APPENDIX ONE

2022/23 BUDGET REPORT

South Somerset
District Council

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SECTION ONE: OVERVIEW, KEY PROPOSALS, & DELIVERY OF CORPORATE PLAN ANNUAL ACTIONS

Overview

1. **Introduction**: This report set outs proposals for South Somerset District Council's (SSDC) revenue and capital budgets for 2022/23 along with how these budgets are proposed to be funded. The 2022/23 budget will be the last budget of SSDC prior to the creation of the new Somerset Council from 1st April 2023: it does not therefore include a Medium Term Financial Plan nor a Capital Strategy.

2. The overall financial environment for all local authorities over the last few years has been very challenging through increased demand for services, the impacts of reduced grant funding from central government, and, more recently, the impact of the Covid-19 pandemic. Nationally, a number of councils have been under extreme financial stress resulting in the issuing of Section 114 notices, applying for capitalisation directives (the use of capital resources to fund revenue expenditure), or entering into discussions with the Department for Levelling up, Housing & Communities (DLUHC).

3. South Somerset District Council is not in the latter position. It has over the years purposefully and prudently built-up its reserve balances: for example, by transferring the New Homes Bonus grant and the gains from being part of the Somerset Business Rates Pool into reserves. It has invested in commercial property and subsidiary companies which have brought in new additional income to help finance the services it provides to residents. This Budget Report gives details of this income (in Section Three) along with the Reserves Position (in Section Five).

4. **2022/23 Revenue Budget:** SSDC is therefore able to set a balanced revenue budget position for 2022/23 as it is legally required to do so. Despite the significant increases to the revenue and capital budgets proposed in this report, a balanced budget is achievable because earmarked reserves will fund some of the increase in expenditure, the reforms to the local government funding regime have been delayed by central government for a further year and this benefits SSDC, and because a zero-based budget review has resulted in adjustments being made to historical estimates that have a net beneficial financial impact. However it is important to note that this beneficial position is for one year only and that a significant budget gap (of £4.535m) is forecast for 2023/24.

5. **Local Government Reorganisation (LGR)**: In July 2021, the Secretary of State made a decision to replace the existing local government structure in Somerset with a single unitary council. This means that the current structure of county plus four district councils will be replaced with a single Somerset Council from 1st April 2023.

6. The proposed budget for 2022/23 recognises that LGR will require significant resources to ensure services remain stable with minimal disruption as well as additional capacity to fund the implementation costs associated with this major reorganisation programme. In addition, in some service areas such as Development Management, extra capacity is being requested in this budget to improve current service levels prior to the new unitary council coming into being.

7. **2023/24 revenue estimates**: The report sets out an indicative position for the 2023/24 revenue budget (the first year of Somerset Council) based on a continuation of the services and delivery methods SSDC currently provides along with estimates of the potential impact of the local government funding reforms, anticipated to be introduced in that financial year. These estimates must be treated with caution particularly as there is a lack of current information on the reforms and it is difficult therefore to forecast their impact with any degree of accuracy. That said, it is widely anticipated that the reforms will redirect resources to help fund pressures in adult and children's services.

8. These 2023/24 estimates will be superseded and reviewed as part of the preparation needed to set Somerset Council's 2023/24 budget. A separate exercise will shortly be undertaken, once each council has set its 2022/23 budget in February 2022, to bring together the five councils estimates into one Somerset Medium Term Financial Plan.

9. **Capital Programme**: SSDC's capital budget proposals for its last year of existence reflect key priorities in the proposed Corporate Annual Action Plan. A number of new capital schemes and growth to existing capital budgets are proposed either in this Budget Report or in separate reports on this District Executive's agenda. Section Four of the Budget Report sets out the overall capital programme expenditure and funding proposals.

10. **Treasury Management Strategy**: The size and funding of the capital programme has an impact on the Council's cash flow position and the amount of money it needs to borrow. These issues are considered in the Treasury Management Strategy found in Section Seven of the report. Members should note that the amount of indebtedness, or borrowing needs, (as measured by the Capital Financing Requirement) has increased substantially in the last few years and will rise further if the capital budget proposals are agreed by Council.

11. **Chief Finance Officer's Statement**: The Chief Finance (S151) Officer's statutory statement, found in Section Six, sets out her advice on the robustness of the budget estimates, the adequacy of reserves, and the potential risks associated with these budget proposals. The Chief Finance Officer is able to offer good but not total assurance on the robustness of the estimates and advises that the level of reserves is adequate for SSDC's last year of existence as well as providing specific reserves to fund costs that will or may arise in 2023/24. The key risks identified relate to (1) ensuring SSDC has the capacity to deliver essential on-going services, the corporate annual plan actions, as well as LGR; (2) potential risks arising from the proposed capital programme (capacity to deliver, construction industry inflation, and grant funding issues),

and (3) the amount of SSDC's indebtedness and the risk of interest rate rises. The Budget Report includes proposals to help mitigate these key risks should they occur.

Key proposals

12. The Budget Report contains the following key proposals for Council decision:

2022/23 Revenue Budget:

- Balanced revenue budget position for 2022/23 (with a small estimated surplus of £140k).
- Net revenue budget requirement in 2022/23 of £19.714m representing an increase on the 2021/22 original approved estimate of £2.971m (17.75%).
- Revenue budget growth proposals totalling £2.108m.

2021/22 to 2023/24 Capital Programme:

- Capital Programme of £117.873m an increase of £21.521m from the 2021/22 original approved estimate of £96.352m (an increase of 22%).
- The creation of a corporate capital contingency fund within the capital programme of £4m.
- Consequential increase in the revenue budget (financing costs) of £1.272m.

Reserves:

- Use of £6.144m of earmarked reserves during 2022/23 to fund the revenue budget and the capital programme.
- Increase the LGR Reserve by £1m to fund potential staffing capacity gaps during 2022/23.
- Create a reserve in 2023/24 of £4.8m for the Yeovil Refresh capital project should there be a requirement in that year to pay back the money received to-date from the Future High Streets Fund (FHSF).
- Transfer £2m from the Commercial Investments Risk Reserve to the MTFP Support Fund reserve to assist the 2023/24 position of the new Council to fund potentially adverse local government finance reforms and the handing back of FHSF grant if required.
- Increase the Treasury Management Reserve by £0.350m to fund an increase in interest rates in 2022/23 should they rise above the rates assumed in this Budget Report.

Council Tax:

- An assumption that the Council Tax will rise by 2.82% (SSDC's element excluding precepts) in 2022/23 to £182.11 (for Band D).

How the budget will fund Annual Corporate Plan Actions

13. The corporate annual action plan priorities for consideration at District Executive for 2022/2023 are as follows:
    - **Priority 1: (Environment)**
      To accelerate action to adapt to and mitigate the effects of climate change which includes reducing the Carbon footprint of the authority and enhancing the natural environment.
    - **Priority 2: (Healthy and Self-Reliant Communities)**
      To enable healthy communities which are cohesive, sustainable and enjoy
    - **Priority 3: (Economy and Covid-19 Recovery)**
      To assist businesses to recover from the Covid-19 pandemic whilst supporting growth within the South Somerset economy in partnership with other organisations.
    - **Priority 4: (Places where we live)**
      To enable housing and communities to meet the existing and future needs of residents and employers
    - **Priority 5: (Local Government Reorganisation)**
      To effect a safe and legal transition to the new Somerset Council on 1st April 2023

14. The Council's budget has included proposals to deliver the Council's Annual Action Plan for 2022-2023. Some of the key projects are highlighted below:-
    - Develop the Octagon Theatre into a flagship Theatre and Cultural Hub (capital)
    - Invest in the South Somerset Families Programme to operate across the district (revenue)
    - Work with Somerset Waste Partnership to pilot an electric refuse vehicle in South Somerset to understand which routes could be suitable for more electric vehicles (capital)
    - Invest in key local volunteer sector organisations (Spark and Citizens Advice South Somerset) to support local people and groups (revenue).
    - Continue our Regeneration programmes in Chard, Wincanton and Yeovil (capital)
    - Staff to support and deliver key aspects of the Environment Strategy (revenue)
    - A contribution towards the Local Government Reorganisation (LGR) implementation plan (revenue)
    - There are also funds included to help with the delivery of the Covid 19 recovery plan (revenue)

SECTION TWO: LOCAL ISSUES AND THE NATIONAL PICTURE

Somerset Local Government Reorganisation

15. In July 2021, the Secretary of State made a decision to replace the existing local government structure in Somerset with a single unitary. This means that the current structure of county plus four district councils will be replaced with a single Somerset Council from 1st April 2023, which is vesting day for the new authority.

16. An extensive Local Government Reorganisation (LGR) Programme has been developed to support the transition of the five councils into the new unitary. The programme started in September 2021 and will continue beyond vesting day, with the first checkpoint in January 2022 signalling the move from the planning to the implementation phase. The main role of the unitary programme is to ensure that the new Somerset Council is compliant and able to operate safely from 1st April 2023. This phase is referred to as ‘transition’ and continues through to vesting day. Beyond vesting day, it is likely that additional work will be needed to align services and implement collective ambitions for the new authority. This phase is referred to as ‘transformation’ and experience from other areas that have implemented an LGR programme suggests that this phase will continue for two years or more following vesting day.

17. All five authorities are proactively collaborating on the shaping of the new council and have committed to providing resources to the programme. Currently, there are more than 60 SSDC employees working part-time on the programme and we expect this to rise substantially over the course of the next year.

18. We are also required to take a share in the costs of implementation which, for the district councils, means a proportionate share of 20% of the overall implementation costs of £16.53m over the financial years 2022/23 and 2023/24, with the county council bearing the majority 80% share of the costs. We are required to ensure that the share for 2023/24 is set aside in a reserve so that the funding is available on vesting day when all assets and liabilities of the five councils are moved to the new Somerset Council.

19. The LGR programme is playing a significant role in our planning for the remaining year of SSDC. It is essential that we continue to deliver high quality services to our residents, communities and businesses over the transition period, whilst also contributing to the development of the new council. In respect of timing, the vesting day for the new authority neatly frames the timescale within which we may deliver against our ambitions and leave a legacy for our residents, whilst recognising that some of our major projects will need to be made ready for adoption by the new authority. There is no doubt that the resources of SSDC will be stretched by the demands upon them over the next

financial year and proposals have been made in the budget to ensure there is staffing capacity to deliver.

20. The impact of LGR on SSDC's 2022/23 budget proposals are as follows:

- An increase in staffing capacity to support and/or back fill existing officers to deliver LGR (costing £2.466m).
- An increase to the LGR reserve of £1m in 2022/23 to fund unknown capacity issues arising through the year whether that is ensuring service delivery continues and/or funding increased capacity to deliver LGR.
- An increase in the budget of £989,856 to fund SSDC's share of the overall Somerset LGR Implementation costs: (£755,856 in 2022/23 and £233,926 in 2023/24).

Covid - 19

21. The COVID-19 pandemic continues to have an impact on the council not only financially but on service delivery. Across a large number of areas (Revenues, Development Management, Housing, Enforcement) we have seen an increased demand for services. In addition, government has recently provided further grant assistance to businesses, which is delivered by the Revenues team thereby diverting their activity away from their primary work. The Benefits team has seen an increase in the take up of self-isolation grants, which impacts there day to day work.

22. The financial impact of Covid in the 2020/21 financial year was considerable and if it were not for the additional funding from central Government the Council would have significantly exceeded its approved net revenue budget by £4.3m.

23. A grant of £0.84m has been received from central government in 2021/22: the grant and the use of earmarked reserves are anticipated to cover the cost impact in 2021/22.

24. The 2022/23 budget proposals assume that no additional grants will be received from central government due to the pandemic. The income from fees and charges and the impact on the relevant budgets will be continually monitored in the year. The 2022/23 income budgets have not been restored to the pre pandemic levels due to the ongoing uncertainty with Covid.

