

COUNCIL

26 APRIL 2018

ADDITIONS TO THE REVENUE BUDGET AND CAPITAL PROGRAMME

Portfolio Holder: Councillor Alan Jarrett, Leader
Report from: Phil Watts, Chief Finance Officer
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Summary

This report requests Full Council approval for a number of additions to the Capital Programme and Revenue Budget.

1. Budget and Policy Framework

1.1. It is the responsibility of Cabinet to ensure that expenditure remains within the budgets approved by the Council, but it remains the responsibility of Council to approve additions to the Capital Programme and Revenue Budget.

2. Background

2.1. Council approved the Capital and Revenue Budgets for 2018/19 at its meeting on 22 February 2018. Since then Cabinet have discussed several new schemes and proposals, which would require spending over and above that previously agreed and have recommended that Council approve a number of additions to the Capital Programme.

2.2. These schemes are:

- A five year programme to be taken forward by the Medway Development Company Ltd;
- A joint venture with Norse Property Services to develop an under-utilised car park in Rainham;
- A scheme for which approval is being sought from SELEP for the Council to borrow funds on behalf of the CHDT to develop the Fitted Rigging House.

2.3. In addition to this, officers have applied for an interest-free Salix loan of £164,000 with which to take forward the replacement of the boiler and installation of a more efficient hot water system at Gun Wharf, which will generate annual savings.

- 2.4. Finally, the Council's collection fund is expecting to produce a surplus and the Leader is recommending to Council that £563,500 is allocated to prepare a detailed master plan and develop the Local Development Order for the Innovation Park Medway. £422,500 of collection fund surplus funds will be added to the £141,000 agreed by SELEP to undertake this work.
- 2.5. Each of these schemes is considered in more detail below.

3. Medway Development Company Ltd.

- 3.1. Cabinet approved the Business Case submitted at the 5 September 2017 meeting for the creation of a new company to be called Medway Development Company Limited. Cabinet agreed to delegate authority to the Chief Legal Officer, in consultation with the Leader, to finalise the Articles of Association in a form similar to those established for an independent, non-Teckal company. It was incorporated with the model Articles to enable an efficient set up on 24 October 2017.
- 3.2. MDC has recruited a Head of Operations, Lewis Small, who is taking forward the initial projects identified in the business case presented to Cabinet. He has created a first draft Business Plan for the MDC Board at its inaugural meeting, to progress the first three schemes. There are nine other schemes identified. Capital funding is now needed for a variety of enabling activity such as producing architect's drawings for planning applications. The business case estimates that over an initial five year period, funding of £120 million will be needed to unlock twelve Council owned sites.
- 3.3. The Board has reviewed the Business Case agreed by Cabinet on 5 September 2017 and considers that to enable the generation of the maximum return for the Council whilst delivering housing units principally in Medway, an alternative Teckal structure for the company should be pursued which is more tax efficient. The Public Contract Regulations 2015 codify the so-called "Teckal Exemption" at regulation 12 allowing public to public contracts without procurement where three criteria are met:
- The contracting authority exercises over the body control which is similar to that which it exercises over its own departments;
 - More than 80% of the activities of the body are carried out in the performance of the tasks entrusted to it by the controlling contracting authority;
 - There is no direct private capital participation in the controlled body.

Criteria 1 is met because the Council has appointed Directors to the Board of MDC. Criteria 2 is met since MDC will carry out 80%+ of its activities for Medway Council. Criteria 3 is met as the capital funding will be from the Council.

- 3.4. The MDC Board of Directors now considers that a company that fully meets the Teckal control test in the early years will allow the Council and to maximise profits from property sales by reducing tax liability. On 10 April Cabinet approved the amendments to the Medway Development Company Ltd (MDC) governance structure to reflect the Teckal test. Under the new arrangements MDC Ltd. would act as the Council's managing agent in developing its owned sites and would provide the following services:

- Potential site identified and high level appraisal and viability test;
 - Feasibility/ business case budget established and approved by MDC board;
 - Complete site surveys and develop planning drawings / tender documents;
 - Submit planning and tender the construction works; and
 - Tenders reviewed and approved by MDC board.
- 3.5. Under the new arrangements, as agreed by the Cabinet on 10 April 2018, the investment required to fund a five year programme with the sum of £120 million would be added to the Council's capital programme to be funded from borrowing in advance of the future receipts generated. As this represents a capital investment, the Council's capital financing requirement (CFR) will increase accordingly. As the intention will be to sell the homes built to generate capital receipts, there is no requirement to fund a minimum revenue provision and the interest incurred during the construction phase may be treated as a capital cost.

