this report, or have been deferred to 2022/23. The latter will be reviewed by SLT and the relevant Portfolio Holders and may seek Council approval to be included in the 2022/23 programme in February 2022.

11. Members are also reminded that in September 2021 they approved the recommendation of the Chief Finance Officer to show the total gross expenditure budget for the Regeneration Projects rather than the net position (i.e net after other, largely external, funding sources had been applied); up to this report the net budget only had been included in the capital expenditure budget. This change, along with that proposed in paragraph 10 above, should aid in enhancing the understanding and improving the transparency of SSDC’s capital programme.

Overall Forecast Capital Position for Q2 2021/22

12. Total spending is forecast to be **£41.703m**; this is £14.493m (53%) more than the original **£27.210m** of planned expenditure agreed by Council in February 2021. A report giving the detailed 2021/22 forecasts by scheme/project is attached at Appendix A. A summary of the budget movements producing the overall net increase is shown in Table One below.

13. It is recommended that the forecast outturn position is approved by Council as the Revised Estimates for 2021/22.

Table One: Movements from the 2021/22 Original to the Revised Capital Estimates

	£ 000
2021/22 Original Capital Budget (approved by Council February 2021)	**27,210**
Over/(Under) spend	300
Slippage from 2020/21 into this financial year	2920
Re-profiling - expenditure forecast to slip into future years	(10,273)
Re-profiling - expenditure brought forward from future years	2,430
Moving Commercial Investment budget from “reserved” programme	18,625
Recommended removals from the capital programme	(1,552)
New capital expenditure approved by Council since February 2021	2,043
Proposed 2021/22 Revised Estimates	**41,703**

N.B: bracketed figures are decreases from the original budget

14. The net increase is partly “cosmetic”, in terms of the impact this has on the funding of the budget, as some of this is a result of moving planned expenditure from the “reserved” commercial investment budget into the capital programme. Other movements from the February 2021 agreed capital programme are due to changes in the profiling of already approved capital expenditure: either bringing forwards expenditure from future years to this year and/or slipping the expenditure into future years.

15. Council has however approved increases in the capital programme since the programme was approved in February 2021.These were for leisure works capital which incorporated the prior Goldenstones and Wincanton schemes and required an increase of £2.46m to the existing budget to bring the total to £3.495m. The Octagon Theatre redevelopment was approved in March 2021 at a total budget of £23.01m (with expenditure primarily occurring in future years).

16. The revised estimates contain the additional capital budget (£600k) seeking Member approval as set out in the confidential part of this agenda. In addition new budgets are requested totalling £482k to undertake capital works on our existing commercial properties at Sherwood Road (Bromsgrove), Alchemy (Welwyn Garden City), Trafalgar House (Taunton), King William House (Bristol,) and Lyndon Place (Birmingham). Details of the works are given in Appendix A. Approval is sought from Council to use the Commercial Investments Risk Reserve to fund this expenditure.

17. As described in paragraph 9 above, recommendations are being made in this report to remove specific projects and their budgets form the capital programme – more detail is shown in Table Two below and in Appendix A. Senior Leadership Team advises that these are either unlikely to complete, due to a lack of officer capacity, or are not now a priority due to Local Government Reorganisation.

Table Two: Recommended removals from the Capital Programme

Scheme	***Original Budget £000***	***Balance Removed £000***
Installation of PV Panels on J O'Donnell Pavilion	30	30
Battery Storage or LED Bulbs at Yeovil Rec	10	10
Yeovil Innovation Centre - 1st Floor Fit-Out	0	21
New Car Parks	200	197
Car Park Improvement Works	310	306
Enhancement to SSDC Buildings	171	141
Brympton Way Building Improvement Works	84	2
Capital Works to Council Portfolio	132	132
Petters Way Refurbishment	0	26
Contingency for Plant Failure	174	174
Careline Product Development	20	20
Empty Property Grants	0	61
Gypsy & Traveller Acquisition Fund	133	133

Affordable Housing – Mortgage Rescue Contingency	277	277
Transformation	22	22
TOTAL	**1,563**	**1,552**

