

## Corporate Policy & Resources Committee

20 February 2023

<b>Title</b>	<i>Sinking Fund Policy as at February 2023</i>
<b>Purpose of the report</b>	To note
<b>Report Author</b>	<i>Paul Taylor Chief Accountant</i>
<b>Ward(s) Affected</b>	All Wards
<b>Corporate Priority</b>	Service delivery
<b>Recommendations</b>	<p><b>Committee is asked to note:</b></p> <ol style="list-style-type: none"> <li>1. <b>The Sinking Fund Policy, which will be reviewed every five years or earlier in the event of a material emergency, as defined in 1.3 below.</b></li> <li>2. <b>The Sinking Fund is to cover <u>unplanned</u> short-term issues, to minimise risk, protect the Council's Revenue Budget and Council Taxpayers from exposure to short term dips in rental income and build sufficient cash backed reserves to provide the Council with future options, which may include funding refurbishments (net of dilapidations) development and or sale of any of the current property portfolio, in particularly in 14 years' time, when BP could exercise their lease break and vacate the entire site at Sunbury.</b></li> </ol>
<b>Reason for Recommendation</b>	<p>The Committee requested that the previous report was restructured to focus on the policy and ultimate aim of the Sinking Fund to:</p> <ul style="list-style-type: none"> <li>• Gain a better understanding of the long-term use of the Sinking Fund,</li> <li>• 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.</li> </ul>

### 1. Summary of the report

#### 1.1 The purpose of the Sinking Fund Policy is:

- (a) to minimise risk and protect the Council's Revenue Budget and Council taxpayers from exposure to **unplanned** short term dips in income.
- (b) to ensure that the Council build sufficient cash backed reserves to provide future options at each property, including:
  - i) refurbishments (net of dilapidations),

- ii) development of a site, particularly in 14 years' time in the case of the Sunbury Campus, when the tenant could exercise their lease break and vacate the entire site at Sunbury.
  - iii) Repayment of PWLB Loans in the event of a tenant default.
- 1.2 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.
- 1.3 **Material Unplanned Events**
- 1.4 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 £10.8m.
- 1.5 Payments from the Sinking Fund, for unplanned items that occur, could include:
  - (a) a tenant going into insolvency and after deducting the lease guarantee held, there could be a small residual balance required to balance the books, as happened recently at one of the Council's Investment & Regeneration Properties.
  - (b) The impact of the war in Ukraine, was a material unplanned event, which has adversely affected the Council's rental income, at one of its Investment & Regeneration properties and whilst the premises are soon to be vacant, the Council has taken the opportunity to bring forward planned upgrades to the building, rather than wait until the premises are reoccupied, this expenditure under the Sinking Fund policy, would be funded from the Sinking Fund Reserve.

The list of what is a material unplanned events is not exhaustive nor is it prescriptive.
- 1.6 The remaining items on the Sinking Fund are deemed to be operational in nature.
- 1.7 Once this Committee/Council confirms its strategic objectives and plans for each site, the operational model for our Sinking Fund, shown below can be adjusted and end balances quantified, that is why is it important that Council exercises in strategic judgement and provides Officers with notice of its intentions at the earliest possible moment, so they can look at the operational issues and provide Council with feedback on their plans or adjust the budget in order to meet these objectives.
- 1.8 As a benchmark, Officers would suggest to the Committee the following operational milestones, until the Committee confirms its strategic objectives, having ensured that each year, the Council receives £10.8m towards funding frontline services, affordable housing and regeneration programme:
  - (a) The first milestone should be to accumulate Sinking Fund balances of at least £37m to ensure that the Council would be able to repay the loans in light of a major catastrophe
  - (b) In fourteen years' time, the Sinking Fund balance should be in the order of £60m and this would enable the Council to pump prime any redevelopment of the Sunbury site, in the event our existing tenant vacates the premises.

- (c) Put an average net payment of £3.5m per annum into the Sinking Fund reserve.

