

**For General Release**

<b>REPORT TO:</b>	<b>CABINET 17 NOVEMBER 2014</b>
<b>AGENDA ITEM:</b>	<b>8</b>
<b>SUBJECT:</b>	Bernard Weatherill House (BWH) – Managing the debt burden
<b>LEAD OFFICER:</b>	Richard Simpson - Director Finance & Assets
<b>CABINET MEMBER:</b>	Councillor Simon Hall – Cabinet Member for Finance and Treasury
<b>WARDS:</b>	<b>All Wards</b>
<b>CORPORATE PRIORITY/POLICY CONTEXT:</b>	
The actions in the report support the deliver of the Financial strategy.	
<b>AMBITIOUS FOR CROYDON &amp; WHY ARE WE DOING THIS:</b>	
To support the objective to use creative solutions to manage our debt and make best use of our assets for the benefit of our residents.	
<b>FINANCIAL IMPACT</b>	
By taking the decision to end the Tranche B payment deed on BWH the council will incur a cost of £20.25m. This is against a cost of at least £43m over the next 23 years. This also reduces any RPI risk as the Tranche B payment is subject to RPI increases each year. The accelerated approach to letting of space with BWH is also likely to deliver a future income stream to the council of between £1.5m and £3m per annum.	
<b>KEY DECISION REFERENCE NO.: 1316.</b> This is a Key Decision as defined in the Council’s Constitution. The decision may be implemented from 1300 hours on the expiry of 5 working days after it is made, unless the decision is referred to the Scrutiny & Strategic Overview Committee by the requisite number of Councillors.	

The Leader of the Council has delegated to the Cabinet the power to make the decisions set out in the recommendations below

## **1. RECOMMENDATIONS**

- 1.1 Cabinet is asked to approve the contractual option to break the Tranche B payment deed to John Laing Development Company Limited (JL).

## **2. EXECUTIVE SUMMARY**

- 2.1 As reported to Cabinet as part of the July Financial Review the council has an option to break the Tranche B payment deed with JL for an agreed sum between 1 year and 2 years after practical completion (May 14 to May 15) for an agreed sum. This would end the arrangement with John Laing on Bernard Weatherill House ('BWH') as Tranche A would be unwound at this time. There are clear advantages to buying out Tranche B if it is affordable as Tranche B is RPI linked and therefore there would be significant RPI risk to the council over 25 years.
- 2.2 Work has now concluded on the accounting issues associated with this option and it is recommended that the break option is exercised as this provides a lower cost and significantly less risk as the amount is fixed rather than linked to RPI.
- 2.3 The proposed new Asset Strategy which is also being reported to Cabinet sets out the fresh approach to making the most out of our assets. Making the best commercial use of a key asset such as BWH is a opportunity to generate income to contribute to the council's financial strategy. Work to progress better utilisation of the space in the building, improved use of technology and more mobile working to support this is underway.

## **3. DETAIL**

- 3.1 As reported to Cabinet in July as part of the Financial Review, the council's debt includes £112m in relation to debt taken out by the council in relation to BWH. The costs associated with BWH do have an impact on the financial strategy of the council and there are a range of ways these can be managed in the future. Detail is set out in table 1 below;-

**Table 1 - BWH Costs**

	£m
Debt taken out by LBC and lent on to John Laing	112
Equity injection by John Laing into BWH (assuming break taken)	20.25
Other costs incurred by LBC;-	
Furniture, Fittings & Equipment	5.6
ICT	4.2
Construction Variations	2.4
<b>Total cost</b>	<b>144.45</b>

- 3.2 In addition to these direct costs, there is interest paid or accrued on the PWLB borrowings. These interest costs will total some £65 million over the life of the loans. This is treated as an element of the overall council debt.
- 3.3 The approach taken to debt previously was to ringfence the costs associated with the construction (excluding other costs above) and offset those against various income and savings items associated with CCURV, BWH and asset savings across the council estate. The approach was to avoid a short term impact on the council tax payer and attempt to smooth the costs against income over a longer period. As at the 31/03/14 there is £13.4m in the earmarked reserve used for this purpose.
- 3.4 In respect of BWH the council has now started payment of a 25 year payment deed to John Laing. This is split into two elements, a Tranche A that sees the payment of the senior debt element, in effect the part the council lent to John Laing and a Tranche B element to repay the £13m equity with interest. Tranche A does not see any cash payments as the council would be paying John Laing for them to pay us back our loan, however because interest has been charged to John Laing and accounted for during the construction period there are timing differences in accounting for the income and expenditure.
- 3.5 The option could be taken to maintain the current arrangement and not take the break. This would maintain the arrangements to pay back the equity associated interest over a 25 year period. As well as being at a high interest rate given the nature of the equity being put in as part of the construction costs the repayment is also RPI linked as set out above and therefore leaves the council with significant risk over the long term of fluctuations in interest rates having an impact on cost from year to year impacting on the council's revenue budget. For every 0.5% increase in RPI above the base case of 2.5% per annum there would be approximately £3m impact on the overall cost to the council.
- 3.6 The option to break was negotiated to give the council the opportunity to reduce the overall cost at this stage once the building was completed. The value of the equity buy out price was subject to negotiation before financial close on BWH. The value of £20.25m was agreed at the time as an appropriate amount by the council's external advisors.