25. There is a risk the pandemic continues in a way currently not anticipated, requiring further response or impact on the Councils service provision and/or financial standing. In this instance, as we have seen during the past two financial years, we would expect the Government to step in to support the entire sector.

National Economic outlook

26. The UK economy continues to recover (see Chart One). In November last year, economic activity was back to where it was before the pandemic. Since then, the spread of Omicron has meant that people have been spending less but as the number of new cases falls, it is expected that spending will go up again. The number of people out of work is going down (see Chart Two). The unemployment rate is only slightly higher than it was before the start of the pandemic.

Chart One: Monthly GDP from 2019 to-date (source: Bank of England website)

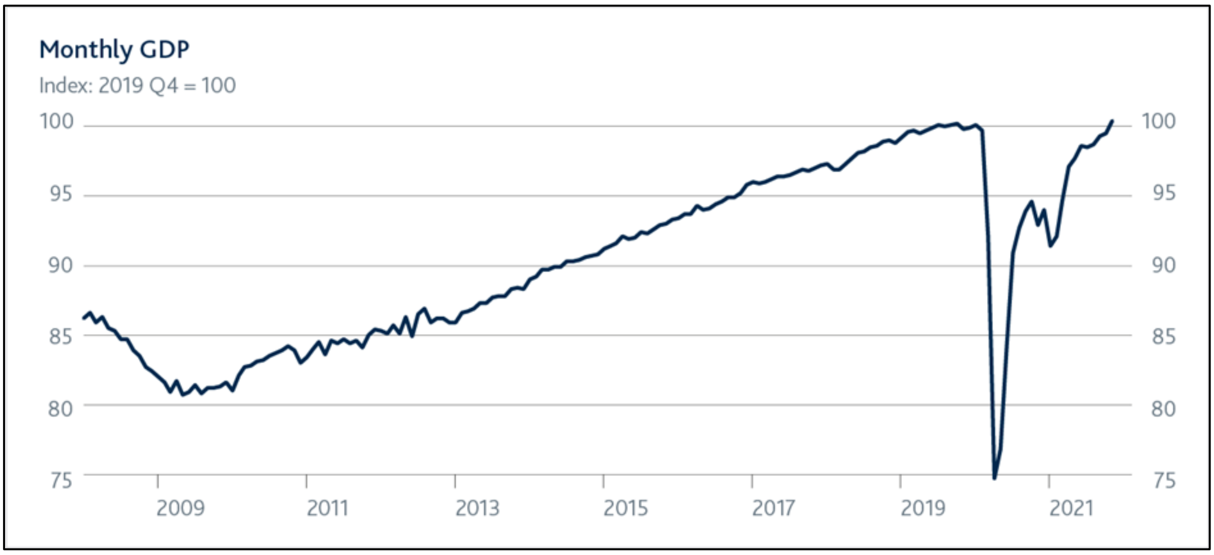


Chart Two: Unemployment rate from 2009 to-date (source: Bank of England website)

27. Inflation (the pace of price rises) has risen above national government's 2% target (see Chart Three below). Prices rose by 5.4% last year. Higher energy

prices is one of the main reasons for this. Large increases in oil and gas prices have pushed up petrol prices and utility bills.

28. Higher prices for goods that we buy from abroad have also played a big role. As economies reopened around the world, people started to buy more goods. This extra demand, was held back by, for example, shortages of materials and workers. That pushed up their costs and led to higher prices for consumers.

29. These effects are likely to continue pushing inflation up in the coming months. The Bank of England's Monetary Policy Committee (MPC) has stated (3rd February 2022) that it expects inflation to rise to around 7% in the spring and to fall back from the middle of this year. It also expects inflation to be close to the national 2% target in around two years' time.

Chart Three: Inflation rate from 2019 to-date (source: Bank of England website)

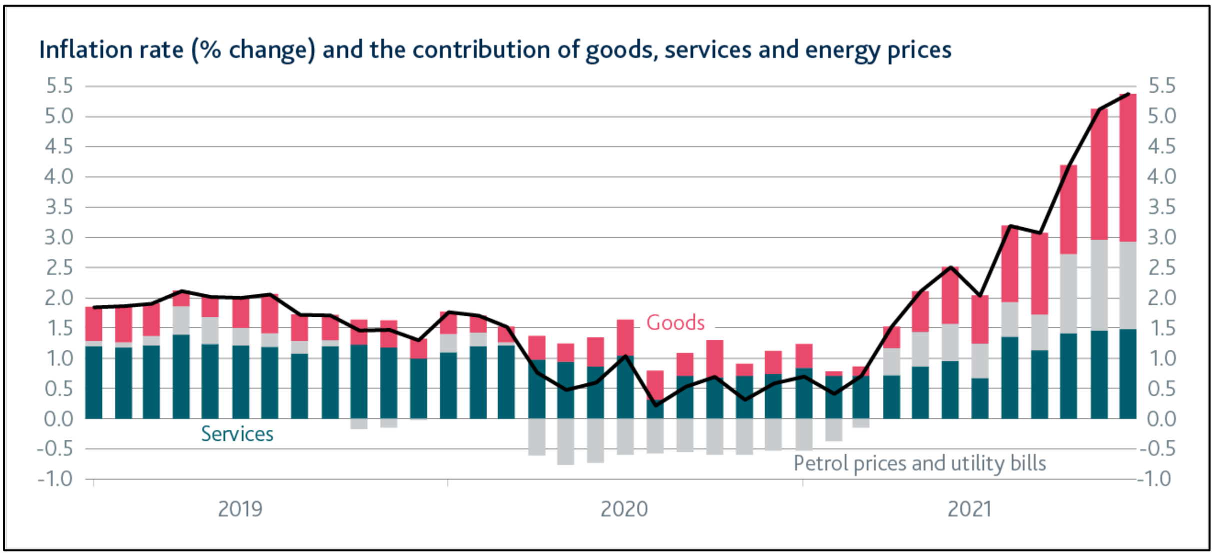
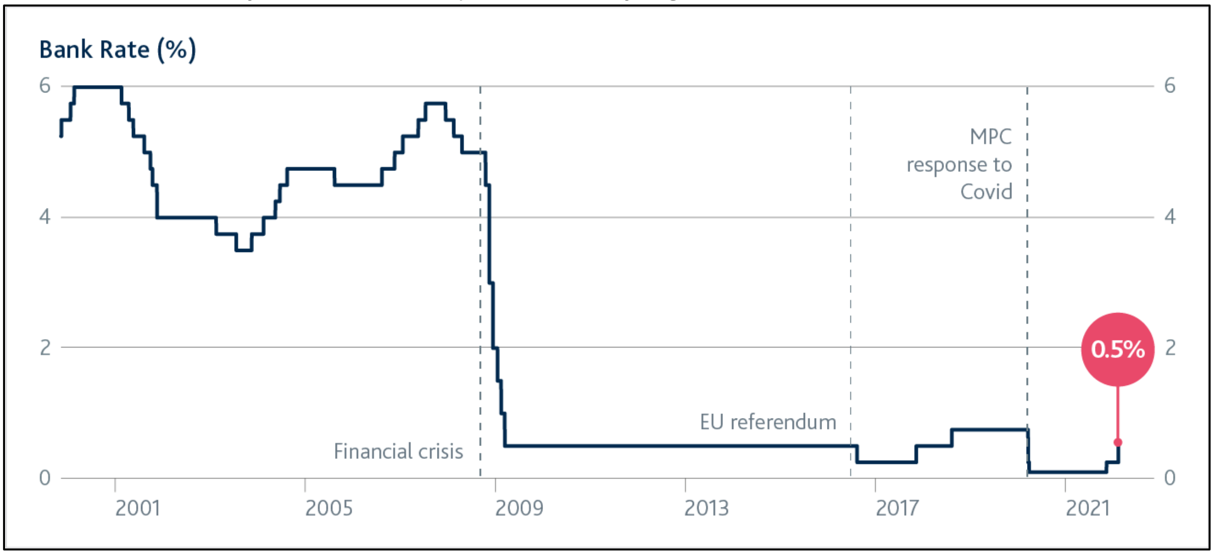


Chart Four: Bank Rate from 2001 to-date (source: Bank of England website



30. The MPC at its meeting 15th December 2021, voted to increase Bank Rate by 0.15 percentage points, to 0.25%. A second rise in interest rates was agreed at the MPC's meeting on 3rd February 2022 to bring the Bank Rate to 0.5%. Further likely increases are expected later in the year as the MPC tries to influence inflation rates to return to the national 2% target.

31. The impact of the national economic outlook on SSDC's 2022/23 budget proposals are as follows:

- An interest rate assumption for calculating estimated financing charges arising from borrowing in 2022/23 of 0.75%. (An estimate of 1% in 2023/24).
- An increase to the Treasury Management reserve of £0.350m to fund a possible further increase in interest rates to 1% in the 2022/23 financial year.
- No inflationary increases included against individual groups such as premises. Budgets adjusted to account for the price increase built into large value contracts.
- A £4m corporate capital contingency to fund possible inflationary rises in the capital programme.

Local Government Financial Settlement

32. On 8th February, the Secretary of State for Levelling Up, Housing, and Communities published the 2022/23 Local Government Finance Settlement for each council in England.

33. **One year settlement**: The 2021 Spending Review covering the whole of the government finances for the period 2022/23 to 2024/25 was published in October 2021. That set out that, on a like for like basis, the increase in local government funding would be £4.9bn over the period, or around 1.0% annually in real terms. However, only a one-year settlement for 2022/23 has been announced for local government. This is because the Chancellor expects to introduce reforms to the local government funding regime in 2023/24.

34. **Business Rates:** The business rates multiplier will be frozen again for 2022/23. It will remain at 49.9p (small business multiplier) and 51.2p (national business multiplier). Councils will continue to receive compensation in 2022/23 for the under-indexing of the business rates multiplier in this and previous years via a Section 31 grant.

35. **Council Tax**: For 2022/23, shire district councils will be able to increase their Band D council tax rate by up to 2%, or up to and including £5, whichever is higher (referendum limit).

36. **New Homes Bonus**: There is a final legacy payment of the New Homes Bonus due in 2022/23 which the government has confirmed it will continue to pay. In

addition the government will also fund a new round of NHB payments in 2022/23 using the 2021/22 methodology. There will be no new legacy payments arising from the new 2022/23 grant allocation. The allocations for 2022/23 will be funded through a £554 million top slice of the Revenue Support Grant.

37. **The Lower Tier Services Grant**: was expected to be a one-off grant in 2021/22 however, as the primary purpose of this grant is to ensure that no authority has a reduction in Core Spending Power (CSP) the government has continued it for a further year in 2022/23, maintaining the grant at the same level as for 2021/22.

38. **Service Grant**: This is a new grant worth £822m nationally. This will be a one-off grant for 2022/23 and government expects that it will be partly used to fund the 1% increase in National Insurance being introduced from April 2022.

39. The impact of the Local Government Finance Settlement on SSDC's 2022/23 budget proposals are as follows:

- We had assumed in previous forecasts that the government would introduce the long awaited local government funding reforms in 2022/23. However, this has not happened and the 2021/22 grants have "rolled forward" into 2022/23 along with amounts from a new grant (Services Grant). The roll forward and deferment of the reforms has benefitted SSDC by £4.4m.
- Details of SSDC's provisional Local Government Finance Settlement are given in Section Three of this report.

Changes to the local government funding regime

40. As highlighted above the financial settlement covers only 2022/23, with the government implementing a 'roll forward' in terms of resources. This means a further delay to the longer-term local government financial reforms.

41. The Secretary of State announced on 16th December that guidance and a timeline for introducing changes to local government funding would be presented as in the early New Year.

