



Arlingclose Ltd:

Independent treasury management services

Leisure and Housing Development Review

Folkestone and Hythe District Council

January 2019

DRAFT

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1. Introduction

- 1.1 Folkestone and Hythe District Council (the Council) are considering a development at Princes Parade, Hythe, which will see the provision of a new leisure centre and 150 units of accommodation.
- 1.2 The Council hopes to achieve an on-going saving in the cost of leisure provision within the district from the proposed scheme compared to its current position.
- 1.3 Most of the capital cost of the new facility will be met from capital receipts generated from land disposals together with S106 and Community Infrastructure Levy (CIL) contributions either already received or due from this development and funding from Homes England. Some short-term borrowing is expected to be required to cover the timing differences between capital spend and funding being received.
- 1.4 The modelling for the new leisure centre is based on it being managed and operated by a leisure trust.
- 1.5 Members are due to receive a report in January 2019 to consider and approve the business case for the proposed scheme. Arlingclose have been commissioned to undertake an independent desktop financial review of the scheme to check the key financial assumptions, outcomes and risks for it and, if applicable, to provide suggested actions/recommendations to be considered before the final report is presented to Members.
- 1.6 Specifically, the desktop review is to include:
 - The cost viability model prepared by Betteridge and Milsom for the construction of the leisure centre itself and the infrastructure and other associated works required to the adjoining land to allow it to be sold and developed for housing. This incorporates valuations for both the residential and commercial land on the Princes Parade site and the site of the existing Hythe Swimming Pool at South Road.
 - To assess the disposal options available to the Council for the residential and commercial land at Princes Parade, as set out in section 4.5 of the Land at Princes Parade soft market testing report prepared by BNP Paribas.
 - The capital financing implications for the scheme, including Minimum Revenue Provision (if applicable), to take account of the proposed funding and cashflow for the project.
 - The impact to the financial viability of the scheme from delays or variations in values of the external capital funding sources.
 - The potential for any lease accounting issues for the council with the leisure trust.

2. Cost Viability Model

- 2.1 Betteridge and Milsom (B&M) have undertaken a viability cost appraisal for the four phases of development associated with this project. The phases of development are as follows:
 - Phase 1 - Site Remediation Works
 - Phase 2 -
 - Construction of the new leisure centre

- Realignment of Princes Parade Road
- Construction of a new promenade
- Associated external works and drainage
- Associated services
- **Phase 3 -**
 - Construction of residential units (east parcel of land)
 - Associated external works and drainage
 - Associated services
- **Phase 4 -**
 - Construction of residential units (west parcel of land)
 - Construction of hotel and restaurant
 - Associated external works
 - Associated services

2.2 In terms of the detailed cost appraisal the costs provided to the Council the following costs have been calculated as £[REDACTED]

2.3 Of the total costs of the project phases 1 and 2 would be funded initially by the Council using a mixture of existing resources, expected capital receipts, developer contributions and borrowing. The costs of phases 3 and 4 will be met by the developers who will purchase the site from the Council either in one or two lots.

2.4 The Councils total costs of this project are to be funded as follows:

• Nickolls Quarry S106 -	£4,792,345
• South Road Capital Receipt -	£[REDACTED]
• CIL Princes Parade -	£1,184,530
• S106 Affordable Housing -	£1,400,000
• Princes Parade Capital Receipt -	£[REDACTED]
• Homes England Grant -	£1,977,879
Total	£[REDACTED]

2.5 The Council will be funding the project during the periods where there are timing differences between capital spend and the receipt of the funding highlighted above. There will be a funding surplus of £1.21million at the end of the project.

2.6 This funding surplus will mean that the Council will have additional capital resources available to fund either past or future capital expenditure. We would expect the Council to apply all of the resources outlined above to finance the scheme with the exception of £[REDACTED] million of the capital receipts from the South Road and/or Princes Parade sites.