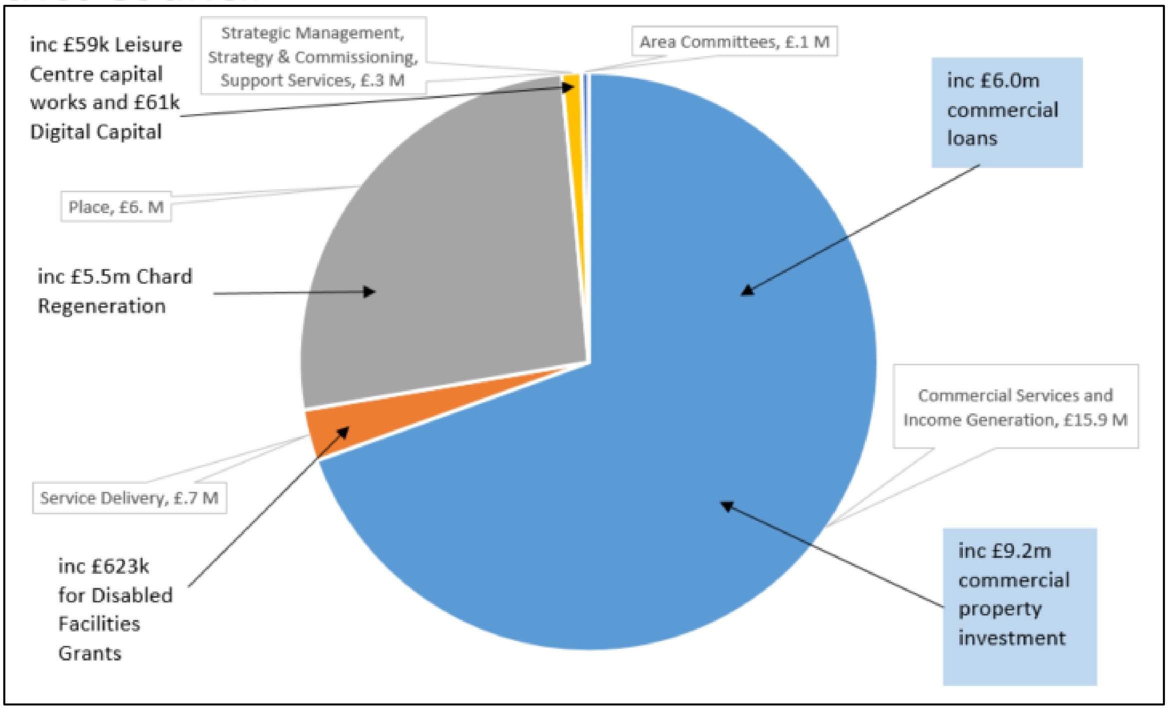
18. Members should note that two schemes within the capital programme will need to come back to Council in February 2022, with Business Cases, to seek approval for an increase in their capital budgets should Members wish to complete the schemes to deliver the scope and outcomes originally intended. These schemes are the Decarbonisation Programme for Council Buildings and the Yeovil Crematorium Project. The former may include the first two schemes shown in Table Two above.

Outcomes delivered through capital spent to-date

19. Spend to-date on the capital programme is £22.837m which is 55% of the revised programme. The spend-to-date figures are illustrated in Pie Chart One below. Key areas of capital expenditure spent to-date are briefly described below:

- £6.013m Commercial Loans to SSDC Opium Power for the Battery Storage Scheme at Fareham – to be repaid in line with loan agreements.
- £9.203m in commercial Investment Properties (Lyndon House, Birmingham; St John's Retail Park, Taunton) – generating new income to fund services to our communities.
- £5.948m on Town Centre Regeneration – the majority of this expenditure was for the Chard Regeneration Project - improving the town centre to stimulate economic growth.
- £623k Disabled Facilities Grants – enabling aids and adapting private properties to support living at home.
- £223k John O'Donnell Pavilion – upgrading and improving to provide better leisure and recreation services.

Pie chart one: capital expenditure by service Directorate



Capital Spending Pattern

20. The graph and Table Three below show the actual spend compared to the original and revised budgets for the last 5 years. The current year shows Q2 actual spend against the full year spend forecast.