42. The Secretary of State also commented that government is committed to ensuring that future funding allocations for councils are based on an up-to-date assessment of their needs and resources. He pointed out that the data used to assess this has not been updated in several years, dating from 2013/14 to a large degree, and even as far back as 2000. He also stated that over the coming months, the Department for Levelling Up Housing and Communities (DLUHC) will work closely with the sector and other stakeholders to update this data and to look at the challenges and opportunities facing the sector before consulting on any potential changes.

43. The 2023/24 preliminary estimates include assumptions on how the changes could impact on SSDC if it remained a sovereign organisation. It is assumed that the funding reforms would move resources from districts such as SSDC to county councils. It is also assumed that there would be a baseline reset to initially reduce the amount of Business Rates councils who have had high growth of businesses in their area, such as SSDC, can retain. However the figures do need to be treated with caution given that it is uncertain whether government will take forward previous proposals to reform local government finance and what the impact will be on the new Somerset Council.

Changes to legislation and statute

44. **Changes to the Prudential Code:** A revised Prudential Code was published by CIPFA (Chartered Institute of Public Finance & Accountancy) in December 2021. A briefing on the changes was given to Full Council at its December 2021 meeting (as part of the Quarter Two Capital Monitoring report). In light of the revised code Full Council agreed that SSDC would no longer undertake "investment purely for yield" commercial activity (such as buying commercial property with a sitting tenant).

45. The revised code does not require the forced sale of existing commercial investments nor does it hinder proactive property management and works to existing investments. It does require however, that in the case where a council has borrowing needs, an annual review is undertaken on whether these assets should be sold and the proceeds used to reduce the council's overall indebtedness.

46. **Changes to the Treasury Management Code:** The main change is the introduction of the Liability Benchmark as a Treasury Management indicator for local government bodies. This is covered in more detail in the Council's Treasury Management Strategy (Section Seven).

47. **Consultation on Changes to the Capital Framework – Minimum Revenue Provision (MRP):** The government published a consultation document on the above topic on 30th November 2021. The key issue for SSDC is consultation on introducing a requirement to charge MRP costs on capital loans outstanding to third parties. SSDC, like several other authorities, lends to subsidiary companies at a commercial interest rate. Currently the council's MRP policy provides that no MRP charge is to be made where there is sufficient evidence to demonstrate that repayment of the loan will be made. This assumption is tested on an annual basis. Any statutory change to the MRP Policy would mean that increased MRP costs would be charged to the revenue budget from 2023/24 onwards.

48. The impact of the statutory changes on SSDC's 2022/23 budget proposals are as follows:

- Council decision made on 16th December 2021 to no longer undertake commercial "investment purely for yield".

- The introduction of the Liability Benchmark in SSDC's 2022/23 Treasury Management Strategy.

- Additional MRP charges added into the 2023/24 estimates for outstanding loans to third parties.

SECTION THREE: REVENUE BUDGET

Overall Position

Table One: 2022/23 Balanced Budget Position

	2021/22		2022/23	2023/24
	Original	Revised	Proposed	Estimate
Net Budget Requirement	**16,743,010**	**16,563,970**	**19,714,320**	**20,048,510**
Funding				
Service Grant (2022/23 Only)	0	0	-252,810	0
Rural Services Delivery Grant	-174,500	-174,500	-174,500	0
Lower Tier Services Grant	-156,180	-156,180	-164,500	0
New Homes Bonus Grant	-1,171,010	-1,171,010	-1,510,850	0
Business Rates Retention	-5,824,873	-5,824,873	-6,546,500	-4,281,828
Council Tax	-10,718,716	-10,718,716	-11,317,600	-11,345,186
Less: Council Tax Paid to Somerset Rivers Authority	113,133	113,133	112,191	113,604
Total Funding	**-17,932,146**	**-17,932,146**	**-19,854,569**	**-15,513,410**
Budget Gap or (Surplus - if negative)	**-1,189,137**	**-1,368,176**	**-140,249**	**4,535,100**
Reserve Transfers to balance budget				
MTFP Support Fund Reserve	162,497	1,368,176	140,249	-4,535,100
Other Earmarked Reserves	1,026,640	0	0	0
Total Reserve Transfers	**1,189,137**	**1,368,176**	**140,249**	**-4,535,100**

49. Table One above shows that the proposed Net Budget Requirement for 2022/23 of £19.714m, can be funded by government grants, the proposed Council Tax proposals, and retained Business Rates to produce an overall balanced budget with a small surplus of £140k estimated (0.7% of the Net Budget Requirement). It is proposed that the surplus is transferred into the MTFP Support Fund Reserve.

50. A preliminary forecast for 2023/24, based on SSDC continuing its services, shows a deficit of £4.535m, which is largely the result of assumptions made about the local government finance reforms to be introduced in that year and the likely adverse impact of the changes. Caution needs to be taken on this preliminary estimate as government's intentions are not clear at this point in time.

51. The overall 2022/23 gross revenue expenditure budget for SSDC is £74.28m. Charts Five and Six illustrate how this budget is planned to be spent and how it is financed.

Chart Five: 2022/23 Gross Revenue Budget Expenditure (£74.28m) by type of expense

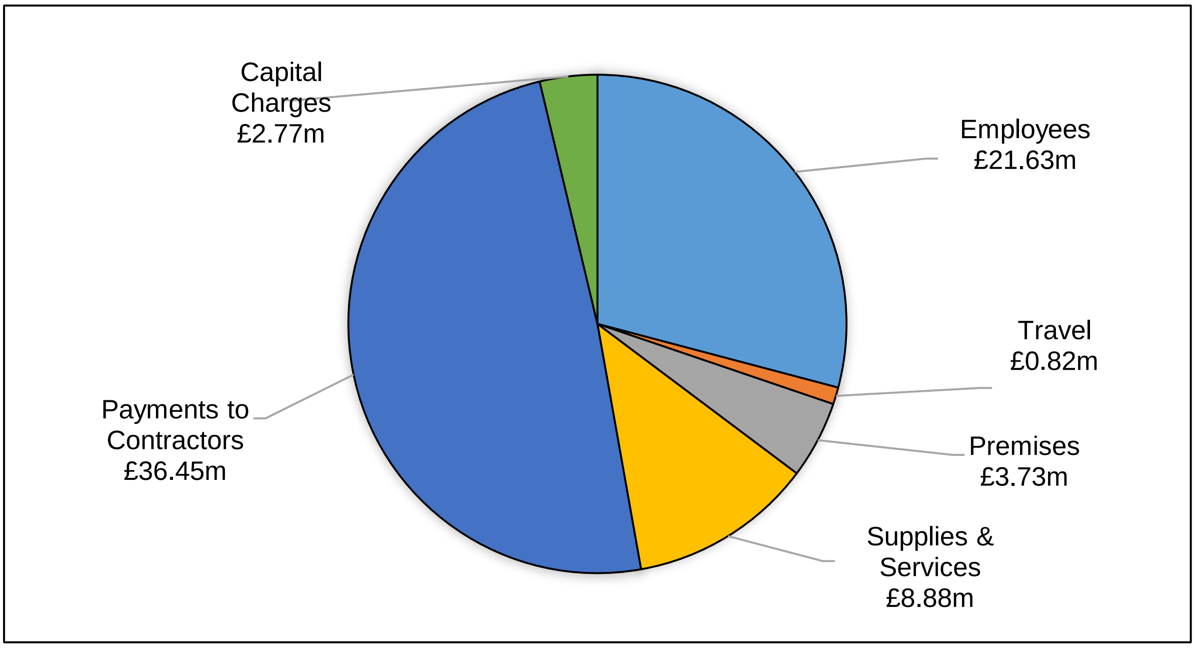
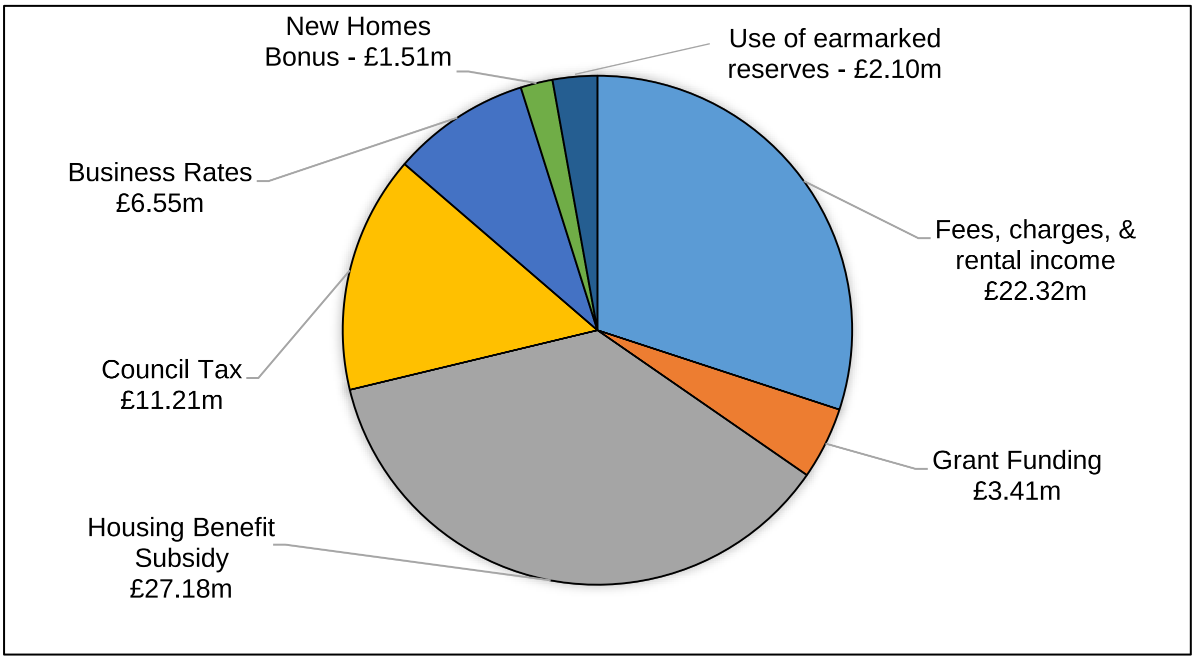


