Annex G

Extract from Executive report June 2008

Financial Implications

44. The first design solution was set to be delivered within a construction cost estimate of £24,669,000 a budget which was approved by the Executive in July 2007. The current scheme submitted for planning approval is the outcome of extensive consultation with key stakeholders and which now represents an increase in construction costs of £3.5m.

45. The business rationale for the move to Hungate has been driven by the fact that the Council currently operates its administrative functions from a mixture of 17 different buildings around the city. Of the 17 buildings 8 are leased and 9 are owned. The majority of the owned buildings are not purpose built offices and are falling short of the modern day standards in terms of both office accommodation and customer contact points. The total budget for the running costs of the 17 administrative properties amounts to £2.6m per annum. However, this budget does not include any provision for any substantial repairs and maintenance works that are required if the Council were to remain with the current arrangements.

46. In developing the business case three main scenarios were developed:

a) Do nothing (stay were we are in existing accommodation, spending existing budgets);

b) Stay where we are, but invest in the buildings to reduce the repairs backlog;

c) Move to a new purpose built facility at Hungate, and use the sale proceeds from the buildings we own, and lease savings to pay for it

Option a would cost the Council's revenue budget £115m over the 30 years from 2005/06 (when the project was approved). In today's prices (the net present value) this equates to £47m.

Option b would cost £130m over the 30 years, and involve an upfront investment of over £8m to improve the existing stock and periodic investment over the next 30 years to maintain to minimum requirements. This equates to a total cost of £53.5m in today's prices

Option c, the move to Hungate, will cost £90m over the next 30 years[1], or £41.7m in today's prices. This is a £5.3m saving in today's prices to the Council over that time. The saving is even greater if we compare

[1] Based on the last position reported to the Executive in July 2007

the Hungate project (option c), to the more likely reality of option b, with savings of over £11m.

47. The main focus of the Councils Administrative Accommodation project is around the construction of the new office on the Hungate site. However, there are a number of other positive spin offs from the project which include a £1m enhancement of the Council's social services facilities, including a new hydrotherapy pool at Oakland's swimming pool. Premises which are, being retained, will have over £500k invested in them, and there will be a new homeless hostel to replace the facility at Peasholme Green. The St Leonard's complex will also be regenerated with the buildings being converted from offices to a mix of uses that complement the city. This is in addition to the economic regeneration of the Hungate area as a whole.

48. The project is funded from the sale of its existing office accommodation (with the exception of the Guildhall and St Anthony's house), and from borrowing, which will be largely financed from the savings the Council will make by not leasing the other office buildings. In addition there will be efficiency savings by operating from fewer sites, with fewer overheads from operating 4 buildings rather than 17.
A final advantage of option c is that the Council will eventually own its main office accommodation outright and will not be tied into leases which would continue to be the case in both options a and b and it is expected that the value of the new building will be more than its construction cost.

<u>Assessing Project Affordability</u>

49. The affordability of the project is affected by three main variables:
   a) The cost of the new building
   b) The level of capital receipts achieved from the sale of existing offices
   c) The level and cost of borrowing

50. The level of borrowing is the balancing figure and has the largest impact on the affordability of the project. Therefore if the cost of the new building increases and the level of receipts stay the same, the increase will have to be met from borrowing, which will reduce the affordability of the project. The same is true if the value of receipts reduce, the gap will be funded from borrowing.

51. In order to measure the viability of the project, two measures of affordability have been developed.
   a) The first is the net present value of the savings that the Council will achieve over the next 30 years by moving to the new arrangements.
   b) The second is a more short term indicator which measures the initial revenue impact of the transition to the new buildings. This is referred to as the early years deficit and will be funded from the

Council's venture fund, which stands at £4m and will therefore have no impact on the Council Tax payer.

52. The last business case reported to the Executive in July 2007, reported the NPV of the savings at £5.15m and the Early Years Deficit at £3.3m.

Updates to the Business Case

53. Since the July 2007 Executive Report, there have been a number of Project Board meetings where the business case model has been updated as new information has become available. These changes were largely linked to changes in the spend profile of the project. Table One illustrates the main changes since the last Executive that have impacted on the affordability of the project. The majority of the changes have resulted in an improvement in the affordability position, with the NPV of the savings increasing by £1.25m to £6.393m and the Early Years Deficit improving marginally. The gross capital expenditure for the whole project has remained at the approved level of £40.3m.

Table One – Previously reported changes to the affordability since the July 2007 Executive Meeting.

