Item: 3

Policy and Resources Committee: 27 February 2024.

Capital Programme Affordability.

Report by Head of Finance.

1. Purpose of Report

To advise on the available headroom within the Loans Fund, to add new projects to the Council's capital programme for the next 5 years, covering the period 1 April 2024 to 31 March 2029.

2. Recommendations

The Committee is invited to note:

2.1.

That development of capital projects can be funded by several sources, as follows:

- Scottish Government General Capital Grant and other specific grants.
- Capital grants from other external sources.
- Capital receipts generated through the sale of assets.
- Capital contributions from internal reserves.
- Capital financed from current revenue income or surpluses.
- Borrowings from the Loans Fund.

2.2.

That the annual award of General Capital Grant allows the funding of the undernoted annual improvement programmes, totalling £3,921,000, with the remaining balance spent in the year of receipt to lower the level of borrowings required to deliver the capital programme:

- Corporate Asset Replacement – £1,351,000.
- Road Asset Replacement Programme – £950,000.
- IT Replacement Programme – £420,000.
- Plant and Vehicle Replacement Programme – £1,200,000.

2.3.

That the General Capital Grant awarded for financial year 2024/25 from the Scottish Government has seen a reduction of £1,234,000 on the previous year, to £4,640,000, which reduces the affordability of the capital programme going forward.

2.4.

That the loan charges budget to repay debt is baselined at £3,500,000 with effect from 1 April 2024 and must cover the cost of any General Fund borrowing to finance capital spend as well as management of the capital programme, at a cost of £200,000.

2.5.

That, in addition to the sum of £200,000 charged in respect of delivery of the capital programme, a further sum of £200,000 is set aside in the Capital Project Appraisal Fund, established to provide revenue budgets for Services to develop capital project appraisals when existing revenue budgets were no longer sufficient to fund those costs.

2.6.

That Services access the Capital Project Appraisal Fund through initial approval by the Capital Planning and Asset Management sub-group and then final approval by the Corporate Leadership Team.

2.7.

That the undernoted trading accounts of the Council do not have access to the loan charges budget to repay their debt, therefore any borrowings incurred on capital projects must be paid for from within their own budgets, including payment of principal, interest and debt management fees:

- Housing Revenue Account.
- Scapa Flow Oil Port.
- Miscellaneous Piers and Harbours.
- Quarry Service.
- Strategic Reserve Fund.

2.8.

That the charges detailed at paragraphs 2.4 and 2.5 above, leave a net loan charges budget of £3,100,000, which equates to headroom for General Fund Services to borrow a maximum of £32,000,000 over the next five years, from 1 April 2024 to 31 March 2029.

3. Background

3.1.

The Council has adopted the Definition of Capital Expenditure, and the stated accounting procedures, as contained within the CIPFA/LASAAC Statement of Recommended Practice (SORP):

- Expenditure on the acquisition of a tangible asset, or expenditure which adds to, and not merely maintains, the value of an existing asset, should be capitalised, provided the fixed asset yields benefit for a period of more than one year.

3.2.

The development of capital projects can be funded by several sources, as follows:

- Scottish Government General Capital Grant and other specific grants.
- Capital grants from other external sources.
- Capital receipts generated through the sale of assets.
- Capital contributions from internal reserves.
- Capital financed from current revenue income or surpluses.
- Borrowings from the Loans Fund.

3.3.

The General Capital Grant awarded for financial year 2024/25 from the Scottish Government has seen a reduction of £1,234,000 on the previous year to £4,640,000. The General Capital Grant is used on an annual basis to fund the annual capital improvement programmes totalling £3,921,000, as follows:

- Corporate Asset Replacement – £1,351,000.
- Road Asset Replacement Programme – £950,000.
- IT Replacement Programme – £420,000.
- Plant and Vehicle Replacement Programme – £1,200,000.

3.4.

The previous annual awards of General Capital Grant allowed the funding of the annual improvement programmes, referred to at section 3.3 above, and the remainder to be spent in the year of receipt to lower the level of borrowings required to deliver the capital programme. The reduction in the level of this funding source does reduce the affordability of the capital programme going forward.

4. Loan Charges

4.1.