4. Medway Growth Joint Venture

- 4.1. The Council has a five year old relationship with Norse Commercial Services which started with considerations about a joint venture company Medway Norse to delivery of Facilities Management. Over time additional services have been added to the joint venture including the delivery of parks and greenspaces services, Special Educational Needs transport and recently the transfer of Household Waste Recycling Centres and the Council's waste collection and cleansing contract from October 2019.
- 4.2. Norse Commercial Services has a property subsidiary Norse Property Services (NPS) which has completed an award winning small residential development scheme in a joint venture with Broadland District Council called "Broadland Growth." NPS approached the Council with a view to exploring a similar joint venture with the Council and prepared a proposal for a small residential scheme on an under-utilised car park in Rainham. On 10 April 2018, Cabinet approved the setting up of a joint venture company with NPS called Medway Growth.
- 4.3. The Council will be required to provide the land and lend the joint venture company £1.352 million and will be added to the Council's capital programme. The funds required for this loan will be met from borrowing. As this represents a capital investment, the Council's capital financing requirement (CFR) will increase accordingly. There is no requirement to fund a minimum revenue provision and the interest charge to the joint venture will have to be at market rate, giving the Council a modest revenue benefit. A detailed financial appraisal of each site as it comes forward will enable the Council to assess the risks and rewards for sites before any investment.
- 4.4. The Council has a power to create joint venture companies under the Localism Act 2011 section 3 and passes "Teckal Exemption" test, meeting the three criteria referred to above. Criteria 1 is met as the proposal is the Council will appoint Directors to the Board of Medway Growth. Criteria 2 is met since Medway Growth will carry out 80%+ of its activities for Medway Council. Criteria 3 is met as the capital funding will be from the Council and Norse Property Services.

5. Chatham Historic Dockyard Trust – Growing Places Fund

- 5.1. Chatham Historic Dockyard Trust have submitted a Growing Places Fund (GPF) bid to bring the Fitted Rigging House into full use and Full Council are requested to approve an £800,000 addition to the Capital Programme, following Cabinet's consideration of the report on 10 April 2018, subject to approval from the South East Local Enterprise Partnership (SELEP) for the funding.
- 5.2. The Fitted Rigging House Project will convert a large, grade 1, former industrial building into office and public benefit spaces, initially providing a base for three organisations employing over 350 people. The project also frees up space to create a postgraduate study facility elsewhere onsite for the University of Kent's Business School.
- 5.3. The total cost of the project is £8.4 million. CHDT have secured £7.6 million from other sources and have sought the remaining £800,000 from the Growing Places Fund. CHDT submitted a final business case to the South East Local Enterprise Partnership (SELEP) at the beginning of March 2018. Subject to an independent technical evaluator being satisfied with the business case, it will be presented to the SELEP Accountability Board for a funding decision on 27 April 2018.
- 5.4. If SELEP Accountability Board approves the loan of £800,000 from the Growing Places Fund, there will be a requirement for the Council to act as an intermediary between SELEP and CHDT. The Council will need to enter into a loan agreement with SELEP on behalf of CHDT, as SELEP will only enter into funding agreements with local authorities. In turn, the Council will enter into a legally binding back to back loan agreement with CHDT, which will give the Council protection should CHDT default on their repayments. The back to back loan agreement would allow the Council to charge interest in line with the Public Works Loan Board rate should CHDT default on the agreed repayment schedule. This mirrors the charges which would be applied by SELEP if the Council were not to meet the repayment schedule set out in the loan agreement. In addition the Council, subject to approval from the SELEP Accountability Board, has the right to withdraw the loan if CHDT fail to comply with the conditions of the loan agreement, fail to demonstrate sufficient progress towards delivery of the project or fail to comply with the agreed repayment schedule. Furthermore, CHDT will be required to pay the amount of all costs and expenses (including legal fees) incurred by the Council in connection with the enforcement of, or the preservation of, any rights under the back to back loan agreement.

