

Corporate Policy & Resources Committee



26 June 2023

This report was approved by CPRC on 26 June, is now sent to all councillors in the briefing pack, a finance officer will be available at the next committee meeting for Admin, Economic Development, Environment & Sustainability, Community Wellbeing & Housing and Neighbourhood Services and Enforcement to answer any questions a committee member may have on the variance analysis (section 3) and appendices, in respect of their committee. Please also note that the Thameside House variance shown below is incorrect, as the Outturn figure of £81m refers to a different design, which has not been approved by Council. Therefore, the capital programme is underspent by £3.9m, as set out in note 1.3 below.

The addendum report is not relevant to any committee other than Corporate Policy & Resources and therefore will not be distributed.

Title	31 March 2023 - Month 12 Capital Outturn report
Purpose of the report	To note
Report Author	Paul Taylor Chief Accountant
Ward(s) Affected	All Wards
Exempt	No
Corporate Priority	Community Affordable housing Recovery Environment Service delivery
Recommendations	The Committee is asked to note the £22.8m overspend (Dec: £22.9m overspend) on capital expenditure against its Capital Programme provision for 2022-23 as at 31 March 2023.

1. Report Summary

- 1.1 This report seeks to update Councillors on the performance of our capital projects against the approved budget, as at 31 March 2023. and the **projected** overspend of £22.8m (Dec: overspend of £22.9m). The main reason for the overspend is shown below:

	Previous Approved Budget	Projected Outturn on latest design	Variance
Thameside House	£54,430,000	£81,000,000	£26,670,000

Full details are shown below in section 3.5 (d).

- 1.2 The projected overspend on Thameside is due to the redesign proposals currently being discussed and evolving, which have not yet been approved by Development Sub-Committee, and therefore, this produces a technical overspend, until the final project is approved by Council. Over the coming months, the approved budget and forecast outturn will align.
- 1.3 Officers will be reviewing this reporting process over the next couple of weeks and will update the Committee on their recommendations, as without this adverse variance on Thameside House, Council would have an underspend of £3.9m.

2. Key issues

- 2.1 The Capital Monitoring report covers the cumulative actual expenditure to date, against the cumulative Council approved Capital Programme budget and compares this against the latest forecast outturn from Officers.
- 2.2 Although the projects may have a budget allocation in the Capital Programme, any increases in budget will require prior approval by Corporate Policy & Resources Committee before drawing down on the budget.
- 2.3 The Council is beginning to see the impact of Brexit, longer term economic impacts of the COVID-19 pandemic, the Ukraine War, and the Cost-of-Living Crisis on the Council's development projects, in particular inflation on building costs, availability of labour and shorter fixed price guarantees from building suppliers. Coupled with the substantial increase in the Bank of England base rate, and the short-term impact on the gilts market, the long term cost of borrowing has increased from an average of 2.3% to over 4.8% in twelve months, which as reported at the Extraordinary Council Meeting (ECM) on 2 February, when the Bank of England base rate was slightly lower at 4.25%, has added another £180m plus to the cost of our developments over the next 50 years based on our current Council approved Capital Programme(if the rates do not start to fall back in the future).
- 2.4 Previous Council decisions to impose height restrictions on the Oast House & Thameside developments has resulted in a reduction of £70m of rental income over the next 50 years, or the equivalent of an average of £1.25m per annum.
- 2.5 Many of the development projects were acquired by the Council several years ago, and due to a mixture of delays including obtaining planning permission, and Council imposed moratoriums, the projected income from these projects

has not materialised as originally planned, creating a triple whammy, on the Council's finances, which will put pressure on future income over the short to medium term.