Chart Six: Funding of 2022/23 Gross Budget of £74.28m



2022/23 Net Expenditure Budget

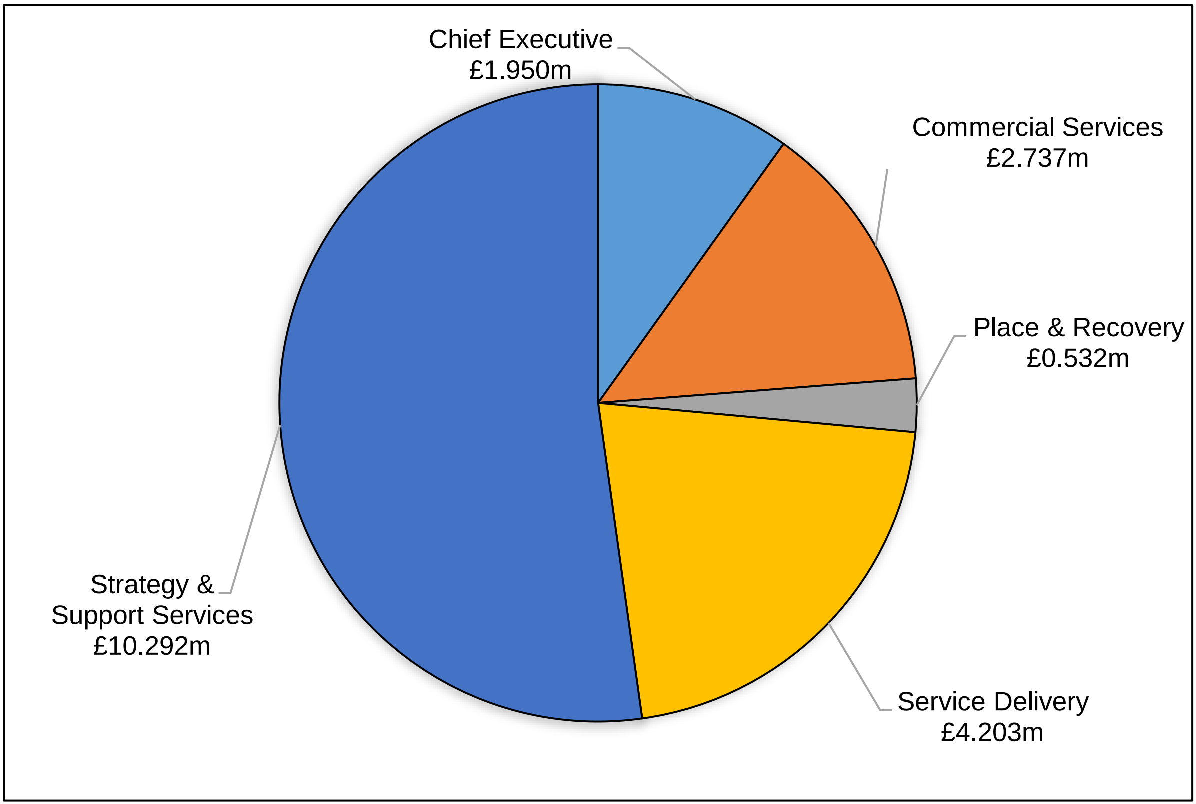
<u>Net Budget Requirement</u>

52. The Net Budget Requirement for 2022/23 is **£19,714,320** which is an increase of **£2,971,310** over the original budget approved for 2021/22 of **£16,743,010** (a **17.75%** increase).

53. The Net Budget Requirement is the amount of net expenditure that needs to be funded from Council Tax, Business Rates, central government grants, and, if there is a budget gap position, any use of the Council's reserves.

54. The 2022/23 Net Budget Requirement is made up of £74.28m of expenditure and £54.57m of income (the latter comprising fees, charges, rental income, service specific grants and the use of earmarked reserves).

Chart Seven: 2022/23 Net Revenue Budget (£19.714m) for each Service Area



55. The rest of this section provides an explanation of the key changes and movements from the 2021/22 approved budget to the 2022/23 proposed budget along with any assumptions made.

Budget approach taken for 2022/23:

56. The general approach to budgeting in local government is to use the previous financial year's approved budget as a starting point (the base budget) and to forward forecast from this point (known as incremental budgeting). Some elements of the budget however are reviewed on a zero base budget approach: effectively where the budget is estimated from scratch and not from the base budget, for example SSDC has always estimated its employees budget using a zero based budgeting approach.

Table Two: Analysis of revenue budget movements proposed from 2021/22 to 2022/23

Nominal Group	2021/22 Base budget £m	Pay Inflation £m	General Inflation £m	Inescapables £m	Realignment £m	Savings £m	Growth Bids £m	2022/23 Base Budget £m
Employees	17.631	1.483	0.033	0.107	(0.035)	(0.257)	2.536	**21.498**
Travel	1.002				0.002	(0.044)		**0.960**
Premises	3.166		0.109	0.228	(0.009)	(0.073)	0.022	**3.444**
Supplies & Services	6.923		0.014	1.989	0.780	(0.383)	0.134	**9.459**
Payments to Contractors	34.748		0.003	1.441		(0.011)		**36.181**
Capital Charges	4.565		0.000	0.005	(1.686)			**2.884**
Reserves	(0.188)	(0.551)	0.000	(0.354)	(0.649)	(0.013)	(0.488)	**(2.242)**
Income	(51.104)		(0.098)	0.010	(0.520)	(0.605)	(0.153)	**(52.470)**
Grand Total	**16.743**	**0.932**	**0.062**	**3.427**	**(2.116)**	**(1.386)**	**2.052**	**19.714**

57. This year Finance Specialists have undertaken zero based budgeting and in-depth reviews in many areas of the base budget, along with Budget Managers and Senior Leadership Team, with the result that significant changes have been made in updating budget figures and in amending historical budget positions and assumptions. The movements fall into the following broad categories:

- **Pay and price inflation** – including increases arising from a review of SSDC's large contracts to ensure budgets meet the contractual inflationary uplifts in the agreements.
- **Inescapables** – Changes to the budget where SSDC effectively has no choice, for example, our share of the Somerset Waste Partnership's increased costs and our share of LGR implementation costs. The in-depth review of budgets also found that increases to some budgets were needed which had not been fully budgeted for in the past.
- **Realignment** – Moving of budgets within a service area to reflect spend or income trends or moving of budgets from one service area or directorate to another. This category also includes the readjustment of the financing charges budget which has historically been overstated in previous SSDC budgets.
- **Savings** – Budget reductions or additional income identified by budget managers and Senior Leadership Team.
- **Growth Bids** – New requests for additional resources which are required to support and enhance service delivery and the delivery of corporate priorities and increased service demands. These require Full Council approval.

Pay Award and National Insurance

58. **Pay Award:** The 2022/23 proposed budget incorporates a 2% pay increase on all salaries. It should be noted however that the 2021/22 pay award has not yet been agreed to-date. The latest offer from the local government employers was a 2% increase.

59. The 2022/23 budget assumes that the 2% pay offer for 2021/22 is agreed. If the 2021/22 pay increase is significantly different this will impact on the 2022/23 salary budgets.

60. **National Insurance:** The new Health & Social Care Levy, which is being introduced from 6th April 2022, through an increase of 1.25% in National Insurance rates, has been incorporated into the 2022/23 proposed budget. The additional budget growth is in the region of £120k.

61. Government expects that this increase will be funded from the one-off Services Grant that was announced as part of the 2022/23 Local Government Finance Settlement.

Price Inflation

62. As part of the 2022/23 budget setting cycle the Finance Specialists reviewed budgets for contracts and realigned the budget to required level to account for the price increase built into the each contract. No inflationary increases were included against individual groups such as supplies and services or premises.

63. However, particular attention was given to the utilities budgets as it is known that energy prices have risen significantly recently. The budgets for these areas have been adjusted and inflated where required.

Changes arising from the zero base budget reviews undertaken

64. It is not proposed to list out all the changes in detail. There have been numerous movements and changes to the base budget arising from the in-depth reviews undertaken. Increased work on budget preparation was considered necessary this year because of LGR and the need to ensure that the 2022/23 budgets for each Council, including SSDC's, were as up-to-date as they could be. The base budget reviews have resulted in budget changes that have been classified as inescapables, realignments and savings. The commentary in the tables below relate only to changes over £100k.

65. Table Three includes the budget movements classified as inescapables. The budget pressures are additional requirements identified which are unavoidable, an example being the Council's contribution to the implementation costs as a result of local government reorganisation in Somerset. The net bottom line increase for this category is £3.427m

Table Three: Budget movements over £100k classified as inescapable

Service Area	**Description**	**£**
Management Board	SSDC's 2022/23 share of Somerset LGR Implementation Costs	£756,000
Commercial Investments	Unavoidable additional budgets for premises maintenance, insurance, NNDR	£231,120
Waste & Recycling	SSDC's share of the increase in Somerset Waste Partnership's costs	£235,120
Development Management	Consultants, professional fees, legal costs & appeals work	£109,590
Housing & Welfare	Homeless Bed & Breakfast increase in demand	£120,000
Sports Facilities	Legally committed costs for new Leisure contract before management fee income is received by SSDC	£693,150
Digital Services	IT Maintenance & Software costs - increase to reflect actual current spend and commitments (e.g. the number of licence agreements actually held)	£491,840

66. Budget realignments comprise of numerous budgets moving from one service area to another, as an example: the employee budgets for the Chief Finance Officer and Monitoring Officer have been moved to the Chief Executive's budget from the Strategy and Support Services budget.

67. The net bottom-line saving of £2.176m shown for this category in Table Two largely the result of adjusting the financing charges base budget which has been overstated in previous budgets. This is described more fully below in the Financing Charges paragraphs.

Table Four: Budget movements over £100k classified as savings

Service Area	Description	£
Management Board	Director of Commercial Services post removed from establishment	(£107,970)
Finance Corporate Costs	Additional income from treasury investments	(£337,540)
	Removal of one year funded additional budget	(£150,000)
Across the council	Increase in various fees & charges income estimates	(£314,480)

Budget Growth proposals

68. The growth being proposed in the revenue budget for 2022/23 totals £2.535m (ignoring funding from reserves). The majority of this is to provide staffing capacity and is described in the report entitled "*Ensuring sufficient staffing capacity during 2022/23*" which is found on this District Executive's agenda.

69. All the other growth proposals are detailed in Table Five below.

Table Five: Revenue budget growth requests for 2022/23

Service Area	Description	£
Revenues & Benefits	S13a Discretionary Discounts budget	£7,000
Community Safety	Enforcement on high-profile Anti-social behaviour and enforcement of Publish Space Protection Orders	£24,000
Procurement, Contract and Risk Management	Additional consultants fees	£5,500
Performance, People & Change	Additional Consultants Fees budget	£15,000
Digital Services	Additional IT Consumables	£3,000
	Additional equipment tools and materials	£15,000
Across the Council	Ensuring sufficient staffing capacity during 2022/23	£2,465,810
Total growth proposals for 2022/23		£2,535,310

Financing charges

70. Historically SSDC's budget included Interest and Minimum Revenue Provision costs in the Commercial Investment budget as a notional internal borrowing charge with the amount charged for interest charges credited to the Treasury Management budget at year-end. There was no budget in the Treasury Management cost centre for this credit so the year-end position always showed "extra" income at the year end. In addition the notional charges to the Commercial Investment Budget were overstated being well above the actual costs incurred on financing charges. This meant that the budget position for financing charges was overstated with the reality of the situation then rectified at year-end in the Statement of Accounts.

71. Whilst SSDC has not lost any income by using this budget methodology it is not very transparent so we have decided to stop internal borrowing and only include realistic corporate financing charges for the year in question. This change in methodology has resulted in a one-off saving of £1.8m in the 2022/23 proposals as compared to the 2021/22 original base budget.

Table Six: Budgeted financing charges 2021/22 to 2023/24

	2021/22 Original	2021/22 Revised	2022/23 Proposed	2023/24 Estimate
Interest charges	2,860,830	210,580	1,153,830	1,595,690
Minimum Revenue Provision	1,641,970	1,198,910	1,548,870	1,685,550
Total financing charges	**4,502,800**	**1,409,490**	**2,702,700**	**3,281,240**

72. The saving masks the fact that financing charges are estimated to increase in real terms over the medium term due to the increase in the amount of borrowing needed to fund the capital programme, rising external interest rates, and an increased need to use external rather than internal borrowing (the latter is more

beneficial in financing terms) because of the Council's December 2021 decision to use its capital earmarked reserves to fund the capital programme which will result in the Council having less cash funds available for internal borrowing. Table Six indicates this position: the 2022/23 financing budget is £1.3m above the 2021/22 revised "corrected" budget position.

73. Using advice from our external Treasury Management advisers Arlingclose interest rates on external borrowing has been assumed at 0.75% in 2022/23 with a further rise in 2023/24 to 1.00%. A recommendation is being made to increase the Treasury Management reserve by £0.350m to provide for any increase in rates to 1% in 2022/23.

74. The Department for Levelling Up, Housing and Communities issued a consultation on the 'changes to the capital framework: Minimum Revenue Provision' in November 2021.If the changes become a legislative requirement the council will need to increase its Capital Financing Requirement in 2023/24 by some £39.7m in respect of outstanding loans to third parties. This would result in an increase in MRP costs charged to the revenue budget of some £483k (given the interest rates currently prevailing).