3. Princes Parade Soft Market Testing Report Prepared by BNP Paribas

- 3.1 During the Summer of 2017 BNP Paribas Real Estate (BNPPRE) were appointed by the Council to prepare advice on alternative delivery options for the Princes Parade site. In January 2018, BNPPRE were subsequently appointed to undertake a Soft Market Test (SMT) exercise on behalf of the Council, to test and refine the Council's proposed approach to delivery, before commencing formal market engagement. This exercise was limited to the value of the residential and commercial land and not the leisure elements of the scheme.
- 3.2 The aims of the strategy for the site are to:
- Maximise capital receipts;
 - Reduce complexity and procurement risk;
 - Maximise market interest; and
 - Deliver a high-quality scheme which responds to the local context
- 3.3 It was agreed that BNPPRE would target a range of developers, including smaller, local, niche developers, as well larger national housebuilders, to secure a representative spread of market opinion. Of the 13 companies contacted, only three parties failed to respond, representing a 75% response rate which is considered a high response rate for developments of this nature.
- 3.4 Along with a number of other questions potential bidders were asked to confirm whether:
- the Princes Parade site would be of interest to their company;
 - whether the opportunity would be best packaged as a single residential development opportunity, or two separate sites;
 - asked to comment on their appetite for delivering the commercial uses included in the Council's masterplan for the site;
 - be interested in the possible inclusion of a small number of self-built units to be retained by FHDC;
 - be prepared to sell the affordable housing allocation of the site to the Council, for inclusion as part of their Housing Revenue Account (HRA) programme.
- 3.5 Where bidders expressed a preference, the majority of parties indicated that they would prefer to take the whole site, although several respondents indicated that they would be happy to bid for either whole or part of the site.
- 3.6 Appetite for the commercial elements of the masterplan was limited. Only a small number of parties indicated that they might be willing to deliver commercial uses. Others indicated that they would potentially be willing to build the commercial units, but that these would be completed to shell and core and handed back to the Council to own/let/manage. Whilst this may appear to be a negative in terms of the potential capital value to the Council the retention of any commercial element may be revenue positive over the longer term as the Council could either lease out to a third-party operator or run the commercial units themselves.
- 3.7 In terms of the affordable housing element of the site the key issue appears to be ensuring that the Council pay an appropriate price for the affordable element. When we consider the capital financing and revenue impact of this project in the next section of this report we will comment

on the ability of the Councils HRA to purchase the affordable element of the housing development.

3.8 The SMT report prepared by BNPPRE mention the possibility of a Joint Venture (JV) arrangement in terms of a JV approach but the report states that the Council would need to consider the following issues:

- Whether there is a guaranteed minimum land value, and at what level;
- The share of profit which the Council would receive;
- The need to scrutinise the developer's financial model, and keep this under review as the development is implemented;
- Whether there is any "downside" risk for the Council;
- Any uncertainty around the timing of the Councils land payment, if paid upon completion of the development;
- The surety for the Councils payments, given that this would be taken out at the end of the development; and
- The fact that individual developers may have differing views on how a JV should be structured.

3.9 It is interesting to note that at no point does the BNPPRE report mention the possibility of the Council undertaking the whole development through a wholly owned company/SPV structure.

3.10 Whilst this approach may be higher risk than the option of selling the sight to a developer this would potentially deliver a higher capital receipt to the Council and with cheap borrowing available then this could be very affordable. The Council may therefore wish to consider this as an alternative delivery option.

3.11 It seems clear from the soft market testing undertaken by BNPPRE that market interest in the Princes Parade site will be from a broad spectrum of developers giving the Council choice in who it works with to undertake the development. This will enable the Council to ensure a competitive bidding process which will result in the key objectives of the maximum capital receipt and high-quality development being delivered.

3.12 In Summary the BNPPRE report recommends the following strategy in terms of disposal and development of the Princes Parade site:

- The Council disposes of the residential development opportunity as a single site, with developers having the freedom to include/exclude commercial uses as they see fit. The Council could retain ownership of the commercial development to generate an income stream;
- The Council bids competitively for the affordable housing, or has an option to purchase, subject to valuation and ability for HRA to absorb the additional housing in the HRA;
- Existing swimming pool site to be included within the disposal. This capital receipt is required to fund the construction of the new leisure centre;
- The Council procures the delivery of the Recreation Centre and key site infrastructure whilst the residential developer undertakes remediation of residential development plots.

- 3.13 As previously stated, the Council may wish to consider the option of undertaking the development of the residential units through its own company structure as this would increase the capital receipt available as all development profits would flow back to the Council. More work would be required to ascertain if any benefits would be achieved through this approach which may delay the project or the delivery of the sources of funding.
- 3.14 The most recent valuation information provided by Savills (October 2018) suggests that the Princes Parade site has been valued at £ million and the Hythe Swimming Pool site is valued at £ million supporting the capital contributions suggested in 2.4 above.
- 3.15 The following section of this report considers the impact on the Councils financial position of the disposal route being favoured by the BNPPRE report.