- 2.6 Officers will continue to closely monitor these risks and assess the impact on our Development Properties specifically and more generally on the Estimated Capital Programme for 2022/23 to 2026/27. Therefore, it is critical that these projects receive planning permission at the earliest opportunity, so that capital investment commitments can be made at the most financially advantageous time without further delay.
- 2.7 As reported last quarter, Officers continue to monitor the impact of inflation on the material and labour costs for our development contracts, which is forecast to have a £40m+ adverse impact on the Council's Capital budgets over the next four years and this will have a knock-on impact on our revenue budgets due to increased interest charges, as notified by the Public Works Loan Board (PWLB) and greater costs to be financed.
- 2.8 For the quarter ended 31 March 2023 the approved 2022-23 Capital Programme was £339.3m (Dec: £374.3m). The latest forecast outturn position is £362.2m (Dec: £397.3m), giving a projected aggregate overspend of £22.9m (Dec: overspend £23.0m) as per Appendix A below. Until planning consent is granted, and final terms have been negotiated for build contracts, there is likely to be ongoing adverse fluctuation due to construction market volatility.
- (a) Please also note, as shown below four assets have been removed from the Capital Programme this quarter, as they are no longer proceeding, hence the difference in the approved capital programme figures.
- 2.9 The projected aggregate over/underspend by Committee as per Appendix B is as follows and the specific detail is shown in the section 3 - variance analysis below:
- (a) Administrative – projected underspend (£195k) (Dec: underspend (£195k)).
- (b) Community Wellbeing & Housing – projected over/underspend £nil (Dec: over/underspend £nil).
- (c) Environment & Sustainability – projected overspend £104k (Dec: overspend £104k)
- (d) Corporate Policy & Resources Committee – projected overspend £22.9m (Dec: overspend £22.9m).
- (e) Neighbourhood Services & Enforcement – no projected over/underspend (Dec: no projected over/underspend)
- 2.10 In arriving at the cumulative expenditure to date, the Finance Team account for capitalised borrowing costs, salaries, and all costs of acquisition on each development project.
- 2.11 As highlighted last quarter, the average **monthly cost** to the Council for the delays in moving the development properties forward is **£170k** (£140k revenue and £30k capital) for the quarter ended 31 March 2023, (Dec: unchanged).

- 2.12 Officers are forecasting that as the Council comes to renew its short-term borrowing (three to twelve months maturity) and with current market interest rates have risen by over 250% in the last six months, from January 2023, they anticipate that the monthly short-term borrowing costs will increase by over £90k per month.
- 2.13 **Capitalisation of borrowing costs**
- 2.14 Under normal circumstances, Officers would capitalise the borrowing costs associated with the six development properties in the Staines-upon-Thames area based on the requirements of section 4 of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Local Authority Accounting. However, the delays caused by the moratorium, planning submission, and obtaining planning permission, have had a significant impact on the Council's finances.
- 2.15 As the Council progresses with the plans for each development, following the end of the moratorium, Officers, in consultation with our external auditors, will have to reassess each project and if the design of the buildings has significantly altered, once planning permission has been granted, and in order to comply with the above CIPFA Code, Council may have to charge the design fees for the previous building designs from Capital to the Revenue budget and this could have a significant adverse impact on the revenue outturn, increasing the predicted budget deficit even further.

3. Variance analysis

- 3.1 We report on any significant movement in forecast variance over £50k or 20% of budget, whichever is the highest, or if there has been a significant development since last quarter, by committee as follows:
- 3.2 Administrative – projected underspend (£195k) (Dec: underspend (£1.7k))
- (a) Recabling – Underspend (£180k) (Dec: over/underspend £nil) ICT have conducted the port audit and the results show that the Council is unlikely to undertake a full re cabling exercise at Knowle Green. Some isolated work will be required.

Please note that for the 2024/25 Budget, because of the future challenges on the Council's revenue and capital cashflow mentioned in section 2 above, all capital projects require a Project Initiation Document to be completed before a growth bid is submitted, to manage the Council Capital Financing Requirement.

- 3.3 Community Wellbeing & Housing – projected Over/underspend £nil (Dec: over/underspend £nil)
- 3.4 Environment & Sustainability – projected overspend £104k (Dec: £104k overspend).
- (a) Laleham Park Upgrade – Overspend £104k, (Dec: overspend £104k) Cost inflation is impacting on this project and Officers will shortly be submitting revised plans for approval by the Development Sub Committee, to increase the budget.

