



To:
All members of the
Corporate Policy and Resources
Committee

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Date: 21 November 2022

Supplementary Agenda

Corporate Policy and Resources Committee - Monday, 28 November 2022

Dear Councillor

I enclose the following items which were marked 'to follow' on the agenda for the Corporate Policy and Resources Committee meeting to be held on Monday, 28 November 2022:

12. Sinking Fund Policy
Report to follow

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Yours sincerely

Karen Wyeth
Corporate Governance

To the members of the Corporate Policy and Resources Committee

Councillors:

J.R. Boughtflower (Chairman)	R.O. Barratt	L. E. Nichols
A.J. Mitchell (Vice-Chairman)	J.T.F. Doran	R.J. Noble
M.M. Attewell	S.A. Dunn	O. Rybinski
I.J. Beardsmore	T. Fidler	J.R. Sexton
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Substitute Members: Councillors: C. Bateson, S. Buttar, J. Button, N.J. Gething,
M. Gibson, H. Harvey, T. Lagden, V.J. Leighton,
D. Saliagopoulos, J. Vinson and S.J Whitmore

Corporate Policy & Resources Committee



28 November 2022

Title	<i>Sinking Fund Policy 2022/23 to 2071/72</i>
Purpose of the report	To note
Report Author	<i>Paul Taylor Chief Accountant</i>
Ward(s) Affected	All Wards
Corporate Priority	Service delivery
Recommendations	<p>Committee is asked to note the report, where Officers are prudently forecasting that the cash backed Sinking Fund Balance at 31 March 2073 will be in excess of £230m and agree the following recommendations:</p> <ol style="list-style-type: none"> 1. That the Sinking Fund is compiled on a portfolio basis, rather than a property-by-property basis and is reported annually to Corporate Policy & Resources Committee as part of the Reserves Strategy Report. 2. The 50 year Sinking Fund Policy is reviewed every five years or earlier in the event of a material emergency, as defined in 1.3 below. 3. In January 2024, Officers will present a 50-year financial risk model, based on an external model, to this Committee to assist with the medium to long term management of risk. 4. The Sinking Fund is to cover unplanned short-term issues, to minimise risk, protect the Council's Revenue Budget and Council Taxpayers from exposure to short term dips in income and build sufficient cash backed reserves to provide the Council with future options, including refurbishments (net of dilapidations) development and or sale of the site, particularly in 14 years' time in the case of BP site, when BP could exercise their lease break and vacate the entire site at Sunbury.
Reason for Recommendation	<p>The Committee is being asked to take this action in order to:</p> <ul style="list-style-type: none"> • Gain a better understanding of the long-term use of the Sinking Fund, • Acknowledge that only Council can authorise a draw down from the Sinking Fund, either through the annual budget setting process or via a special report seeking Council approval. • Reduce the Council's exposure to risk, by developing its 50-year financial model.

1. Summary of the report

- 1.1 The Sinking Fund is currently a collection of individual earmarked reserves for each investment and regeneration property and any movement into or out of the reserves is subject to Council approval, as part of the annual budget setting and monitoring reporting processes.
- 1.2 In the event that a draw on the Sinking Fund is required, it will be subject to a report that will require full Council approval and, on that basis, Officers are recommending that the Sinking Fund should be compiled on a portfolio basis, i.e., aggregated moving forward and included as part of the annual Reserves Strategy Report presented to Corporate Policy & Resources Committee in January each year.
- 1.3 The Sinking Fund Policy will be reviewed every five years or earlier, in the event of a material emergency issue (such as another Pandemic) facing the Council's Investment & Regeneration Property Portfolio. (Material is defined as a multi-million pound challenge, that cannot be resolved through the annual budget setting process or reduces the annual contribution from the investment and regeneration property portfolio below £10m).

2. Financial Model

- 2.1 The annual sinking fund movements (in/out) form part of the overall strategy of the investment and regeneration properties portfolio that aims to deliver at least £10m+ annual contribution to the Council's affordable housing programme, regeneration programme and the delivery of key frontline services.
- 2.2 The model is made up as follows:
 - (a) Asset Acquisition Income - Gross rental income as per the current signed lease for all our tenants.
Less the following:
 - (b) Landlord Costs, these are typically known and or planned costs, and would include (not an exhaustive list) the following:
 - i) Voids arising from break/lease terminations
 - ii) Capital & Revenue (rent free) contributions for new tenants
 - iii) Planned repairs and enhancements, particularly after a tenant change.
 - iv) Short term leases reductions.
 - (c) Minimum Revenue Payments, provided fully against the capital repayment element of each PWLB loan.
 - (d) Interest payments based on the charge for each Public Works Loan Board loan.
 - (e) Set aside – the Council provides funding of up to £1m per annum from rental income to cover all the new costs, i.e., staff in support functions, consultancy costs etc., typically only £600k is used.
 - (f) Contributions to the sinking fund reserves, predetermined each year (to date have ranged between £5m and £9m per annum), aiming to build sufficient funds to cover unplanned:

- i) Voids
- ii) Rent free periods, business rates, repairs, and enhancements (not covered by service charges or dilapidations).