	NPV of Savings £m	Early Years Deficit £m
Executive July 2007	5.150	3.318
Changes:		
Mill House Rent Review (£45k p.a. increase)	0.455	-0.124
Ashbank Disposal slip from 2008/09 to 2010/11	-0.094	0.170
Yearsley Bridge Disposal – Slip to 2008/09	-0.165	0.554
Social Services Adaptations slip £800k	0.033	-0.058
York Customer Centre – cost savings in 2010/11	0.861	-0.163
3 month build delay until 30th June 2010	0.131	-0.380
Monitor 2 slippage	0.022	-0.038
January 2008 Project Board	6.393	3.280

The Current Position

54. The current design is significantly different from the first design solution estimated to cost £24.669m a budget which is contained within the wider project budget of £40.3m approved by the Executive in July 2007.

The new design will result in an increased cost of £3.5m which is mainly attributable to the changes in materiality and the use of additional glass natural stone, reconstituted stone and zinc cladding. The 12 week delay for further design development has meant that additional inflation costs have to be factored in along with additional costs for the introduction of a Combined Heat and Power Plant and a more complex substructure.

55. A detailed cost breakdown and explanation is attached at annex 1. However, as part of the Government's drive towards making Local Authorities adopt the international financial report standards (IFRS's) and bring accounting in line with the private sector, there has been a significant accounting development that the Council can opt to take advantage of, and will benefit the project affordability.

56. The project is currently budgeted to borrow approximately £27m and was being repaid in line with the statutory rules of 4% debt repayment per annum. This method of financing was approved at the July Executive and would have meant that at the end of the 30 years there would be some debt outstanding (£9.2m), although the building would be worth far in excess of this. The new accounting regulations allow Councils to defer the repayment of debt during the construction period and match their debt repayments to the life of the asset they are buying. In the case of this project, the building is being constructed to have a life of 60 years. The benefit of deferring and extending the debt repayments over this time is to reduce the upfront costs to the Council which will reduce the early years deficit significantly. The NPV of the savings measured over the 30 years also increase, although there will continue to be a level of outstanding debt associated with the building at the end of the 30 years modeling period, this will effectively be secured against the value of the building, which will be significantly more than this level of debt estimated at £15.4m. In today's prices this equates to £3.2m in NPV terms.

57. Table 2 shows the affordability indicators assuming the new accounting rules are adopted and then assuming a capital cost increase of £3.5m and the impact on the affordability. The impact of the year end slippage has been minimal but has been shown for completeness.

Table 2 – Impact on Affordability of increased costs and accounting changes

	NPV of savings £m	**Early Years Deficit £m**
Original Business Case July 2005	**2.760**	**3.090**
Executive July 2007	5.150	3.318
January 2008 Project Board	6.393	3.280
Change to accounting rules (repay debt over the life of the asset)	0.660	-2.579
Slippage from 2007/08 to 2008/09	0.040	-0.063
Base Position May 2008	**7.093**	**0.683**
Impact of £3.5m increase in construction costs	-2.325	1.456
Grand Total – June 2008	**4.768**	**2.094**

58. The revised affordability position therefore shows a net present value of the savings as being £4.768m, an improvement of £2m since the original business case, and the early years revenue deficit of £2.094m, a reduction of £1m from the original business case. These represent the new affordability parameters that the project is now expected to deliver.

59. Any increase in the cost of the building will result in an increased level of debt required. Table 3 illustrates the assets and liabilities associated with the position reported in July 2007 and the position assuming a £3.5m increase in the main build costs.

60. The net asset position in today's prices in 2035/36, shows that the Council's net asset base in association with the Hungate build will be almost £32m following the additional £3.5m investment requested as part of this report. The comparative asset base, if we were to remain in our existing buildings is £8m (the value of current owned accommodation).

Table 3 – Assets and Liabilities in 2035/36

	Exec 24th July 2007		Latest Position Assuming £3.5m additional investment	
Prudential Borrowing*		24,422,000		29,096,000
Gross Cost of the Building		31,293,000		34,793,000
Value of Building once completed		35,000,000		35,000,000
Outstanding Debt (cash figure) in 2035/36	- 9,200,000		- 17,400,000	
NPV of Outstanding Debt (as at 2035/36)		- 1,600,000		- 3,135,000
Asset Value less Outstanding Debt in 2035/36		33,400,000		31,865,000

** the increase in net borrowing is more than £3.5m because of the changes to the accounting regulations allow a debt repayment holiday during construction, which was not the case in July 2007.*