Funding the HCA transfer

1. This note looks at the options for funding the HCA transfer.

2. The Cabinet report shows how we have determined the cost of the transfer and these calculations are not repeated here, although it is worth noting that the final position may change

3. Based on the proposition to the HCA of 3 December 2011 we have calculated the principal and interest costs to total £2.7m annually. These are based on the purchase of assets with a market value of £45.6m.

4. The critical issue from the s151 Officer's viewpoint is that I need to advise members that what is being proposed does not undermine the Council's overall financial position and that I need to consider the worst case scenario. I have therefore recommended that as a minimum the council needs to ensure that there is a backstop position in place which has a reasonably secure source of funding for a 5 year period. It is not, however the intention to maintain the requirement for this level of funding over the 5 years, the note therefore deals with two key issues:

    - An assessment of funding options; and

    - What action the council may take to minimise the call on its resources

5. The final section of the report deals with impact on the identified funding stream if the recommended approach is adopted.

What are the funding options?

6. The table below sets out the principal funding options and some of the models in existence elsewhere and their suitability to the proposition we have put to the HCA:

Table 1: Assessment of funding options

Options	Commentary	Recommended
Revenue funding	Funding from existing (base) revenue budgets is a possibility but would require the Council to find additional savings at a time when we are looking at a further £50m of savings over 3 years. Given these pressures and the fact that this is essentially a purchase of capital assets, it wouldn't seem sensible to recommend this option	No
Reserves	The Council's General Fund reserves are forecast to be £8m at the year end, and in all likelihood will be required to manage the risk on the 2012/13 budget. All other reserves are earmarked for specific purposes, mainly for future capital schemes or anticipating future liabilities. Reserves are one-off resources, i.e. once they have been spent they are no longer available, whereas the costs of financing the HCA asset purchase will be on-going until assets are sold. Revenue reserves are therefore not a feasible option for funding the HCA asset purchase.	No
One-off resources	On an annual basis the Council generates up to £5m of one-off resources – from sources such as collection fund surplus, revenue underspends, debt financing. None of these are guaranteed but they are a useful source of funds to support one-off expenditure items within the budget. The degree of risk attached to one-off resources means that it isn't a secure funding source but could used to replace or reduce the call on other resources on an annual basis.	No (but could take annual decisions to use instead of other resources)
Capital	The Capital Programme allocates about £46m of unringfenced capital funding for 2012/13, however	

Programme	£17m is already committed to complete continuing schemes. If the remaining £29m was used to part-fund the purchase of HCA assets, this would mean no work could take place on highways or schools in 2012/13. Over the medium term the needs of the programme will require all the potential resources identified to date. Use of currently identified capital resources is therefore not a feasible position considering the health and safety responsibilities and other statutory and service priorities the Council must meet.	No
Capital receipts	Sale of council assets generates between £1m and £3m annually. These cannot be used to meet revenue costs but could be used to repay principal borrowing (see reducing the costs to the council section below). However, in the medium to longer term the receipts from the Western Expansion Area could be used to replace other borrowing.	Yes (it is a resource that in the medium term could reduce the level of prudential borrowing and in turn reduce revenue costs)
Prudential Borrowing	Financing the purchase through prudential borrowing is a feasible approach. This would mean the Council borrowing to finance the initial purchase of the assets. The Council will then need fund the costs of the borrowing, rather than the full initial purchase price. To meet the requirements of the Prudential Code, the Council must satisfy itself that the borrowing is affordable and the debt can be repaid in the future. The costs of borrowing are revenue costs and so could only be met from revenue resources. This would be the initial means of financing the purchase but the council would have to meet the borrowing costs (which have been calculated at £2.7m)	Yes (but revenue costs would need to be funded)
Bonds	Local Authority issued Bonds are a form of Prudential Borrowing, other than for HRA self financing where the PWLB (i.e. the Government) are giving a special rate, they are slightly cheaper (0.2%) than PWLB over the long term – however the minimum value of bond is c£150m – so it would not be feasible. Again the costs of borrowing on bonds are revenue costs and so could only be met from revenue resources.	No

Private sector	The Council is considering a number of models – I have set out 3: - Birmingham JVC – complex company structure involving multiple companies. The legal composition and the degree to which these are influenced companies and therefore subject to EU procurement rules would need to be investigated. Whilst it is not envisaged that the Council would create such an elaborate structure the use of an investment vehicle with individual development companies involved on specific sites/areas is a possibility. There could be direct investment into the vehicle but due diligence would be extensive and could only be considered as a medium term approach.	Yes (possible but in the medium term)
	- Leeds renaissance partnership. This model is basically a Memorandum of Understanding to work in a partnership arrangement but no legally binding contracts – a fairly lose arrangement easy to set up but not seen as particularly effective	No
	- Manchester Eastlands regeneration around Stadium of Manchester based on collaboration agreements. A good model although there is a question how effective is the Private Sector input and there is no investment in the vehicle; but there are benefits of joining up land holdings. We could use this approach – probably easier route than setting up a company – but there maybe a mix and match approach between Birmingham JVC and Eastlands	Yes (possible but in the medium term)
HRA self-financing	This remains a ring-fenced account and under the new self financing regime has a cap on the amount of borrowing above the existing/self-financing at only £5m so not an option to move land/financing into the HRA. In longer term as borrowing is reduced the council could transfer land into HRA at appropriate valuation to create, say, a more effective regeneration offering	Not in short term but in medium term linking landholding to HRA is a possibility

