Committees:	Dates:
Finance Committee Resource Allocation Sub-Committee	9 December 2014 11 December 2014
Subject: Financing of Capital and Supplementary Revenue Projects	**Public**
Report of: Chamberlain	**For Information**

Summary

This report indicates the scale of the City's programme of Capital and Supplementary Revenue Project (SRP) expenditure over the current planning period from 2014/15 to 2018/19 and the funding challenges this entails. These figures are being incorporated into the initial update of the medium term financial forecasts to inform the 2015/16 budget process.

The key points are:

- The updated forecasts of Capital and SRP expenditure over the planning period total £648m. They include provisions to fund some major schemes including the Police Accommodation programme, major works at the Central Criminal Court, safety works to the Hampstead Heath ponds, highways improvements and contributions to Crossrail.
- The City Fund capital programme is funded from a combination of external contributions, revenue reserves and proceeds from asset disposals. With regard to the latter, forecasts assume receipts totalling £278m of which £182m had been received. The £96m balance of outstanding receipts is to be realised through various property disposal programmes and represents a potential funding risk, which is being monitored in close consultation with the City Surveyor.
- To help mitigate against the risk of current and future City Fund capital funding shortfalls, some £27m of revenue cash balances previously earmarked for property investment continues to be set aside to avoid the need to sell high yielding investment property to the detriment of revenue income.
- With regard to City's Cash, the forecasts indicate that there are sufficient resources within the fund (including asset disposals where necessary) to meet the cost of the Capital and SRP programmes.
- The financial health of the Bridge House Estate Trust remains bouyant, 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, property acquisitions and other significant schemes in the pipeline.
2. Chief officers provide regular reports (via the Town Clerk's 'Project Vision' system) 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 only to the City Fund restrict the use of capital reserves (derived from the sale of assets) solely to the financing of capital expenditure or repayment of debt. 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. (This is contrary to the treatment of City's Cash capital grants to third parties under UK Generally Accepted Accounting Principles (UKGAAP), which are expensed as supplementary revenue projects).
5. 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, it will be recalled that Members approved capital investment of up to £176m of City Fund *revenue* reserves in property as a means of increasing revenue income, of which a sum of £27m has been set aside to help mitigate the risk of a shortfall in the amount of capital receipts required to finance the capital programme. This is to avoid the need to sell high yielding investment property to the detriment of revenue income.
6. 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.
7. This report provides details of the latest Capital and SRP programmes over the current planning period from 2014/15 to 2018/19 and the impact on the finances of the three funds.

Current Position

8. The latest estimated Capital and SRP expenditure over the planning period from 2014/15 to 2018/19 amounts to £648m. A summary analysed by fund, together with sources of financing, is shown below:

Table 1: Forecast Capital and SRP Expenditure and Financing 2014/15 to 2018/19

	City Fund £m	City's Cash £m	Bridge House Estates £m	Total £m
Forecast expenditure:				
Capital				
- Crossrail	200	-	-	200
- Investment	16	16	67	99
- Operational	208	71	1	280
Supplementary Revenue Projects				
- Crossrail	-	54	-	54
- Investment	-	2	1	3
- Operational	9	2	1	12
	433	145	70	648
Financed by:				
External Contributions	87	3	0	90
Internal Funds	*346	142	70	558
	433	145	70	648

* this includes capital receipts of £278m of which £96m has yet to be received, posing a potential risk of shortfall

9. Further analysis of the forecast expenditure and the anticipated sources of finance for each fund are provided in Appendix 1.

10. These figures are based on profiles of estimated capital and SRP expenditure provided by Chief Officers over the summer and are being used in the preparation of the *initial* drafts of the medium term financial forecasts. A further review by Chief Officers is currently underway which will be incorporated into the *final* versions of the financial forecasts, to inform the basis of the 2015/16 budgets for each fund.

11. The introduction of additional schemes into the programme is generally restricted by the priority of the scheme and the availability of funding, with most new schemes being financed externally or met from existing earmarked/ring-fenced funds. Otherwise, funding for new projects is generally contained within the annual provisions for new schemes (£3m per annum each for City Fund and City's Cash), subject to the approval of the Resource Allocation Sub Committee. However, a number of additional provisions totalling £77m (£7.1m City Fund and 69.9m City's Cash, of which £11.6m will be repaid) have been included within the figures in Table 1 as follows:

- as part of the Service Based Review, it has been agreed that additional City Fund resources of £2.1m will be made available for Barbican Centre capital investment in order to deliver an on-going increase in revenue income;
- a one year extension to the Barbican (City Fund) and Guildhall School (City's Cash) Capital Cap arrangements (£2m and £1.8m respectively in 2016/17, subject to separate approval);
- a loan from City's Cash to the Freemen's School of £11.6m to be repaid over a 5 year period commencing in 2017/18;
- a contribution of £3.5m of match funding for the Crossrail Art Foundation together with a possible contribution to Crossrail of up to £50m, both funded from City's Cash (in addition to the £200m from City Fund); and
- additional provisions in 2018/19 of £3m each for City Fund and City's Cash (i.e. £6m in total) to allow flexibility for new capital investment.

Management of Risk Factors

12. 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 Code[1] when planning capital investment to ensure that capital expenditure is affordable, sustainable and prudent.