Where possible, these costs should be budgeted for, within the five-year business cycle, under Landlord Costs in 2.2(b) above and from 2024/25 will require a separate revenue and capital growth bid to be submitted as part of the Council Budget setting process, for maximum transparency.

- (g) Payments from the Sinking Fund, typically for unplanned items that occur, i.e., a tenant going into insolvency and after deducting the lease guarantee held, there is a small residual balance required to balance the books.

Overall, the Investment & Regeneration portfolio aims to annually contribute £10m+ towards Council's, affordable housing programme, regeneration programme and essential services.

3. 2023/24 to 2026/27 Sinking Fund Forecasts

3.1 Attached to this report are the Sinking Fund Forecasts for the four years from 2023/24 to 2026/27, which incorporates Officers forecast for the elements included in section 2 above.

3.2 The Council's Investment & Regeneration portfolio has performed extremely well during COVID-19 pandemic, the worst economic downturn in over 300 years.

3.3 The impact of the war in Ukraine has also adversely affected the Council's rental income, and whilst the premises are soon to be vacant, the Council has taken the opportunity to approve upgrades to the building, rather than wait until the premises are reoccupied.

3.4 Following extensive negotiations with an existing tenant, at another building, they have finally decided to terminate their lease in December 2022 and whilst there is an option to relet some or all of these units, which will be shortly discussed by Council.

3.5 The Council is looking to fund a significant budget variance in 2023/24 and a decision could be made to only partially fund the shortfall in contribution from the Investment & Regeneration portfolio from the Sinking Fund, with additional reserves and or income generation strategies or cost reduction initiatives.

3.6 Once Council has advised on the way for items 3.4 and 3.5, Officers will reflect and confirm where the forecast Sinking Fund Reserve will be at the end of 31 March 2027.

3.7 Subject to the above, Officers are forecasting that the closing balance on the Sinking Fund Reserves at 31 March 2027, will be in the region of £33-37m.

3.8 2027/28 to 2072/73 Sinking Fund Forecast

3.9 On average, each year the Council aims to contribute at least £3.5m net towards the Sinking Funds.

3.10 Over the remaining 45 years and with an average forecast annual net contribution of £3.5m per annum, and with an average annual interest income on these cash back reserves of £1m, the Council should have accumulated

over £230m to meet the objectives of establishing the Sinking Fund, as set out in section 8 below.

3.11 The difference between what the Council has contributed to the Sinking Fund in the first ten years and what it will contribute for the next 45 years, does provide sufficient head room to ensure that the Council can mitigate its risks and leave sufficient funds to either:

- (a) Increase the contribution towards the Council's essential services, affordable housing & regeneration programme
- (b) Increase the annual contribution to the sinking fund beyond £3.5m
- (c) Provide for additional landlord costs

This will provide Council with greater flexibility to meet the demands of a multi-faceted local authority.

3.12 However, this simplistic view is not robust enough to stress test the Council's investment and regeneration portfolio and therefore, Officers are recommending that, although the Council has demonstrated the portfolio robust through the COVID Pandemic, due to current challenges posed by the Cost-of-Living crisis and time pressures on Officers during the budget setting process, the production of the updated 50 year sinking fund model and risk analysis bench testing is deferred for 12 months, to enable Officers to consider two options:

- (a) Council develops its own financial model from the existing data within Bluebox. Whilst this option is preferred in the medium to long term, as it provides resilience within the team, ensures that there is career progression and would provide the Council with an FTE that could be put to good use over the whole year, rather than using an external consultancy firm for a few weeks just for this project.

(An FTE would also provide more support to both the Assts and Finance teams, with the Knowle Green Estates Ltd., projections which is another long-term financial model the Council must maintain in order to mitigate its risk and ensure it provides Value for Money for all its residents).

- (b) Subject to further evaluations, Officers are currently recommending using a third-party model to provide the data but to do so in a way that would enable the Council to undertake future modelling refresh, for the reasons mentioned in 3.8(a) above.

3.13 The financial implications of each option are similar:

- (a) £30-70k for an FTE or
- (b) £40-£100k for an external consultancy.
 - i) £30-70k for an external consultancy to design the model, the more bespoke the model, the higher the cost.
 - ii) £10-30k for annual support.

3.14 The funding for either of the options would come from the existing annual set aside budget and therefore, would not impact on the Council's revenue budget, i.e., it is fully funded.

4. Cost of living adjustment – BP Properties.

- 4.1 Please note that the terms of the lease agreement with BP for their two properties include an upwards only escalation clause based on the annualised inflation figures for the last five years (indexed uplift happens every 5 years under the lease and is subject to a collar of 0% and a cap of 3% per annum).
- 4.2 In autumn 2021 the annual uplift resulted in an additional £1.8m of rental income per annum being received for the next five years.
- 4.3 Given the current inflation levels in the United Kingdom, the Council is expecting a substantial uplift in the annual rental income in 2026 onwards (with 4% uplift already locked in for the 12 months to September 22).