## **2. Options Analysed**

2.1 **Stick with the existing policy** - this was considered and rejected, as Officers believe that the Council should ensure that the planned income and expenditure is incorporated into the budget setting process, and that the use of the Sinking Funds (a reserve) is not delegated to a subcommittee but remains with CPRC/Council for a formal decision, in the overall scheme of the Council's finances.

- (a) **Stick with the existing strategic objectives** – which are vague and not quantified.

2.2 **Amend the policy as per the report (Recommended)** – this provides greater clarity to Council on how the Sinking Funds should be utilised and restores control of the Sinking Fund (a reserve) back to CPRC/Council. The definition of material unplanned event clarifies when the Sinking Fund can be used.

- (a) **Updating Strategic Objectives** – the Committee is asked to provide Officers with a revised/updated set of Strategic Objectives for the Sinking Fund, to enable them to prepare the 50 year projections and accept the interim objectives set out in 1.8 (a), (b) and (c) above, until the new objectives have been agreed

## **3. Operational Model for the Sinking Fund**

3.1 As part of the budget setting process, Assets and Finance Officers update the rolling 5 year financial plan for each individual property that makes up the Investment & Regeneration portfolio.

3.2 The Annual Budget Setting process and Medium Term Financial Strategy provide Council with the expected cashflow movements and anticipated contributions in to and out of the Sinking Fund Reserve, for the 4 years ahead.

3.3 The annual Sinking Fund movements (in/out) form part of the overall operational management of the investment and regeneration properties portfolio that aims to deliver at least £10.8m annual contribution to the Council's affordable housing programme, regeneration programme and the delivery of key frontline services.

3.4 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 £0.63m per annum from rental income to cover all the new costs, i.e., staff in support functions, consultancy costs etc.
- (f) Contributions to the Sinking Fund reserves, are predetermined each year and approved by Council (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).

These costs should be budgeted for, within the five-year business cycle, under Landlord Costs in 2.2 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.

3.5 Every 5 years or in the event of a major catastrophe Officers will review the Sinking Funds and prepare revised 50 year forecasts for the Sinking Funds.

3.6 The Committee will need to agree the strategic objectives for the Sinking Fund, to enable the Finance Team to model the next 50 years and ensure that it is operationally possible to deliver the outcomes. Once received the Finance Team will commence work on modelling the next 50 years, noting that:

- (a) Due to the current workload pressure on the Finance Team with Budget Setting and preparing the Annual Accounts, between December and April, as well as implementing a new budget monitoring system by 1 October 2023. Together with the volume of work this Committee has to deal with between January and February each year, to agree the annual budget, Officers will work to build a robust and updated financial model to deliver the 50 year review of the Sinking Funds based on the Committees updated strategic objectives and present their report to this Committee by June 2024.

#### **4. Financial implications**

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

#### **5. Risk considerations**

5.1 There are no further risk considerations.

#### **6. Procurement considerations**

6.1 There are none.

#### **7. Legal considerations**

7.1 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.

**8. Other considerations**

8.1 There are none.

**9. Equality and Diversity**

9.1 There are none.

**10. Sustainability/Climate Change Implications**

10.1 There are none.

**11. Timetable for implementation**

11.1 From 1 April 2023:

- (a) managing the Sinking Funds becomes a function for the Finance Team and will be reported annually in the Capital & Reserves.
- (b) All expenditure for the Investment & Regeneration Properties will be dealt with under Landlord Costs (which are made transparent in the below the line detailed budget analysis).
- (c) At the end of the year, as part of Outturn and the Capital & Reserves Strategy, Officer will make recommendations for any additional funds to be paid into the Sinking Fund.
- (d) Based on the definition of material unplanned events in 1.3 above or to maintain the level of contribution of £10.8m to Council from the Investment & Regeneration Properties, Officer will make recommendations to this Committee for approval, as to the aggregate amount of support required from the Sinking Fund, over and above those amounts set in the annual budget.

11.2 June 2023 - to be implemented with the 2024-25 Budget Setting Process – the Investment & Regeneration portfolio, should complete a Service Plan for this Committee to review.

11.3 June 2024 – Report on 50 year projections on Sinking Fund.

**12. Contact**

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**Background papers:** There are none.

**Appendices –** There are none.