The loan charges budget to repay debt is baselined at £3,500,000 with effect from 1 April 2024 and forms part of the revenue budget being presented as a separate report to this Committee. The loan charges budget repays the debt held in the loans fund.

4.2.

The loan charges budget must cover the cost of any General Fund borrowing to finance capital spend and £200,000 in respect of the management of the capital programme.

4.3.

In addition to the £200,000 charged in respect of the capital programme delivery, a further £200,000 is set aside in the Capital Project Appraisal Fund. This fund was established to provide revenue budgets for the Services to develop their capital project appraisals when existing revenue budgets were no longer sufficient to fund those costs.

4.4.

The Services access the Capital Project Appraisal Fund through initial approval by the Capital Planning and Asset Management sub-group and then final approval by the Corporate Leadership Team.

4.5.

The charges detailed at sections 4.2 and 4.3 above, leave a net loan charges budget of £3,100,000, which equates to headroom for the General Fund Services to borrow a maximum of £32,000,000 over the next five years, from 1 April 2024 to 31 March 2029.

5. Loans Fund

5.1.

Under the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016, the Council operates a statutory Loans Fund which is administered in accordance with the 2016 Regulations, proper accounting practices and prudent financial management.

5.2.

All loans raised are paid into the Fund and then advances are made to Services to finance capital expenditure during the year.

5.3.

Repayments to the Loans Fund are calculated on a prudential basis using the asset life method where the annual repayments of principal are calculated as equal instalments based on the initial life and value of the asset.

5.4.

In addition to repaying the principal on the loan, the debt also incurs interest and debt management fees.

5.5.

The trading accounts of the Council do not have access to the loans fund budget to repay their debt, so any borrowings incurred on capital projects by the Housing Revenue Account, Scapa Flow Oil Port, Miscellaneous Piers and Harbours, the Quarry or the Strategic Reserve Fund must be paid for from within their own budgets.

5.6.

This means there is no headroom figure quoted for the trading services, referred to at section 5.5 above, and any projects they bring forward for approval must prove they are affordable to the Service and that they have enough budget to cover the repayments, including principal, interest, and debt management fees. Any budget required to repay debt must be factored into the annual budget setting process for their Service area.

6. Existing Capital Programme

6.1.

The existing approved capital programme has been factored into the headroom calculations, referred to at section 4.5 above, which ensures the funding is in place to allow them to proceed to completion.

6.2.

However, the Council has seen slippage in the delivery of capital projects over a number of years. The 2021/22 annual audit report recommended the Council addresses recurring slippage in its capital programme, however this has continued in 2022/23. A capital out-turn report presented to the Policy and Resources Committee in September 2023 indicated an approximate 20% underspend on the combined General/Non-General Fund capital programmes.

6.3.

Capital slippage can occur for a number of reasons such as capacity issues, delays in governance, legal dispute, affordability issues, loss of financing. For example, the following projects have not progressed as planned to date, and an explanation for slippage is also provided.

6.3.1. Integrated Waste Facility

The Integrated Waste Facility project was recommended for approval by the Policy and Resources Committee on 29 November 2021, at a gross capital cost of £17,206,000 with potential funding of £12,000,000 from the Scottish Government's Recycling Improvement Fund, leaving a net cost to the Council of £5,206,000 to be funded by borrowings from the Loans Fund.

6.3.1.1.

Anticipated external grant funding has still to be secured with a high chance that the level of external funding available could be significantly less than originally anticipated. Therefore, the financial profile for the project may need to change and in turn the project scope so the two realign. A full technical review is currently being undertaken by the project team and it is anticipated that a report will be presented to the appropriate Committee in due course, with the outcome and recommendations of this review. In the meantime, minimal project expenditure is forecast for this financial year.

6.3.2. Redevelopment of Garden House

The project to develop Garden House for use by the third sector was recommended for approval by the Policy and Resources Committee on 19 June 2018, at a gross capital cost of £980,000. There has been no confirmation of funding towards this project so the total approved cost will be funded by borrowings from the Loans Fund.

6.3.2.1.