6. Gun Wharf Hot Water System – Salix Loan

- 6.1. The boilers and hot water system at Gun Wharf have reached the end of their useful life and are starting to become problematic. Replacement with new fuel efficient boilers and associated plant would reduce gas consumption and generate revenue savings.
- 6.2. This replacement would be funded through an interest free loan from Salix Finance, which would be repaid over five years from the resultant savings.

7. Innovation Park Medway – Master Plan and LDO

- 7.1. The council is committed to bringing forward development at Innovation Park Medway and revenue funding £563,500 is required.
- 7.2. To date, SELEP funding of over £8.0 million has been allocated to enable development at this location. SELEP has also allocated £141,000 towards a masterplan and Local Development Order from the Sector Support Fund (SSF), with the requirement of at least 30% match between Medway Council and Tonbridge and Malling Borough Council. However, a number of further elements remain which include surveys, soft market testing, branding and PR. It is proposed to supplement the £141,000 from SELEP with £422,500 of the anticipated collection fund surplus to prepare a Master Plan and LDO.
- 7.3. A cost breakdown is provided in the table below:

Item	2018/19	2019/20	2020/21	2021/22	Total
Masterplan and LDO	200,169.00	23,141.00			223,310.00
Trees and signage enabling costs	10,000.00				10,000.00
Branding launch and temporary signage	62,100.00	40,000.00			102,100.00
Ecology surveys	15,251.00				15,251.00
Development options match funding	4,200.00				4,200.00
NKEZ accountable body contribution	4,000.00	4,000.00	4,000.00	4,000.00	16,000.00
GPF match funding and economic case costs	4,575.00				4,575.00
Soft market testing	15,000.00				15,000.00
QS cost review	8,000.00				8,000.00
Geophysical survey and trial trenching	65,000.00				65,000.00
Consultant overview/approval of RAL works	50,000.00	50,000.00			100,000.00
	438,295.00	117,141.00	4,000.00	4,000.00	563,436.00

8. Risk Analysis

8.1 Medway Development Company Ltd.

Risk	Description	Action to avoid or mitigate risk	Risk rating
Teckal (i.e. procurement exempt) contracts made between MDC and Medway Council do not represent value for money	The wider market or the in-house teams are able to provide better savings and benefits than MDC	National building rates are available for the Council to test value on a scheme by scheme basis.	

MDC unable to take quick decisions on developments, acquisitions and disposals affecting its ability to be agile in a competitive and fluctuating commercial environment	Strategic and key decisions are reserved to the shareholder requiring a Cabinet decision and Council timescales for reports and publishing of notices.	This is a low risk in short term as the sites to be developed are Council owned.	
Tenants exercise their right to buy of General Fund properties or LATCO properties (if extended to Local Authority Housing Companies as predicted)	Financial risk to the Council as a potential lender, lack of investment return and increased borrowing costs.	The Company's medium term financial plan should allow flexible delivery and factor in a given percentage of "right to buy" sales.	
Overall loss of tax efficiencies and cost savings by simultaneously operating multiple Teckal companies	The new proposed structure is similar to the set up for MCG. Whilst there are benefits in ring fencing property development activity from the other services that MCG provides, if both MCG and MDC make a profit, both companies will pay corporation tax.	Tax advice will be taken by the Company and the Council.	

8.2 Medway Growth Joint Venture

Risk	Description	Action to avoid or mitigate risk	Risk rating
Schemes pursued by the Company are built out but not sold or rented	Financial risk to the Council as a potential lender, lack of income and increased borrowing costs	Proposal includes Marketing expertise to be sought to promote sites. Joint venture minimises risk	