3.5 Corporate Policy & Resources – Overspend £22.9m (Dec: overspend £22.9m).

Please note that there are a number of memorandum accounts in the Appendix, in respect of the original purchase of the development properties, which were completed a number of years ago, and therefore, variance is shown for completeness. as these variances are historic and will not change.

- (a) Ashford Multistorey Car Park - residential scheme (MSCP) – Overspend is projected at £1.3m, (Dec: overspend £1.3m). The anticipated overspend is due to building material and labour cost inflation, value engineering will be undertaken where possible to reduce overspend. Development Sub Committee approved a £267k increase in budget for additional design fees.
- (b) Benwell House Phase 1 Development & Build costs – Underspend (£2.6m) (Dec: underspend (£2.6m)). Final contract continues to be negotiated, due to contractor claiming costs for loss and expense, which are currently unsubstantiated.
- (c) Victory Place (keyworker and affordable homes) – Overspend £6.0m (Dec: Overspend £6.0m). The overspend is due to the issues mentioned in 2 above, i.e., building cost inflation and delays in getting pre commencement conditions discharged. Final construction costs continue to be reviewed and any possible value engineering will be undertaken to keep construction costs as low as possible.
- (d) Thameside House (private rental) – Overspend £26.7m (Dec: overspend £26.7m), and the overspend relates to the issues mentioned in 2 above, and that the current project is not viable for Knowle Green Estates (KGE). (Please note that at the ECM on 2 February 2023, a motion was agreed to retain this project within the Council's remit for private rental and this is not reflected in this report). Further work will be undertaken to consider the viability of the scheme, as it needs to be viewed in conjunction with the Tothill Development.
- (e) Oast House (affordable rental and NHS health and community wellbeing centre)– Underspend (£6.1m) (Dec: underspend (£6.1m)). Significant cost increases as discussed in 2 above. Given the council agreed height restrictions, alternatives designs are being considered before submitting a scheme for approval at Development Subcommittee and to achieve a scheme that is financially viable for KGE.
- (f) Acquisition of a potential housing/regeneration asset – **WAS REMOVED FROM THE CAPITAL PROGRAMME**
- (g) 91/93 High Street – Underspend (£1.2m) (Dec: underspend (£1.2m)). Currently proposals were not viable for KGE, so Officers are reengineering the proposals for future agreement at Development Subcommittee.
- (h) Former Decathlon unit (future Library)– Underspend (£2.0m). (Dec: underspend (£2.0m. Subject to completion of the letting to Surrey County Council, the planned capital expenditure is no longer required, and the capital programme will be amended to reflect this saving.

3.6 Neighbourhood Services & Enforcement - Over/underspend £nil (Dec: over/underspend £nil)

4. Financial implications

4.1 Once a project is completed, any underspend on the approved Capital Programme enables the Council to invest the monies to gain additional treasury management investment income or to fund additional schemes.

4.2 Working closely with our Treasury Management advisors, Officers are currently saving the Council more than £1,300k per annum in interest charges, through prudent use of short-term interest rates to fund regeneration development projects.

4.3 Council funds these development projects via short term borrowings, typically from other local authorities. The interest is capitalised against each project, in accordance with the CIPFA Prudential Code.

4.4 When each project is completed, in most cases Officers obtain long term fixed rate interest loans from the Public Works Loan Board (PWLB) to significantly reduce the Council's exposure to risk of future interest rate rises.

4.5 For many of the smaller capital projects, especially those which will not generate revenue income streams or revenue savings, officers will fund the project from the annual Revenue Contribution to Capital, existing capital grants, capital receipts or short-term lease/HP agreements, rather than long term loans.

Officers have reviewed the actual capitalised costs (relating to accumulated costs capitalised in accordance with approved accounting policies, for residential delivery schemes yet to be completed) from the date of inception of each project to 31 March 2023 and the results are shown in the table below:

	£
Oast House	2,572,000
Thameside House	3,296,000
Ashford MSCP	261,000
Victory Place	2,582,000
Benwell Phase 2	202,000
Total	8,913,000

4.6 Should there be any continued delays to getting the Council's development projects into the planning process or granting planning permission or failure to sign contracts with contractors, Officers, in consultation with our External Auditors, will have to assess whether it is still appropriate under the Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code, to continue to capitalise, salaries, interest and fees against these capital projects. If some of those costs were to be treated as abortive they would need to be charged to Revenue.