Following the decision of Scottish Ministers not to confirm the stopping up order, revised car parking and access arrangements were approved. A planning application was submitted to vary a condition to allow occupation of development, which attracted objections. Planning permission was subsequently granted by the Planning Committee in August 2023. Construction tender documentation was returned in October 2023 and options are being discussed with Voluntary Action Outcome, the outcome of which will be presented to the Policy and Resources Committee for review as soon as possible.

6.4.

Section 7 of the Financial Regulations relates to the Capital Programme and quotes the following:

- Where no contractual commitment exists or will be made in the current or previous financial years for an approved capital project, the relevant programme provision(s) may be redeployed by the Policy and Resources Committee.

6.5.

This means that, if the two projects referred to above do not proceed, the borrowings currently committed to those projects could be redeployed to fund new additions to the 5-year capital programme.

6.6.

The approved capital programme also includes a contribution of £8,070,000 from the Strategic Reserve Fund, to fund the General Fund capital programme. Due to slippage on delivery of the programme this contribution has not been required to date, however, it is still accounted for in both the capital programme and the Strategic Reserve Fund, as a future commitment. If a decision was made to remove that funding source from the capital programme, it would significantly reduce the headroom to develop new projects but would also reduce the draw on reserves from the Strategic Reserve Fund.

7. Future Capital Programme

7.1.

Work has commenced to develop a 10-year Capital Investment Strategy and elected members were provided with a seminar in June 2023 to discuss and identify high-priority strategic projects to be developed for delivery in the future capital programme, and strategic projects to be concept-designed internally to explore external grant funding opportunities.

7.2.

The seminar highlighted that the current capital programme does not include an approved project to demolish the former Papdale Halls of Residence, which had previously been estimated at £2,500,000 due to high levels of asbestos contained in the building.

7.3.

The seminar also referenced the potential for a project to develop an Additional Support Needs Centre of Excellence, with an estimated build cost of £38,500,000. On 19 October 2022, the Education, Leisure and Housing Committee recommended that a funding application be submitted to the Scottish Government’s Learning Estates Improvement Programme. The application was successful, and the Council was awarded up to £20,000,000 in October 2023, towards the cost of a £40,000,000 project.

7.4.

Work has commenced to develop the full business case, or Capital Project Appraisal, for the Additional Support Needs Centre for Excellence to come forward for consideration by Members, however, it should be noted that, if this project proceeds, it will use over 60% of the available headroom to borrowings from the Loans Fund and therefore significantly reduce the funding available for other projects to be delivered.

7.5.

The preferred site for the Additional Support Needs facility is the former Papdale Halls of Residence and the total cost referred to at section 7.3 above would include demolition costs.

7.6.

The annual improvement programmes are also now considered to no longer be sufficient to cover the costs of the required replacements or improvements. Any request to increase those annual budgets would also impact on the headroom available to allow new projects to be added to the General Fund capital programme.

8. Peer Group Comparison

8.1.

The Council, along with the other Scottish local authorities, was recently asked to provide information on the level of debt repayments as percentage of net revenue streams and whether it had any plans to cap the level of borrowings to address revenue pressures.

8.2.

The Council performs very favourably in this comparison, with debt repayments equating to less than 2% of net revenue, however, it should be noted that this is partly due to high levels of slippage, and projects not progressing as planned and that the Council's revenue budget is higher pro-rata than many other authorities due to the use of the Strategic Reserve Fund to balance the annual revenue budget for General Fund Services.

8.3.

The low percentage of debt repayments to net revenue stream, detailed at section 8.2 above, can also be attributed to the previous strategy of accelerating debt repayments on previously completed projects, when the loans charges budget was not fully spent in the financial year. This strategy was considered a prudent approach to repay debt more quickly, allowing the headroom to increase and new projects to be added to the capital programme.

8.4.

Since financial year 2012/13 a total of £16,800,000 of accelerated debt repayments have been made from General Fund year-end surpluses, however, no acceleration has been possible at the end of financial year 2021/22 or 2022/23 as budgets across the Council have become more constrained and, in many instances, actually returning deficits against budget. This means any unspent loan charges budget is used to reduce the deficit position across the General Fund. It is also very unlikely that there will be sufficient funds to allow any acceleration to take place at the end of financial year 2023/24.

8.5.