City Fund

13. The main risks centre around the affordability of the City Fund capital programme, particularly the achievability of capital receipts. The estimated internal funds of £341m required to finance capital expenditure (see Appendix 1) comprises £278m assumed from capital receipts and £63m from revenue - mainly comprising the on-street parking reserve applied to highways improvements and the Crossrail revenue reserve which includes interim rental and interest income from the Crossrail Estate.

14. The various disposal programmes from which the £278m of capital receipts are expected to be derived is analysed as follows:

[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.

Table 2: Anticipated Capital Receipts from City Fund Asset Disposals

	Total Anticipated Receipts £m	Received to Date £m	Unrealised Disposal Proceeds £m
Planned Disposals:			
Balance in hand 31 March 2014	35	35	0
Strategic Investment Property	44	42	2
Operational Property	41	7	34
Total Planned	120	84	36
Asset Realisation Programme:			
Balance in hand 31 March 2014	14	14	0
Surplus Operational Property	20	0	20
Total Asset Realisation	34	14	20
Crossrail Property Disposals:			
Balance in hand 31 March 2014	23	23	0
Crossrail Disposals	62	40	22
Realisation of short term re-investment of Crossrail receipts	39	21	18
Total Crossrail	124	84	40
Total Receipts Required to 2018/19	278	182	96

The main points to note from table 2 are set out below:

- At the beginning of the planning period we held a total of £73m in capital reserves, generated by prior year disposals of strategic investment property and operational property (£35m), Crossrail property (£23m) and £14m achieved through the asset realisation programme. (HRA receipts are excluded as they are ring-fenced under statute for new dwellings). During 2014/15, a number of anticipated receipts have been realised by the City Surveyor which has mitigated our funding risk.
- Significant planned Investment Property receipts amounting to £42m have been received during the year, mainly derived from two high profile redevelopment sites. Receipts from a further redevelopment site will cover the balance of £2m required within the planning period.

- Operational property disposals, including the sale of surplus Police properties and Barbican Flats are expected to realise a further £41m, of which £7m has been received. Proceeds from the sale of surplus police properties will provide partial funding for the costs of the new Police Accommodation.
- The Asset Realisation Programme aims to maximise returns whilst minimising any ongoing loss of revenue. With this in mind, priority has been given to the identification and disposal of surplus operational property. A sum of £34m is anticipated within the planning period, of which £14m has been received to date. Some uncertainty remains over the achievability of the remaining £20m which is being monitored through a dedicated officer group, whose remit is being extended through the operational property workstream of the service based reviews.
- The funding of the £200m City Fund Crossrail commitment is dependent on capital receipts estimated at £124m from the Crossrail estate of which £84m had been received, leaving £40m yet to be realised.
- Of this £124m required, £39m relates to sums received which have been earmarked for re-investment in property, in accordance with Treasury Management decision to improve revenue returns. A separate report on the Crossrail commitments is due in the new calendar year which will include details of the properties for disposal, which are being selected to minimise the loss of rental income. The balance of the £200m commitment is to be met from interim rental and interest income generated by the Crossrail Estate (£23m) and other funds earmarked from planned disposals which have been largely realised (£53m).

15. Another risk factor particularly associated with the City Fund relates to the certainty and timeliness of the significant external contributions upon which some schemes are predicated. Accordingly, safeguards are in place to ensure that commitments are not entered into unless the receipt of external funds is assured.

16. Looking ahead beyond the planning period, significant expenditure to complete the major works at the Central Criminal Court and further investment in the City Fund Strategic Investment Property Estate is planned, with capital expenditure forecasts indicating a future capital financing shortfall. The Operational Property Review aims to rationalise the operational property estate and identify further surplus assets, resulting in capital receipts to fund our future capital programmes.

17. Pending this review, a sum of £27m of revenue reserves earmarked for property investment is being retained to meet shortfalls in funding of the capital programme.

<u>City's Cash</u>

18. 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 minimised the need for a further asset realisation programme for City's

Cash. Revenue savings and disposal proceeds arising from the Operational Property Review may provide resources towards the funding of capital and supplementary revenue projects, with any shortfall to be met from the liquidation of investments (financial or property).

Bridge House Estates

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

20. In addition, further investment is included in the capital programme to improve the long term resilience of both City's Cash and Bridge House Estates, financed from the receipts generated by the recent investment property sales to the City Fund.

Conclusion

21. Significant capital and supplementary revenue project expenditure amounting to some £648m is currently forecast, to be 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 particularly dependent on the achievement of operational property sales, the Crossrail funding strategy and the asset realisation programme. To provide some mitigation against this risk, a sum of £27m has been prudently set aside from City Fund revenue resources to fund unforeseen shortfalls in capital reserves and/or to finance future funding deficits beyond the planning period.

22. Controls are in place to generally restrict the amount of new capital investment. Nevertheless, additional (mostly exceptional) items totalling £77m (£65.4m net after repayment) have been built into the programmes in respect of the items listed in paragraph 11.

23. The current medium term financial forecast for City's Cash indicates that there are sufficient resources within the fund to meet the cost of the programme, involving the disposal of property and possibly financial investments an immediate need for further asset realisation, and the long term resilience of the fund is to be improved by strategic property reinvestment and rationalisation of the operational property estate.

24. The financial health of the Bridge House Estates Trust remains buoyant.

Appendices

Appendix 1: Capital and Supplementary Revenue Expenditure Forecasts and Financing

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