Income from Treasury Management Investments

75. The Council currently has £23.5m saved in treasury investments, which are classified as strategic long-term investments. The 2022/23 Treasury Management Strategy Statement includes more detail on these investments which can be found in Section Seven of this report.

76. The income budget from treasury investments, which are mainly pooled funds, is estimated at £1m for 2022/23 and the following year.

77. The Council reviews the performance of these investments on a quarterly basis with its treasury advisor (Arlingclose). Part of the role of the treasury advisor is to continually provide updates on the performance of pooled funds and other investments and to advise if the portfolio spread should be changed based on risk and return.

Income from commercial investments made purely for yield

78. 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.
- Lending to third parties and/or purchase of shares undertaken purely for gain.

79. In light of the revised Prudential Code Full Council agreed in December 2021 that it would no longer invest purely for yield.

80. The Council's commercial strategy approved a budget of £150m for investment in commercial property, the investment as at the end of 2021/22 will be just under £140m. £97m has been invested in commercial property and £43m in the Council's subsidiary, SSDC Opium Power Limited.

81. The table below details the projected position on rental income from commercial property investments for 2021/22, 2022/23 and 2023/24.

Table Seven: Income from Commercial Property Portfolio

	Projected 2021/22	Budget 2022/23	Estimate 2023/24
	£		
Gross Rental Income	**(£6,463,116)**	**(£6,695,600)**	**(£6,352,690)**
Less Revenue costs	£10,883	£11,220	£11,480
Less Commercial Team Costs	£335,490	£335,490	£335,490
Net Receipt	**(£6,116,743)**	**(£6,348,890)**	**(£6,005,720)**
Transfer to Commercial Risk Reserve	£137,290		
Net Gain to Revenue	**(£5,979,453)**	**(£6,348,890)**	**(£6,005,720)**

82. The risks associated with the investments are mainly around the non-payment of rent loan repayments. The gross income receivable (in the region of £6.5m) from commercial property is included in the revenue budget and a 5% shortfall of income would cause a budget gap of £0.3m.

83. However, as part of the Commercial Strategy a Commercial Investment Risk Reserve was created with transfers to the reserve being made if the rental income exceeded the budget in a particular year. This reserve therefore mitigates a large element of the risks associated with the commercial property investments and should be sufficient to cover any 'gap' in the commercial investment budget should it arise.

84. An element of the £140m spend has been invested in the Council's subsidiary, SSDC Opium Power Limited. The investment to date is £41.04m with another £1.69m to be spent before the 31 March 2022. The investments are capital loans which have repayment periods of 7 and 25 years.

85. The interest received on the loan repayments is included in the revenue budget to reflect the repayments due from the company. The interest receivable in 2022/23 in respect of the loans is £1.33m which is included in the treasury

management income budget. There are dividends payable from the company in addition to the loan repayments, the dividend payments are not due in 2022/23 so no budget adjustments have been made for this element of commercial investments.

Fees and charges

86. The S151 Officer has delegated authority to agree the fees and charges. No inflationary increase was added to the 2021/22 fees and charges and this has not changed for 2022/23.

Use of earmarked reserves and specific grant income

87. The 2022/23 service expenditure of £74.28m has been funded by:

- Using earmarked reserves to the value of £2.101m.
- Specific government grant income (including Housing Benefit Subsidy) of £28.015m.
- Other contributions and miscellaneous government grants income of £1.805m.

Funding of the 2022/23 Net Expenditure Budget

Council Tax Income

88. The Secretary of State has confirmed within the Provisional Settlement that Shire Districts are able to increase Council Tax by the greater of 2% or £5 (on a Band D) in 2022/23 without the need for a referendum. For SSDC the maximum £5 increase equates to a 2.82% increase from £177.11 in 2021/22 to £182.11 in 2022/23.

89. The proposed Band D charge of £182.11 includes £180.26 for SSDC and £1.85 in respect of the Somerset Rivers Authority (SRA).

90. In 2016/17 the Government amended Somerset Council Tax levels to allow each of the Somerset authorities to raise a precept on behalf of the SRA. The Band D charge of £1.85 will raise £112,191 of funding, which will be paid to the SRA.

91. The tax base for 2022/23 is 60,643.62 Band D equivalents, which is a reduction of 509.33 (0.8%) compared to 2021/22. The reduction in the tax base is mainly due to a change in the debt collection rate to more accurately reflect the current position; the collection rate has been reduced from 99% to 97%.

92. The draft budget estimate for Council Tax income for SSDC is 60,643.62 x £180.26 = £10,931,619, which represents an increase of £213,966 compared to the previous year, see below:

Table Eight: Proposed Council Tax Income for 2022/23

Description	**£**
Council Tax Income Budget 2021/22	10,717,653
Reduction due to change in tax base (Band D equivalents)	(91,812)
Increase due to proposed 2.82% increase in council tax	305,778
Estimated Council Tax Income 2022/23	**10,931,619**

93. As a billing authority, SSDC has to calculate a basic level of tax based on its own spending plans, to which is added the precepts from Somerset County Council, Devon and Somerset Fire Authority, Avon and Somerset Police Authority and any town/parish council.

94. The Council Tax setting report is a separate report that will go to Full Council for approval on 28th February 2022 once preceptors' Council Tax needs are known.

Business Rates Retention

95. Local authorities receive a significant proportion of their funding through the Business Rates Retention (BRR) system. The Council must set its business rates budget estimate by 31 January each year, and the Council has delegated responsibility for this to the Chief Financial Officer because of the considerable time constraints in place.

96. As billing authority, the Council collects business rates income on behalf of itself, Central Government, Somerset County Council and the Fire and Rescue Authority under the Business Rates Retention funding system. The shares for 2022/23 will be Central Government 50%, SSDC 40%, SCC 9% and Fire 1%.

97. The table above shows a breakdown of the SSDC business rates income estimate for 2022/23 that has been included in the proposed budget along with the prior year for comparison.

Table Nine: 2022/23 Estimated Business rates income

Description	**2021/22 £'000**	**2022/23 £'000**
Standard share of net business rates income (40%)	18,051	16,661
S31 grant compensation for Government-funded reliefs	2,504	4,925
Renewable energy schemes business rates income (100%)	465	451
Tariff payment	(13,864)	(13,864)
Levy cost	(1,332)	(1,627)
Total BRR Funding Estimate	**5,825**	**6,546**

98. The standard share of business rates income has reduced in 2022/23 because the Government has introduced some new reliefs for businesses impacted by

the Covid pandemic. These include the Transitional Relief & Supporting Small Business Scheme and the Retail, Hospitality and Leisure Relief. The application of these reliefs to business rate accounts reduces the income received by the Council. In order to mitigate the impact of these reliefs the Government fully compensates the Council with additional income in the form of a S31 grant.

99. The Council is able to retain 100% of any business rates generated from renewable energy schemes. The income is broadly the same year on year: there has been a small reduction in 2022/23 due to the application of Small Business Rate Relief to some of the accounts.

100. The Tariff payment to Government, is set through the Finance Settlement and has remained unchanged year on year.

101. The Government set a Levy calculation to recoup a share of the financial benefit some authorities will see as a result of business rates base increases. The Levy is a proportion of the authority’s business rates income over and above the Baseline. As this Council is part of the Somerset Business Rates Pool, the Levy is paid to the Pool Lead authority.

102. The formal decision to remain in the Somerset Business Rates Pool has been delegated to the Chief Finance Officer in consultation with the Finance & Legal Services Executive Portfolio Holder. The Chief Finance Officer confirmed SSDC’s intention to remain in the Pool in December 2021.

103. All the authorities within the Somerset Pool must complete their NNDR1 return before the Pool Lead authority can calculate an estimated pooling gain, and at the time of writing, we do not have this information. The Council does not include an estimate of the pooling gain within its revenue budget, but on receipt, any gain is added to the Regeneration Fund reserve.

104. The risks associated with business rates income are around write offs of uncollectible debt and alterations of lists and appeals against rateable values.

105. The level of arrears is monitored on a monthly basis and the Chief Financial Officer in consultation with the Revenues Team have reviewed the current provision and agreed an increase to cover potential write offs. Providing that there is an adequate bad debt provision in place, any write offs will be charged to the provision and will not affect the forecast income.

106. The most challenging risk to business rates income is the uncertainty around alterations of lists and appeals against rateable values. The Valuation Office provide ‘Non-domestic rating: challenges and changes, 2017 and 2010 rating lists’, which are reviewed on a monthly basis. We have decided to make a modest increase to our appeals provision to protect the authority from this risk.

Local Government Finance Settlement

107. The finance settlement was announced on 8th February 2022, the table below provides details of the central government grants received. The 2021/22 original figures are shown as a comparator. There is an increase of £348,160 compared to the 2021/22 funding figures included in the 2021/22 budget.

Table Ten: 2022/23 Provisional Finance Settlement

	2021/22	2022/23	Increase
	£	£	£
Service Grant (2022/23 Only)	0	-252,810	-252,810
Rural Services Delivery Grant	-174,500	-174,500	0
Lower Tier Services Grant (new 2021/22)	-156,180	-164,500	-8,320
New Homes Bonus Grant	-1,171,010	-1,510,850	-339,840
Total	**-1,501,690**	**-1,849,850**	**-348,160**

Use of general reserves

108. There is an estimated surplus of £140,249 on the 2022/23 budget, meaning that no general reserves are required to finance the budget. The surplus is proposed to be transferred into the MTFP Support Fund reserve.

2023/24 Revenue Estimates

109. As reported elsewhere in this Budget Report the estimates for 2023/24 are preliminary forecasts and are based on SSDC continuing as a separate authority and delivering the same services as it currently does. This forecast will provide a base input into the development of the new Somerset Council's 2023/24 budget and Medium Term Financial Plan.

110. The estimates have been based on the following key assumptions:

- A 2% Pay Award and Inflation of 2%.
- Interest rate charges of 1%.
- An increase in the MRP budget arising from likely legislative changes requiring MRP costs to be charged for outstanding loans to third parties.
- An assumption in calculating the financing charges that the capital programme will spend as profiled in the budget.
- The one-off growth in the 2022/23 revenue budget for staffing capacity (of £1.026m) removed from the 2023/24 estimates.
- Loss arising from changes to the local government funding reforms of some £4.4m (loss due to Business Rates baseline reset of £2.3m, loss of New Home Bonus Grant of £1.5m, and loss of other grants received in 2022/23 of £0.6m).