- 4.7 Based on the above table, if all the development properties were deemed not to be progressing under the terms of the Prudential Code, £9m will be charged to the revenue budget, creating a substantial deficit, which Council will have to resolve, by a number of options, which are not mutually exclusive and would need to be assessed on a project by project basis:
- (a) Reducing discretionary services
 - (b) Increasing Council Tax – should an increase beyond £5 or 3% be required, then it will be necessary to hold a referendum.
 - (c) Remove the height restrictions from the Council's development properties in order to maximise rental rents and reinstate £70m over 50 years, i.e., £1.25m positive cashflow to the Council.
 - (d) Form one or more Joint Ventures to get the properties built.
 - (e) Selling our development properties at this current time, is likely to make the matter worse, because the current market value is below the cost price and therefore it will crystallise losses into the Council's Revenue Budget, which will need to be covered by further drastic action, as mentioned above. It would be more preferable to wait until some stability returns to the property market and property valuation are more than the aggregate capital cost on our development projects.
- 4.8 Officers will be modelling these scenarios for Council as part of the Medium Term Financial Plan (MTFP) and highlighting the impact on the revenue budget and the residents of the Borough, in the light of the continued delays imposed by Council generally and obtaining planning permission specifically, so that councillors are fully aware of the challenges, risks and financial implications of their decision making.

5. Risk considerations

- 5.1 The significant risks for our capital programme continue to be the delay in commencing our development projects.
- 5.2 These delays are seeing construction costs rise rapidly, as the construction industry experiences significant inflationary increases in building material and labour costs, which in turn is creating shortage of both in the marketplace, adding to lead times and driving financing costs upwards.
- 5.3 The recent upward trend in interest base rates is impacting on our development properties, as the Council funds these projects from short term borrowing, before fixing the loan interest via the Public Works Board on completion of each project.
- 5.4 The development restrictions place on Thameside House in its current format, make it financially unviable, and council will either have to change the design or link the project with another one, such as, the Tothill Development to mitigate the risks to the Council.

6. Procurement considerations

- 6.1 In accordance with the Council's Contract Standing Orders, the Corporate Procurement team provides support in tendering for projects with a value of £40k or over. This includes major capital (and revenue) projects, such as development scheme projects.

6.2 Corporate Procurement plays a vital role in ensuring that tenders are conducted compliantly and under a process designed to achieve optimal whole life value for money.

7. Legal considerations

7.1 None.

8. Other considerations

8.1 On the smaller projects, Officers will be expected to progress their capital bids and complete by 31 March 2024. Where projects have not commenced, by this date, in view of the challenges facing the Council as mentioned in 2 above, Project Managers may be requested to cancel the project and reapply for capital funds when they are ready to complete the project, so that the unused funds can either be utilised elsewhere by Council or to reduce the Capital Finance Requirement, rather than being tied up in projects that are not progressing.

9. Equality and Diversity

9.1 This Council is committed to delivering equality, improving diversity and being inclusive in all our work as a service provider and an employer.

9.2 We incorporate equality into our core objectives, making every effort to eliminate discrimination, create equal opportunities and develop good working relationships between different people.

10. Sustainability/Climate Change Implications

10.1 Spelthorne Borough Council has declared a climate emergency and each capital project will be looking to reduce its carbon footprint within the financial constraints imposed on it.

11. Timetable for implementation

11.1 Not applicable.

12. Contact

12.1 Paul Taylor p.taylor@spelthorne.gov.uk

Background papers: Extraordinary Council Meeting 2 February 2023 – Ensuring the long-term viability of the Council’s housing Delivery Programme.

Appendices:

Appendix A – Summary Capital Monitoring Report by Committee as at 31 March 2023.

Appendix B – Detailed Capital Monitoring Report by Committee as at 31 March 2023.