

Committee(s):	Date(s):
Resource Allocation Sub Committee Policy and Resources Committee	22 October 2020 22 October 2020
Subject: Capital Funding – Prioritisation of 2021/22 Annual Capital Bids - Initial Review	Public
<i>Which outcomes in the City Corporation's Corporate Plan does this proposal aim to impact directly?</i>	<i>These capital bids span all 12 outcomes of the Corporate Plan to some degree</i>
<i>Does this proposal require extra revenue and/or capital spending?</i>	<i>No decisions about specific commitments are required at this stage</i>
<i>If so, how much?</i>	
<i>What is the source of Funding?</i>	<i>All <u>central</u> funding sources of the three main funds could be impacted</i>
<i>Has this Funding Source been agreed with the Chamberlain's Department?</i>	
Report of: The Chamberlain	For Decision
Report author: Dianne Merrifield, Group Accountant (Capital)	

Summary

In this second annual capital bid round, there are 51 bids amounting to **£146m** of which £76m (13 bids) relates to the Climate Action Strategy. An initial sift has identified **£105m** relating to projects of a capital nature, with the remaining **£41m** falling outside the scope of the capital funding bid process since they:

- will not result in a capital project i.e. the type of expenditure and required funding stream is **revenue** in nature (13.5m); or
- do not require *central* capital funding as they rely on local **ring-fenced** sources of funding e.g. City's Cash and BHE Designated Sales Pools (£27.5m).

The £13.5m of bids requiring **revenue** resources all relate to Climate Action across a four year period, for which funding plans are being worked on as part of the medium-term financial planning.

The £76m of Climate Action bids exceeds the £68m quoted within the Climate Action Strategy document, with some of the bids submitted under the Climate Action heading being additional proposals from departments. The Climate Action Team will be undertaking a review of the bids to confirm priorities and profiles of proposed expenditure, to be brought back for consideration in December as part of the overall funding prioritisation.

Most of the £105m of capital bid submissions have been classified as essential and identified against one of the agreed prioritisation criteria. Based on the narrative supporting the bids, an assessment of how essential these schemes appear from a

corporate perspective has been undertaken using a RAG rating approach - resulting in £82.4m green, £14.1m amber and £8.3m red. Of the £82.4m green, £45.5m relates to business as usual (BAU) and £36.9m to Climate Action.

To set these bids in to some context, £89m of capital bids were approved in principle via the 2020/21 annual capital bid process. However, at that time it was anticipated that such a high level was exceptional and would not be sustainable on an ongoing basis alongside the other current financial priorities and pressures such as the major projects and balancing the revenue budgets, now further impacted by the pandemic.

- For City Fund, a large element of the £62m of green rated bids (£53m) would naturally fall to be funded from the capital reserves. However, this would leave capital balances severely depleted by the end of the medium term (<£20m) *before* making allowance for certain other potential commitments e.g. future years' bids for essential schemes, cash flow loans for the HRA etc. Capital reserves are a finite resource that can only be replenished through the sale of assets which would in turn impact on revenue income from rents. On this basis the current green rated City Fund bids amounting to £62m is not sustainable. An affordable funding envelope will be played out as part of the MTFP modelling for the 2021/22 budget.
- For City's Cash, funding for the £20m of green rated bids would require disposal of investments which would also in turn impact on revenue. Therefore, whilst £20m for the green schemes may not appear to be excessive compared to asset balances, this needs to be considered in the context of all the other pressures, including the need to balance the revenue position, the impacts of funding the Major Projects etc. An affordable level of bids needs to be built into the new City's Cash MTFP model to address the significant risk of unsustainability over the 10-year horizon.

Therefore, even if the bids classified as amber and red were to be deferred, the level of remaining green bids at £82.4m is considered to be too high and will require further scrutiny before final bid proposals can be agreed in December as part of the build up to the 2021/22 budget round. Therefore, the proposed way forward is:

- Chief Officers be requested to further consider the ranking of their bids in consultation with the service committee chairs (if not already done so) to identify the most critical proposals (with innovation and reputational impact uppermost) and that bids ultimately RAG rated as amber and red be deferred.
- A review of Climate Action bids be undertaken in liaison with the Climate Action Team, to confirm the priority of proposals alongside the business as usual bids.
- The affordability of the highest- ranking new bids to be determined via the MTFP modelling which will inform sustainable 2021/22 budget proposals for Members to consider in December.

Recommendation(s)

Members are asked to:

1. Note the total value of bids amounting to £146m of which £27.5m are to be funded from existing local resources and £13.5m which do not meet the capital criteria and would need to be funded from revenue resources.
2. Agree that the remaining £105m of capital bids is currently unsustainable and therefore Chief Officers, in consultation with Service Committee Chairs, be requested to further consider ranking of schemes to identify the most critical bids, with innovation and reputational impact uppermost.
3. Subject to the outcome of Chief Officer rankings, to agree in principle that bids with a final RAG rating of amber and red be deferred.
4. Note that the Climate Action Strategy bids will be subject to further review to confirm the priority of proposals.
5. Note that options for revenue funding of the Climate Action revenue bids that do not meet the capital criteria (currently £13.5m) will be brought forward in December.

Main Report

Background

1. Members have agreed the necessity for effective prioritisation of capital and SRP projects, with central funding allocated in a measured way via the annual capital bid process by applying prioritisation criteria to ensure that corporate objectives are met and schemes are affordable.
2. The following criteria against which capital and supplementary revenue projects are assessed have been agreed:
 - i. Must be an essential scheme (Health and Safety or Statutory Compliance, Fully/substantially reimbursable, Major Renewal of Income Generating Asset, Spend to Save with a payback period < 5 years.)
 - ii. Must address a risk on the Corporate Risk register; or the following items that would otherwise be escalated to the corporate risk register
 - a. Replacement of critical end of life components for core services;
 - b. Schemes required to deliver high priority policies; and
 - c. Schemes with a high reputational impact.
 - iii. Must have a sound business case, clearly demonstrating the negative impact of the scheme not going ahead, i.e. penalty costs or loss of income, where these are material.

In addition, bids in support of the Climate Action Strategy are to be allowed a degree of priority, subject to affordability.

3. The scope of schemes subject to this prioritisation relates only to those funded from central sources, which include the On-Street Parking Reserve, Community

Infrastructure Levy (CIL), flexible external contributions and allocations from the general reserves of City Fund or City's Cash. This means that projects funded from most ring-fenced funds, such as the Housing Revenue Account, Designated Sales Pools and Cyclical Works Programmes are excluded, together with schemes wholly funded from external grants, and tenant/developer contributions e.g. under S278 agreements and most S106 deposits.

4. In view of the various current financial pressures arising from the pandemic and other high priority initiatives, Chief Officers were requested to submit bids for only the most critical and essential schemes for the 2021/22 bid round.

Current Position

5. Departments have submitted their bids for central funding from 2021/22 which they consider necessary to deliver business plans. It should be noted that whilst these schemes are to be started during 2021/22, costs are anticipated to be incurred over the medium term as the lead-in time for projects mean that they routinely span across more than one financial year.
6. An initial assessment of the bids is summarised below:

Initial Assessment	BAU £000	Climate Action £000	Total £000
Qualifying Capital Bids:			
Capital Bids - Operational	67,435	18,991	86,426
Capital Bids - Investment	500	17,891	18,391
Total Capital Bids	67,935	36,882	104,817
Outside Scope Bids:			
Revenue (BBB Fund?)	-	13,470	13,470
To be funded from local sources	1,700	25,850	27,550
Total Outside Scope Bids	1,700	39,320	41,020
Total All Bids	69,635	76,202	145,837

7. There are 51 bids amounting to £146m of which £76m (13 bids) relates to the Climate Action Strategy. This initial sift identified £105m relating to projects of a capital/SRP nature, with the remainder of £41m falling outside the scope of the capital funding bid process since they:
 - will not result in a capital project i.e. the type of expenditure and funding stream is **revenue** in nature (£13.5m), or
 - do not require *central* capital funding as they rely on local **ring-fenced** sources of funding (£27.5m) e.g. City's Cash and BHE Designated Sales Pools.

The bids requiring **revenue** resources amount to £13.5m all relating to Climate Action across a four year period, for which funding plans are being worked on as part of the medium-term financial planning.

8. The £76m of Climate Action bids exceeds the £68m quoted within the Climate Action Strategy document, with some of the bids submitted under the Climate Action heading being additional proposals from departments. The Climate Action Team will be undertaking a review of the bids to confirm priorities and profiles of proposed expenditure, to be brought back for consideration in December.
9. Most of the £105m of capital bid submissions have been classified as essential and identified against one of the agreed prioritisation criteria. Based on the narrative supporting the bids, an assessment of how essential these schemes appear from a corporate perspective has been undertaken using a RAG rating approach where:
 - Green = demonstrates the essential criteria
 - Amber = essential criteria less clear
 - Red = does not demonstrate essential criteria.

The table below shows the results, with £82.4m green, £14.1m amber and £8.3m red.

Analysis by Category of Bid	Green £000	Amber £000	Red £000	Total Capital Bids
Critical End of Life Replacement	4,738	1,320	-	6,058
Statutory Compliance/Health and Safety	33,348	12,250	2,965	48,563
High Profile Policy Initiative	5,089	-	-	5,089
Spend to save with a payback < 5 years	2,375	500	5,350	8,225
	45,550	14,070	8,315	67,935
Climate Action	36,882	-	-	36,882
	82,432	14,070	8,315	104,817

To set these bids in to some context, £89m of capital bids were approved in principle via the 2020/21 annual capital bid process. However, at that time it was anticipated that such a high level was exceptional and not sustainable on an ongoing basis alongside other current financial priorities and pressures, such as the major projects and balancing the revenue budgets.

Therefore, even if the bids classified as amber and red were to be deferred, the remaining green bids at £82.4m is still considered to be too high and requires further scrutiny.

Of the £82.4m green bids:

- Business as usual schemes total £45.5m
Analysis of centrally funded schemes over recent years gives a broad average of £30m per annum which is a further indication that the current level of bids is high.
- Climate action bids total £36.9m
Climate Action capital bids have been assessed as green **for the time being** and the spend is currently profiled fairly evenly across the medium

term. The Climate Action Team will be reviewing to confirm the priorities and profiling.

Additionally, initial discussions with Chief Officers on potential classification indicate a difference of opinion on which are more important, e.g. surveyors may have a view on structural urgency, but this needs to be overlaid with service priority.

Affordability

10. In order to further assess affordability, bids have been identified against the relevant fund as summarised below:

Capital Bids by Fund	City Fund	City's Cash	BHE	Total
<u>BAU</u>				
Green	38,734	6,687	129	45,550
Amber	12,605	1,450	15	14,070
Red	3,106	5,181	28	8,315
Total BAU	54,445	13,318	172	67,935
<u>Climate Action</u>				
Green	23,730	12,761	391	36,882
Total Capital Bids	78,175	26,079	563	104,817

Affordability – City Fund

11. Of the £78m City Fund Capital Bids, £62m are rated as green, £13m amber and £3m red.

City Fund Analysis by Category	Green £000	Amber £000	Red £000	City Fund £000
<u>BAU:</u>				
Critical End of Life Replacement	3,543	120	-	3,663
Statutory Compliance/Health and Safety	28,258	12,250	260	40,764
High Profile Policy Initiative	4,739	-	-	4,739
Spend to save with a payback < 5 years	2,194	235	2,850	5,279
Total BAU	38,734	12,605	3,110	54,445
<u>Climate Action</u>	23,730	-	-	23,730
Total City Fund Capital Bids	62,464	12,605	3,110	78,175

There is a predominance of statutory compliance/health and safety schemes, although not all appear to comply with the criteria (hence ambers and reds). Possible funding of the City Fund capital bids is as follows:

City Fund Sources of Funding	OSPR	CIL	Reserves	Total
<u>BAU</u>				
Green	-	4,515	34,219	38,734
Amber	12,000	250	355	12,605
Red	-	-	3,106	3,106
Total BAU	12,000	4,765	37,680	54,445
<u>Climate Action</u>				
Green	-	-	23,730	23,730
Total Capital Bids	12,000	4,765	61,410	78,175

Of the total, £12m could be funded from OSPR and £5m from CIL, leaving £61m to be met from City Fund Reserves. If only green status projects were progressed the total funding would reduce to £62m, with £4m from CIL and £58m from reserves (predominantly capital reserves £53m and £5m revenue reserves).

It is important to bear in mind that there are other potential calls on City Fund capital resources on top of this year's capital bids, such as:

- internal borrowing for the HRA (may be delivered via external PWLB borrowing)
- Cyclical replacement of major components for the operational estate over the medium term and beyond
- Other future years' capital bids for the remainder of the medium term
- Highways and Street scene works for major projects £28m for the demolition of current Museum site; £66m public realm: presumably these will need to come out of CIL and OSPR.

It is noted that Climate Action Bids have resulted in exacerbating funding pressures, emphasising the need for further prioritisation.

City Fund Capital Reserves

12. The last MTFP anticipated capital reserves balances of approximately £70m by the end of 2022/23. The latest position remains to be confirmed as part of the update of the City Fund MTFP, currently underway. Using this indicative figure, progression of all the green bids would result in minimal capital reserves by the end of the planning period (< £20m) after a £53m drawdown. Capital Reserves are a finite resource, with replenishment requiring disposal of City Fund assets. An asset disposal programme would likely reduce rent income with negative impact on our ability to fund revenue activities.

