This Report will be made public on 24 October 2022

Folkestone & Hythe District Council

Report Number **C/22/56**

To:	**Councillor David Monk, Leader of the Council and Finance Portfolio Holder**
Date:	**1 November 2022**
Status:	**Non-Key Decision**
Responsible Officer:	**Susan Priest, Chief Executive**
Cabinet Member:	**David Monk, Leader of the Council**

SUBJECT: PRINCES PARADE PROJECT UPDATE

SUMMARY: Significant work is underway to deliver a new leisure centre, housing and public open space at Princes Parade in Hythe. This report gives an update on key matters since decisions were made in early 2022. It also concludes that in response to significant recent changes in the leisure, energy and financial markets giving rise to a high degree of cost pressures and uncertainty across the economy, the council is unable to deliver the project within existing budget.

REASONS FOR RECOMMENDATIONS:

The Leader is asked to consider urgently the matters raised in this report because the changing and extremely challenging economic climate through 2022 has resulted in additional cost pressures and elevated risk to the council at a time of significant pressure on the council's MTFS.

RECOMMENDATIONS:

1. **To receive and note report C/22/56.**
2. **To pause current spending on the project.**
3. **To agree that officers re-evaluate available options in light of the current economic climate and propose a way forward.**

1. Introduction & Background

1.1 In January 2022 cabinet agreed to deliver the new leisure centre project (Report C/21/75) and budget was made available (Report A/21/27) by Full Council.

1.2 Since January 2022, the following activities have been undertaken to progress the project under a pre-contract services agreement (PCSA):

a. Reptile fencing & badger sett relocation;
b. Badger sett closure;
c. Disposal of Giant Hogweed;
d. Site vegetation clearance and flail;
e. Site hoarding;
f. Canoe club relocation design;
g. MMO (Marine Management Office) licence application;
h. Embankment testing and liaison with Historic England;
i. UKPN (UK Power Network) Preparatory Design Works;
j. Southern Water Preparatory Design Works;
k. Remediation methodology development;
l. Vegetation Clearance / flail mowing following re-growth;
m. Additional lighting control requirements to S38 road;
n. Closure of newly constructed badger setts following successful relocation;
o. Additional site investigation testing in areas previously inaccessible due to sensitive treatment of wildlife; and
p. Negotiation and agreement of on-site remediation implementation plan with independent assessor following site testing.

1.3 Members agreed a budget of £45.3m, and this is broken down as shown in the table below. The construction price offered by BAM was predicated on commencement on site by 31/03/22. Delays in discharging planning conditions (particularly condition 25 relating to the methodologies to be employed in carrying out remediation), entering into licensing agreements with the Marine Management Office (MMO) and Radnor Estates, and resolving a s.38 agreement with Kent County Council continue to cause delay and as a result neither party has been able to enter into the main contract.

1.4 In July 2022 BAM advised that due to increases in sub-contractor tenders the contract price had increased to £41.19m, and this was reported to relevant portfolio holders with the increase in cost being available from the scheme contingency, so at this time no change to the overall budget was necessary.

Cost Heading	Cabinet Approved Budget (Jan 2022)	Current Forecast (Oct 2022)
Construction Costs, including utilities (BAM's Offer)	£40,518,210	£41,185,939
Consultant Fees, licence fee, and other Council direct costs	£3,566,823	£3,830,430
Contingency (3% of construction costs)	£1,215,546	£284,210
Total	£45,300,579	£45,300,579

1.5 The council also tendered for a leisure operator to manage the new leisure centre. Bids were received in the autumn 2021 and the outcome of the tender reported to Cabinet 26/1/22 (C/21/75). The tender was awarded to Freedom Leisure. Preparations began on drafting of the contract during which Freedom Leisure informed the council that they were no longer able to take on the full financial risk for changes in utility tariffs following the significant increases in costs triggered by the war in the Ukraine. A revision was proposed to the draft agreement whereby the Leisure Operator’s share of utility costs would be capped at the tariffs set out in the original bid (Oct 21) and the council would pay the share of additional utility costs above this cap. Alternative options were considered but the increases in utility costs and resulting financial uncertainty affecting the leisure market meant it was unlikely that we would achieve improved terms elsewhere. The revised proposal was considered and approved by Cabinet in July (C/22/24). The contract is in the final stages of drafting but is not yet signed.

2. Current Situation

2.1 The economic climate has changed significantly through 2022, much of it in a remarkable and unforeseen way, with international events such as the war in Ukraine and other domestic events causing a high degree of turbulence and volatility in the energy and financial markets.