SECTION FOUR: CAPITAL BUDGET

Proposed capital programme 2021/22 to 2023/24 and future years

Chart Eight: Proposed Capital Programme by Service Area along with major projects

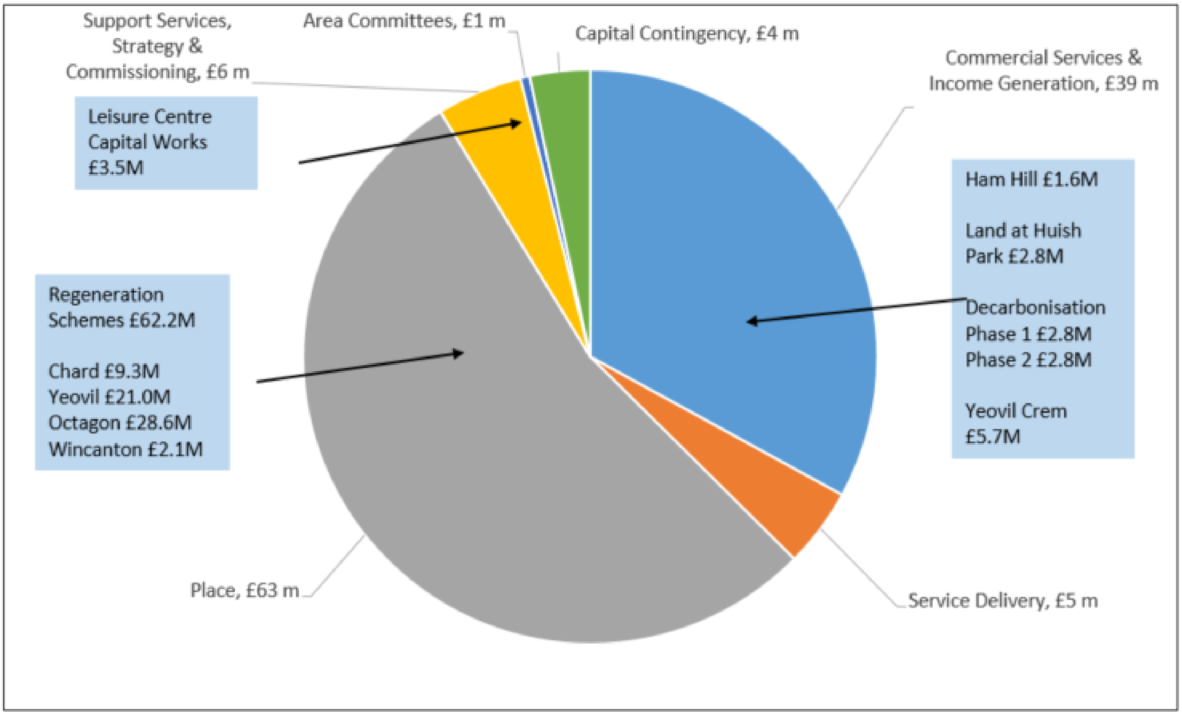


Table Twelve: Proposed Capital Expenditure Budget 2021/22 to 2025/26

	2021/22 Revised £'000	2022/23 Proposed £'000	2023/24 Estimate £'000	Future Years £'000	TOTAL £'000
Approved Capital Programme	40,055	34,083	14,081	8,133	96,352
Growth Proposals	-	13,307	4,824	3,390	21,521
TOTAL	**40,055**	**47,390**	**18,905**	**11,523**	**117,873**

111. The proposed total capital programme for the years 2021/22 to 2023/24 (and ongoing expenditure until 2025/26) is £117.873m. Details of the capital projects included in the programme and profiled expenditure for each scheme are included in Appendix B.

112. New capital proposals and increased expenditure on existing approved schemes are proposed to the value of £21.521m. These amounts are included in Appendix B in the rows highlighted in blue. Proposals relating to increased expenditure on existing approved schemes have the scheme name highlighted in blue and the year in which the increased budget is needed is also highlighted.

Capital Expenditure Growth Proposals

113. Capital growth proposals totalling £21.521m for the years 22/23 and beyond are included in the capital programme. The request relating to 2022/23 is £13.307m. This takes the total capital programme from £96.352m to £117.873m, an increase of 22%.

114. The total capital programme includes the recommendations made by District Executive at its meeting on 10th February to make increases to the programme of £782k and reductions totalling £5.156m (see Quarter Three capital budget monitoring report).

115. The growth proposals increase SSDC's indebtedness (Capital Financing Requirement) by £21.476m (an increase of 14.84% on the 2021/22 position) and requires a full year rise in capital financing charges of approximately £1.272m per annum.

116. A summary of the proposed schemes and increases on existing budgets are found in Appendix C. Any specific funding of the expenditure is shown in the Appendix.

117. A number of reports on this District Executive's agenda give details of some of the capital growth requested, namely: Decarbonisation Phase 2 (£2.76m), Yeovil Crematorium (£0.821m), Yeovil Refresh (£1.059m), and the Octagon Redevelopment (£5.558m).

118. Other significant proposals for capital investment include the following:

- **Ham Hill (£1.624m)**: This is a project to improve the country park infrastructure and facilities. The site is currently on Historic England's 'At Risk' register. Total expenditure is estimated to be £1.6m with £1.3m funded by National Lottery heritage grant.

- **Huish Park (£2.8m)**: District Executive at its meeting in December 2020 agreed to purchase the land at Huish Park in Yeovil, including the land occupied by the Yeovil Town Football Club, in order to secure the public amenity provided by the site. The conditions precedent to the District Executive decision continue to be met and the owner of the land is now ready to proceed with the sale.

- **Capital works on commercial property (£1.648m):** A number of works maybe necessary on our existing commercial property portfolio (investments made purely for yield) depending on the scale of dilapidations needed when tenancy leases expire. Other work is pre-planned improvement to the property. This expenditure on existing investments made for yield is permissible under the revised Prudential Code and is proposed to be fully funded from the Commercial Investment Risk Reserve.

- **Corporate Capital Contingency Budget (£4m)**: The Chief Finance Officer proposes that a capital contingency of £4m is included in the capital budget to fund the risk of budgets needing to be increased due to the exceptional high inflation currently being experienced in construction. This is on top of the contingency budgets already included in the larger capital budgets (e.g. in the Regeneration Programme budgets). Any request to use this contingency would be submitted to District Executive during the year by the Senior Responsible Officer.

Funding the capital programme

Table Thirteen: Funding the capital programme

	2021/22 Revised £'000	**2022/23 Proposed £'000**	**2023/24 Estimate £'000**	**Future Years £'000**	**TOTAL £'000**
Specific Funding:					
Grants & Contributions	7,157	12,853	9,481	4,171	33,662
S106 Developers Contributions	733	329	400	0	1,462
Regeneration Fund (earmarked reserve)	659	1,107	0	0	1,766
Cremator Replacement earmarked reserve	0	549	0	0	549
Other Reserves	550	1,235	975	113	2,873
CIL Funding	0	1,335	0	0	1,335
Loan Repayments (capital receipts) from SSDC Opium Ltd and SWP	2,126	2,099	2,691	3,102	10,018
Subtotal	11,224	19,507	13,547	7,386	51,664
Corporate Funding					
Capital Fund (earmarked reserve)	1,167	1,666	0	0	2,833
Useable Capital Receipts	16,172	1,827	935	0	18,934
Borrowing	11,492	24,390	4,423	4,138	44,442
Subtotal	**28,831**	**27,883**	**5,358**	**4,138**	**66,209**
Total Financing	**40,055**	**47,390**	**18,905**	**11,524**	**117,873**

119. **Use of reserves**: Full Council at is December 2021 meeting agreed that reserves held for capital funding purposes (for example the Capital Fund, the Useable Capital Receipts Reserve and the Regeneration Fund reserve) should be fully utilised in 2021/22 and 2022/23 to fund SSDC's capital programme and thereby reduce the amount of borrowing required (for the benefit of SSDC and

the successor Somerset Council). The funding of the capital programme shown above fully reflects this decision.

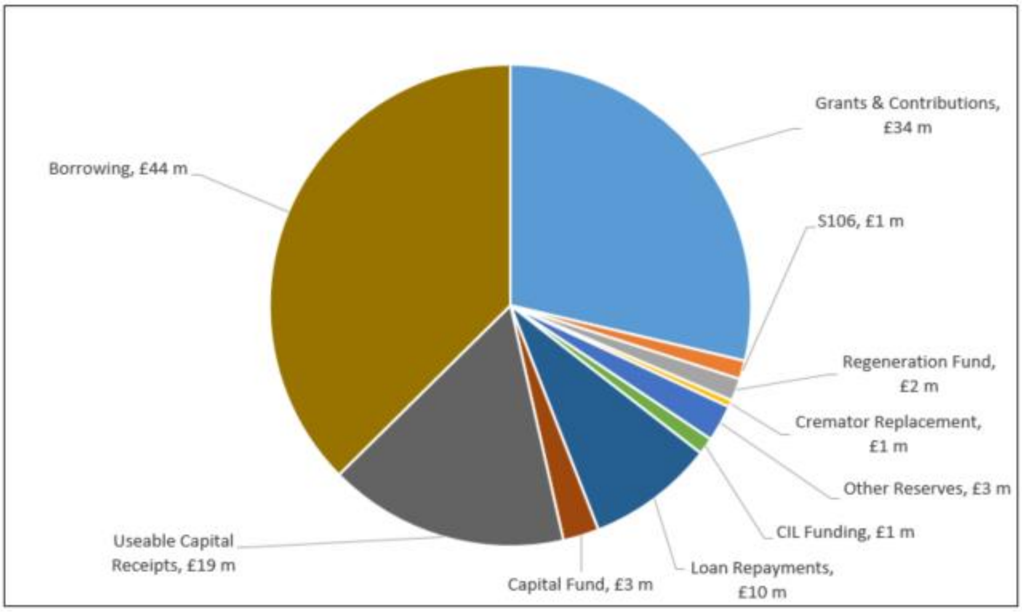
120. **Community Infrastructure Levy (CIL):** The Strategic Development Board agreed in early December 2021 to spend current CIL receipts as follows: £194,000 for Chard Leisure Centre Public Access project and £1,141,000 for Yeovil Refresh 'Triangle' project.

121. **Grants and Contributions**: Table Eleven below shows a breakdown of all the anticipated grants and contributions. A report elsewhere on this agenda describes how the grant from the Future High Street Fund, for the Yeovil Refresh public real works may need to be repaid in 2023/24.

Table Fourteen: Capital grants and contributions

Scheme	Amount £'000	Description
Ham Hill	1,300	National Lottery Heritage Fund
Decarbonisation of operational buildings	2,800	Government energy grant – Salix Finance
Yeovil Crematorium Refurbishment	103	Yeovil Without Parish Council
Disabled Facilities Grant	2,771	Better Care Fund
Barnabus House	23	Next Steps Accommodation Programme
Chard Regeneration	1,248	Historic England Grant
Yeovil Refresh	14,888	Future High Streets Fund £9.757M Private Sector Contributions £5.131M
Octagon Redevelopment	10,250	DCMS Grant and fundraising
Lyde Road Pedestrian & Cycle Way	150	Government Active Travel Fund
Lyde Road Strategic Cycleway	129	Government Active Travel Fund

Chart Nine: Funding of the overall Capital Programme



SECTION FIVE: RESERVES

122. The Council holds earmarked revenue reserves for a variety of good financial management reasons. Some reserves are for specific expenditure that will occur in the future, some reserves are held to mitigate possible risk, and others are reserves specifically built up over the past to help support the Medium Term Financial Plan. We also hold reserves for each Area Committee.

123. Earmarked reserves are either revenue reserves (which can be used to fund both revenue and capital expenditure) or capital reserves which, unless the Sectary of State gives the council a specific dispensation, can only be used to fund capital expenditure. The capital reserves showing in the table below are primarily comprise of capital receipts.

124. Further detail can be found in Appendix D.

Table Fifteen: Estimated Reserves Position

Reserves Summary	Balance as at 01/04/2021 £'000	Movement £'000	Balance as at 01/04/2022 £'000		Movement £'000	Balance as at 01/04/2023 £'000		Movement £'000	Balance as at 31/03/2024 £'000
Corporate Reserves	(9,081)	(4,426)	(13,507)		(1,381)	(14,888)		4,784	(10,104)
Capital Reserves	(18,222)	16,162	(2,060)		1,981	(79)		0	(79)
Revenue Earmarked Reserves	(21,991)	8,918	(13,073)		5,544	(7,529)		1,209	(6,320)
Total Reserves	**(49,294)**	**20,654**	**(28,640)**		**6,144**	**(22,496)**		**5,993**	**(16,503)**

125. The Council held £49.294m in capital and revenue reserves as at the beginning of the financial year, 2021/22. In December 2021 Full Council agreed to use its capital reserves (and some revenue reserves that had been set aside to fund capital expenditure) to fund the capital programme and thereby reduce the council's borrowing needs. In addition Full Council agreed to delete some small reserves and move the NNDR volatility reserve into the MTFP Support Fund reserve. The latter and the General Fund Balance have been described as corporate reserves in the table above.

