

Item No. 12.	Classification: Open	Date: 17 January 2024	Meeting Name: Cabinet
Report title:		Policy and Resources Strategy: Capital Monitoring Report 2023-24	
Ward(s) or groups affected:		All	
Cabinet Member:		Councillor Stephanie Cryan – Cabinet Member for Communities, Democracy and Finance	

FOREWORD - COUNCILLOR STEPHANIE CRYAN, CABINET MEMBER FOR COMMUNITIES, DEMOCRACY AND FINANCE

Our capital programme delivers real and tangible benefits for our residents and despite ongoing financial pressures, we continue to invest to improve our neighbourhoods. Our range of projects covers all areas across the length and breadth of the borough. We have committed to improving air quality, increasing the number of cycle hangers, making improvements in care home settings, delivering new children’s homes, and investing in our parks and leisure centres.

Our proposed new capital programmes continue to support improvements in our environment and infrastructure – such as investing in road maintenance to support a long-term solution to potholes, investing in our street markets and updating our street lighting to maintain well-lit and safe areas for our residents.

In addition, substantial investment has been made in our leisure facilities to improve the quality of our residents’ lives, improve physical and mental well-being. The key leisure capital schemes are focused on improving the fabric and decoration of the centres, repairing and replacing equipment, improving heating and ventilation systems and refurbishing our gyms.

The housing investment programme is experiencing significant economic risk through rising interest rates, together with the potential for cost overruns, due to huge inflationary pressures particularly in energy costs, building materials and labour costs.

The council has reviewed the affordability of the housing investment programme. Recent changes in the legislative, regulatory and policy environment have added very significant costs to an already ambitious programme and without any additional funding from government. In addition, interest rates are near their highest level in 15 years. It is becoming increasingly clear that the council will need to reduce the pace of borrowing. We have a planned approach to reduce our borrowing and these measures will ensure that our housing investment programme remains financially sustainable.

Our capital programme remains ambitious despite the national financial outlook and continues to deliver on the things that are important to our residents.

RECOMMENDATIONS

That cabinet:

1. Approve the virements and variations to the general fund and housing investment capital programme as detailed in Appendix D and the new capital bids in Appendix E;
2. Notes the significant funding requirement of £263m which needs to be identified for the general fund programme to be fully delivered over the remaining term of the programme, as detailed in Appendix A;
3. Notes the £1.7bn housing investment programme to be fully delivered over the remaining term of the programme, as detailed in Appendix C.
4. Notes the mitigating actions to ensure the affordability of the housing investment programme and the sustainability of the housing revenue account.

BACKGROUND INFORMATION

5. On 17 October 2023, the medium term financial strategy and capital update report was presented to cabinet. The report considered the key aspects of both revenue and capital accounts, the interplay between the accounts, the main risks and identified potential mitigations. This report updates cabinet on the forecast capital outturn for 2023-24 together with the revised 10 year capital programme,
6. Capital investment plans are driven by the council delivery plan and by the council's housing strategy. The council has a long tradition of investing in housing, local infrastructure and facilities that support the development of the borough for the benefit of residents and businesses. The scale of the capital programme is immense, representing a major element of the council's financial activities.
7. The council's constitution requires council assembly to agree the capital strategy and programme at least once every four years, ensuring effective financial control and the achievement of value for money, within the provisions of financial standing orders. Council assembly will be presented with the refreshed 10 year general fund capital programme and housing investment programme (HIP) in February 2024.
8. Due to the size and scale of the programme and the number of projects involved, it is inevitable that unforeseeable delays can occur which lead to some variations against planned spend. This has historically resulted in the capital programme being over-programmed in year, whilst retaining a balanced programme over the entire ten year life of the programme. However, it was reported in October 2023 that the council faced a position

where planned spend is considerably in excess of forecast resources, not only in year, but also over the life of the programme.

9. Given high rates of inflation, the capital budgets were revisited to ensure that the programme was based on an up to date price base and inflationary pressures are captured in the programme for the period to 2032-33.