4. Capital Financing and Accounting Implications of the Scheme

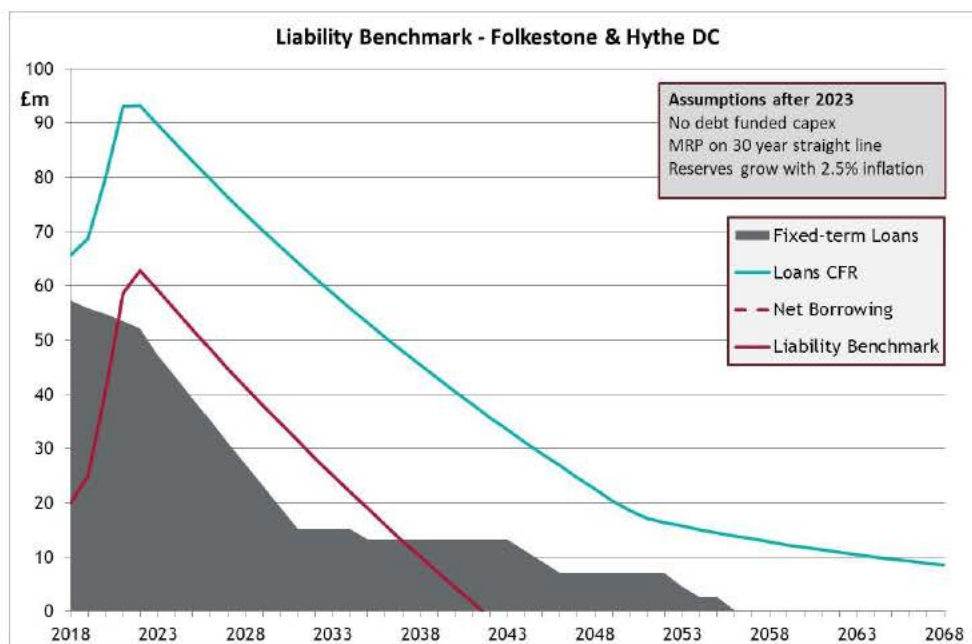
- 4.1 As outlined in 2.2 above the total cost of Phase 1 and 2 is expected to be in the region of £ million and after capital and revenue contributions are applied there is a funding surplus of £ million.
- 4.2 Since the majority of the funding of the total scheme is from capital receipts and other sources dependent of the full delivery of the project the Council will be exposed to a funding requirement of £ million during the construction period which may require some external borrowing.
- 4.3 As part of our role as Treasury Advisors to the Council we undertake annual Balance Sheet analysis and forward projections on behalf of our clients. Using the Councils 31st March 2018 Balance Sheet and the projection of balances and reserves and Capital Financing Requirement from the Councils Treasury Management Strategy and Prudential Indicators we can provide the following short-term summary:

Table 1: Balance Sheet Analysis - Base Position

Folkestone & Hythe DC					
Balance Sheet Summary and Projections in £millions - last updated 31 Mar 2018					
31st March:	2018	2019	2020	2021	2022
Loans Capital Financing Req.	65.5	68.7	80.0	93.1	93.3
Less: External Borrowing	-57.3	-55.9	-54.8	-53.5	-52.2
Internal (Over) Borrowing	8.3	12.8	25.2	39.6	41.1
Less: Usable Reserves	-41.0	-39.1	-34.8	-29.9	-25.9
Less: Working Capital Surplus	-4.6	-4.6	-4.6	-4.6	-4.6
Investments / (New Borrowing)	37.3	30.9	14.2	-5.1	-10.6

- 4.4 From the above we can see that the Council held investment balances of £37.3million at the 31st March 2018 and was forecast to hold investment balances of £30.9million at the 31st March 2019.
- 4.5 As the Council's CFR increases, debt is repaid, and balances and reserves reduce investment balances reduce to £14million during 2019/20 and by the 31st March 2022 a borrowing requirement of £10.6million exists. This increase in CFR does not include the impact of the Princes Parade development. We have assumed that the HRA CFR is not reduced by any Voluntary Revenue Provision (VRP) and so remains constant.
- 4.6 If we extend this analysis further, to 50 years, we can show how the Council moves from a position of being a net investor of funds to a net borrower as shown in the following graph.

Chart 1: Liability Benchmark - Base Position



4.7 The graph shows the movement of the CFR (blue line) and what we describe as the Liability Benchmark. The CFR is the maximum of level of debt required by a local authority whilst the Liability Benchmark is the minimum amount (assuming all balances and reserves plus cash flow surpluses are used in lieu of external borrowing).

4.8 Where the Liability Benchmark is shown below the absolute level of external debt (the grey “wedge”) this indicates an investment position (investment balances will equal the sum of the area between the red line and the top of the grey area) and once the Liability Benchmark breaches the debt position a borrowing requirement exists.

4.9 The analysis suggests that the Council borrowing requirement will peak at £16.2million by the 31st March 2031 and will fall back to £zero by 31st March 2037 as MRP is applied to finance the CFR. This is the base position and does not include the impact of the Princes Parade development.

4.10 We have adjusted the above graph to illustrate the impact of the Princes Parade development using the expected spend and funding profile provided to us by the Council. We have used the net spending/funding position for each financial year as follows:

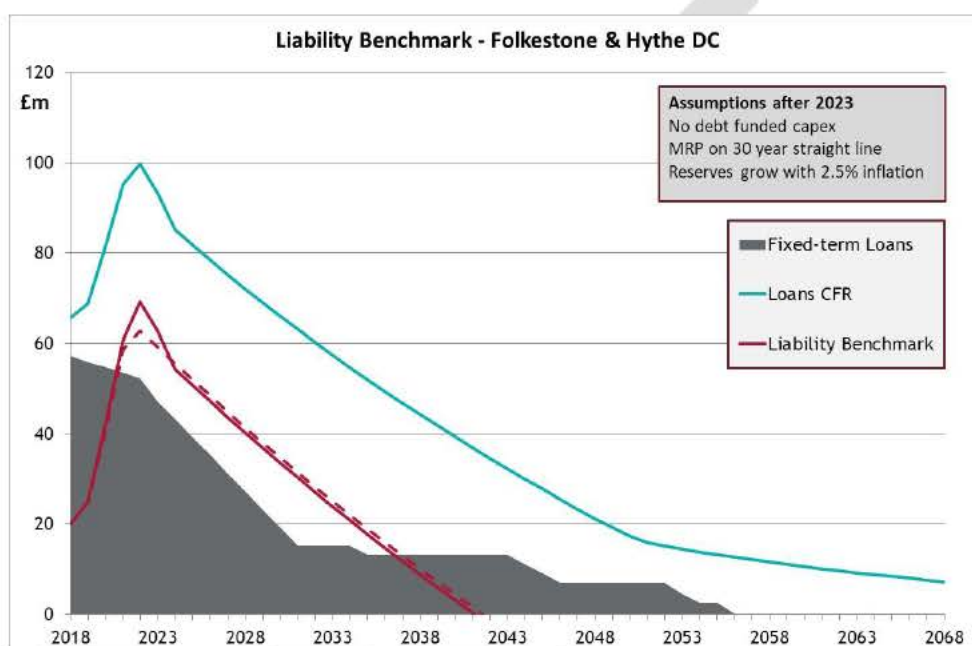
- Year ending 31st March 2020 £ [REDACTED]
- Year ending 31st March 2021 £ [REDACTED]
- Year ending 31st March 2022 £ [REDACTED]
- Year ending 31st March 2023 -£ [REDACTED]
- Year ending 31st March 2024 -£ [REDACTED]
- Total net capital spend - **-£1,219,087**

4.11 The adjusted Balance Sheet summary and Liability Benchmark is as follows:

Table 2: Balance Sheet Analysis - Revised Position

Folkestone & Hythe DC						
Balance Sheet Summary and Projections in £millions - last updated 31 Mar 2018						
	31st March:	2018	2019	2020	2021	2022
Loans Capital Financing Req.		65.5	68.7	81.5	95.2	99.6
Less: External Borrowing		-57.3	-55.9	-54.8	-53.5	-52.2
Internal (Over) Borrowing		8.3	12.8	26.7	41.7	47.4
Less: Usable Reserves		-41.0	-39.1	-34.8	-29.9	-25.9
Less: Working Capital Surplus		-4.6	-4.6	-4.6	-4.6	-4.6
Investments / (New Borrowing)		37.3	30.9	12.7	-7.2	-16.9

Chart 2: Liability Benchmark - Revised Position



4.12 The dotted red line in the graph above illustrates the previous Liability Benchmark position and the additional borrowing required by the Council matches the amount of unfinanced capital expenditure in each of the financial year as shown in 4.10 above.

4.13 There is an additional borrowing requirement but this is short-term in nature, pending the receipt of the capital receipts and other grants/contributions.

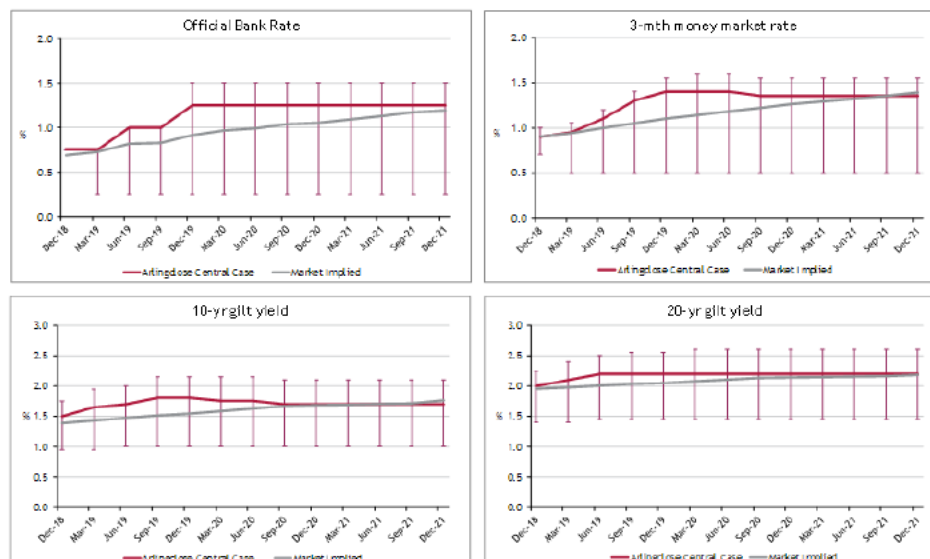
Suggested Borrowing Profile

4.14 As shown in Table 2 above in the current financial year the Council can fund the unfinanced capital expenditure from its own balances and reserves until 31st March 2021 where it will need to borrow £2.1million, with short-term investment rates linked to the Bank of England Base Rate this would be the most cost-effective method of funding.

4.15 Additional borrowing of £6.3million will be required in 2021/22 falling to £3.6million in 2022/23 before the scheme is fully funded in 2023/24.

