

Taunton Deane Borough Council

Executive – 18 January 2012

Capital Funding - Southwest One Transformation Projects

Report of the Performance and Client Lead

(This matter is the responsibility of Executive Councillor Vivienne Stock-Williams)

1. Executive Summary

£2.1m of capital borrowings, taken out to part fund the Southwest One Transformation Projects, will not be repaid from procurement savings when originally scheduled (during 2011/12). This is because procurement savings have not been realised as quickly as originally forecast.

The repayment arrangements for this capital borrowing therefore need to be reviewed.

This report discusses the options available and comments on the relative merits of those options.

2. Background

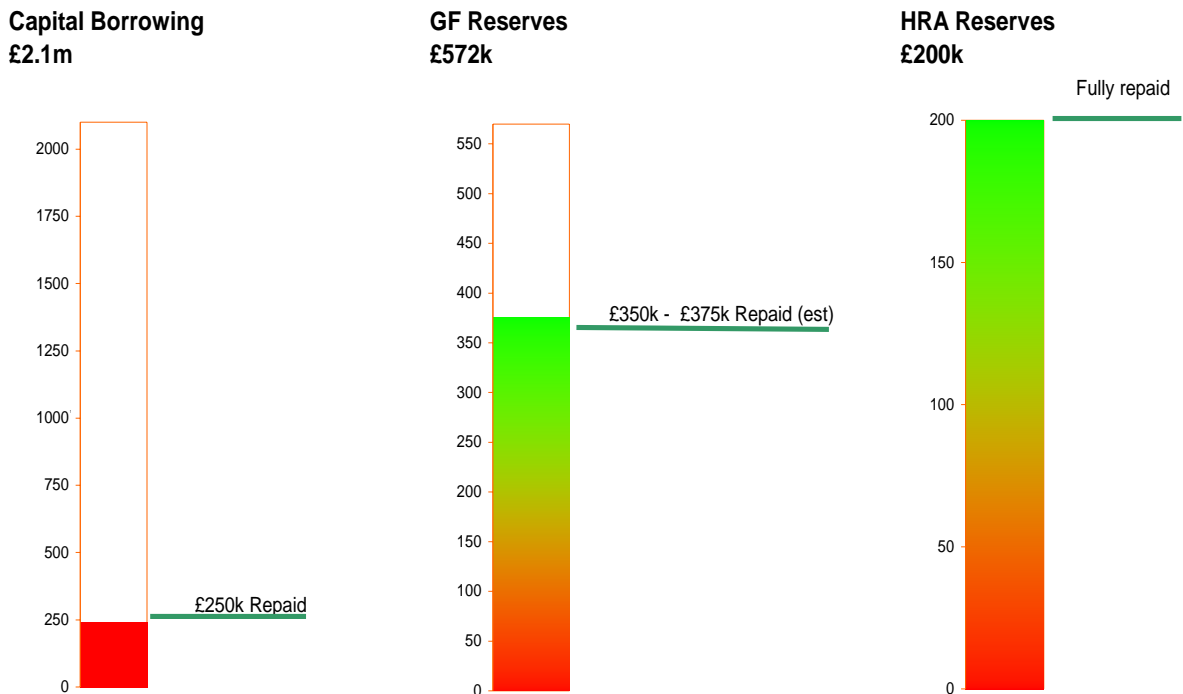
- 2.1 The Southwest One partnership was created to deliver five key Transformation Projects, in addition to the operational back-office services element of the contract. These Transformation Projects are the SAP BOP (Back Office Processing) system, SAP CRM (Customer Relationship Management) system, PEM (People Excellence Model), Locality Based Service Delivery proof of concept and Procurement Transformation.
- 2.2 The total cost of the Transformation Projects is £3.65m. The £3.65m total cost is comprised of capital costs totalling £2.1m and revenue costs totalling £1.55m.
- 2.3 The funding requirements for the Transformation Projects were agreed by the Executive on 14 November 2007. This would have seen the revenue borrowings from reserves (£772k) repaid by 2010/11 and the capital borrowings (£2.1m) repaid by end of 2011/12.
- 2.4 However, procurement savings have been delivered at a lower rate than originally anticipated in 2007. Back then it was estimated by IBM that £3.376m savings would have been generated by close of 2011/12. This would have been sufficient to have repaid reserves and to repay the capital borrowing within that time.
- 2.5 On 13 April 2011 a report went to the Executive (Transformation Projects - Funding Update Report) which sought approval for rescheduling repayment of the part of the revenue costs for these projects which had been funded from reserves.

- 2.6 This report seeks approval for rescheduling the repayment of the capital borrowings.
- 2.7 On 15 December this report went before corporate scrutiny. The recommendation received support of the committee. A question was asked as to whether the revised proposed timeframe for repaying the borrowing was realistic in light of savings delivery to date. It was suggested that perhaps extending repaying to the end of the Southwest One contract might be more appropriate. However, in response it was felt this would send out the wrong message to Southwest One and dilute the importance and urgency of maximising procurement savings to the Council.