2.2 These events have caused uncertainty and the operating environment to change and, as a consequence, additional pressures across a range of operational matters are being felt by the council and its partners in delivering this project. The following describes the nature of those pressures:

a. The revised contract figure from BAM of £41.9m is offered on a fixed price basis being held until 31/10/22. This time-limited contract figure excludes any unforeseen unexpected costs, or those incurred by further delays. The contingency allowance in the budget has been allocated and as contracts may not be signed by this date, this represents further exposure of financial risk to the council;

b. The recent increased cost of borrowing available to the council has moved significantly from around 2% to 5% resulting in an additional cost pressure relating to this project. Cabinet was advised on 20th October 2022 of the latest Treasury Management Monitoring report (C/22/53) and this gives more detail on the contextual background on this matter;

c. The contract for the sale of the residential land has not progressed at the pace expected although it is very close to a settled form. The timing of exchange is commercially linked to the timing of entering into the BAM main works contract and is envisaged as happening in concert with it;

d. The planning permission needs to be formally implemented with a substantial commencement on site by July 2023. If not it will lapse;

e. The site remains allocated for mixed use redevelopment to include 150 residential dwellings, a leisure centre, a hotel and public open space under the adopted local plan policy UA18; and

f. Freedom Leisure have provided estimate of utility tariff costs based on October 2022 prices. Utility costs compared to the tender bid (Oct 21) have increased by 110% for electricity and 184% for gas. Based on the current prices, the estimated annual total utility costs for the new leisure centre would be £613,000. Applying the current tariff costs to the contract financial model based on an opening date in 2024, could potentially result in an estimated cost to the General Fund of £966,000 over the first 3.5 years.

2.3 In addition, refinements on matters of detail in delivering the project have led to a number of additional unforeseen costs in the order of some £0.9-£1.4m, e.g. new landfill tax requirements as a result of legislative change, commuted sums greater than estimated in original budget, unexpected cost demands from the MMO, additional testing demands and costs, etc.

2.4 While volatility remains, any project of this size should include sufficient contingency to allow for unexpected and unforeseen costs to be accommodated. Allowing a 3-5% contingency for the entire scheme would put a further cost pressure on the scheme and in turn further borrowing & funding pressure on the council.

2.5 In summary, and taking all matters into consideration, a revised budget in the order of some £47 to 49m would be needed to deliver the project (£45.3m + £1.4m + 3% to 5% contingency). As this is beyond the budget currently available, council would need to make this available in the Medium Term Capital Programme (MTCP) and the revenue implications through the MTFS and future years budgets.

2.6 In view of the council’s broader financial pressures in the emerging MTFS, officers are of the view that the council should now pause spending and re-evaluate options in light of the current economic climate, returning to Members with a proposed way forward.

3. Financial Position

3.1 When Full Council and Cabinet considered the revised budget requirement for the scheme in January 2022, the revenue costs (£210k) of the associated borrowing required (£6.625m) at that time was based on the prevailing rates at 2%, and could be more than fully funded by the revenue impacts of closing Hythe Pool and the Management Fee income from the new Operator. The closure of the existing pool site would generate a £165k per annum saving, and at that time the operator anticipated providing an average management fee of £175k as an annual income to the Council, these were to be utilized to offset the capital financing costs.

3.2 The Council is governed by the Prudential Code when it undertakes capital projects including the associated borrowing. This framework requires our plans to be prudent, affordable and proportionate. We have to consider our plans in light of the overall organisational strategy and resources available to ensure the decisions are being made with sufficient regard to the long term financing implications and potential risks to the authority. The framework requires us to consider the affordability and sustainability of our plan, including the arrangements for the repayment of debt; consideration of risk; the impact and potential impact on the authority's overall fiscal sustainability. We must consider our decisions in light of the Medium Term Financial Strategy (MTFS) and with due regard to risk and uncertainties.

3.3 Officers are now well advanced with the revision to the MTFS which reflects the period 2023/24-2027/28. Whilst this is not a published position, we have discussed the headline findings with the Portfolio Holder for Finance and the relevant Portfolio Holders for this project, given its significance and the need to evaluate our decisions with regards to this project with that as critical context. The gap in the MTFS has increased significantly since it was last considered by Full Council in November 2021 primarily due to the utilisation of reserves, inflationary pressures (staffing & contractual) and the impact of energy price volatility.