4.16 We suggest that most of this borrowing requirement is funded from short-term borrowing from other local authorities as this is the cheapest form of debt currently available. Arlingclose has recently (30th November 2018) updated its interest rate forecast and our view on the path of short, medium and long-term rates can be found in the following graphs:

Chart 3: Arlingclose Interest Rate Forecast - November 2018



4.17 It can be seen from the above that Arlingclose (red line) expect short-term rates to rise to 1.25% by December 2019 whilst the money markets (grey line) predict a slower rise to this level (December 2021). These short-term rates will be lower than the long-term rates as illustrated by the 20-year Gilt forecast which underpins the PWLB rate, a margin of 0.8% should be added to this forecast rate which suggests that longer-term funding rate will be between 2.8% and 3% over the next 3 years (for information the 20-year PWLB rate is currently 2.19% and the 50-year rate 2.50%).

4.18 Using the short-term interest forecast and the cumulative net funding position the interest costs associated with the development phase would be as follows:

Table 3: Expected Short-Term Funding Costs

Financial Year	Cumulative Borrowing Requirement	Average Rate	Interest Cost
2020/21	£2.1m	1.12%	£23,520
2021/22	£6.3m	1.19%	£74,970
2022/23	£3.6m	1.23%	£44,280
Total			£142,770

4.19 In terms of the interest associated with the construction phase of the Princes Parade development we would recommend that the Council considers capitalising this cost. Under the

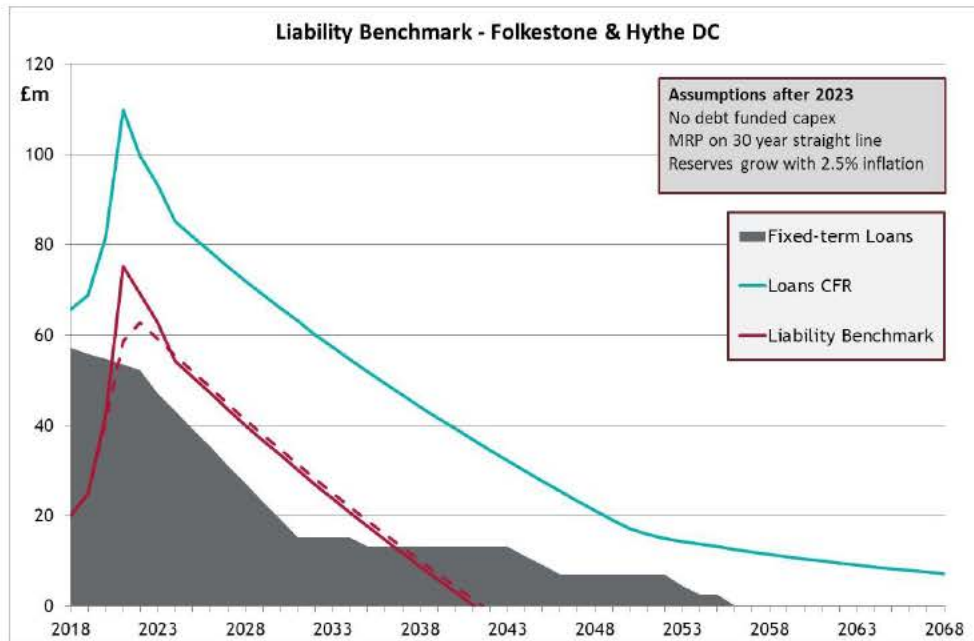
CIPFA Code local authorities have the option to do this and can capitalise the interest cost associated with bringing a qualifying asset into use.

- 4.20 'Qualifying assets' constitutes an asset that takes 'a substantial period to get ready for its intended use or sale'. This will commonly be assets under construction, so the new leisure centre will qualify under this categorisation.
- 4.21 The 'borrowing costs' that can be capitalised are defined as 'interest and other costs that an authority incurs in connection with the borrowing of funds'. The policy to capitalise interest or not must be applied equally to all qualifying assets and once in place must be consistently applied. This will increase the value of the asset in the Councils balance sheet and will be written down over the life of the asset through the annual MRP charge.

