REPORT FOR:	**OVERVIEW AND SCRUTINY COMMITTEE**
Date of Meeting:	27 February 2018
Subject:	Financing of the Regeneration Programme – Scrutiny Review Financial Modelling
Responsible Officer:	Paul Nichols, Divisional Director of Regeneration, Enterprise and Planning Dawn Calvert – Director of Finance
Scrutiny Lead Member area:	Cllr Jeff Anderson Cllr Manji Kara
Exempt:	No, except for Appendices 1 & 2 which are exempt on the grounds that they contain 'exempt information ' under paragraph 3 of Part 1 of Schedule 12A to the Local Government Finance Act 1972 (as amended) in that it contains information relating to the financial or business affairs of any particular person (including the authority holding that information)
Wards affected:	All
Enclosures:	Appendix 1 – Regeneration Programme 2018/19 to 2022/23 (exempt) Appendix 2 – Sensitivity Analysis (exempt)

Section 1 – Summary and Recommendations

This report sets out:
- Regeneration Capital Programme 2018/19 to 2022/23, as reported to February Cabinet / Council
- Financial sensitivity analysis of the 6 key scenario's used to stress test the Regeneration Programme

Recommendations:
The Committee is asked to note the results of the sensitivity analysis.

Section 2 – Report

BUILDING A BETTER HARROW

2.1 The Regeneration Strategy was agreed at Cabinet in December 2014 and further developed in September 2015. The strategy is a wide ranging and Council wide programme for the future development of Harrow. It sets out an ambitious programme of investment and delivery that reflects the Council's Ambition Plan: To Build a Better Harrow. The objectives of the strategy are summarised below:

- 'Building a Better Harrow' together , for today and for future generations
- Addressing housing need, particularly for affordable housing
- The Council developing its own land – to meet community need and to make batter use of its own assets
- A new initiative for the Council to build homes for private rent
- Renewing civic, cultural and community facilities and meeting infrastructure needs
- Creating quality places
- Getting maximum benefit for the local economy

2.2 Over the course of the Regeneration Programme, it is estimated that around £1.75b will be invested in Harrow and Wealdstone town centres, from both Council and private resources, delivering the action plan for the 'Heart of Harrow'. This includes the provision of 5,500 new homes, around 3,000 new jobs, new schools and central library, a new civic centre and an improved pedestrian environment in the town and district centres. This report is focused on the Council funded element which forms part of the Council's Capital Programme.

REGENERATION CAPITAL PROGRAMME 2018/19 to 2022/23

2.3 The previous expenditure requirements of the Regeneration Programme over the financial years 2017/18 to 2019/20 were estimated to be £325m, to be funded through a combination of land receipts and new borrowing, with the total cost of the Regeneration programme anticipated to be in the region of £349m over the life of the programme which extended to 2021/22. There were land receipts anticipated in the region of £108m being generated to help fund the cost of works which gave a net scheme cost of £241m.

2.4 In 2017, a Commercial & Financial Review of the Regeneration Programme was launched, which focused on the following areas:

- Phasing and profiling of the programme
- Further commercial review of designs
- Peer review of approaches taken in other Councils and organisations
- Further analysis of debt and cash flows
- Clarification of advice on the legal and tax implications
- Seeking advice on partnering structures.

2.5 This resulted in a revised indicative Programme budget being taken to December 2017 Cabinet. This showed gross expenditure of £293m reduced to £220m after the application of capital receipts. The December Cabinet report stated that this indicative position was subject to further review in preparation for it being included in the Final Capital Programme to be agreed by Cabinet/Council in February 2018.The revised Regeneration budget which extends to 2022/23 is set out in Table 1 below.

Table 1 – Regeneration Programme

	January 2017 Approved budget, (A) £'000s	December 2017 Update, (B) £'000s	February 2018 Budget (C) for Approval, £'000s	Variance (A)-(C) £'000
Gross Expenditure	349,096	292,252	295,171	(53,925)
Capital Receipts	(108,245)	(72,660)	(87,771)	20,474
Net Expenditure	240,851	219,592	207,400	(33,451)

2.6 The following areas are reflected in the revised programme budget (C) above:

- Re-phasing of Poets' Corner Phase 1 by elongation of construction and dividing the site into 3 sections. This has the effect of reducing peak debt and also reduces risk as further sections will only be committed to once the previous one is progressing well. This further de risks the programme as major projects are not starting on site at the same time.