KEY ISSUES FOR CONSIDERATION

Programme position at month 8 2023-24

10. The capital programme is detailed within the report and appendices as follows:
 - Appendix A provides further detail on the general fund capital programme 2023-2033;
 - Appendix B the accompanying departmental narratives;
 - Appendix C sets out the housing investment programme for 2023-2033;
 - Appendix D sets out the general fund capital programme budget virements and variations for approval (and notes the Housing Investment Programme changes to codes to reflect the phasing of projects);
 - Appendix E provides a summary of the new capital bids;
 - Appendix F provides the narrative detail of the new capital bids.

General Fund Capital Programme

11. In response to the inclement financial conditions (inflation, borrowing costs), and in anticipation of the capital programme refresh at council assembly, the council has undertaken a full review of all capital projects. The review found that whilst some costs had increased (due to construction inflation), management of projects and re-distribution of unused contingencies and project underspends meant the programme reported for month 4 could be contained within the existing funding envelope. This position remains at month 7.
12. As noted in the October cabinet report, affordability of the General Fund capital programme is dependent on grant income, 'Section 106', and Community Infrastructure Levy (CIL) receipts and capital receipts. Any shortfall is met through prudential borrowing, which incurs financing costs. The council currently has sufficient budget to afford these financing costs and provision is made through the budget-setting process to increase this amount annually to allow for growth within the programme.

Table 1 General Fund Capital programme (M8) to 2033-34

Department	2023/24			2024/25			Total Programme 2023/24-33/34		
	Revised Budget	Forecast	Variance	Revised Budget	Forecast	Variance	Revised Budget	Total Forecast	Total Variance
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Children's and Adults' Services	33,850	33,189	(661)	43,319	44,019	700	103,722	103,722	-
Southwark Schools for the Future	2,229	327	(1,902)	-	1,902	1,902	2,229	2,229	-
Finance	7,538	6,396	(1,142)	2,171	3,074	903	11,053	10,053	(1,000)
Governance & Assurance	5,783	5,227	(556)	5,783	5,425	(358)	18,828	18,828	-
Environment, Neighbourhoods & Growth	96,358	62,016	(34,342)	59,287	88,994	29,707	219,545	219,545	-
Housing	2,360	2,408	48	3,244	3,244	-	28,571	28,571	-
TOTAL EXPENDITURE	148,118	109,563	(38,555)	113,804	146,658	32,854	383,948	382,948	(1,000)
FUNDED BY:									
Corporate Resource Pool	1,039	1,039	-	10,000	10,000	-	26,039	26,039	-
Major Repairs allowance	-	-	-	-	-	-	-	-	-
Supported Borrowing	-	-	-	-	-	-	-	-	-
Reserves	719	719	-	-	-	-	719	719	-
Revenue	-	-	-	-	-	-	-	-	-
Capital Grants	26,148	23,566	(2,582)	13,321	17,106	3,785	60,483	60,655	172
Section 106 and CIL	15,205	14,430	(775)	7,147	7,922	775	28,368	28,368	-
External Contributions	3,680	3,680	-	62	62	-	3,742	3,742	-
TOTAL RESOURCES	46,791	43,434	(3,357)	30,530	35,090	4,560	119,351	119,523	172
Financing to be agreed/Borrowing	101,327	66,129	(35,198)	83,274	111,568	28,294	264,597	263,425	(1,172)

13. Table 1 shows that programmed expenditure over the period 2023-24 to 2033-34 is currently £382m and that approximately £263m will be funded by borrowing, this remains the same as the month 4. Appendix A details the departmental capital programmes and Appendix B provides the departmental narratives. Appendix D sets out the budget virements to be approved.