Minimum Revenue Provision, Interest Costs and Revenue Implications

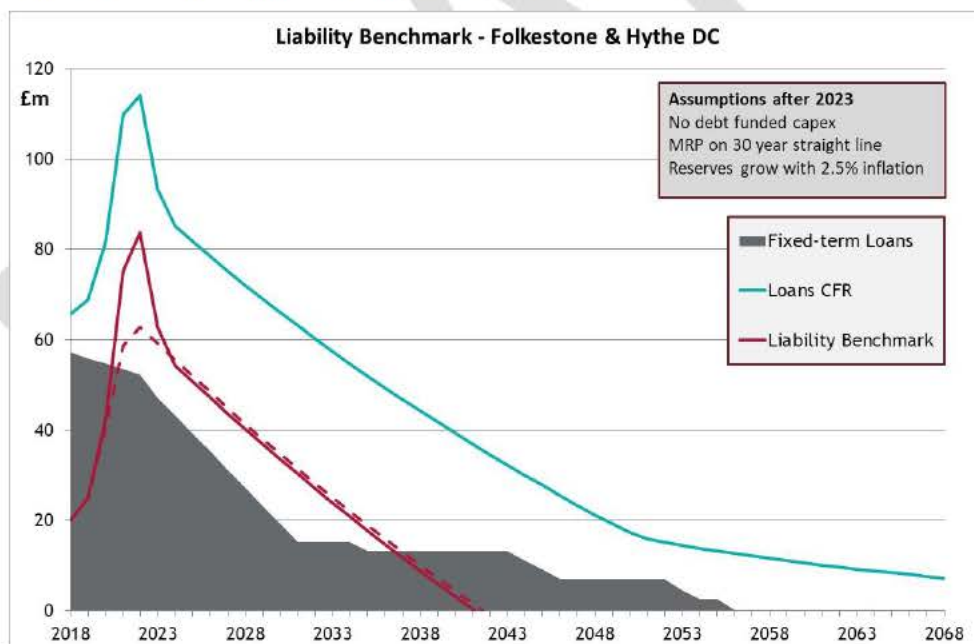
- 4.22 The Council will be exposed to the initial costs of phases 1 and 2 of the Princes Parade development so the CFR will increase until the capital receipts and other resources are available to finance the spend.
- 4.23 An underpinning principle of the local authority capital finance system is that all capital expenditure must be financed either from capital receipts, capital grants (or other contributions) or eventually from revenue income. The broad aim of prudent provision is to require local authorities to put aside revenue over time to cover their CFR.
- 4.24 The fact that the Council's CFR will increase as monies are spent on the development should trigger the requirement to make MRP if resources are not available to finance the spend, however as the scheme is dependant on capital receipts and other resources we would recommend that the Council's MRP policy makes it clear that for this development MRP will only be made on any unfinanced element of the scheme. As this scheme is expected to be fully financed there will no requirement to make MRP.
- 4.25 The report provided by the Sports Consultancy indicates that the current leisure centre is being run at an annual cost of £323,000. The report suggests that the new centre can provide an annual income of £[REDACTED] and after funding costs generate a net income of £[REDACTED] per annum over the next 10 years.
- 4.26 The new leisure centre at Princes Parade can therefore be delivered at an initial capital outlay of £[REDACTED] million but once capital receipts and other contributions are received the scheme will be fully financed.
- 4.27 The short-term borrowing requirement can be funded from a variety of sources; the lowest cost option would be to fund from short-term borrowing whilst the most expensive would be to fund from a maturity loan. Short-term funding will introduce an element of interest rate risk but with the funding requirement being only for a very short period it is expected that this should not cause concern to the Council.
- 4.28 The biggest risk to the project is the ability of the Council to generate the capital receipts required to keep the scheme fully financed, delays in receipts being generated will cause extra interest costs during the construction phase.
- 4.29 A delay of one year in the receipt of the £[REDACTED] million land payment will not impact on the overall financing of the scheme but will increase the borrowing requirement in the early years of the project as shown in the following graph:

Chart 4: Liability Benchmark - 12-month Funding Delay



4.30 A further 12-month delay would have the following impact:

Chart 5: Liability Benchmark - 24-month Funding Delay

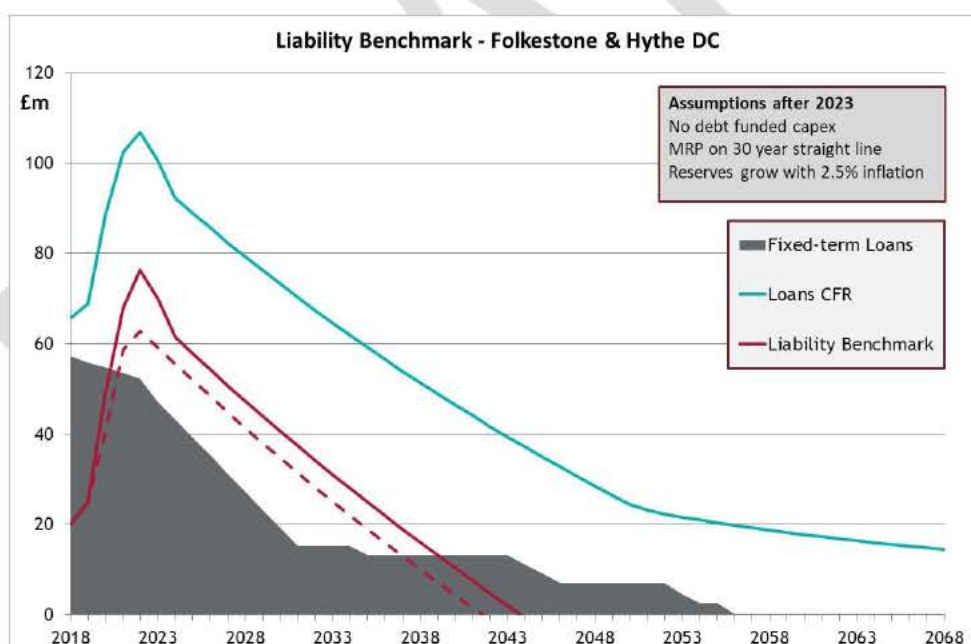


4.31 The net potential benefit associated with the provision of the new leisure centre ignores the other positive revenue benefits that this overall scheme can deliver including additional Council Tax income, additional parking charges and rental from any commercial units. These additional benefits should be included to the cost appraisal process.