The responses from the other local authorities to the questions referred to at section 8.1 above varied considerably, with the majority still considering their options in relation to Capital Programmes, as follows:

- Significant reduction in capital plans over the next 5 years and a cap on borrowing at 8.5%.
- Agreed a cap of 10% on financing costs.
- Huge issues in terms of backlog maintenance and significant improvements to the school's estate, so will be increasing debt levels and not considering a cap.

- Borrowing levels in the short term are causing a huge issue and adding multiple millions to revenue pressure due to high interest rates. Capital programme has been reviewed and projects stripped out.
- No limits imposed but no borrowings approved beyond the 5-year programme.
- Several attempts at reprioritising the programme and deferring projects where possible but found this difficult due to pressures from increasing pupil numbers, new housebuilding and backlog maintenance of buildings and roads.
- Low percentage of debt to net revenue stream but have used reserves to prop up the capital programme in the past.
- Have approval for an extra £1.5m Prudential Borrowing annually for the next 5 years but still face an annual shortfall.
- Options to generate funds are limited given land sale prices.
- Capital programme reduced, based on affordability concerns.

9. Corporate Governance

9.1.

This report is presented in order to comply with internal governance and reporting requirements and is not for the exclusive purpose of supporting or relating to improved outcomes for communities as detailed in the Council Plan or the Local Outcomes Improvement Plan.

9.2.

However, projects contained within the approved capital programmes are based on the priorities of the Council as articulated in the Council Plan and therefore support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

10. Financial Implications

10.1.

The Council’s Financial Regulations in respect of capital expenditure state the following:

- Approval by the Council of the capital programme constitutes approval of the individual projects or provisions contained therein.
- Any requests to incur expenditure out with the provisions included in the approved capital programme shall be reported to the Policy and Resources Committee for approval, prior to any commitment being made.
- The Chief Executive and Executive Directors cannot exercise virements within the capital programme, except in exceptional circumstances and only after consultation with the Head of Finance. The action taken and reasons for such virement must be reported to the next meeting of the Policy and Resources Committee.

- Where no contractual commitment exists or will be made in the current or previous financial years for an approved capital project, the relevant programme provision(s) may be redeployed by the Policy and Resources Committee.
- If the cost is likely to exceed the approved capital programme the shortfall must be reported to the next meeting of the appropriate Service Committee before the project is reconsidered by the Policy and Resources Committee, where additional budget can be allocated, or the existing provision redeployed.

10.2.

The General Capital Grant awarded for financial year 2024/25 from the Scottish Government has seen reduction of £1,234,000 on the previous year to £4,640,000.

10.3.

The net loan charges budget of £3,100,000, equates to headroom for the General Fund Services to borrow a maximum of £32,000,000 over the next 5 years, from 1 April 2024 to 31 March 2029

10.4.

No accelerated debt repayments have been made in financial years 2021/22 or 2022/23 and will be unlikely to happen in financial year 2023/24 due to the General Fund budget overall returning a deficit.

10.5.

The current approved capital programme includes a contribution of £8,070,000 from the Strategic Reserve Fund, to fund the General Fund capital programme. Due to slippage on delivery of the programme this contribution has not been required to date, however, it is still accounted for in both the capital programme and the Strategic Reserve Fund, as a future commitment. If a decision was made to remove that funding source from the capital programme, it would significantly reduce the headroom to develop new projects but would also reduce the draw on reserves from the Strategic Reserve Fund.

10.6.

The trading accounts of the Council do not have access to the loans fund budget to repay their debt, so any borrowings incurred on capital projects by the Housing Revenue Account, Scapa Flow Oil Port, Miscellaneous Piers and Harbours, the Quarry or the Strategic Reserve Fund must be paid for from within their own budgets.

11. Legal Aspects

11.1.

Section 95 of the Local Government (Scotland) Act 1973 requires the Council to make arrangements for the proper administration of its financial affairs. As part of that, the Council is expected to have regard to economy, efficiency and effectiveness in its use of resources.

11.2.

Section 35 of the Local Government in Scotland Act 2003 requires the Council to determine and keep under review the maximum amount which it can afford to allocate to capital expenditure.

12. Contact Officers

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