New capital bids

14. New capital bids of £121m over the 10 year are detailed in Appendix E and Appendix F. These will be financed from corporate resources, with the debt financing being assessed as affordable from the general fund revenue budget. The new bids include £40m for leisure, environment and planning projects to 2027-28, £36m (c£4m per annum) to support the future investment requirements of digital transformation and £45m (c£5m per annum) for the maintenance and compliance with health and safety regulations of the operational buildings. If these bids are approved, they will be included in the approved capital programme.

Housing Investment Programme (HIP)

15. The 'Housing Investment Programme' (HIP) is the capital programme for the Housing Revenue Account (HRA). Broadly, there are two major strands; the New Build programme and the Asset Management (AM) programme. The New Build programme is the commitment to new council home delivery. The Asset Management programme arises from the council acting as a social landlord, with legal obligations to ensure the maintenance of its council homes, to ensure they are safe, healthy and free from things that can cause harm, as well as day to day repairs and maintenance.
16. From 2010-11 to 2022-23, the council has invested:
 - £1.1bn in programmes to ensure homes are safe, warm and decent and an additional £127m in those estates that have had high investment needs;
 - £754m in new homes;
 - £170m in regeneration projects.
17. Appendix C shows the programme expenditure over the period 2023-24 to 2033-34 is currently £1.74bn, comprising of £974m for new homes, £761m for asset management and £8m for other programmes.
18. The forecast spend for the Housing Investment Programme for 2023-24 is £368m (£427m at month 5). Of this, £260m (£308m at month 5) relates to the new build programme, £101m (£112m at month 5) is for asset management and £6.5m (£7.5m at month 5) for other schemes.
19. A breakdown of the schemes and budgets within the housing investment programme is included in Appendix C.

Financing the Housing Investment Programme

20. The New Build Programme is financed through a range of funding sources including grants, Section106 receipts, Right to Buy receipts and capital receipts from the sales of assets. Any shortfall is made up through

prudential borrowing and the financing cost of this is charged, as a 'first call', to the Housing Revenue Account (HRA).

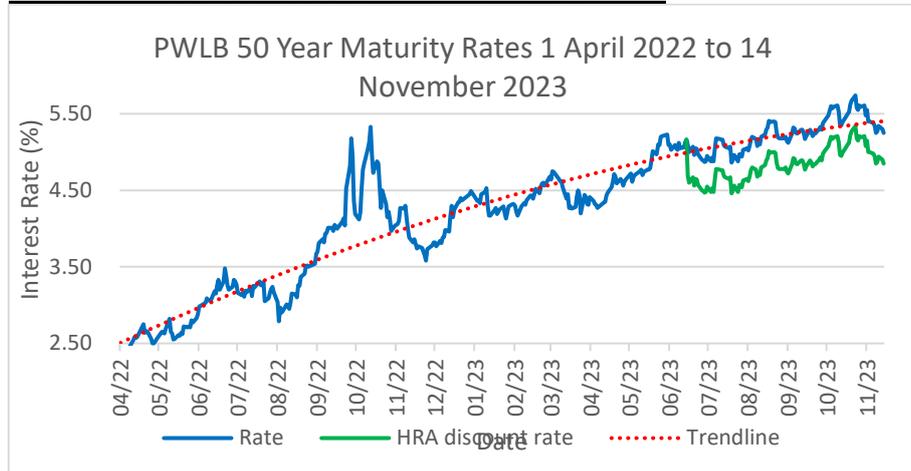
21. The Asset Management (AM) programme is financed through the depreciation charges levied on the HRA and through the discretionary revenue contribution to capital. However, it is increasingly likely that external borrowing will be required in 2023-24 and beyond with the financing cost of this adding to the burden on the housing revenue account which may result in the slowing of the New Build programme overall.