126. The Budget Report recommends movements in the reserves during 2022/23 as follows. This is estimated to leave £22.496 in reserves at the end the year.
   - Use of £6.144m of earmarked reserves during 2022/23 to fund the revenue budget and the capital programme.
   - Increase the LGR Reserve by £1m to fund potential staffing capacity gaps during 2022/23.
   - Increase the Treasury Management Reserve by £0.350m to fund an increase in interest rates in 2022/23 should they rise above the rates assumed in this Budget Report.

- Create a reserve in 2023/24 of £4.8m for the Yeovil Refresh capital project should there be a requirement in that year to pay back the money received to-date from the Future High Streets Fund (FHSF).
- Transfer £2m from the Commercial Investments Risk Reserve to the MTFP Support Fund reserve to assist the 2023/24 position of the new Council to fund potentially adverse local government finance reforms and the handing back of FHSF grant if required.

SECTION SIX: CHIEF FINANCE OFFICER'S STATEMENT

Statutory requirements

127. Section 25 of the Local Government Act 2003 places specific responsibilities on the Chief Finance Officer (S 151 Officer) to report on the robustness of the budget and the adequacy of proposed financial reserves when the council is considering its budget requirement. The council is required to have regard to this statement when it sets the budget. This statement includes a consideration of the key potential risks of the budget proposals.

Robustness of Reserves

128. Budget estimates are exactly that – estimates of spending and income made at a point in time and which will change as circumstances change. This statement about the robustness of estimates cannot give a 100% guarantee about the budget but gives Members reasonable assurance on whether the budget has been based on the best information and assumptions available at the time.

129. **Revenue Budget**: In relation to the 2022/23 General Fund Revenue budget: a considerable amount of extra work this year has been undertaken both by the Finance Specialists and by Budget/Service Managers in reviewing the base budget and in undertaking zero based budget reviews. The outcomes from this work have also been critically reviewed on several occasions by the Senior Leadership Team. The additional work was undertaken not only to follow good financial management principles but also in preparation for LGR – where an accurate robust estimate of all five councils' budgets will be required to provide an initial consolidated base budget position. This work at SSDC has resulted in a number of historic budget assumptions and estimates being thoroughly revised and adjusted to reflect up-to-date estimates.

130. I am therefore satisfied that the proposed revenue budget estimates are robust.

131. **Capital Budget:** As with the revenue budget a lot of work has been undertaken since April 2021 in reviewing the capital programme budget estimates. In particular, the Director of Place and Recovery and Chief Financial Officer have undertaken deep dive reviews of the Regeneration Programme budgets - including the financing assumptions made in the original Business Cases – which have resulted in more realistic estimates being agreed by Council and an enhanced transparent way of reporting these projects to District Executive (for example including the total budget and not just the "net" figure that SSDC is expected to finance). Given the significant financial sums (and risks) of this programme a specific resource, the interim Regeneration Project Accountant, has been employed to continue to critically review and provide financial advice on these projects.

132. The rest of the capital programme has also been reviewed in depth both in order to propose 2021/22 Revised Estimates for the capital programme at Full

Council in December 2021 and also to make the capital budget proposals for 2022/23.

133. Despite all of these reviews caution needs to be applied to the capital estimates at this time given the significant inflationary pressures we are currently experiencing when going out to tender for the capital works required. It is recommended that a £4m corporate capital contingency is approved in the 2022/23 budget to help mitigate this inflationary risk.

134. Whilst I am comfortable in giving assurance to Full Council that the majority of the capital estimates are robust, dependent on the corporate capital contingency budget proposal being agreed by Full Council, what is less certain, based on historic performance, is the actual phasing of expenditure. Also I am unable to give full assurance on two particular projects, namely:

- **Octagon Theatre Refurbishment**: whilst the estimates shown in the budget report are based on costing undertaken in the last two months and are therefore up-to-date – these costs are at RIBA Stage Two and are not yet based on final detailed designs (RIBA Stage Three). There is the potential therefore that these could change prior to the Final Business Case being approved in November 2022.

- **Yeovil Refresh**: The capital expenditure budget for this programme shown in this report includes estimates for the development of two key sites (Cattle Market and Glovers Walk) that may not be taken forward. A full update report will be taken to District Executive later this calendar year once proposals are firmer. If it should be the case that these projects do not proceed then the capital budget is overstated by £9.023mm. In addition the Yeovil Refresh report on this District Executive's agenda has described the risks of new Somerset Council having to potentially hand back Future High Street Funding Grant in 2023/24 of £4.8m. These budget proposals recommend that a new reserve is created to fund this risk should it arise.

135. In summary I can give partial but not complete assurance over the robustness of the capital budget estimates given the inflationary pressures currently existing in the construction industry, which are not in SSDC's control, and given the quantum of the budget for the two particular projects highlighted above.

136. In addition I am concerned that the council may not have the capacity to deliver this capital programme, particularly given the LGR work required. We still don't know the full extent of the work required for LGR, which may reduce capacity across the organisation and impact on the capital program. To try and mitigate any impact we are proposing that the LGR Reserve is increased by £1m to provide extra capacity if it is required.

Adequacy of Reserves

137. In giving an assurance on the adequacy of reserves a S151 Officer would usually take a medium term view over whether there was sufficient reserves over the next three to five years based on the organisation's revenue and

capital medium term expenditure plans and an understanding of the amount of grants and resources likely to be available from the local government finance settlement. However given that SSDC is in its last year of existence, that the local government finance settlement is also for one year only, and the future medium term spending plans of the new Somerset Council have not yet been agreed, then my assurance on the adequacy of SSDC's reserves position can only be assessed using a very short time scale. I am able therefore to give assurance to Full Council that the reserves are adequate for the 2022/23 financial year.

Financial Risks

138. The following table sets out the key financial risks in 2022/23 for SSDC and the mitigations and/or management of these risks.

Table Sixteen: Assessment of key financial risks

RISK	DESCRIPTION AND ANY MITIGATION
Staffing capacity	**Risk**: There is the possibility that SSDC may lose staff during 2022/23. There is also additional work load arising from LGR implementation. There is a risk therefore that there may not be sufficient capacity to maintain service delivery, deliver the corporate annual action plan, as well as LGR implementation. **Mitigation:** On-going proactive management of staffing resources. Increase LGR Reserve by £1m to fund any additional capacity requirements over those proposed in these budget proposals.
Interest Rates	**Risk**: Whilst interest rates remain low at 0.5% there is now an expectation that they will rise to at least 1% over the next two financial years to help curb rising inflation rates. SSDC has a high Capital Financing Requirement (indebtedness) and currently borrows on a short term basis through peer-to-peer lending, which is cheap and also does not fetter the flexibility of the new Somerset Council to manage its future borrowing needs. **Mitigation**: Regular meetings with our external Treasury Management advisers are held to inform us of the potential risks and any need for action. A 0.75% interest rate is assumed in the 2022/23 budget estimates. The CFO is proposing an increase of £0.350m in the Treasury Management Reserve to fund any rise of interest rates to 1% in 2022/23. Discussions will be held with the S151 officers in the other Somerset councils on whether some long term borrowing should be acquired in order to fix interest rates for some of the borrowing needed.

RISK	DESCRIPTION AND ANY MITIGATION
Pay Award	**Risk:** The 2021/22 pay award for local government services employees remains unresolved as the unions have rejected the employer's offer. Negotiations on the pay award for 2022-23 do not form part of this year's dispute and will be considered separately once the pay award for 1 April 2021 has been finalised. There is a risk that the pay award maybe above the amounts estimated in these budget proposals. **Mitigation**: SSDC holds sufficient reserves to fund any increase for this year and next.
Price Inflation	**Risk**: General inflation is expected to peak at 7% in the first quarter of the 2022/23 financial year whist inflation on fuel, gas and electricity is even higher (for example inflation on gas prices was some 28% in December 2021). Construction inflation is currently running at 20% to 40%. **Mitigation**: The risk is most acute for the delivery of the capital programme. Whilst agreed budgets for the council's major projects already have a contingency amount within the approved budget the CFO is proposing the creation of a corporate capital contingency of £4m to help mitigate this risk.
Business Rates, Income	**Risk:** The funding from business rates is based on the accurate calculation of the NNDR1 form. There is volatility in the estimates due to various factors, such as anticipated discretionary and mandatory reliefs, growth in the rateable value, bad debts, and volume of appeals. All of these factors can affect the surplus or deficit position on the collection fund that will affect the next financial year's revenue budget. **Mitigation**: The Collection Fund estimates have been produced using recommended guidance from CIPFA (Chartered Institute of Public Finance & Accountancy), and a review of the figures has been undertaken by LG Futures, an external consultancy firm.
Covid-19	**Risk**: The pandemic could continue in 2022/23 and in future years in a way that requires further responses which impacts on the Councils service provision and/or financial standing. **Mitigation**: In this instance, as we have seen during the past two financial years, we would be expecting the Government to be stepping in to support the entire sector if the impacts were high.

SECTION SEVEN: TREASURY MANAGEMENT STRATEGY

Introduction

139. Treasury management is the management of the Council's cash flows, borrowing and investments and the associated risks. The Council has borrowed and invested substantial sums of money and is, therefore, exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of finical risk are, therefore, central to the Council's prudent financial management.

140. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

141. Investments held for service purposes and for commercial income generation (investments undertake purely for yield) are also considered in this section of the Budget Report.

142. All the indicators required to be published under CIPFA's (Chartered Institute of Public Finance & Accountancy) and DLUHC (Department for Levelling Up, Housing & Communities) Investment Code are found in Appendix E.

Overall Position to-date and medium term forecast

143. On 31st December 2021, the Council had external borrowing of £121m and £31m of treasury investments. These balances are summarised below.

Table Seventeen: Existing Debt and Investment Position

	01/04/2021 Balance £'000	31/12/2021 Balance £'000
External Borrowing:		
Local Authorities	(98,000)	(121,000)
Total External Borrowing	(98,000)	(121,000)
Treasury Investments:		
Covered Bonds (secured)	1,000	0
Term Deposits (Other LA's and Banks)	0	0
Money Market Funds & Business Reserve	0	7,500
Property and Pooled funds	23,500	23,500

Total Treasury Investments	24,500	31,000
Net Debt(-)/Investment	(73,500)	(90,000)

144. Forecast changes in these sums are shown in the balance sheet analysis in the table below.

Table Eighteen: Balance Sheet Summary and Forecast

	2020/21 Actual £'000	2021/22 Projection £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Capital Financing Requirement	133,985	144,761	166,238	169,068	171,534
Less: External Borrowing	(98,000)	(122,000)	(145,976)	(150,807)	(155,273)
Less: Other Debt Liabilities (Leases)	(20)	0	0	0	0
Internal Borrowing	35,965	22,761	20,261	18,261	16,261
Less: Usable Reserves	(69,437)	(42,777)	(27,213)	(21,555)	(17,146)
Less: Working Capital Surplus (-) / Deficit	(2,800)	(2,800)	(2,800)	(2,800)	(2,800)
Treasury Investments / New Borrowing (-)	(36,273)	(22,816)	(9,751)	(6,093)	(3,685)

Borrowing Strategy

145. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investments. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

146. The Council has an increasing CFR due to the planned spending within the capital programme including significant expenditure on regeneration schemes. The trend of increased expenditure indicates it will be required to borrow up to £160m over the forecast period.

147. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. The table 3 included in Appendix E includes information on the Council's total debt position and demonstrates that the projected level of outstanding debt is lower than the CFR for the period.

