

<b>Committee(s):</b>	<b>Date(s):</b>
Resource Allocation Sub Committee Finance Committee	22 March 2013 23 April 2013
<b>Subject:</b>	<b>Public</b>
Financing of Capital and Supplementary Revenue Projects	
<b>Report of:</b>	<b>For Decision</b>
Chamberlain	

## Summary

The purpose of this report is to provide details of the full extent of forecast capital and supplementary revenue project (SRP) expenditure over the planning period from 2012/13 to 2016/17, the sources of anticipated funding and the impact on the finances of the three main funds. This is summarised below:

	City Fund £m	City's Cash £m	Bridge House Estates £m	Total £m
<b>Forecast Expenditure:</b>				
Capital				
-Crossrail	200	-	-	200
-Other	191	115	24	330
Supplementary Revenue Projects	11	10	2	23
	402	125	26	553
<b>Financed by:</b>				
-External Contributions	62	14	1	77
-Internal Funds	340*	111	25	476
	402	125	26	553

\*significant risks and a shortfall in capital reserves have been identified

The main risk centres around the affordability of the City Fund Capital and SRP programmes of £402m. The funding of this £402m includes assumed proceeds from asset disposals of £278m; the balance being met from external contributions and use of earmarked reserves. The £278m includes £226m from planned

disposals and £52m from the proceeds of further asset realisation. Of this £278m, some £91m has been received to date. Whilst we continue to take steps to manage, challenge and ultimately reduce the funding requirement; it raises the issue of whether a capital programme of this magnitude is sustainable.

Schemes are under review to ensure that only high priority/essential proposals are progressed. Major items which give rise to this funding requirement include the Crossrail contribution, the Central Criminal Court works and delivery of the Police Accommodation Strategy. Regarding the latter, prudent provisions and tolerances have been included at this stage and every effort will be made to minimise the net cost.

Progress is on target to achieve the £52m of further asset realisation, with two sets of operational assets having been declared surplus, marketed and under offer, the sale of one investment property completed and further operational sales being planned. However, there is a residual shortfall of £27m which at this stage it is assumed will be met from the sale of further investment property, resulting in both a limitation in the opportunity to optimise capital appreciation and an ongoing loss of some £2m p.a. rental income which has been factored into the City Fund Financial Forecast from 2016/17. In the event that the planned disposals were deferred beyond 2015/16, it would be necessary to seek alternative funding such as borrowing to fulfil our capital commitments, with the resulting detrimental impact on the revenue position.

In December 2011 the Resource Allocation Sub-Committee agreed to annual provisions being included in the City Fund and City's Cash financial forecasts to allow new high priority/essential schemes to be progressed over the four years from 2012/13 to 2015/16. As the current planning period has been extended to 2016/17, additional sums of £3m have been provisionally included in each forecast and funding identified accordingly. Formal agreement to this approach is now sought.

### **Recommendations**

- Members are asked to note the contents of this report.
- Members of the Resource Allocation Sub-Committee are asked to approve the allocation of £6m to be set aside in 2016/17 as a provision for new schemes (£3m each for City Fund and City's Cash).

## **Main Report**

### **Background**

1. Five year programmes of Capital and SRP schemes are maintained for financial planning purposes which inform the preparation of the medium term financial forecasts for each of the three main funds. The forecasts include prudent provision for the latest estimated costs of schemes approved via the

Corporate Project Procedure, planned property acquisitions and other significant schemes in the pipeline.

2. Capital expenditure generally results in an increase in asset values and typically relates to acquisitions and enhancements, whereas supplementary revenue projects are one-off items which do not fulfil the capital criteria e.g. feasibility and option appraisal costs, major cyclical repairs.
3. The capital controls which apply to the City Fund restrict the use of capital reserves (derived from the sale of assets) solely to the financing of capital expenditure. In this context, grants to third parties for capital purposes, such as the City Fund contribution to the Crossrail project, would qualify as capital expenditure.
4. The Court of Common Council has delegated to me authority to determine the methods of financing capital and supplementary revenue project expenditures. In making such decisions consideration is taken of the strategic and tactical interests of the three funds. However, the use of revenue reserves to fund capital expenditure instead of asset disposals is not considered, as the current City Fund Medium Term Financial Strategy/Budget Policy includes a requirement that “ordinarily capital projects should be financed from capital rather than revenue reserves”.
5. The Town Clerk’s Programme Office provides regular reports on the progress of individual schemes against milestones.