3. Use of Procurement Savings to date

- 3.1 At end March 2011 a total of £944k had been 'top sliced' from budgets in recognition of procurement savings initiatives. During 2011/12 a further £310k approx will be 'top sliced' from budgets; giving a total of £1.25m procurement related savings (against the £3.376m that was originally envisaged).
- 3.2 £276k of the £1.25m savings has been used to fully repay the borrowing from HRA reserves. £76k had been used to partly repay GF reserves and a further £310k approx will also be allocated to GF reserves. The remaining £668k has been used for revenue costs associated with the transformation projects.
- 3.3 The charts below illustrate the likely position at end 2011/12 in relation to repayment of the borrowings for the Southwest One Transformation projects.

Repayment of Transformation Borrowing at End 2011/12



4. Options

- 4.1 There is a standard annual calculation for the repayment of capital debt – called Minimum Revenue Provision (MRP) – which provides for 4% of capital borrowing debt to be repaid each year. Therefore the Council has already started to repay the £2.1m capital debt in the accounts as shown below and within the chart at 3.3:

	2008/09	2009/10	2010/11	2011/12
	£'000	£'000	£'000	£'000
Sw One Capital Borrowing Balance	2107	2107	2023	1942
MRP at 4% of borrowing balance b/f		-84	-81	-78
Capital Borrowing Balance c/f	2107	2023	1942	1864
Cumulative Debt Repaid		-84	-165	-243

- 4.2 It is estimated that during the early part of 2014/15 sufficient procurement savings will have accrued to settle this debt in full. This would be 24-30 months later than originally forecast, back in 2007.
- 4.3 The delay in repayment would lead to additional interest costs being incurred. The calculation of interest costs are based on the CRI (consolidated interest rate – effectively the average of interest cost % and interest income %). On this basis it is estimated that a delay in repayment would cost £2m x 3.05% (current CRI) = £61k per year.
- 4.4 The MRP requirement is already factored into the MTFP and failure to repay these capital borrowing will not widen the present budget gap although the interest costs and 4% capital repayment are opportunity costs to the Council, as would otherwise have been available to support the budget.
- 4.5 Three repayment options have been considered as a solution to this item;

i) Repay the borrowing from procurement savings, as originally planned, albeit completing repayment in 2014/15 (24-30 months later than initially forecast). Repaying the debt at the earliest opportunity from procurement savings provides a more sustainable financial position for the Council in the long run. The capital debt would still be repaid within the lifetime of the capital item it was funding. This is the recommended option.

Two further options have been considered, although neither are options which can be recommended to members as prudent financing solutions in current circumstances;

ii) Continue with the current MRP and repay the capital borrowing at 4% per annum. This would enable the Council to divert procurement savings sooner to close the budget gap/protect services rather than repay debt. However, continuing with the current MRP profile delays the reduction in annual debt repayment and interest costs, meaning total interest costs over the life of the debt are much higher. It is generally not best practice to allow debt repayment to be extended beyond the lifetime of a capital item. In this case the Southwest One transformation contract is for ten years, ending in 2017.

If we settle the debt through continuing with MRP it would take 25 years to settle the debt, incurring significant annual interest costs throughout that period. Such monies would be unavailable to close the budget gap/protect services/support new investment. This option would provide a less sustainable financial position for the Council in the long term. For the foregoing reasons, this option cannot be recommended to members.

iii) Repay the capital borrowing from reserves. However, the Council needs to maintain or increase reserves in order to build resilience to meet financial challenges that are likely to be brought about by Government proposals for Local Government funding through Business rate retention as well as reform and localisation of the Council Tax Benefit system, for example. The Council would be exposed to significant additional financial risks should reserves be depleted to such an extent as would be required to settle this borrowing. For this reason, this option cannot be recommend members.

5. Finance Comments

The Council's finance team have seen this report and are satisfied the recommendation is prudent.

6. Legal Comments

There are no legal implications associated with this report.

7. Links to Corporate Aims

This report has no direct links to Corporate Aims.

8. Environmental Implications

This report has no environmental and community safety implications.

9. Community Safety Implications

There are no community safety issues associated with this report.

10. Equalities Impact

Equalities impact has been considered. It is concluded that there are no equalities impacts associated with the rescheduling of the repayment of this borrowing.

11. Risk Management

Specific risk management processes are in place between the Authority and Southwest One to manage risk within the partnership.

12. Partnership Implications

The delivery of procurement savings is the responsibility of Southwest One Strategic Procurement Service. The Southwest One partnership is one of the Authority's key partnerships.

13. Recommendation

That the Executive support the recommended option set out at **4.5 i** within this report.

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Transformation Projects Funding Summary

<u>Transformation project costs</u>	
Capital investment	£2.1m
Revenue investment	£1.55m
TOTAL INVESTMENT	£3.65m

<u>Funding arrangements</u>	
Capital – funded by prudential borrowing repayable in 5 years (2011/12)	£2.1m
Revenue – borrowed from reserves (£200k from General Fund Reserve) (200k from Housing Revenue Reserve) (£372K from Core Council Review Reserve)	£772k
Revenue – being funded directly from ongoing procurement savings	£778k
TOTAL FUNDING	£3.65m

<u>Variance between anticipated & actual procurement savings</u>	
Anticipated procurement savings @ 31st Mar 2012 based on the original model	£3.37m
Amounts removed from budgets based on anticipated savings from implemented procurement initiatives to 31st March 2011.	£944k
Estimated sum to be removed from budgets based on anticipated savings from implemented procurement initiatives during 2011/12	£310k
DIFFERENCE at 31 March 2012 between original anticipated and actual level of savings.	£ 2.12m