Appendix E: Financial Savings

Redacted to exclude information that is not for publication by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972

This document sets out further details of the proposed amendment to payment arrangements in 2017, as referenced in paragraphs 1.74 to 1.79 of the main report.

A direct cost saving in the order of £500k could be achieved by amending the payment arrangements for CSG. [redacted] of this is the saving that could be achieved through amending the payment profile of the annual contract management fee, which the council is contractually required to pay each year. This fee – which overall costs around £25m each year – is currently payable on a quarterly basis, i.e. for 2017, it is due to be paid in four instalments due in March, June, September and December. Paying the fee as one payment in December 2016, would trigger the saving. At the request of the Resources Director, the reduction would be credited to the council in the next financial year.

A further saving of [redacted] would be achieved by adopting a similar arrangement for the payment of invoices associated with the dedicated project teams that have been established to support the council's transformation and capital programmes. This would involve a pre-payment of approximately £1.9m, based on one year's spend. Whilst these fees do not form part of the core contract payment, the council has already committed to funding these teams to March 2018 (transformation projects team) and March 2020 (capital projects team) and this is therefore considered to be low risk.

This would represent a genuine, guaranteed, cashable saving, without any impact on the scope or quality of services. The saving is equivalent to approximately [redacted], which is significantly in excess of the opportunity cost to the council of retaining funds on deposit.

A pre-payment for 2017 needs to be considered against a position where, under the current payment profile, the council starts the year effectively in arrears. The council would then return to a position of being arrears by the end of October.

The prepayment relates to that element of the contract that the council is obliged to pay in any event and does not create additional risk in that regard. The key additional risk associated with this proposal would arise in the event of Capita ceasing to trade during the period to which the payment relates. Mitigation against such an event is set out in the "Financial Distress" section of the contract. This identifies a range of key accounting ratios that are used to assess financial risk. If Capita were to exceed the thresholds set out in the contract, various measures would be put in place to protect the council's interests.

The key ratios are:

1. Net Total Interest Cover ratio – [redacted] and

2. Total Net Debt to EBITDA – [redacted].

EBITDA is "earnings before interest, taxes, depreciation and amortization", which is an accounting measure that is used as a proxy for a company's current operating profitability and cash flow.

For 2015 the actual reported ratios were:

1. Net Total Interest Cover ratio – **14**
2. Total Net Debt to EBITDA – **2.5**

For 2016 and beyond, Capita expects to remain well within these targets, specifically:

1. Net Total Interest Cover ratio – forecast to be remain above [redacted] over the medium term; and
2. Total Net Debt to EBITDA – forecast to remain [redacted] over the medium term.

Therefore, on both measures, Capita are a very long way from being near either threshold. The proposed prepayment is, therefore, considered to be low risk.

In respect of Capita's recent trading statement (profit warning), it should be noted that this related only to a reduction in the level of profit being forecast for the year (from £630m for the year to £550m). The profit forecast for the year is now broadly in line with what Capita achieved last year. Previous expectations were that profit would grow in 2016 and the trading statement forecasts that this will be the case in 2017.

Paying the management fee up front does not impinge on the council's ability to issue service improvement notices or apply service credits in year, if services do not meet agreed performance levels.