Housing Revenue Account Implications

- 4.32 So far, we have concentrated on the impact that this proposed development would have on the GF in terms of the capital financing and interest costs.
- 4.33 In the SMT report prepared by BNPPRE developers will want to find a buyer for the affordable housing that needs to be delivered at the site in accordance with the Councils planning policy. This could be a Registered Provider or the Council itself.
- 4.34 The Council's currently operates an HRA so would be able to bring the 45 units of affordable housing into its current housing stock. The B&M report suggests that the expected value of the affordable units would be £[REDACTED] million.
- 4.35 The HRA CFR at 31st March 2019 is forecast to have been £47.417million and is set to rise to £52.5million by 31st March 2021, we have no information of the expected HRA CFR beyond this date. If the Council borrowed to purchase the affordable element of the Princes Parade development, then the HRA CFR could reach £59.684million. The lifting of the HRA debt cap in October 2018 would allow the Council to take on additional HRA debt if it wished to bring these units into the HRA.
- 4.36 With no requirement to make MRP on HRA related capital expenditure any decision to purchase the affordable housing within the HRA would have the following impact on the Liability Benchmark projection (assuming units purchased in 2021/22):

Chart 6: Liability Benchmark - HRA Affordable Housing



- 4.37 It is assumed that any additional borrowing costs incurred because of borrowing to fund the purchase of affordable units would be charged directly to the HRA and therefore have no impact of the GF. The HRA Business Plan may or may not be able to incorporate these additional dwellings and associated costs and this would need to be considered by the Council.
- 4.38 If the Council wished to purchase the affordable housing and not account for it within the HRA then there are options available to do this through either a wholly owned company or SPV structure. The Council could also work with a local registered provider to form a JV or to fund

the purchase by the RP via a capital loan. These potential options would need to be considered outside of the scope of this report but could generate additional revenue income to the Council.

5. The Potential for any Lease Accounting Issues

- 5.1 The Sports Consultancy report includes a detailed analysis on the potential management options that are available to the Council once the new leisure centre is operational. The options that were considered are:
- In-house management
 - Outsource to a specialist operator
 - Set up a new leisure trust
 - Asset transfer
- 5.2 In-house management has been discounted as it appears to be the costliest option and as the current centre is being run at a cost to the local taxpayer one of the factors in making the new scheme affordable is the assumption that an income stream can be achieved from the new facility.
- 5.3 The outsourcing and leisure trust options would see the Council offer an operating contract, typically for a period of between 7 to 15 years, with the service controlled through a service specification and the management of the physical asset of the centre managed under an asset management agreement.
- 5.4 The asset transfer model would see the Council transfer the asset to a third party on a long-term lease or through physical disposal of the asset. It is unlikely that the Council would elect for this option so either the outsourced management or trust model would be favoured.
- 5.5 In terms of the accounting implications for the Council this will depend on the structure of any lease between the operator and the Council. Leases are classified as finance leases where the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the property, plant or equipment from the lessor to the lessee. All other leases are currently classified as operating leases (changes to accounting requirement will remove this distinction from 1st April 2019 for the lessee but not the lessor who can still treat the lease as an operating lease structure). Where a lease covers both land and buildings, the land and buildings elements are considered separately for classification.
- 5.6 Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are summarised below, along with their application to this potential transaction.

Table 4: Finance Lease Classification Criteria

Criteria	Application
The lease transfers ownership of the asset to the lessee by the end of the lease term	This is an indicator of a finance lease because it implies that no other party will have access to the remaining economic benefits of the asset. It is unlikely that the Council will transfer ownership to the operator at the end of the lease term
The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised	This is an indicator of a finance lease because the lessor would expect to achieve substantially all its return on investment through the lease rentals. Again, it is unlikely that the Council would provide an option to purchase through any lease arrangement
The lease term is for the major part of the economic life of the asset even if title is not transferred	It is expected that any lease would be for a period of between 7 to 15 years which will be less than the economic life of the asset
At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all the fair value of the leased assets	Construction value of the centre is estimated at £■■■■ million, and the annual management fee being used is £■■■■, it is unlikely that the lease payments will match the fair value of the asset
The leased assets are of a specialised nature such that only the lessee can use them without major modifications being made	If an asset is specialised, then this implies that no other entity has a use for the asset. It is doubtful that this condition is recognised or relevant.

5.7 From the schedule above, it would seem clear that this transaction being proposed is an operating lease and the necessary accounting for such a transaction will need to be considered.

5.8 Where the Council grants an operating lease over a property or an item of plant or equipment, the asset is retained in the Balance Sheet. Rental income is credited to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement. Credits are made on a straight-line basis over the life of the lease, even if this does not match the pattern of payments (e.g. there is a premium paid at the commencement of the lease). Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the relevant asset and charged as an expense over the lease term on the same basis as rental income.

