

Committee(s):	Date(s):
Finance Committee Resource Allocation Sub-Committee	19 November 2013 12 December 2013
Subject: Financing of Capital and Supplementary Revenue Projects – 2012/13 Outturn and Update	Public
Report of: The Chamberlain	For Information

Summary

The last report on financing of the capital and supplementary revenue project (SRP) programmes was prepared in March 2013 covering the planning period from 2012/13 to 2016/17. This report:

- Provides details of the 2012/13 outturn (including the Prudential Indicators for the City Fund); and
- Updates the forecasts of capital and SRP expenditure and the impact on the finances of the three main funds over the same planning period.

The key points are:

- Actual capital and SRP expenditure in 2012/13 amounted to £56m, some £21m less than the forecast of £77m. This reduction was largely due to re-phasing of expenditure to later years.
- The 2012/13 prudential indicators, which are a statutory requirement under the CIPFA Prudential Code, highlight that the City Fund held no external debt as at 31 March 2013 and confirmed that there was no underlying need to borrow.
- The updated forecasts of capital and SRP expenditure over the planning period give a revised overall total of £542m, which is £11m less than the March 2013 forecast of £553m. The reduction has arisen mainly as a result of deferral of expenditure on the Police Accommodation Strategy beyond the planning period. This has been partially offset by the acquisition of an additional City Fund investment property, driven by the treasury management-based decision to divert up to £176m of City Fund revenue balances from cash to property as a means of improving revenue returns.
- The affordability of the City Fund capital programme requires proceeds from asset disposals totaling £248m of which £117m has been received to date. This presents a potential significant risk, although the City Surveyor advises that current progress indicates we are on target to achieve the property disposals required to deliver the £131m balance of outstanding receipts.
- A further update of the capital and SRP programmes is currently in progress which will extend the planning period. Members have agreed that any

residual shortfall in funding of the City Fund capital programme, previously estimated at £27m, should be set aside from the £176m of City Fund revenue cash balances earmarked for property investment and it is prudent to assume for planning purposes that this sum continues to be set aside to meet the cost of the extended forecast.

- Current forecasts indicate that there is an adequate level of reserves to meet the City's Cash Capital and SRP programmes. The financial health of the Bridge House Estates Trust remains buoyant, with modest capital and SRP programmes currently in place.

Recommendations

Members are asked to note the contents of this report.

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. The Town Clerk's Programme Office provides regular reports on the progress of individual schemes against milestones.
3. 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 and maintenance.
4. 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.
5. The Court of Common Council has delegated to the Chamberlain 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.
6. The use of revenue reserves to fund operational capital expenditure instead of asset disposals is not generally allowed, 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". However, Members have approved the investment of up to £176m of City Fund revenue reserves in property as a means of increasing revenue income and, whilst this is driven by a Treasury Management decision, the capital controls require such investment to be treated as capital expenditure. In

addition, Members have also agreed that, should a shortfall in the amount of capital receipts required to finance the capital programme arise, it may be funded from this balance. This is to avoid the need to sell high yielding investment property to the detriment of revenue income. A sum of £27m has been set aside for this purpose based on the March 2013 forecast position.

7. The last report on financing of Capital and Supplementary Revenue Projects was prepared in March 2013, based on the forecast figures over the planning period from 2012/13 to 2016/17 which were used in the preparation of the 2013/14 budget. The purpose of this report is two-fold – to provide details of the 2012/13 outturn against the forecast (including the actual Prudential Indicators for the City Fund) and to provide an update on the financial impact of the capital and SRP forecasts.

2012/13 Outturn

8. The actual Capital and Supplementary Revenue Project expenditure incurred in 2012/13 was £56m which was £21m less than the forecast of £77m. A breakdown of expenditure by fund is attached at Appendix 1. The variance can be further analysed as follows:

Table 1 2012/13 Analysis of variations in Actual Capital and Supplementary Revenue Project Expenditure and Financing compared with Forecast

	City Fund £m	City's Cash £m	Bridge House Estates £m	Total £m
Expenditure on new schemes approved after the forecasts were prepared	-	1	-	1
Net rephasing of expenditure to later years	-8	-10	-1	-19
Net Savings	-3	-	-	-3
	-11	-9	-1	-21
Financed by:				
External Contributions	-2	-3	1	-4
Internal Funds	-9	-6	-2	-17
	-11	-9	-1	-21

9. The main reason for variations between forecast and actual expenditures in 2012/13 is the rephasing of expenditure, accounting for a net total of £19m which is therefore simply deferred to later years. Savings of £3m arose mainly from the residual balance of the City Fund provision for new schemes which was not required and various other minor reductions which were mainly funded from external contributions.
10. The CIPFA Prudential Code¹ provides a framework for ensuring that capital expenditure and financing (in particular borrowing) is affordable, prudent and

sustainable, and requires the calculation and monitoring of certain prudential indicators in respect of City Fund capital activities.