5. Cash backed reserves.

- 5.1 The Sinking funds are cash backed earmarked reserves and officers have invested this money in medium term investments that are currently yielding over £1m per annum. As earmarked reserves the funds in those reserves can only be applied for the purposes, in this case as set out in 2.2 f and g above, for which those funds have been set up with the approval of Council. This sum is included in Interest Earnings within the budget and as the Sinking Fund Reserves increase, the interest received should also increase, subject to the interest rates prevailing at the time.
- 5.2 This money is added to the sinking funds at the end of the year and is an additional source of annual growth for the sinking fund reserves.

6. 2021/22 Revenue Outturn Surplus

- 6.1 In 2021/22 officers reviewed the Sinking Funds for the next five years and in view of the short-term pressures that were building, particularly in 2022/23 and 2023/24, Council approved an additional contribution of £2.49m to the Sinking Fund from the aggregate Revenue Outturn surplus.
- 6.2 These additional funds will be fully utilised to meet the additional expenditure approved by the Development Subcommittee.

7. 2022/23 Q1 Revenue Monitoring Report

- 7.1 Summarising the above based on the June Q1 Revenue Monitoring report the 2022/23 budget and forecast is as follows:

Commercial Assets	Revised Budget £'000	Forecast Outturn £'000	Variance £'000
Rental Income (as per signed lease)	(54,001)	(52,327)	1,674
/ess: Landlord costs	8,161	7,670	(491)
Net Rental Income receivable	(45,840)	(44,657)	1,183
Loan Interest Payable	22,420	22,420	0
Minimum Revenue Provision	11,067	11,067	0
Sinking Funds - contributions to	6,062	6,062	0
Sinking Funds - release from	(3,767)	(4,950)	(1,183)
Set Asides for specific revenue purposes	455	455	0

Net Income (to fund Revenue budget)	(9,603)	(9,603)	(0)
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Regeneration Assets	Revised Budget £'000	Forecast Outturn £'000	Variance £'000
Rental Income (as per signed lease)	(5,245)	(5,114)	131
less: Landlord costs	883	1,415	532
Net Rental Income receivable	(4,363)	(3,700)	663
Loan Interest Payable	747	747	0
Minimum Revenue Provision	900	900	0
Sinking Funds - contributions to	751	751	0
Sinking Funds - release from	(57)	(720)	(663)
Set Asides for specific revenue purposes	675	675	0
Net Income	(1,347)	(1,346)	0

7.2 The release from the Sinking Fund amounting to £1,846m (£1,183m) for investment and (£0,663m) regeneration properties was covered by the £2.49m put into the Sinking Fund from the 2021/22 revenue outturn surplus (see section 5 above).

8. What is the purpose of the Sinking Fund?

8.1 As mentioned above, part of the purpose of the Sinking Fund is to cover unplanned short-term issues, to minimise risk, protect the Council's Revenue Budget and Council taxpayers from exposure to short term dips in income.

8.2 It is also to build sufficient cash backed reserves to provide the Council with future options, including refurbishments (net of dilapidations) development and or sale of the site, particularly in 14 years' time in the case of BP site, when BP could exercise their lease break and vacate the entire site at Sunbury.

9. Financial implications

9.1 The financial implications have been highlighted in the report above.

10. Risk considerations

10.1 There are no further risk considerations.

10.2 One area that has been worked on in the last year, is within the budget setting process as we now show gross Asset Acquisition Rents (per the signed lease) then deduct Landlord Costs, rather than netting the two off under Asset Acquisition Income heading. This has provided greater transparency, accountability, with stronger budgeting and forecast modelling going forward.

11. Procurement considerations

11.1 Officers have received indicative quotes of between £30,000 and £70,000 from external consultancy firms for developing a financial model for the

Council, if it is agreed to go with the lower cost figure, then it will be under £40,000 and will not have to go through the normal procurement process.

12. Legal considerations

- 12.1 Further to the Local Government Act 1992, the Council has a duty to produce a 'balanced budget'. Proper management of the Sinking Fund helps to strengthen the Council's financial position which will assist with setting a balanced budget in future and mitigate against exposure to financial risks.

13. Other considerations

- 13.1 There are none.

14. Equality and Diversity

- 14.1 There are none.

15. Sustainability/Climate Change Implications

- 15.1 There are none.

16. Timetable for implementation

- 16.1 Submit a 50-year model of the sinking fund, from 2028/29 through to 2077/78 for the Corporate Policy & Research Committee at their meeting on January 2024.

17. Contact

- 17.1 Paul Taylor p.taylor@spelthorne.gov.uk

Background papers: There are none.

Appendices – There are none.

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