### **Current Position**

6. This report provides details of the full extent of forecast capital and supplementary revenue project (SRP) expenditure over the planning period from 2012/13 to 2016/17, the sources of anticipated funding and the impact on the finances of the three main funds.
7. Figures are based on a detailed review of the profiles of estimated capital and SRP expenditure undertaken by Chief Officers as at the end of October 2012, together with any subsequent material changes. The total estimate of such expenditure across all funds amounts to some £553m for the planning period from 2012/13 to 2016/17 and is financed from a variety of sources, both internal and external.

### **Financing**

8. Each scheme has its own funding strategy, derived as follows.
  - External funding is generally allocated to schemes according to the associated terms and conditions, with the use of some grants being restricted to a specific purpose and others allowing degrees of flexibility. For example, the Guildhall School Trust is currently overseeing the raising of significant charitable donations, specifically to meet the cost of specialist equipment for the new Milton Court extension. The method of allocating ‘flexible’ sources of external funding, such as certain S106 deposits, unrestricted capital grant from government and formula-based

Transport for London Grant is subject to prioritisation criteria. Further work is currently being undertaken to identify flexibility within S106 deposits in order to maximise the benefits derived.

- Internal funding is determined according to the CoL fund, the nature of the expenditure and the availability of resources. Further details of the internal sources of funding are provided in Annex A.

9. The total estimated capital and SRP expenditure and financing over the planning period 2012/13 to 2016/17 is summarised below:

**Table 1:  
Total Capital and Supplementary Revenue Project Expenditure 2012/13 to 2016/17**

	City Fund £m	City's Cash £m	Bridge House Estates £m	Total £m
<b>Forecast Expenditure:</b>				
Capital				
-Crossrail	200	-	-	200
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10. More detailed analyses of the forecast expenditure and the anticipated sources of finance for each fund are provided in Annex B.

### Management of Risk Factors

11. Clearly such significant sums have a material impact on the financial health of the funds. In addition there is a legal requirement to comply with the Prudential Code<sup>1</sup> when planning City Fund capital investment to ensure that capital expenditure is affordable, sustainable and prudent.

<sup>1</sup> The Prudential Code is a professional code of practice developed by the Chartered Institute of Public Finance and Accountancy to support capital investment decisions. Local authorities are legally required to have regard to it under the Local Government Act 2003.

## City Fund

12. The main risks centre around the affordability of the City Fund capital programme, particularly the achievability of capital receipts. The estimated internal funds of £340m comprises £278m assumed capital receipts and £62m mainly from earmarked reserves (On Street Parking Reserve and investment income generated from Crossrail Estate properties).
13. The £278m assumed capital receipts is analysed as follows:

**Table 2: Anticipated receipts from asset disposals**

	Total Anticipated £m	Received to Date £m	Unrealised £m
<b>Planned Disposals:</b>			
Strategic Investment Property	75	20	55
Crossrail Property	113	48	65
Operational Property	38	17	21
	226	85	141
<b>Asset Realisation Programme:</b>			
Surplus Operational Assets	19	0	19
Investment Properties	33	6	27
	52	6	46
	278	91	187

- Strategic Investment Property disposals are anticipated to supplement capital reserves by some £75m over the planning period. These sales have been subject to some uncertainty and delay, and only £20m has been received to date. Whilst there are currently sufficient capital reserve balances to meet our short term funding requirement, if the bulk of the disposals are not completed by 2015/16, alternative funding would need to be identified to fulfil our capital commitments. This would result in further detriment to the revenue position e.g. further loss of rental income arising from the sale of investment properties and/or borrowing costs.
- The funding of the Crossrail commitment is dependent on capital receipts from Crossrail properties totalling £113m, of which £48m has

been received to date and £65m has yet to be realised. The balance of the £200m commitment is to be met from rental income and interest receipts generated by the Crossrail Estate (£26m) and other disposals (£61m) from within the overall disposal proceeds of £278m (see para. 14 below).