- Sale of Haslam House and Wax well lane - A review of these schemes suggests it would be better to sell for a cash receipt due to the desirable location and recycled back into the programme. Current assumptions within the modelling are that both these schemes will be sold upon completion and the capital receipt recycled back. However, this will continue to be reviewed to ensure maximum benefit to the programme.

- Inclusion of the GLA grant receipt , in 2017/18, of £3.75m against Poets' Corner Phase 1

- An estimation of Stamp Duty Land Tax liability of £8.2m where applicable.

- Review of the Management and Maintenance cost assumptions resulting in increases from £650/unit to £750/unit

- Start on Site and practical completion dates have been updated to reflect their current assumptions.

- To aid transparency, Value Engineering savings, yet to be made, have been removed from the costs. Further design work to ensure that schemes reach their viability target is on-going.

2.7 The comparable total cost of the programme is now anticipated to be £295m to 2022/23 whereas it was at £349m in January 2017. Capital receipts are now expected to be £88m down from £108m in January 2017 in line with the design changes. A detailed breakdown of budget allocations is set out over the life of the Programme in Appendix 1 and summarised in table 2 below. How the overall expenditure is to be re-profiled for the period of the existing Capital Programme is detailed in table 3 for information:

Table 2-Regeneration Capital Programme 2015/16 to 2022/23

	Gross Expenditure	**Capital Receipt**	**Net Expenditure**
	£'000	£'000	£'000
2015/16	973	0	973
2016/17	9,660	0	9,660
2017/18	15,488	-3,750	11,738
2018/19	70,996	-5,016	65,980
2019/20	162,120	-27,111	135,009
2020/21	35,534	-51,894	-16,360
2021/22	200	0	200
2022/23	200	0	200
TOTAL	**295,171**	**-87,771**	**207,400**

Table 3:-Capital Programme 2018/19 to 2020/21

	2018/19	2019/20	2020/21	Total
	£'000	£'000	£'000	£'000
Total Expenditure	70,996	162,120	35,534	268,650
Previous budget	197,870	81,638	0	279,508
Variation	(126,874)	80,482	35,534	(10,858)

Table 4- Capital Receipt Assumptions

Capital Receipts/Contributions:	**Feb 18-**
Non Residential Land sales	10,500,000
Residential sales-to purchasers	7,710,550
Non Residential sales- Other	48,956,250
Non Residential Sales: Retail Units	358,667
Other Contributions-Sale of Poets 2	5,000,000
GLA Grant Poets-Phase1	3,750,000
Sales Receipt: Haslam House	3,070,783
Sales Receipt: Waxwell Lane	8,424,596
	87,770,846

2.8 Borrowing strategies are being developed which will enable interest rates to be controlled. These include structuring new borrowing with a mix of maturities, such as short-term borrowing (e.g. 3/5/7 year loans) over the development period to enable the Council to access the cheaper rates currently available for these maturities and long term borrowing once the private rented sector units become operational.

2.10 The design and tenure mix of new housing will be adjusted and finalized as each project proceeds through the planning process, to ensure that schemes are financially viable. Table 5 shows the current tenure assumptions:

Table 5- Tenure Assumptions

TENURE	Jan 17	Dec 17	Feb 18
UNITS FOR MARKET RENT	509	509	480
UNITS FOR INTERMEDIATE RENT	101	133	133
UINITS FOR AFFORDABLE RENT	72	92	92
SOLD DIRECT TO PURACHSERS	149	21	50
SOLD AS PRIVATE SALE TO RP/DEV	0	0	0
SOLD AS RENTED TO RP/DEV	7	0	0
SOLD AS SHARED OWNERSHIP TO RP/DEV	0	0	0
TOTAL RESIDENTIAL	**838**	**755**	**755**
PARKING SPACES	802	194	193
CIVIC CENTRE	1	2	1
RETAIL UNITS	2	4	3
COMMUNITY CENTRE	3	2	1
OTHER 1	3	5	3
OTHER 2	0	3	1
LAND SALE	0	0	0
TOTAL NON-RESIDENTIAL	**811**	**210**	**202**
TOTAL - RESI & NON RESIDENTIAL	**1649**	**965**	**957**