3.4 If the scheme costs were to be increased to £49m (based on a 5% contingency), the revenue implications of the capital financing (borrowing of £10.7m) would be £583k (based on current rates) per annum. This cost would need to be met from general fund revenue resources. In addition, as outlined in 2.2 and in the Cabinet paper in July, the operator costs are anticipated to move due to the rises in energy prices globally. Whilst the original position reported in January 2022 anticipated an annual income to the council from the operator (from year 2), this is now anticipated to be an annual cost to the Council (for the first ten years of operation). Based on current rates in the first 3.5 years of operation this is projected to also require general fund revenue resources of £966k. The closure of the Hythe Pool site will still generate a saving, and potentially a larger saving as its energy costs will also have risen in line with the market, but this will not sufficiently offset the other increases. Over the first 3.5 years of operation, on current rates with a £49m scheme, the costs to the general fund revenue (after savings) are anticipated to be in the region of £2.53m, which given the emerging MTFS is unaffordable to the Council at this time.

3.5 In addition, the market itself is very volatile, and therefore there are associated risks for construction costs, broader inflation, challenges for the leisure & housing markets (which a significant proportion of scheme funding is reliant upon) and further potential interest rates increases, to name a few.

3.6 The Council has incurred a significant sum on this project to date. Further work is required to estimate the final value but it is anticipated that if the project does not proceed, the Council will be required to write off revenue costs in the region of £4-5 million. These costs will need to be met from General Fund revenue resources and the write off will need to be made in year to comply with capital accounting requirements. If the decision is taken to re-evaluate the available options this will be more fully explored and considered as part of that picture.

4. RISK MANAGEMENT ISSUES

4.1 A summary of the perceived risks follows:

Perceived risk	Seriousness	Likelihood	Preventative action
The scheme is unable to be delivered within the agreed capital programme budget within the timescale	High	High	The scheme is re-evaluated and all available options are explored.
The Council proceeds with a scheme with insufficient contingency available	High	Low	The scheme is re-evaluated and all available options are explored.
The Council borrows funds that it is unable to service	High	Low	The Council cannot borrow funds that it does not have the ability to service the debt, therefore the available options for this scheme need to be considered and an alternative resolution identified.
Market volatility continues to affect the scheme and its associated budget	High	High	Given the wider market conditions this is considered to be a high risk, it can be mitigated by sufficient contingency if affordable to do so.

Utility costs continue to rise and the Operator Management fee rises further before the centre is able to open, creating a further revenue pressure to the general fund	High	Medium	The scheme is re-evaluated and all available options are explored.
The Leisure Operator withdraws due to sector and business pressures	High	Low	Regular dialogue is taking place and industry dynamics monitored.
Threat of legal action arises from re-evaluating the scheme	High	Medium	The scheme is re-evaluated and all available options are explored.
Reputational damage from re-evaluating the scheme	High	Medium	The scheme is re-evaluated and all available options are explored.
Volatility in the housing market leads to residential developer withdrawing or renegotiating leading to funding gap in scheme	High	Medium	The scheme is re-evaluated and all available options are explored.
Repayment of the Brownfield Land Release Fund (BRLF) if the scheme is delayed beyond March 2024	High	High	The scheme is re-evaluated and all available options are explored.

Planning permission lapses	High	High	Scheme re-evaluation work is completed as a matter of urgency.
Statutory obligation to remediate contaminated land	High	High	The scheme is re-evaluated and all available options are explored.

5. LEGAL/FINANCIAL AND OTHER CONTROLS/POLICY MATTERS

5.1 **Legal Officer's Comments (AK)**
There are no direct legal implications arising from the substance of this options report at this stage. However, it is essential that legal advice must be sought when evaluating the options going forward and officers are encouraged to work with the legal team with immediate effect.

5.2 **Finance Officer's Comments (CS)**
The Finance Officer has contributed to the body of this report and outlined all relevant matters in section 3 of this report.

5.3 **Diversities and Equalities Implications (CS)**
No implications arising directly from this report. These matters will be fully appraised in the options evaluated.

5.4 **Climate Change Implications (CS)**
No implications arising directly from this report. These matters will be fully appraised in the options evaluated.

6. CONTACT OFFICERS AND BACKGROUND DOCUMENTS

Councillors with any questions arising out of this report should contact the following officers prior to the meeting

Susan Priest, Chief Executive
Telephone: 01303 853315
Email: susan.priest@folkestone-hythe.gov.uk

The following background documents have been relied upon in the preparation of this report:

None.