- 3.7 As a result of the Council exercising the option to repay tranche B for £20.25m the debt transactions associated with the BWH financing will all need to be unwound. This relates to the loan to John Laing and the tranche A payment deed due to John Laing. The end result of these transactions will be the long-term debt and liability currently showing on the Council's balance sheet for BWH will be written-out against each other. The effect of these accounting transactions is to reverse accumulated interest charged on the loan back to the Council's Comprehensive Income and Expenditure. This will result in the earmarked reserve for CCURV being fully used.

### **Financing of Tranche B buy-out**

- 3.8 It is proposed that the £20.250m will be treated in the Council's accounts as a payment in advance and will be charged to the Council's revenue account over the estimated life of the building which is 50 years. The impact of this will be a charge each year to revenue of £0.405m.
- 3.9 This is done on the basis that this should be treated in the same way as the other debt on BWH and spread over the lifetime of the building in line with accounting practise. Further discussions will be had with the councils external auditors to agree the final treatment.

### **Use of BWH**

- 3.10 It is becoming clear given the changing size of the council and nature of how we do business that there are clear opportunities to make better use of BWH. The Asset Management strand of the Croydon Challenge includes a review of all corporate office accommodation. This review will enable the Council to understand its current capacity, map future requirements and identify surplus space that could be let to third parties to generate an income stream.
- 3.11 An initial data collection exercise has commenced to gather utilisation information for BWH and Jeanette Wallace House. This study will enable the Council to fully understand the options available to better use the space at both of these buildings and to bring forward the potential release of space at BWH for letting in 2015.

## **4. CONSULTATION**

- 4.1 There has been no specific consultation on the buy option as it is a contractual option and will no impact staff or customers directly.

## **5 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS**

- 5.1 The body of the report sets out the detailed financial considerations of the option recommended. The overriding benefit would be the elimination of risk in relation to the cost of BWH and the winding up of the SPV set up to deliver the building and who received the loan from the council, therefore reducing the overhead cost of the company, paid for by the council through the payment deed.
- 5.2 The savings associated with better use of the corporate office estate and renting out of BWH are estimated at between £1.5 and £3m per annum by 2018

(Approved by : Richard Simpson, Director of Finance and Assets)

## **6. COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER**

- 6.1 The Council Solicitor comments that in order to effectively exercise the Break Option set out and detailed earlier in this report, a Break Notice will need to be served in accordance with the mechanics set out in the Tranche B Payment Deed entered into on the 15<sup>th</sup> of March 2010 between the Council and John Laing (Croydon Development Company) LLP. Detailed advice will be given by the Council's legal team to officers in that regard. Such other legal considerations as there are, are already set out in the detail of this report.

(Approved by: Sean Murphy, Principal Corporate Solicitor (Regeneration) on behalf of the Council Solicitor & Director of Democratic & Legal Services)

## **7. HUMAN RESOURCES IMPACT**

- 7.1 There are no immediate HR implications that arise from the recommendations of this report for LBC staff.

(Approved by: Michael Pichamutu on behalf of the Director of Human Resources)

## **8. EQUALITIES IMPACT**

- 8.1 No impact of the recommendations

## **9. ENVIRONMENTAL IMPACT**

- 9.1 No impact of the recommendations

**10. CRIME AND DISORDER REDUCTION IMPACT**

10.1 No impact of the recommendations

**11. REASONS FOR RECOMMENDATIONS/PROPOSED DECISION**

11.1 The recommendations are proposed to enable the council to reduce future risk on payments in associations with BWH and also to allow opportunities to be explored to help support the financial strategy by generating new income streams

**12. OPTIONS CONSIDERED AND REJECTED**

12.1 The council could continue with the current payment deed and not exercise the break option, this was rejected due to the risk it leaves the council exposed to.

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**CONTACT OFFICER:** Richard Simpson – Director of Finance and Assets

**BACKGROUND PAPERS - LOCAL GOVERNMENT ACT 1972:** none