REGENERATION PROGRAMME – FINANCIAL SCENARIO'S

2.12 As with any significant capital programme, the potential scenario's to stress test a financial model are numerous. Therefore 6 key scenarios' have been selected for the purposes of this report and used to stress test the impact on the baseline Regeneration Programme position which are summarised below:

- Scenario 1a/1b: Delay to start on site for the 3 main sites (New Civic, Byron and Poets Corner) by 6 month and 12 months (B & C)
- Scenario 2a/2b: 1a/1b plus delay to the start on site date of Haslam House & Waxwell Lane and hence a subsequent to the capital receipt by 6 months and 12 months (D & E)
- Scenario 3a/3b: Interest Rate increase/decrease by 0.5% (F & G)
- Scenario 4a/4b :Build cost inflation increase/decrease by 1% (H & I)
- Scenario 5a/5b: Sales value inflation increase/decrease 1% (J & K)
- Scenario 6: Poets Corner (PH1) built to schedule and the rental stream delayed by 1 year (L)

2.13 The results of the sensitivity analysis are shown in Appendix 2. The following narrative explains each scenario:

A – Baseline. This is the revised baseline programme agreed by Cabinet / Council in February 2018 as part of the final Capital Programme. All scenarios are tested from this base position. The original budget set aside to cover revenue related expenditure during the development period was £7.1m. This capacity was created following a standard review of the Council’s Minimum Revenue Provision Policy as reported to Cabinet in December 2015. The baseline assumes that £3.792m of the set aside will be utilised, leaving £3.3m. The baseline assumes that from 2021/22 the overall programme will generate positive cashflows (i.e. sufficient annual income to cover annual revenue expenditure (including capital financing costs)). At this point a decision will be made to formulise a contribution to the Medium Term Financial Strategy (MTFS).

B - Scenario 1a, Delay to start on site for the 3 main schemes by 6 months. This scenario shows the impact on the base position (A), of deferring the start on site date by 6 months for the 3 main sites, Byron Quarter, New Civic and Poets Corner (PH1). The impact is an increase in net capital expenditure of £1.27m over the life of the programme as a result of an increase in development overheard costs due to the delay, netted off against a reduction in capital financing costs in the short term. The potential revenue impact will be a loss of income from delayed rentals of £2.93m. Positive cash flows will still arise in 2021/22, which is consistent with the baseline scenario.

C- Scenario 1b, Delay to start on site for the 3 main schemes by 12 months. This scenario shows the impact on the base position (A), of deferring start on site date by 12 months on the 3 main sites, Byron Quarter, New Civic and Poets Corner (PH1). The impact is an increase in gross capital expenditure of £4.98m over the life of the programme as a result of an increase in development overhead costs due to the delay, netted off against a reduction in capital financing costs in the short term. The potential revenue impact will be a loss of income from delayed rentals of £9.63m .Positive cash flows will be delayed until 2022/23. The requirement is not to draw down any additional funding from the set aide (over £3.7m) therefore, if this risk materialised, mitigations would need to be found.

D & E – Scenario’s 2a & 2b, 1a/1b plus delay to the start on site date of Haslam House & Waxwell Lane and hence a subsequent delay to the capital receipt by 6 and 12 months. These scenarios show the impact of the delay on start on site, by 6 months and 12 months, for Haslam House and Waxwell Lane. As these two sites are now included in the baseline as been sold upon completion and the assumed capital receipt recycled back in the programme, the scenarios show the potential impact of the delayed capital receipt.

The baseline shows positive cash flows from 20/21. A delay in the capital receipt by six months and 12 months will result in an increase in net capital expenditure of £1.22m and £5.3m respectively as a result of additional capital development overhead costs. The impact on revenue will be the loss of rental income of £2.91m and £7.7m respectively. Positive cash flows will be delayed until 2022/23.

F & G- Scenario 3a & 3b, Interest rate increase / decrease by 0.5%. Scenario F shows the impact of an increase in interest rates by 0.5%.The impact is an increase in net expenditure of £1.70m in total as a result of increased capital financing costs. However, this is an unlikely risk as the borrowing strategy will include fixed interest rates. The baseline assumes an interest rate of 4.7% during the development period and 5.4% during the operational period. Based on current rates from the Public Works Loan Board, the cost of borrowing for the five year development period would be 4.4% which is 0.3% lower than in the current baseline. The cost of borrowing over the operational period at current rates would be 5.5%, 0.1% higher than in the current baseline.