Graph One: SSDC Capital expenditure against budgets for the last five years

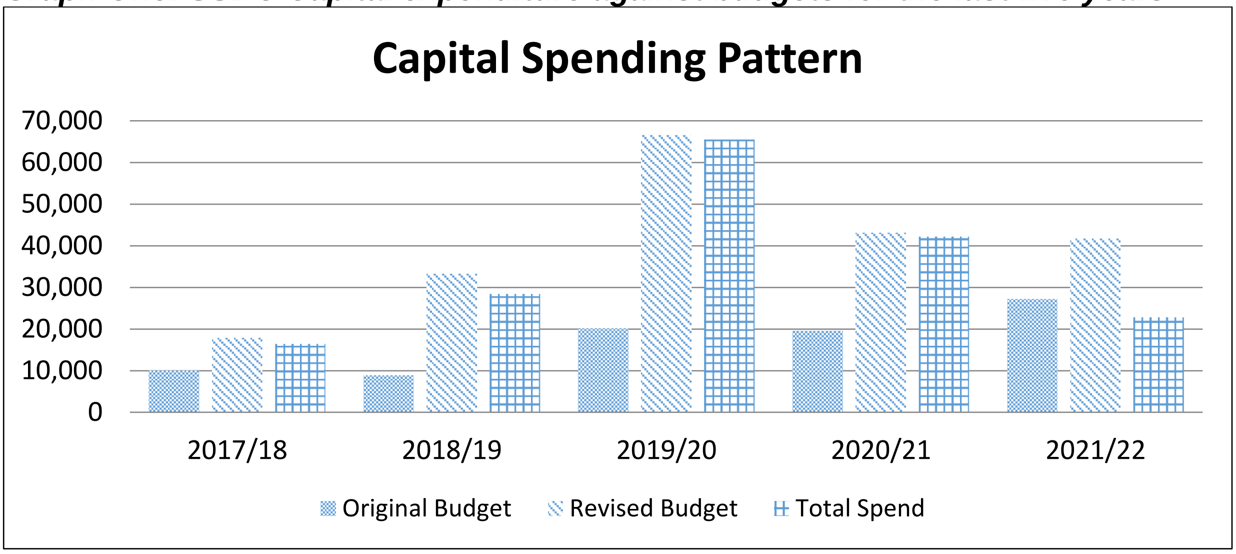


Table Three: SSDC Capital expenditure against budgets for the last five years

Year	Original Budget	Revised Budget	Total Spend	% of Budget Spent
	£'000	£'000	£'000	%
2017/18	10,064	17,863	16,424	92
2018/19	8.908	33,251	28,414	85
2019/20	20,130	66,547	65,482	98
2020/21	19,549	43,109	42,177	98
2021/22	27,210	41,703	22,837	55

Completed schemes (including feasibility)

21. Table Four below shows the projects/schemes completed this year to-date with a value over £25k.

Table Four: Projects over £25k completed to-date

Scheme	Revised Budget £'000	Actual Spend £'000	Within acceptable limits?	Responsible Officer
Firewalls & Security (Civica Upgrade)	41	45	Y	T Beattie

22. In order for an over/under spend to be within acceptable limits, the variation should be within £10,000 or 5% (whichever is greater) of the revised budget. On this basis, the completed schemes (including those below £25k) are within an acceptable margin of the overall budget.

Area Committee unallocated capital balances

23. Each Area Committee was allocated an additional £25,000 in February 2021 for schemes in 2021/22. The table below shows that following scheme approvals in 2021/22, unallocated capital balances have decreased by £285,000 from the position at the start of the year.

Table Five: Unallocated capital balances for each Area Committee

	Area East £'000	Area North £'000	Area South £'000	Area West £'000	Totals £'000
Position at start of financial year	55	120	123	69	367
Additional resources approved by District Executive	25	25	25	25	100
Transfers to/(from) reserve during year	-9	-94	-112	-70	-285
Position at Quarter Two	**71**	**51**	**36**	**24**	**182**