- Operational property disposals, including the sale of surplus police property arising from the Police Accommodation Review and Barbican Flats are expected to realise £38m, of which £17m has been received.
- The Asset Realisation Programme aims to maximise return whilst minimising any ongoing loss of revenue. With this in mind, priority is being given to the identification and disposal of surplus operational property, with the sale of higher yielding investment property as the last resort.
  - i. Progress in identifying asset sales of £52m is on target, with two sets of operational assets having been declared surplus, marketed and under offer. Net proceeds of £7m are anticipated by the end of March. Plans for further sales of some £12m are in progress, although success is dependent on the identified assets being released for disposal. In addition the sale of a lower yielding investment property has netted a £6m receipt.
  - ii. The residual shortfall of £27m will be met from the sale of higher yielding investment property, resulting in both a limitation in the opportunity to optimise capital appreciation and the ongoing loss of some £2m per annum rental income which has been prudently factored into the City Fund Financial Forecast from 2016/17.
  - iii. The £52m to be funded from the proceeds of the Asset Realisation Programme is some £12m less than the potential shortfall of £64m over the planning period from 2011/12 to 2015/16 which was reported in December 2011. However, it should be appreciated that the two figures are not directly comparable due to the change in the planning period, subsequent reviews of expenditure phasings, new schemes approved/completed, etc.

We continue to monitor progress closely in consultation with the City Surveyor.

14. In summary, the application of the £278m between our Crossrail commitment and the remainder of the capital programme is as follows:

Crossrail commitment	£174m *
Remainder of capital programme	£104m

\*the balance of the £200m being funded from rental income and interest receipts from the Crossrail Estate

15. A review of planned schemes is being undertaken to ensure that only essential, high priority schemes are progressed, i.e. within high priority categories (legal/ health and safety requirement, spend to save with short payback or other schemes that Members have agreed as corporate priorities),

or funded from non-flexible external sources. As the major items which give rise to the deficit include the Crossrail contribution, the Central Criminal Court works and delivery of the Police Accommodation Strategy, the impact of the review may be limited. Regarding the Police Accommodation Strategy, prudent provisions and tolerances have been included at this stage and every effort will be made to minimise the net cost.

#### City's Cash

16. In December 2011, a £34m potential shortfall in City's Cash reserves was identified. However, a significant reduction in the required level of capital investment in the Strategic Property Estate, achieved through a revised strategy agreed by the Property Investment Board, together with reprofiling of project expenditure, now leaves an adequate level of reserves to fund the capital programme during the current planning period. This means that there is currently no need for a further asset realisation programme for City's Cash, other than those items already identified.

#### Provisions for new schemes and unforeseen costs

17. To allow a degree of flexibility, central funding for new, high priority/essential schemes and any unforeseen cost increases arising in existing schemes has been provided.
18. In December 2011 the Resource Allocation Sub-Committee agreed to annual provisions of £3m being included in the City Fund and City's Cash financial forecasts to allow such new schemes to be progressed over the four years from 2012/13 to 2015/16. As the current planning period has now been extended to 2016/17, additional sums of £3m have been provisionally included in each forecast and the funding impact on the City Fund has been taken into account in the asset realisation targets. Formal agreement to this approach is now sought. No additional provisions have been made for new Bridge House Estates schemes as they are expected to be contained within the resources available in the various designated funds.
19. In May 2012 the Resource Allocation Sub-Committee agreed to provisions of £0.5m for each fund being set aside (earmarked from the 2012/13 £3m provisions for City Fund and City's Cash) to accommodate unavoidable cost increases arising from schemes in progress. To date, there has been only one call on the provisions, relating to the additional cost of the Animal By-Product Facility at Smithfield Market (City's Cash). Therefore, in view of the minimal demand to date, no additional provision is considered necessary at this stage.