New Build Programme

22. Like the General Fund programme, the HIP underwent a detailed review in 2022-23 to ensure that it continues to meet the strategic aims and policy objectives of the council whilst remaining affordable and sustainable. As part of this review, the new homes programme has been separated into two categories; a 'committed' and an 'uncommitted' programme.
23. The committed programme comprises those projects for which a contractual commitment exists or where the council has demonstrated a deep commitment to proceed with, such as by way of a resident ballot. However, these committed projects still need constant review to ensure their continuing affordability, particularly when both borrowing costs and construction costs are rising. So completion of these 'committed' projects remains subject to the test of affordability, as they are affected by a range of factors, including inflation, interest rates and other pressures impacting the Housing Revenue Account.
24. The uncommitted programme comprises the pipeline of projects that the council would like to pursue, but for the time being cannot be contained within the affordability envelope. The council will endeavour to introduce these to the committed programme as and when funding and affordability allow.
25. In light of rapidly increasing build and financing costs, the council took a decision in November 2023 to pause planned construction on a small number of sites across the borough, namely Bells & Lindley and Sceaux Gardens. This action significantly reduces the council's need to borrow over the next few years and goes some way towards reducing pressures on the Housing Revenue Account. Officers will continue to review proposals for these sites with a view to identifying alternative approaches to delivery that remain affordable.
26. Exposure to interest rate rises and the consequent cost of borrowing remains the key constraint on the council's New Build programme. The cost of borrowing has effectively tripled since December 2021. With effect from 15 June 2023, HM Treasury introduced a new concessionary PWLB rate for Housing Revenue Accounts (HRA) borrowing. The discount margin is set at 40 basis points (i.e. 0.4%) below the rate at which local authorities

usually borrow from the PWLB. While this is welcome, it has so far had limited impact in achieving its objective due to continuing underlying interest rate rises. On implementation, the prevailing rate was 5.13% before the application of the HRA discount, and on 14 November 2023 the rate was 4.85% after the application of the discount. Table 2 shows the movement in the PWLB since April 2022.

Table 2: Interest rates over time for the HIP



27. The prospect of interest rates falling significantly over the short to medium term is extremely unlikely, which needs to be acknowledged when programming for the HIP. While interest rates remain relatively high the council will seek to minimise borrowing over and above that to which it is already committed.
28. Unfortunately, borrowing rates are near their highest level in 15 years just as the council reaches a peak in its borrowing requirement for the new homes programme. It is becoming increasingly clear that the council will need to reduce the pace of borrowing in order to prevent the cost of servicing the debt from exceeding available resources. This will be achieved in a number of ways, including by slowing down or pausing projects or by finding other sources of income including capital receipts from the sale of vacant or unproductive assets.

Asset Management (AM)

29. Recent changes in the legislative, regulatory and policy environment, described in the October 2023 report, have added very significant costs to an already ambitious programme and without any additional funding from government. The HIP has an annual budget of £60m-£70m to undertake capital works to its stock, but is currently anticipating expenditure in the region of £101m (£112m at month 5), largely on works to ensure the stock is safe. This potentially leaves a funding gap in 2023- 24 of around £31m (£42m at month 5).

30. Officers are considering a range of options to reduce the gap in 2023-24, and beyond including:

- Reducing spend on the housing revenue account to allow more of the capital asset management programme to be funded via revenue contribution,
- Reducing or re-profiling the existing asset management programme to bring it closer to the £70m envelope,
- Reviewing contracts and procurements to maximise value for money,
- Selling surplus housing assets (e.g. a small number of long-term voids that have proved uneconomical to repair, vacant land) in order to generate capital receipts,
- Limiting works to the statutory minimum duty.

Table 3: Financing of 2023-24 spend

Funding Source	£
Major Repairs Reserve & Revenue Contributions	60,000,000
Non RTB receipts	31,469,984
RTB receipts	2,371,536
Grants & external contributions	19,074,729
S106 receipts	26,352,311
Borrowing	220,670,352
Total financing	368,235,053

31. As identified, the borrowing requirement is forecast at £220.7m (£251.4m at month 5). The annual revenue cost of this borrowing in terms of interest payable at interest rates estimated between 4.5% and 5.5% would be between £9.9m and £12.1m (£11.3m-13.8m at month 5) as illustrated below. This places a significant financial pressure on the HRA.