The Medway market becomes saturated by available units thereby causing capital values to decrease	Financial risk to the Council as a potential lender, lack of income and increased borrowing costs	Market research is carried out plus expertise sought to promote sites. Consideration of a joint venture in the right circumstances.	
There is a crash in the housing market such that capital values reduce significantly	Financial risk to the Council as a potential lender, lack of income and increased borrowing costs	Market research is carried out plus expertise sought to promote sites. Consideration of a joint venture in the right conditions.	
Tenants exercise their right to buy of General Fund properties or LATCO properties	Financial risk to the Council as a potential lender, lack of income and increased borrowing costs	Proposal includes units for private sale only.	
The housing company's ethos is contrary to Council Policy.	Reputational risk to the Council	Two cabinet members on the board. Initial financial funding is from the Council.	
Planning risks. Proposed company schemes are seen as unsuitable.	Reputational risk to the council. Financial risk to the council as a potential lender, lack of income and increased borrowing costs.	The Chief Finance Officer will test individual schemes for financial viability	
Company failure. Exit strategy.	Reputational risk to the council. Financial risk to the council as a potential lender, lack of income and increased borrowing costs.	The Chief Finance Officer will test individual schemes for financial viability. Company structure ring-fences risk. Insolvency proceedings would protect the council.	

8.3 Chatham Historic Dockyard Trust - Growing Places Fund

Risk	Description	Action to avoid or mitigate risk	Risk rating
Funding might not be received.	If the Business Plan is not robust, the loan could be refused	Robust Business Plan has been developed	D2
Cost of the works are higher than agreed funding	If the cost of the works are higher than the anticipated costs the scheme may be unaffordable	CHDT will be undertaking a robust procurement exercise to ensure value for money is offered by suppliers. As the project is being delivered by CHDT the liability for any cost overrun lies with them	D2
Medway Council become liable for the loan	If CHDT fail to make repayments to Medway Council in line with the Business Case, Medway Council will become liable for the loan repayments	A robust loan agreement to be in place between Medway Council and CHDT to protect Medway Council in the event that CHDT default on the payments, pre agreed by Legal and Finance	E2

8.3 Gun Wharf Hot Water System – Salix Loan

Risk	Description	Action to avoid or mitigate risk	Risk rating
Energy savings might not cover the loan	The interest free loan is repayable over five years from the savings generated by the scheme	Robust estimation of energy savings by the energy consultants supporting our bid	D2

8.4 Innovation Park Medway – Master Plan and LDO

Risk	Description	Action to avoid or mitigate risk	Risk rating
Costs are higher than agreed funding	If the cost of works is higher than the anticipated costs the scheme may be unaffordable.	Cost estimates are based either on quotes following robust procurement exercises or on reliable estimates which will be verified through procurement exercises.	D2
SSF funding might not be awarded	If SELEP do not consider that the proposed Masterplan and LDO offer good value for money they may refuse to transfer the funding.	SELEP Strategic Board approved the funding allocation in June 2017, subject to demonstration of the value for money. Robust calculations have been submitted to SELEP.	D2
Poor response to public consultation	Public consultation on the masterplan and Local Development Order receives a negative response.	Ensure that the material consulted upon is clear and understandable and that the masterplan and LDO are in line with existing Rochester Airport masterplan and other relevant guidance.	D2

9. Financial and Legal Implications

9.1. The financial and legal implications are fully analysed in the report and summarised in the table below:

Capital programme	Medway Development Co. Ltd.	£120,000,000
Capital programme	Medway Growth joint venture	£1,352,000
Capital programme	Loan to CHDT – Fitting Rigging House	£800,000
Capital programme	Hot Water System – Salix Loan	£164,000
Revenue budget	Innovation Park Medway – Master Plan	£563,500

10. Recommendation

- 10.1. The Council is asked to add the schemes set out in sections 3 to 6 of the report to the Capital Programme and to add the scheme set out at section 7 to the Revenue Budget.

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Appendices

None

Background papers

Medway Development Company Ltd. Update, Cabinet 10 April 2018
<https://democracy.medway.gov.uk/mgconvert2pdf.aspx?id=41318>

Joint Venture with Norse Property Services, Cabinet 10 April 2018
<https://democracy.medway.gov.uk/mgconvert2pdf.aspx?id=41316>

Fitted Rigging House – Addition to the Capital Programme, Cabinet 10 April 2018
<https://democracy.medway.gov.uk/mgconvert2pdf.aspx?id=41303>