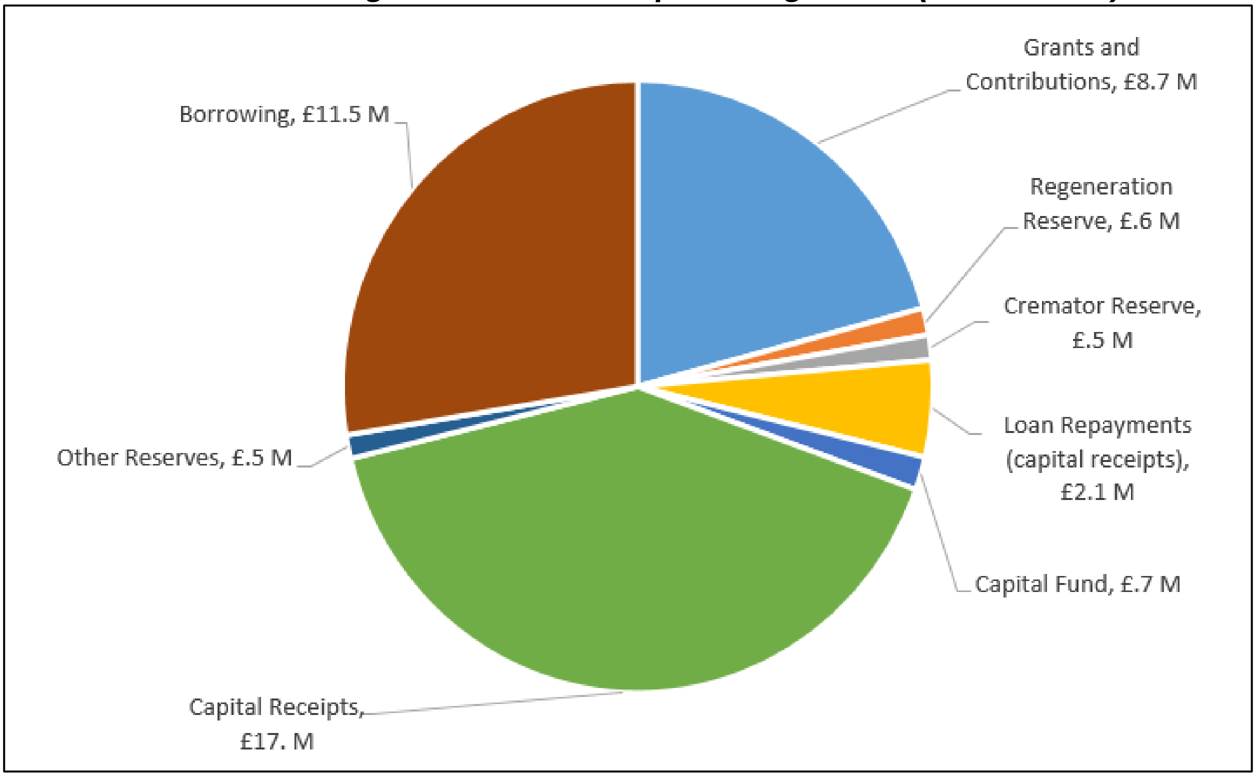
Funding of the Capital Programme

24. The proposed funding of the revised 2021/22 capital programme is shown in Table Six and illustrated in pie chart two. Prudential borrowing is funding 41% of the expenditure incurred.

Table Six: Financing of the 2021/22 Capital Programme

Financing Source	£'000
Specific Funding:	
Grants and Contributions	8,705
Regeneration Fund (earmarked reserve)	594
Proposed use of Cremator Replacement earmarked reserve	549
Other Reserves (primarily Commercial Investment Risk Reserve)	521
Loan Repayments (capital receipts) from SSDC Opium Ltd and Somerset Waste Partnership	2,126
Subtotal	12,495
SSDC Funding:	
Proposed use of Capital Fund (earmarked reserve)	730
Proposed use of Useable Capital Receipts earmarked reserve	16,994
Borrowing	11,484
Subtotal	29,208
Total Financing Required	**41,703**

Pie Chart Two: Financing of the 2021/22 Capital Programme (of £41.703m)



25. The borrowing amount of £11.5m is a combination of internal and external borrowing, with the forecast split being £7.9m internal and £3.6m external. Internal borrowing is when the Council uses its cash balances to temporarily fund its need to borrow. The use of these cash balances is only temporary. Continual monitoring of the Council's cash position is undertaken to ensure a working capital cash balance is maintained and if this is estimated to be at risk a switch is made from internal to external borrowing.

26. External borrowing is the action of obtaining loan finance from a third party. As described in the MTFP Refresh report presented to District Executive at its meeting in October 2021, SSDC currently meets its external borrowing needs though short-term loans on a rolling basis with other local authorities. It is proposed to continue this strategy given that such borrowing is currently cheap and also gives flexibility to the new successor council.

27. Borrowing (both internal and external) comes at a cost to the council's revenue budget through external interest charges, interest income foregone from holding cash (although this is minimal given current low interest rates), and through the requirement to fund future loan repayments by charging MRP (Minimum Revenue Provision) costs to the revenue budget. The latter is a charge to the revenue budget both for internal and external borrowing.

28. The funding strategy shown in Table Six above requires Council approval to use corporate Council reserves, as follows:

- The allocation of £2m of the Useable Capital Receipts earmarked reserve to the Octagon Theatre Project to fund forecast expenditure during this and next financial year. This funding will help improve the financial viability of the overall proposal which is currently at risk because of the high inflationary cost pressures currently being experienced in the construction industry.

- The use of the remaining amount currently in the Useable Capital Receipts earmarked reserve, of £16m, to fund the revised 2021/22 capital programme. This earmarked reserve has been built up over the years from the sale proceeds of land and property previously owned by SSDC. It seem appropriate therefore that this reserve is used to fund existing SSDC capital expenditure. The recommendation, if agreed by Council, would also result in lowering the borrowing needs of this Council by £16m which benefits SSDC's revenue budget and, moving forwards, that of the new successor unitary Council. The use of the reserve will however mean that SSDC has less cash balances with the result that more external rather than internal borrowing will need to be undertaken.

- The use of the Capital Fund earmarked reserve of £1.164m to fund the revised 2021/22 capital programme. This earmarked reserve is historic and has been built up from charges made to the revenue budget intended, but never used, to fund capital expenditure. The use of this reserve will have the merit of reducing SSDC's borrowing needs as explained in the paragraph above.

29. Officers are currently reviewing the possible use of the remaining forecast balance in the Regeneration Fund earmarked reserve to fund the Regeneration Programme in order to further reduce borrowing needs. Firm recommendations on this are not being proposed here because some of the estimated balance contains assumptions on the amount of Business Rates Pool Gain SDC will receive and officers are awaiting updated estimates on this amount.

30. Approval will also be sought from the Strategic Development Board at its meeting scheduled on the 7th December 2021 to use existing CIL (Community Infrastructure Levy) funds to fund Regeneration Projects that meet the agreed criteria.

Outstanding Loans to Third Parties

31. As part of the agreed loans policy the amount of any outstanding loans lent to third parties at the end of each financial year must be reported to this committee. As at 30th September 2021 the following loans were outstanding:

Table Seven: Outstanding loans lent to Third Parties as at 30th September 2021

Third Party	Original Sum Lent £	Fixed Interest Rate	Outstanding at 30/09/21 £	Period of Loan	Final Repayment Date
Hinton St George Shop	190,000	2.76%	136,033	19 years	November 2034
Somerset Waste Partnership (1)	1,567,216	2.22%	453,853	7 years	August 2023
Somerset Waste Partnership (2)	4,150,062	3.19%	3,543,807	10 years	October 2029
OPIUM Taunton	14,508,705	Various	12,680,005	7.5 years	July 2026
OPIUM Fareham 1	18,690,559	Various	18,690,559	25 years	March 2047
Elleston	132,000	5.00%	47,000	7 years	2026/27
Total Outstanding			**36,026,231**		

Investment purely for yield

32. On 26th November 2020 HM Treasury introduced changes to PWLB (Public Works Loans Board) lending terms which effectively mean that any new "investment purely for yield" commercial activity after that date cannot be financed using PWLB borrowing – the source most used by councils to obtain loan finance. The restriction also applies to other capital expenditure (for example regeneration and leisure projects), if the council has "investment purely for yield" activity in its capital programme in that financial year.

33. In order to now get a PWLB loan:

- Councils must submit a high-level description of their capital spending and financing plans for the following 3 years.
- The S151 Officer must certify that the borrowing is not to be used to fund investment assets with the primary objective of generating yield.

34. HM Treasury has defined "*investment primarily for yield*" as an investment that has one or more of the following characteristics:
    - Buying land or existing buildings to let out at market rate.
    - Buying land or buildings that were previously operating on a commercial basis which is then continued by the Council without any additional investment or modification.
    - Buying land or buildings other than housing that generate income and are intended to be held indefinitely.

35. PWLB will continue to support the following categories of spending as long as there is no "investment purely for yield" activity planned in the budget: service spending, housing, economic regeneration, preventative action, treasury management (e.g. refinancing of existing debt). Recent clarifications from HM Treasury have led to the understanding that debt existing before the 26th November 2020 arising from "investment purely for yield" can be refinanced using PWLB loan finance.

36. CIPFA (Chartered Institute of Public Finance and Accountancy) has recently consulted on proposed changes to the Prudential and Treasury Management Codes and revised codes are due to be published on 21st December 2021. English and Welsh local authorities are required by regulation to "*have regard to*" the Prudential and Treasury Management Codes when carrying out their duties under Part 1 of the Local Government Act 2003. Councils can choose not to implement the Codes but must state why they are not doing so.