New homes bonus	New Homes Bonus (NHB) is unringfenced grant top-sliced nationally from formula grant. Significant benefit to MK, as more new homes built in MK than most other areas. Could replace some of shortfall in other grants – such as Growth Area Funding and LABGI which no longer exist. Use of NHB to fund principal and interest payment in first 5 years will reduce resources in short term, but the gain to MK is longer term receipts from development of HCA land which should outweigh short term loss. Table 2 indicates the likely level of NHB going forward and the potential impact of the worst case scenario without the benefits of the action outlined in paragraphs 7-13	Yes (short-term use is a sensible option)

<u>Reducing the costs to the Council</u>

There are a number of ways that the capital and resulting revenue costs to the Council can be reduced:

7. The initial asset price includes an endowment to the Parks Trust. The Council is intending to negotiate with the Parks Trust to pay this through a combination of development land and cash funding to reduce the impact.

8. Over the next 10 years it is estimated that some of the development assets will be sold, generating capital receipts for the Council and reducing the borrowing requirement.

9. The Council will negotiate with the Parks Trust and/ or the Community Foundation to generate additional capital receipts, with the additional benefit of avoiding clawback.

10. The Council will continue to realise capital receipts from its current land assets, some of which could be used to reduce the capital investment in the HCA assets. For example the receipts forecast on the Western Expansion Area. It is estimated that over the next 10 years, approximately £15m of capital receipts from current assets could be generated.

11. The valuation of assets is based on the current planned land use the Council will review the potential use of sites before resale. This could increase their value in the first 5 years.

12. Revenue costs could be further reduced by applying capital receipts from the Council's current portfolio. Future revenue costs of borrowing are dependent on the actual average debt cost for the Council each year

13. The long-term intention is to enter into a partnership with a private sector company to develop the assets. While the market conditions will influence the private sector appetite and the timing of this approach. The Council's aspiration would be to use this vehicle to clear the debts remaining on the assets.

Potential impact of the use of New Homes Bonus

14. The New Homes Bonus will increase each year, as there is a six year commitment to match-funding Council Tax. The Council has recently been allocated an additional £1.9m as its 2012/13 allocation; this is in addition to the £2.5m received for 2011/12. So a total of £4.4m of New Homes Bonus will be received in 2012/13. As the New Homes Bonus increases, the funding of the total borrowing requirement at £2.7m would be a smaller proportion of this funding. Table 2 shows potential New Homes Bonus income, assuming future year's allocations are equivalent to the 2012/13 allocation.

Table 2: New Homes Bonus Estimated Future Income

	2012/13 £m	**2013/14** £m	**2014/15** £m	**2015/16** £m	**2016/17** £m
Year 1	2.5	2.5	2.5	2.5	2.5
Year 2	1.9	1.9	1.9	1.9	1.9
Year 3		1.9	1.9	1.9	1.9
Year 4			1.9	1.9	1.9
Year 5				1.9	1.9
Year 6					1.9
Total NHB	**4.4**	**6.3**	**8.2**	**10.1**	**12**
Allocation to finance HCA assets	**2.7**	**2.7**	**2.7**	**2.7**	**2.7**
Balance available for other investments	**1.7**	**3.6**	**5.5**	**7.4**	**9.3**

15. As set out above the Council is identifying ways of reducing the initial purchase costs of the assets, accelerating receipts and attracting private investment, all of which will reduce the annual borrowing costs and therefore reduce the call on New Homes Bonus. However, in order to provide assurance that even in a worst case scenario the Council could finance the purchase of the HCA assets it is recommended that a provisional allocation of up to £2.7m of New Homes Bonus is made for the next five years.

Conclusion

If the Council is to fund the transfer of the HCA asset it will need to identify a means of financing the purchase. The most obvious route is to undertake prudential borrowing which would allow time for the development of alternative vehicles for exploiting the portfolio to be implemented. However, any form of borrowing incurs a revenue cost and as such there needs to be an identified means of meeting the borrowing costs not just in the short-term i.e. 2012/13, but over a time period (5 years) which avoids the risk of having to deal with a resource gap at a time of significant central government cuts to Local Authority funding. I have set out above the alternative sources of funding the initial borrowing costs and concluded that the use of a proportion of the predicted income from New Homes Bonus would be the best option to provide this degree of security.

Tim Hannam

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