11. In addition to setting indicators for the forthcoming year during each budget cycle, the Code requires authorities to calculate certain indicators drawn from the end of year balance sheet. Appendix 2 contains the actual indicators for 2012/13, including commentaries which highlight, in particular, that the City Fund held no external debt as at 31 March 2013 and there was no underlying need to borrow.

Updated Financial Impact over the planning period 2012/13 to 2016/17

12. The latest estimated capital and SRP expenditure over the planning period 2012/13 to 2016/17 amounts to £542m, a net reduction of £11m since the March 2013 forecast figures were prepared. Details of the actual expenditure and impact on the financing is summarised below:

Table 2: Total Capital and Supplementary Revenue Project Expenditure and Financing 2012/13 to 2016/17

	City Fund £m	City's Cash £m	Bridge House Estates £m	Total £m	March 2013 Comparator
Forecast Expenditure:					
Capital					
-Crossrail	200	-	-	200	200
-Investment	31	28	14	73	64
-Operational	150	83	2	235	266
Supplementary Revenue Projects					
-Investment	-	7	6	13	6
-Operational	14	6	1	21	17
	395	124	23	542	553
Financed by:					
External Contributions	69	13	1	83	77
Internal Funds	*326	111	22	459	476
	395	124	23	542	553
<i>March 2013 forecast figures</i>	402	125	26	553	
<i>Variation</i>	-7	-1	-3	-11	

* this includes capital reserves of £248m of which £131m has yet to be received, posing a potential risk of shortfall

¹ 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.

13. Detailed analyses of the latest forecast expenditure and the anticipated sources of finance for each fund are provided in Appendix 3.
14. Figures are based on a review of the profiles of estimated capital and SRP expenditure undertaken by Chief Officers as at the end of July 2013.
15. The net overall reduction in capital and SRP forecast expenditure of £11m since March 2013 is analysed below:

Table 3: Main reasons for variations in forecast capital and SRP expenditure over the planning period 2012/13 to 2016/17

	City Fund £m	City's Cash £m	Bridge House Estates £m	Total £m
Rephasing of expenditure beyond the planning period	-24	-	-	-24
Property Investment Funded from City Fund surplus cash balances	11	-	-	11
Other net variations				
-Investment	-1	-1	-3	-5
-Operational	7	-	-	7
Total Variation	-7	-1	-3	-11
Financed by:				
External Contributions	7	-	-	7
Internal Funds	-14	-1	-3	-18
Funding Variation	-7	-1	-3	-11

16. The reductions arising from rephasings of £24m relate mainly to an extended delivery period for the Police Accommodation strategy which is simply deferred to later years. The residual underlying increase of £13m forecast expenditure is mainly comprised of:
 - additional investment property acquisition approved to improve revenue income (see para 5).
 - Additional highways and streetscene (including the enhanced cost of the Aldgate Gyratory Project) and affordable housing schemes – which are largely funded from S106 and other external contributions.

Management of Risk Factors

17. Clearly such significant project expenditures present a material risk to the financial health of the funds. In addition there is a legal requirement for the City Fund to comply with the Prudential Code¹ when planning capital investment to ensure that capital expenditure is affordable, sustainable and prudent.

City Fund

18. The main risks centre around the affordability of the City Fund capital programme, particularly the achievability of capital receipts. The estimated internal funds of £326m required to finance capital expenditure (see table 2) comprises £248m assumed capital receipts and £133m from revenue - mainly earmarked reserves (On Street Parking Reserve and investment income generated from Crossrail Estate properties) and £11m for one property already purchased from the revenue balances earmarked for long term investment in property.
19. The total capital receipts of £248m required to fund the capital programme is some £30m less than reported in March. This reduction has arisen mainly from the deferral of Police Accommodation expenditure (funded from capital reserves).
20. The various disposal programmes from which the £248m of capital receipts are expected to be derived is analysed as follows:

Table 2: Anticipated receipts from asset disposals

	Total Anticipated Receipts £m	Received to Date £m	Unrealised Disposal Proceeds £m
Planned Disposals:			
Strategic Investment Property	82	33	49
Crossrail Property	114	53	61
Operational Property	27	17	10
Total Planned	223	103	120
Asset Realisation Programme:			
Surplus Operational Assets	19	8	11
Investment Properties	6	6	-
Total Asset Realisation	25	14	11
Total Anticipated Receipts 2012/13 to 2016/17	248	117	131