37. The changes aim to define more clearly, with examples, on what borrowing activities, commercial activity, and investments are permitted by local authorities and will prohibit borrowing "to invest primarily for financial return'. There will also be the requirement to report on a new indicator termed the "liability benchmark". CIPFA wishes, by making its definitions less flexible in interpretation, to stave off intervention by central government and the possible return of a capital controls system where government determines the amount of capital individual councils can spend.

38. The Prudential Code amendments propose that authorities should consider selling commercial investments to repay debt or reduce new borrowing requirements rather than take on new borrowing. The Local Government Association has asked CIPFA to clarify this further before the Revised Code is published later in the month.

39. CIPFA has announced a "soft launch" for the revised Code, and asks that councils try to implement some of the requirements if they can for 2022/23 with full implementation in 2023/24.This does not apply to the "core principles" including

that of not borrowing ‘to invest primarily for financial return’ which should be applied immediately.

40. It is therefore recommended to Council that SSDC now ceases its capital investment for yield expenditure as this does not comply with the requirements of the revised Prudential Code. It is our understanding that the revised code does allow capital works to modify or enhance already owned commercial property to be undertaken: specific advice on this issue is being sought from our external Treasury Management advisers Arlingclose as we are proposing such capital works in the revised capital estimates shown in Appendix A.

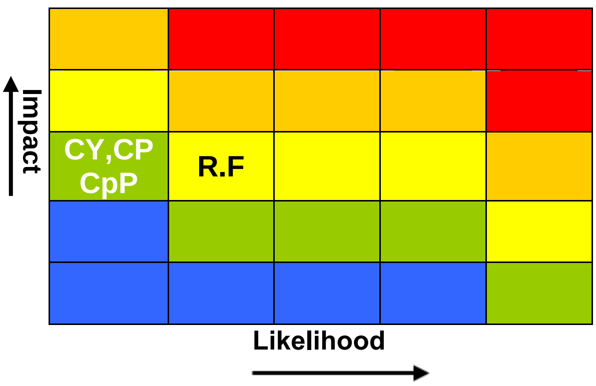
41. The financial impacts of the recommendation are (a) £8.643m (6%) of the £150m commercial investment budget will be unspent and will be removed from the capital programme and (b) the net impact on the revenue budget after accounting for financing charges arising from borrowing, will be an opportunity cost of not receiving new additional income in the region of £216k to £259k per annum (reflecting the current net yield on investment arising from acquiring commercial property of 2.5% to 3%).

Financial Implications

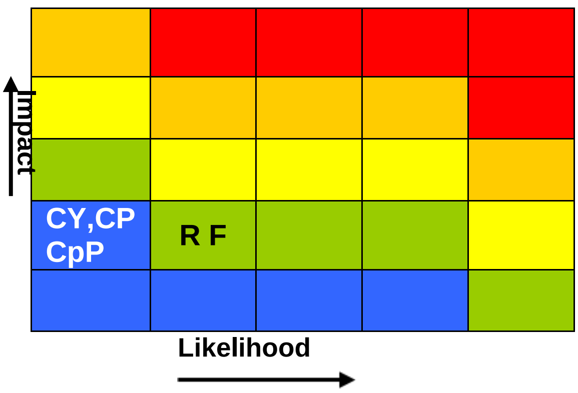
42. These are contained in the body of the report.

Risk Matrix

Risk Profile before officer recommendations



Risk Profile after officer recommendations



Key

Categories	**Colours** (for further detail please refer to Risk management strategy)
R - Reputation	High impact and high probability
CpP - Corporate Plan Priorities	Major impact and major probability
CP - Community Priorities	Moderate impact and moderate probability
CY - Capacity	Minor impact and minor probability
F - Financial	Insignificant impact and insignificant probability

South Somerset District Council

Council Plan Implications

43. The budget is closely linked to the Council Plan, and maintaining financial resilience and effective resource planning is important to enable the Council to continue to fund its priorities for the local community.

Carbon Emissions and Climate Change Implications

44. There are no implications currently in approving this report.

Equality and Diversity Implications

45. When the budget was set any growth or savings made included an assessment of the impact on equalities as part of that exercise.

Privacy Impact Assessment

46. There is no personal information included in this report.

Background Papers

Budget Setting reports to Full Council in February 2021
MTFP Refresh Report to District