#### Future Reports

20. Three periodic reviews are currently undertaken by Chief Officers to update the forecast profiles and latest estimated costs of capital and supplementary revenue projects. The timing has been designed to feed in to the annual

forecast update process ( (i) in the spring after the prior year outturn, (ii) as at the end of July and (iii) as at the end of October). It is proposed that future reports will update Members on the financial impact of such changes, following the timing of the three reviews.

## **Conclusion**

21. Significant capital and supplementary revenue project expenditure amounting to £553m has been factored in to the five year financial forecasts, funded from various sources as described in this report. The main area of risk relates to the affordability of the City Fund Capital Programme, which is heavily dependent on the achievement of significant strategic property disposals, operational property sales, the Crossrail funding strategy and the asset realisation programme, which are being carefully monitored in consultation with the City Surveyor. At the same time, a degree of flexibility is being permitted through new schemes which are restricted to ensure only high priority essential proposals are progressed, with costs being contained within the agreed provisions. In this context, approval is sought to the allocation of £6m to be set aside in 2016/17 as a provision for new schemes (£3m each for City Fund and City's Cash).

## **Appendices**

Annex A - Internal Sources of Capital and Supplementary Revenue Project Funding  
Annex B – Analyses of Forecast Capital and Supplementary Revenue Expenditure and Financing

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## Annex A

### Internal Sources of Capital and Supplementary Revenue Project Funding

1. Internal funding is determined according to the CoL fund, the nature of the expenditure and the availability of resources.

City Fund resources include earmarked reserves, capital reserves and general balances

  - The most significant City Fund earmarked reserve is the Crossrail Reserve, which is being assembled from various capital and revenue funds set aside to meet the City Fund £200m contribution to the Government's Crossrail project, due to be made in March 2016.  
Current forecasts are based on anticipated returns/profits/accrued interest of £39m, together with the realisation of the original £100m investment in property. The balance of £61m is to be met from City Fund capital reserves through strategic and asset realisation programme sales which are factored into the financial forecasts.
  - The other significant earmarked reserve is the On Street Parking Reserve, which has statutory limitations on its use for highways works and enhancements to the built environment, open spaces etc. Potential demand currently exceeds available funds and officers are developing a prioritisation matrix for Member consideration.
  - Other earmarked reserves relate to specific service areas such as the Police, Spitalfields Market and the Central Criminal Court.
  - Capital Reserves arise from the disposal proceeds from the sale of capital assets and their use is restricted by statute to the financing of capital expenditure (or repayment of debt). Significant risks and shortfalls have been identified which are under close scrutiny in consultation with the City Surveyor.
  - General Revenue Balances are mainly used to finance SRP expenditure which cannot be financed from other sources. Whilst it would be *permissible* to fund capital expenditure from revenue, our current budget strategy generally precludes this on the grounds of sustainability.
2. City's Cash resources include designated funds and the general reserve.
  - The most significant designated fund is the Designated Sales Pool, which is supplemented by the proceeds from investment property disposals and is applied to finance acquisitions and enhancements. Its performance is overseen by the Property Investment Board.
  - Other significant designated funds relate to specific service areas, such as the markets and the schools.
  - The City's Cash General Reserve is applied to finance both capital and SRP operational projects, together with any investment schemes falling outside the remit of the Designated Sales Pool e.g.the strategic estates.
3. Bridge House Estate resources also include designated funds and the general reserve.
  - The Designated Sales Pool operates in the same way as the City's Cash pool and is also overseen by the Property Investment Board.
  - The Bridges Repair and Replacement Fund is generally used to finance schemes identified within the 50 year repairs and maintenance plans for the five City bridges, under the direction of the Planning and Transportation Committee.
  - The Tower Bridge Tourism Fund is derived from surpluses from the tourism operation and is used to fund related enhancements, under the direction of the Culture, Libraries and Heritage Committee.
  - The General Reserve is mainly applied to this fund's proportion of Guildhall complex and other corporate schemes.