148. The Council currently holds £121m of loans (as at 31 December 2021), compared to £98m on 1 April 2021, as part of its strategy for funding previous

years' capital programmes. The balance sheet forecast in table eighteen shows that the Council expects to borrow up to £146m in 2022/23. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the proposed authorised limit for borrowing of £195m as set out in Appendix E.

149. The Council'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 Council's long-term plans change is a secondary objective. In addition, given that a new unitary authority will come into being on 1st April 2023 there is need to not undertake longer term loan agreements, unless required, in order to give maximum flexibility to the new council to best manage the consolidated Capital Financing Requirement of the five councils.

150. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short term to either use internal resources, or to borrow short term loans instead. By doing so, the Council is able to reduce net borrowing costs (despite foregoing investment income) and reduce overall treasury risk.

151. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

152. Discussions will also be held with the other S151 Officers within Somerset to assess on a combined basis whether it is beneficial that the council/s borrow additional sums in 2022/23 at long-term fixed rates.

153. Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period (although forward loan interest rates will usually factor in an allowance for interest rate risk during the intervening period).

154. Additionally, the Council may borrow further short term loans to cover unplanned cash flow shortages.

155. The approved sources of long-term and short-term borrowing are:
- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- Any other UK public sector body
- UK public and private pension funds (except Somerset County Pension

Fund)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

156. Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase
- Private finance initiative
- Sale and leaseback

157. Debt rescheduling: The HM Treasury's PWLB lending facility allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Treasury Investment Strategy

158. The Council invests funds that it holds for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments),

- to support local public services by lending to or buying shares in other organisations (service investments), and

- to earn investment income (known as commercial investments where this is the main purpose).

159. This investment strategy meets the requirements of statutory guidance issued by the Government in January 2018.

Treasury Management Investments

160. The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and Central Government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of treasury management investments is expected to fluctuate between £30m and £60m during the 2022/23 financial year.

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

162. The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council'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. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

163. Given the increasing risk and very low returns from short-term unsecured bank investments, the Council has diversified into more secure and/or higher yielding asset classes during 2020/21 and 2021/22. The Council has increased its strategic (long-term) investments from £23.25m at the start of the financial year to £23.50m and it is estimated to remain at this level as at the end of 2021/22. We do not plan to make any new strategic investments but will continue to review the portfolio with Arlingclose and will make any necessary investments based on risk and return.

164. The Council will continue to monitor the risk and returns on its strategic (long-term) investments and will work closely with its treasury advisors ensuring that strategic investments continue to be an appropriate option for the Council.

165. A proportion of the Council's surplus cash is currently invested in short-term unsecured bank deposits, money market funds and other local authorities.

166. Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's 'business model' for managing them. The Council aims to achieve value for money from its internally managed treasury investments by a business model of collecting the contractual cash flows and, therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

167. **Approved Counterparties:** The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Table Nineteen: Approved investment counterparties and limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3 m 5 years	£6 m 20 years	£6 m 50 years	£3 m 20 years	£3 m 20 years
AA+	£3 m	£6 m	£6 m	£3 m	£3 m

	5 years	10 years	25 years	10 years	10 years
AA	£3 m 4 years	£6 m 5 years	£6 m 15 years	£3 m 5 years	£3 m 10 years
AA-	£3 m 3 years	£6 m 4 years	£6 m 10 years	£3 m 4 years	£3 m 10 years
A+	£3 m 2 years	£6 m 3 years	£3 m 5 years	£3 m 3 years	£3 m 5 years
A	£3 m 13 months	£6 m 2 years	£3 m 5 years	£3m 2 years	£3 m 5 years
A-	£3 m 6 months	£6 m 13 months	£3 m 5 years	£3 m 13 months	£3 m 5 years
None	n/a	n/a	£6 m 25 years*	n/a	£3 m 5 years
Money market funds, Strategic pooled funds and real estate investment trusts		£10m (nominal value) per fund or trust			

166. **Credit rating**: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

167. **Banks unsecured**: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

168. **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

169. **Corporates**: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £2m per company as part of a diversified pool in order to spread the risk widely.

170. **Registered providers (unsecured)**: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These

bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

171. **Money market funds**: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

172. **Strategic pooled funds**: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

173. **Real estate investment trusts**: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

174. **Operational bank accounts**: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £200,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

175. **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

176. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

177. **Other information on the security of investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council’s treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

178. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

179. **Investment Limits:** The Council’s revenue reserves available to cover investment losses are forecast to be £3m on 31 March 2022. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £10m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table Twenty: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group

Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£30m per broker
Foreign countries	£12m per country
Registered providers and registered social landlords	£8m in total
Unsecured investments with building societies	£8m in total
Loans to unrated corporates	£4m in total
Money market funds	£20m in total
Real estate investment trusts	£10m in total

180. **Liquidity management**: The Council uses an in-house spreadsheet based cash flow forecasting model to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

181. The Council will spread its liquid cash over at least three providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Service Investments – Loans

182. The Council lends money to local businesses, local charities, other local authority partnerships, and local residents to support local public services and priorities, and stimulate local economic growth. Currently the Council has loans invested with:

- Hinton St George Shop
- Somerset Waste Partnership – for waste vehicles, with added benefit of keeping waste contract costs down

The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to minimise this risk and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table Twenty One: Loans for Service Purposes

Category of Borrower	Actual as at 31/03/2021			2022/23 Approved Limit £k
	Balance Owing £k	Loss Allowance £k	Net Figure in Accounts £k	
Local Businesses	140	0	140	200
Local Authorities	4,363	0	4,363	7,500
Community (small) Loans	0	0	0	1,000
Employees	12	0	12	100
Total	4,515	0	4,515	8,800

183. Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Councils statement of accounts will be shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

184. No loss allowance is set aside for the current loans made for service purposes. In the case of the loan to the local business and the loan to the joint operation, the Council has a charge over the asset. The asset values are currently higher than the value of the balance owing on the respective loans, therefore no loss allowance is currently required. Assets are revalued in line with the accounting policies and the loss allowance will be revised if asset value reduces to a level below the balance outstanding on the loan.

185. The Council assesses the risk of loss before entering into and whilst holding service loans by working up a robust business case and applying due diligence to all requests for service loans, and proportionate monitoring of credit risk of borrowers. For example, with loans to key businesses the Council's finance specialist team (qualified accountants) will review financial statements and service officers will maintain communication with the borrower in order that emerging risks are identified promptly. The Council will use credit rating information where available, and will use external specialist advisors if appropriate.

Service Investments – Shares

186. The Council does not currently hold any direct investment in the shares of subsidiaries, its suppliers or local businesses.

Commercial Investments – Property

187. The Council has invested in a diverse investment property portfolio both locally and nationally with the intention of generating surplus income that will be spent on local public services delivered within the district. This was in response to significant reductions in government funding over recent years and in order to meet service delivery objectives and the place making role of the Council.

188. The Council agreed at its meeting on 16th December 2021 to no longer make such investments due to changes in the revised Prudential Code that no longer allowed such investments to be undertaken.

189. The total value of property acquired for investment purposes as at 31 December 2021 is £99.251m. The current value in the accounts in respect of these purchases is not known at the stage as the gains and losses on properties are undertaken as part of the closure of accounts.

190. In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. The Council also recognises that asset values may increase and decrease over time due to market volatility, and takes a long term perspective with the assumption that capital values are likely to hold or grow over the life of the asset.

- **Where value in accounts is at or above purchase cost**: A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2021/22 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

  Or

- **Where value in accounts is below purchase cost:** The fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss, and the Council is therefore taking mitigating actions to protect the capital invested. These actions include: planning to hold the assets for the long term; maintaining assets to appropriate quality; mitigating risk of realised losses through maintaining adequate funds in an Investment Risk Reserve, and reducing capital borrowing through its MRP policy.

191. The Council assesses the risk of loss whilst holding property investments by undertaking appropriate due diligence including full valuation surveys and operating an asset management plan. The Council also considers strength of local market conditions to give confidence on future re-letting and also considers possible alternative uses if appropriate, and actively monitors the portfolio to ensure tenant obligations for maintaining assets are fulfilled.

192. Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council actively manages cash flow through its treasury management arrangements and plans to under-borrow against its CFR so that it can temporarily borrow at short notice if required.

193. The Council's asset disposal policy includes the approved process for asset disposal and performance indicators (property management indicators) which provide the information on the performance of each property. The performance indicators provide information on assets which are not yielding the level of return required.

194. The Council uses industry standard software, to track the performance of its investment portfolio. The software is capable of monitoring running yields asset by asset and across the portfolio, and adopting multiple scenarios. By continually reviewing the market, the tenant covenant and unexpired lease term of each property, the Council is able to find the optimum time to dispose of assets.

Other Categories of Investment

Table Twenty Two: Other Investments

Category of Borrower	Actual as at 31/03/2021			2022/23 Approved Limit £k
	Balance Owing £k	Loss Allowance £k	Net Figure in Accounts £k	
Joint Operations	31,600	0	31,600	35,000
Total	31,600	0	31,600	35,000

195. **Special Purpose Vehicles -** The Council has setup a special purpose vehicle (SSDC Opium Power Ltd) which has successfully delivered a renewable energy project, a second project is nearing completion and a third project is in the early stages of development. The Council's is continuing its journey into ownership and development of renewable energy which will provide essential support to the National Grid for balancing power demand and storing renewable energy. The company is 50:50 owned between the Council and Opium Power Limited, with the Council providing a secured term loan facility to the SPV. A repayment schedule for both projects has been agreed with the SPV as part of the loan conditions.

Proportionality

196. The table below shows the extent to which the expenditure planned to meet the service delivery objectives and place making role of the Council is dependent on achieving the expected net income from investments over the lifecycle of the Medium Term Financial Plan.

197. Should it fail to achieve the expected net income, the Council's contingency plans for continuing to provide these services including holding adequate funds in an earmarked Investment Risk Reserve as well as carrying adequate General Reserves. Budget estimates are also set using prudent assumptions about net income from the portfolio.

Table Twenty Three: Proportionality of Investments

	2020/21 Actual £'000	2021/22 Projection £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Gross Service Expenditure	81,003	66,988	74,279	69,807	72,618
Investment Income:					
Treasury Investments	3,958	1,973	2,486	2,906	2,587
Commercial Investments	5,744	8,213	7,410	5,732	5,385
Total Investment Income	9,702	10,186	9,896	8,638	7,972
Proportion %	**11.98%**	**15.21%**	**13.32%**	**12.37%**	**10.98%**

198. Investment income shown in the above table is the gross income included in the budget estimates, disregarding asset management and capital financing costs.

Borrowing In Advance of Need

199. Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Up to December 2021, the Council has chosen not to follow this guidance and borrowed for this purpose to generate income to lessen the impact of reductions in grant funding from Government.

200. On the 16 December 2021, Council agreed not to undertake any new commercial investments in order to be compliant with the revised prudential code.

Related Matters

201. **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

202. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

203. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit

rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

204. In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

205. **Markets in Financial Instruments Directive:** The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the S151 Officer believes this to be the most appropriate status.

Financial Implications

206. The budget for investment income and debt interest in 2022/23 is summarised as follows:

Table Twenty Four: Interest Income and Costs Budget Estimates

	2022/23 Investment Income £'000	2022/23 Average Interest Rate %	2022/23 Interest Costs £'000	2022/23 Average Interest Rate %	2022/23 Net Income or Costs £'000
Total	(2,486)	2.00%	1,197	1.00%	(1,289)

207. If actual levels of investments and borrowing, or actual interest rates differ from those forecast, performance against budget will be correspondingly different. Significant variances will be identified in budget monitoring reports to the Senior Leadership Team and the District Executive.

Other Options Considered

208. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The S151 Officer, having consulted the Portfolio Holder for Finance believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Table Twenty Four: Other options considered

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain