

# Financial Appraisal Report

## Capital Project - Street lighting conversion from SOX to LED (Salix loan funding)

### Report to Cabinet

Date Issued: 24<sup>th</sup> October 2018

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## 1 Executive Summary

### Introduction

Regeneration & Economy are seeking approval to submit an application for an interest free loan to Salix for £3.146m, to support the conversion of 11,329 sodium trioxide (SOX) street lanterns to LED lights across the borough.

SALIX is a 'not for profit organisation' funded by the Department for Energy & Climate Change, the Department for Education and Higher Education Funding Council for England. The organisation operate an energy efficiency loan scheme programme which allows public sector bodies to apply for an interest free loan to finance up to 100% of the costs of energy saving projects.

SOX lanterns are currently used in 30% (11,329) of the borough's street lights. LED lamps also currently account for 30% of lighting across the borough, with the remaining 40% of street lighting utilising other types of lanterns, such as incandescent, high pressure sodium, mercury, florescent etc.

Manufacturers have now advised that replacement parts of SOX lanterns will cease in 2020 and no further orders will be accepted after July 2019.

The Council currently has sufficient stocks of replacement parts to last until 2021/22.

It is understood that local authorities do not have a statutory duty to provide street lighting but have discretion under statutory powers.

Strategic Finance has been asked to carry out an appraisal of the funding application, which has been evaluated against HM Treasury Green Book guidance. The appraisal process recorded a score of 68%, with some areas of risk identified.

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## Project Objectives

- To ensure adequate street lighting is provided across the borough post 2021/22.
- To deliver revenue savings through increased energy efficiency.
- To assist with delivering the carbon reduction targets to be met by the Council.

## Project Details

Project proposals include the replacement of the borough's remaining 11,329 SOX lanterns with LED lights by November 2021.

The project also includes the purchase and installation of a Controlled Management System (CMS), which will allow greater control of the street lighting across the borough, including the ability to reduce the level of lighting on individual lamps.

The total project cost is £3.867m and it is proposed that an interest free loan from Salix of £3.146m is utilised to reduce the borrowing costs of the Council. The loan will be repaid over a 9 year period. Funding of the loan and remaining capital costs will be via prudential borrowing and will incur borrowing costs of £1.003m, based on an interest rate of 2.75%. The total cost to the Council of £4.870m will be funded over a 25-year period, through Regeneration & Economy's revenue budget from energy savings generated by the project.

## Scope and objectives of financial appraisal

The purpose of financial appraisals is to consider the guidance provided by HM Treasury in evaluating business case proposals and assessing the potential risk to the Council in achieving its objectives. The following components and risks are assessed:

HM Treasury Green Book	Potential Risks
<u>Strategic Case</u> Objective, need, demand and reasonableness	Insufficient justification for project/will not meet strategic objectives
<u>Economic case</u> Option analysis and risk	Poor use of council resources & excessive risk to Council
<u>Commercial Case</u> Legal and statutory implications	Project may contravene legal/statutory regulations
<u>Financial Case</u> Affordability	Proposals are not affordable or realistic
<u>Management Case</u> Governance, project management, monitoring and evaluation	Non-delivery of project and outputs

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LEVEL OF ASSURANCE GAINED FROM FINANCIAL APPRAISAL

Limited (0%-65%)	Satisfactory (66%-80%)	Substantial (81%-100%)
There is a high risk of objectives not being met due to insufficient assurance within the project proposals. There is limited evidence to confirm that the risks to the Council could be adequately mitigated.	There is adequate assurance that objectives could be met, but further actions are required to adequately mitigate the risk to the Council.	There is good assurance that objectives will be met, with little risk to council resources.

Overall Conclusion

The appraisal scored 68% and provides **satisfactory assurance** over the adequacy of the proposals.

Financial appraisals will identify the following levels of issues:

**Fundamental**  
Action is imperative to ensure that the objectives of the project are met

**Significant**  
Action is required to avoid exposure to significant risks in achieving objectives

**Merits Attention**  
Action is advised to enhance operational efficiency

Summary of key issues identified

- The financial appraisal has identified NO ‘fundamental’ issues
- The financial appraisal has identified 6 ‘significant’ issues
- The financial appraisal has identified 1 ‘merits attention’ issue

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## 2 Issues Arising

Action is required to avoid exposure to significant risks in achieving objectives  
**Significant**

No	
2.1	<p><b>Strategic Case – Reasonableness</b> - Project costs are to be funded via prudential borrowing over a 25-year period in order for Regeneration &amp; Economy to generate efficiency savings. The proposed payback period appears excessive and may be unreasonable, given the current rate of technology advancement. There is a risk that the LED lanterns could become obsolete before the prudential borrowing is repaid.</p> <p><b>Implication:</b> Further council expenditure is required to replace the LED street lighting before they have been funded.</p> <p><b>Recommended action:</b></p> <ul style="list-style-type: none"><li>• Review payback period of project with the Council's Capital Accountant to ensure that a prudent approach is taken in relation to the repayment period.</li></ul>
2.2	<p><b>Strategic Case – Need</b> - The Controlled Management System is not critical to the success of the Council's objective in providing street lighting. The CMS has an additional cost of £0.828m, along with associated borrowing costs and whilst it is acknowledged that without it, the level of energy savings would be reduced, it may not be the best use of limited resources.</p> <p><b>Implication:</b> Council resources are not used in the most effective way.</p> <p><b>Recommended action:</b> Review the benefits of the CMS technology, with the production of whole life costings.</p>
2.3	<p><b>Strategic Case – Demand</b> - There was limited evidence to support the demand for the project. No evidence of public consultation was provided. Recent research undertaken by the Barcelona Institute for Global Health and the University of Exeter in May 2018, raised health concerns regarding the use of LED lighting, including street lighting. Although no further evidence has confirmed the issues, it is not known how this may affect public opinion</p>

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or future guidelines from Public Health England on the use of LED street lighting.

**Implication:**

Public health concerns could impact on future council policy, reputation of the Council and lead to additional expenditure being incurred on alternative light sources.

**Recommended action:**

- Ensure risk is identified within Risk Register, with appropriate mitigating actions.

**2.4 Economic Case – *Option Analysis*** - Insufficient evidence was provided to confirm that adequate option analysis had been undertaken and that the proposal optimises the use of council resources to deliver its objectives. Costs and benefits, in the form of whole life costings, identifying the net present value of cash flows, were not provided.

**Implication:**

That the full cost of the project is not quantified and does not provide adequate assurance that the proposal offers the best use of resources.

**Recommended action:**

- Produce whole life costings for the project to identify the net present value, along with sensitivity analysis to ensure that the proposal will provide value for money to the Council.

**2.5 Economic Case – *Risks*** - A corporate risk register has been provided but is considered inadequate for a project of this size. Only 3 risks have been recognised and risks relating to increased costs, reduced savings, obsolete technology or public opinion have not been included.

**Implication:**

Risks to the project may not be identified and mitigated sufficiently, resulting in non-delivery of the objectives and financial implications to the Council.

**Recommended action:**

- That the Risk Register is reviewed to ensure all risks are identified and adequately mitigated.

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**2.6 Financial Case – Accurate Costs & Budget Forecasts** – It was advised that costs for the replacement of LED lamps and the management of the CMS system will be managed from existing resources within the maintenance budget. However, there was limited evidence to confirm that additional resources will not be required. Whilst it is acknowledged that LED lamps have a longer design life than SOX lamps, the cost to replace LED lanterns appears significantly higher. Without detailed costings for the future revenue requirement, it cannot be confirmed that existing revenue resources will be sufficient to manage future costs.

**Implication:**

Existing revenue resources may not be sufficient to fund future revenue expenses.

**Recommended action:**

- That all future revenue requirements for the project are identified and costed to ensure that funding requirements can be met from Regeneration & Economy's existing resources.

Action is advised to enhance operational efficiency  
**Merits Attention**

No

**2.7 Management Case – Project Evaluation** - Limited detail was provided to establish how expected efficiency savings and revenue costs for the project would be monitored, in relation to the overall street lighting budget.

**Implication:**

The true value of savings relating to the project cannot be adequately measured and evaluated to determine the level of success of the project.

**Recommended action:**

- That a system be established to capture all savings and expenditure relating to the project, to ensure that the project can be effectively evaluated.

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