City Fund Revenue Reserves

13. We are holding considerable general fund reserves of £80m as part of the financing strategy for the City Fund major projects. However, the general fund reserves also underpin any loss in investment property rental income as a result of COVID and failure to deliver the flightpath of savings required over the MTFP.

Choices would need to be made if Members wished to continue the current level of spend on the annual programme which will be played out during the modelling of the latest MTFP.

On-Street Parking Reserve and CIL

14. Both of these funds are already largely committed to existing schemes including highways and streetscene works for the major projects. However, it is anticipated that the £4m of CIL required to fund the green rated schemes could be accommodated within anticipated balances.

City Fund Affordability - Conclusion

15. Choices would have to be made if Members wished to continue the proposed level of spend required by these annual bids. Further ranking and prioritisation of the BAU bids will assist in identifying a reasonable funding envelope during the modelling of the latest MTFP. Further review of the Climate Action costs will be undertaken to confirm priorities.

Affordability City's Cash

16. The City's Cash bids of £26m would fall to be funded from general reserves - requiring asset disposal from either financial investments or property. This would reduce to £20m if only green rated bids were progressed, which includes £13m for Climate Action.

City's Cash Funding	Reserves
<u>BAU</u>	
Green	6,687
Amber	1,450
Red	5,181
Total BAU	13,318
<u>Climate Action</u>	
Green	12,761
Total Capital Bids	26,079

Whilst £20m for the green schemes may not appear to be excessive compared to asset balances, this needs to be considered in the context of all the other pressures, including the need to balance the revenue position and the impacts of funding the Major Projects.

In addition, other potential calls on City's Cash reserves include internal loans for schools and future operational estate cyclical requirements.

City's Cash Affordability - Conclusion

17. In conclusion, there is a need for further challenge to identify the most critical schemes in order to address the significant risk of unsustainability over the 10-year horizon. These costs will need to be built into the new City's Cash MTFP model to assess the financial impact.

Affordability - Bridge House Estates

18. Bridge House Estates bids amount to £563k in total or £520k if only green rated schemes are progressed:

Bridge House Estates Funding	Income Fund
<u>BAU</u>	
Green	129
Amber	15
Red	28
Total BAU	172
<u>Climate Action</u>	
Green	391
Total Capital Bids	563

These bids relate to the BHE share of corporate capital schemes (Guildhall complex or corporate IT systems) and would fall to be met from the unrestricted income funds - it is anticipated that these relatively modest sums would be affordable. Note that any costs of Climate Action relating to BHE investment property would be funded from the designated sales pool which is part of the permanent endowment.

Conclusion

19. In this second annual capital bid round, there are 51 bids amounting to **£146m** of which £76m (13 bids) relates to the Climate Action Strategy. An initial sift has identified **£105m** relating to projects of a capital nature, with the remaining **£41m** falling outside the scope of the capital funding bid process either because they are wholly revenue in nature (£13.5m) or should be funded from local sources e.g Designated Sales Pools (£27.5m).
20. The £13.5m of bids requiring **revenue** resources all relate to Climate Action across a four year period, for which funding plans are being worked on as part of the medium-term financial planning. Most of the £105m of capital bid submissions have been classified as essential and identified against one of the agreed prioritisation criteria. Based on the narrative supporting the bids, an assessment of how essential these schemes appear from a corporate perspective has been undertaken using a RAG rating approach - resulting in £82.4m green, £14.1m amber and £8.3m red. Of the £82.4m green, £45.5m relates to BAU and £36.9m to Climate Action.
21. However, even if the bids classified as amber and red were to be deferred, the remaining green bids at £82.4m is considered to be too high and will require further scrutiny before final bid proposals can be agreed in December as part of the build up to the 2021/22 budget round. Therefore, the proposed way forward is:

- Chief Officers be requested to further consider the ranking of their bids in consultation with the service committee chairs (if not already done so) to identify the most critical proposals (with innovation and reputational impact uppermost) and that bids ultimately RAG rated as amber and red be deferred.
- A review of Climate Action bids be undertaken in liaison with the Climate Action Team, to confirm the priority of proposals alongside the business as usual bids.
- The affordability of the highest- ranking new bids to be determined via the MTFP modelling which will inform sustainable 2021/22 budget proposals for Members to consider in December.

Report author

Dianne Merrifield
Group Accountant, Capital

E: dianne.merrifield@cityoflondon.gov.uk

T: contact via Teams whilst working from home

Appendices: Appendix 1: Listings of the individual bids within each RAG rating