5.9 The asset will therefore remain on the Councils balance sheet and the capital financing implications that we have already discussed will not be impacted by the provision of an operating lease.

5.10 Changes to lease accounting due to the implementation of IFRS16 will come into effect from 1st April 2020 which may change the accounting requirements.

6. Financial Assurance Overview

- 6.1 In considering this project the Council have engaged several consultancy firms, each with experience of the various stages required to deliver the project providing assurance that the project is achievable.
- 6.2 The Capital Cost Plan has been produced by Betteridge and Milsom with the most recent update (January 2019) confirming that the expected cost of Phases 1 and 2 would be £[REDACTED] million. This is an increase of £[REDACTED] million over the estimated costs provided in January 2018 but provides assurance to the Council that they are working with up to date figures when considering the scheme for approval.
- 6.3 Valuation of the major sites which will produce the capital receipts required to fund Phases 1 and 2 (Princes Parade and South Road) have been provided by Savills, one of the Worlds largest property agents, and again updated valuations have been obtained (October 2018). The latest valuations suggest an increase in the value of Princes Parade (£[REDACTED]) and South Road (£[REDACTED] million) and this explains the surplus capital funding in the project.
- 6.4 The operating cost model for the new leisure centre has been produced by The Sports Consultancy and their work has been updated (January 2019) to show that an average operation surplus of £[REDACTED] could be achieved over the first ten years of the operation of the new facility.
- 6.5 As with any project of this size there will be risks around the delivery and as the whole project is dependent on Phases 1 and 2 being delivered the Council is exposed to major risks if some of the funding sources are not forthcoming. We have modelled the impact of a delay in the Princes Parade capital receipt on the Councils overall borrowing position, but the delays could be longer and apply to any of the funding sources.
- 6.6 We have assumed that the Council will be exposed to short-term funding costs due to the timing differences between capital spend and funding sources being delivered and that since the scheme will be fully financed we have concluded that MRP will not be required.
- 6.7 Any delay or reduction in the amount of funding sources expected could result in the Council having to take on longer-term borrowing and incur MRP.
- 6.8 Based on the maximum life for both borrowing and MRP (50 years) every £1million of funding not delivered could cost the Council £45,000 in additional revenue costs (£20,000 MRP on a 50-year straight line and £25,000 interest on a 50-year PWLB maturity loan at 2.5%). These potential costs would be dependent on the maximum life of the asset, the MRP method used and the exact borrowing profile selected.

7. Summary

- 7.1 The Council is seeking to facilitate a development at Princes Parade which will see the provision of a new leisure centre and 150 units of residential accommodation. Arlingclose have been requested to undertake a desktop review of the various pieces of work undertaken by other third-party consultants included B&M, Savills, BNPPRE and The Sports Consultancy.
- 7.2 The Council will be exposed to a funding requirement of £[REDACTED] million during the construction of Phase 1 and 2 of the scheme but once capital receipts and other contributions have been received the scheme will have a funding surplus of £[REDACTED] million.

- 7.3 We have reviewed the financial information contained in the B&M report and where possible £1.2 have linked information with other reports particularly the viability assessment report prepared by Savills. The scheme therefore looks affordable in terms of the Council's overall capital contribution to the scheme.
- 7.4 BNPPRE were commissioned to undertake soft market testing of the site and have ascertained that several developers would be interested in developing the site. Most of those developers contacted stated the site was an affordable proposition.
- 7.5 A key requirement of the Council's planning policy is that affordable housing needs to be provided within the development and all the developers contacted would require a buyer to be agreed for this housing and developers were also not keen on retaining any commercial development on the site. It is most probably therefore that the Council would need to take on both affordable housing and any commercial developments. It is noted that that the option of the Council undertaking the development of the whole site has not been considered.
- 7.6 In terms of funding Phase 1 and 2 the Council will be exposed to a short-term funding requirement of £ million (providing all capital receipts Etc are delivered). We recommend that the short-term funding is met through short-term borrowing and/or the use of investment balances and that interest costs are capitalised through the construction phases.
- 7.7 The biggest risk to the project is a delay in the delivery of the expected sources of funding including capital receipts and s106 contributions. Delays will increase the Council's exposure to funding costs during the construction phases but as the scheme is fully financed this should be low risk.
- 7.8 If any of the funding sources are reduced or are not delivered then the Council will incur a longer-dated borrowing requirement increasing interest costs associated with the project and requiring MRP to finance any unfunded element.
- 7.9 The Council's HRA could absorb the affordable housing into the Council's existing housing stock however the Council could consider an alternative method of delivery if it wished to provide affordable housing outside of the HRA.
- 7.10 The Sports Consultancy report suggests that the outsourcing/leisure trust model should deliver a positive income contribution to the Council rather than a cost which is the case with the current leisure facility. If a short-term funding solution is chosen, this income would be enough to contribute to the funding/financing costs of the project.
- 7.11 The preferred operating model for the new leisure centre is through a leisure trust. It is anticipated that this will be treated as an operating lease arrangement and this will continue when IFRS 16 is incorporated into the Code in 2020/21.