Interest Rate	Annual Interest
5.50%	£12,136,869
5.00%	£11,033,518
4.50%	£9,930,166

Community, equalities (including socio-economic) and health impacts

32. This report monitors expenditure relating to the council's capital programme. Although as a monitoring report this report has been judged to have no direct impact on local people and communities, the expenditure it is reporting reflects plans designed to have an impact on local people and communities. Community impact was considered at the time the projects

and programmes were agreed. It is important that resources are efficiently and effectively utilised to support the council's policies and objectives.

Climate change implications

33. This report provides an update on the council's capital programme as a whole and includes climate change programme updates. The impact of individual projects and programmes will be considered in line with constitutional requirements as part of the specific decision making and procurement processes.

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Assistant Chief Executive (Governance and Assurance) (AJW 12.12.2023)

34. The council has a duty to maintain a balanced budget throughout the year and, accordingly, members are required to regularly monitor the council's financial position. Section 28 of the Local Government Act 2003 imposes a duty on the council to monitor its budgets throughout the financial year. The council must take necessary appropriate action to deal with any deterioration in the financial position revealed by the review. This report sets out the current situation regarding the general fund capital programme indicating that the costs can be contained within the current funding envelope. It also sets out the position regarding the housing investment programme and the planned mitigation given the current projected funding gap.
35. Decisions regarding the strategic aspects of the regulation and control of the council's finances are reserved to the cabinet in accordance with Part 3B of the constitution. This part refers to the cabinet having responsibility for the "council's revenue and capital budgets, including the housing revenue account, ensuring effective financial control and the achievement of value for money, within the provisions of financial standing orders. The Financial Standing Orders require the chief finance officer to report on the overall financial position of the council and on capital expenditure incurred by the council to the cabinet on a regular basis.
36. Specific provisions for the approval of virements over £1,000,000 and up to £10,000,000 between capital projects or programme headings as set out in the overall programme approved by council assembly are reserved to cabinet in Part 3C.
37. The capital programme assists the council in complying with the duty under the Local Government Act 1999 which requires it to make arrangement to secure the continuous improvement in the way its functions are exercised, by having regards to the combination of economy, efficiency and effectiveness.

38. The council is required under section 149 of the Equality Act 2010 to have due regard to the need to:
- Eliminate unlawful discrimination harassment and victimisation
 - Advance equality of opportunity between people who share protected characteristics and those who do not
 - Foster good relations between people who share protected characteristics and those who do not.
39. Cabinet needs to take account of this duty in considering this report.
40. The Community, equalities (including socio-economic) and health impacts section above indicates that whilst this report has been judged to have no direct impact on local people and communities, the expenditure it is reporting reflects plans designed to have an impact on local people and communities.
41. The public sector equality duty is a continuing duty and will need to be taken account of in any processes to mitigate budget pressures.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
Policy and Resources report- October cabinet	Southwark Council Finance and Governance 160 Tooley Street London SE1 2QH	Tim Jones, Departmental Finance Manager, Finance and Governance
Link: Cabinet, 17 October 2023 - Agenda Item 9		

APPENDICES

No.	Title
Appendix A	General fund capital programme month 8 2023-24
Appendix B	Departmental Narratives month 8 2023-24
Appendix C	Housing investment programme 2023-24
Appendix D	Capital programme budget virements and variations 2023-24
Appendix E	Capital Bids
Appendix F	New Capital Bids – Narrative

AUDIT TRAIL

Cabinet Member	Councillor Stephanie Cryan, Communities, Democracy and Finance	
Lead Officer	Clive Palfreyman, Strategic Director of Finance	
Report Author	Tim Jones, Departmental Finance Manager,	
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Key Decision?	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
	Officer Title	Comments Sought
	Assistant Chief Executive, Governance and Assurance	Yes
	Strategic Director for Finance	N/a
	Cabinet Member	Yes
	Date final report sent to Constitutional Team	4 January 2024