Scenario G shows the impact on the base position of 0.5% decrease in interest rates. The result is a decrease in the net capital expenditure of £1.6m as a result of a reduced borrowing requirement. As described above for scenario F, interest rates will be fixed at the point of borrowing.

H & I - Scenarios 4a & 4b, Build cost inflation increase / decrease by 1%- This scenario shows the impact on the base position of build cost inflation increasing/decreasing by 1%. The baseline position already assumes inflationary increases as a result of external advice:

2018/19 +0.8%

2019/20 +2.0%

2020/21+4.0%

2021/22 +4.0%

The scenario tested here is an increase /decrease above that which is already assumed .Hence a decrease in inflation will result in a favourable reduction in net capital expenditure of £2.7m over the life of the programme. An increase in inflation would incur additional capital expenditure of £2.6m over the life of the programme. It is also important to note that most schemes have a design and construction contingency built in at an average 5 %.

J & K - Scenarios 5A & 5B, Sales value inflation increase / decrease by 1%. This scenario shows the impact on the base position of sales value inflation increasing/decreasing by 1%. The impact of this scenario is marginal in relation to the overall value of the programme.

L - Scenario 6, POETS Corner (PH1) built to schedule and rental stream delayed by 1 year. This scenario shows the impact of Poets Corner (PH1) being built to schedule but the rental income being delayed by 1 year. There will be no impact on capital development costs but there will be a loss in rental income of £6.18m over the life of the programme if rental sales are delayed by a year. Positive cash flows will be pushed back to 2022/23. This sensitivity has been included to show a prudent, worst case scenario position. The likelihood is that if PH 1 is built on time, but there are difficulties with letting the units, there would have to be a review of the rental strategy. An element of voids is included in the base model.

Financial Implications

The financial implications are detailed within the report.

Legal Implications

There are no specific legal implications arising from the various financial scenarios modelled in this report.

Performance Issues
This report is focused on testing a number of financial scenarios on the Regeneration Programme. The impact on the financial performance is detailed in the narrative supporting each scenario. Performance issues for the Regeneration Programme as a whole are considered as part of the Building a Better Harrow quarterly update to Cabinet, the next one being due March 2018.

Environmental Impact

Environmental issues for the Regeneration Programme as a whole are covered are considered as part of the Building A Better Harrow quarterly update to Cabinet, the next one being due March 2018.

Risk Management Implications
The Regeneration Programme is included with the Corporate Risk Register:

Risk 32 – New Civic Centre is not built within cost and on time. The risk rating at Qtr 2 17/18 is C2, medium likelihood and critical impact

Risk 33 – The Harrow Regeneration Strategy / Programme fails to deliver its core objectives and is unaffordable. The risk rating at Qtr 2 17/18 is C1, medium likelihood and catastrophic impact.

There is a separate risk register for the Regeneration Programme which is currently under review alongside the review and implementation of robust governance arrangements.

The narrative supporting the sensitivity analysis shows that a number of risks already have mitigation's built into the model. The financial model is dynamic to reflect a dynamic programme within its development period. As shown in Appendix 1, the overall programme includes an additional 5% construction and design contingency (£13.3m in total). As the programme moves forward and designs are finalised this contingency should reduce as final costs and designed are confirmed and the contingency is re- profiled to specific construction costs or it remains unused.

Equalities implications

No - an Equality Impact Assessment is not applicable to the focused nature of this report. carried out?

Council Priorities

The Council's vision:

Working Together to Make a Difference for Harrow

Please identify how the report incorporates the administration's priorities.

- Making a difference for the vulnerable
- Making a difference for communities
- Making a difference for local businesses
- Making a difference for families

Section 3 - Statutory Officer Clearance

Name:…Dawn Calvert…………….	X	Chief Financial Officer
Date: …………19/02/18………………………..		
Name: ………Matthew Adams…………	X	on behalf of the Monitoring Officer
Date: ……19/02/18……………………………..		

Ward Councillors notified:	**NO**

Section 4 - Contact Details and Background Papers

Contact: Dawn Calvert, Director of Finance, 0208 420 9269