- Strategic Investment Property disposals, as shown in the table above, are anticipated to supplement capital reserves by some £82m over the planning period. These sales have been subject to some uncertainty and delay and only £33m has been received to date. The outstanding receipts of £49m are critical to our ability to fund the capital programme, in particular the Crossrail commitment due in March 2016. There are three major property developments giving rise to these outstanding receipts. The City Surveyor advises that they are progressing according to plan and he currently expects to achieve the target incomes within the required timeframe.
- The funding of the £200m City Fund Crossrail commitment is also dependent on capital receipts estimated at £114m from the Crossrail estate of which £53m has been received to date - leaving £61m yet to be realised. The City Surveyor is in the progress of formulating a disposal strategy to achieve these receipts by the anticipated payment date of March 2016, with a view to reporting to Members in the spring. The strategy may involve the substitution of lower yielding properties to replace some of those purchased as part of the Crossrail strategy. The balance of the £200m commitment is to be met from interim rental and interest income generated by the Crossrail Estate (£27m) and other receipts (£59m) from within the overall proceeds from disposals (see para. 21 below).
- Operational property disposals, including the sale of Barbican Flats and miscellaneous highways disposals, are expected to realise £27m, of which £17m has been received. It should be noted that the proceeds from the sale of surplus police properties to be realised as part of the Police Accommodation Strategy are now anticipated to be received beyond the planning period, in line with the deferral of the scheme.
- The Asset Realisation Programme aims to maximise return whilst minimising any ongoing loss of revenue. With this in mind, priority has been given to the identification and disposal of surplus operational property. The sum of £25m now required within the planning period has reduced by some £27m since March, largely as a result of the deferral of the police accommodation strategy.
 - i. Progress in identifying asset sales of £25m is on target, with three sets of operational assets having been declared surplus, and sold. Net proceeds of £14m have been received to date. Plans for further sales of some £11m 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. It was originally planned that any shortfall in receipts from surplus assets would be filled by the sale of investment property. However, in order to minimise the potential negative impact on revenue through loss of rental income, Members have agreed that any residual shortfall should be funded from the £176m of City Fund cash reserves earmarked for potential property investment.

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

21. In summary, the application of the £248m of capital receipts between our Crossrail commitment and the remainder of the capital programme is as follows:

Crossrail commitment	£173m *
Remainder of capital programme	£75m

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

22. The current programme includes major items requiring significant resources including the Crossrail contribution, the Central Criminal Court works and delivery of the Police Accommodation Strategy. A policy is currently in place to ensure that only essential, high priority schemes are progressed, i.e. within high priority categories (legal/ health and safety obligations, spend to save with short payback or other schemes that Members have agreed as corporate priorities), or funded from non-flexible external sources. 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.
23. Looking ahead beyond the planning period, it will be noted from above that some £24m of expenditure has been deferred, mainly in respect of the Police Accommodation Strategy. In addition, significant expenditure to deliver the Central Criminal Court works and further investment in the City Fund Strategic Investment Property Estate is planned. Certain capital receipts, including the proceeds from the disposal of the surplus police properties are anticipated, but capital expenditure forecasts indicate an ongoing capital financing shortfall. Therefore, it will be necessary to continue to 'sweat our assets' and strive for a leaner, more efficient property portfolio to deliver services, including the generation of further capital receipts. There is an expectation that Service Based Reviews may result in the identification of further surplus assets and the Asset Realisation Group of officers continues to operate. For planning purposes it is prudent to assume that, of the £176m earmarked for property investment, the sum of £27m continues to be retained to meet future shortfalls in funding of the capital programme.

City's Cash

24. 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, has left 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.

Bridge House Estates

25. The financial health of the Bridge House Estates Trust remains buoyant, with modest capital and SRP programmes currently in place.

Conclusion

26. Significant capital and supplementary revenue project expenditure amounting to some £0.5bn 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 liaison with the City Surveyor. At the same time, a degree of flexibility is being permitted for new schemes - but restricted to ensure only high priority essential proposals are progressed, with costs being contained within the agreed provisions.

Appendices

Appendix 1: 2012/13 Outturn

Appendix 2: 2012/13 Actual Prudential Indicators

Appendix 3: Updated Analyses of Forecast Capital and Supplementary Revenue Expenditure and Financing

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