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Folkestone
Hythe & Romney Marsh
Shepway District Council
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Report Number **A/06/19**

To:	**Council**
Date:	**22 February 2007**
Status:	**Non-Executive Decision**
Responsible Portfolio Holder:	**Councillor Mrs C J Waters, District Secretary for Tourism and Leisure**
Corporate Director:	**Keith Cane, Community Services**

Subject: **SHEPWAY LEISURE PRIVATE FINANCE INITIATIVE**

SUMMARY:
The business case submitted to the Department for Culture Media and Sport (DCMS) in June 2006 demonstrated that the project had become unaffordable to the Council. Subsequent discussions with the DCMS identified an alternative twin contract arrangement involving part Private Finance Initiative (PFI) and part design, build, operate and maintain (DBOM) as being acceptable to them, provided viability, affordability and good value for money could be demonstrated.

On 30 August 2006 (Report C/06/30 refers) Cabinet resolved to accept the PFI/ DBOM model as the only viable means of delivery. On 13 December 2006 (Report A/06/12 refers) Council approved a £28,000 fee budget increase to enable a revised business case to be prepared on this basis.

Following consideration of Report C/06/108, Cabinet resolved that a revised draft business case developed in conjunction with Tribal Consulting and as approved by Steering Group on 30 January 2007, be submitted to the DCMS on 31 January 2007. This was subject to the proviso that the financial implications of the project be considered by full Council.

This report summarises the financial content of the draft business case; identifies the predicted additional capital and revenue contributions that the District Council would be required to make over the lifetime of the project and sets these within the context of the Council's overall financial position.

Subsequent to the Steering Group meeting, the Chairman of the Folkestone Sports Centre Trust (FSCT) has written to the Responsible Portfolio Holder reiterating the Trust's commitment to the project but expressing concerns about a number of issues including financial viability.

REASONS FOR RECOMMENDATIONS:
Council is asked to agree the recommendations set out below because:

a) Stage 2 of the consultant's analysis indicates that the Council would be required to make significant additional capital and revenue contributions over and above those originally envisaged to make the scheme financially viable;
b) The increase in costs associated with the project should be approved by Council in view of the potential impact on the Council's Medium Term Financial Strategy and overall Budget;
c) Council needs to take into consideration the view of its partner, the FSCT;
d) The Council is committed to improving the district's sporting facilities for the next thirty years and beyond.

RECOMMENDATIONS:

1. **To receive and note Report A/06/19.**
2. **To consider in context of the Council's overall financial position, whether or not the project offers an affordable solution to deliver its strategic priority of improving opportunities for sport and leisure.**

1.0 INTRODUCTION

1.1 Following Council's consideration of Report A/06/12 on 13 December 2006, it's resolutions included approval of a fee budget increase in the sum of £28,000 to enable a final business case to be prepared and submitted to the DCMS. The analysis undertaken by the Council's leisure and finance consultant, Tribal Consulting has been undertaken in two stages.

1.2 As reported to Cabinet on 20 December 2006, the Stage 1 analysis undertaken by Tribal identified an additional annual revenue requirement of £178,000 and £1.58m capital resources to bridge the then projected affordability gap for the Hythe DBOM element of the project. Cabinet resolved to commit to identifying sufficient resources to bridge these projected affordability gaps subject to Hythe Town Council agreeing and being prepared to enter into a binding commitment to accept a centre with reduced facility mix on the site of the South Road Recreation Ground currently identified for the location of the leisure centre.

1.3 Modelling subsequently undertaken by Tribal as part of their Stage 2 analysis has included:

(i) Further, review of facility user projections;
(ii) Benchmarking against other leisure facilities; and
(iii) Informal soft market testing to confirm interest in the project on the basis of a PFI/DBOM.

Tribal Consulting have been as prudent as possible in their predictions, ensuring that the figures are realistic and sustainable. The PFI Steering Group has considered the facility user predictions contained within the draft business case and is comfortable with this analysis.

1.4 The updated affordability position was reported to the PFI Steering Group on 30 January 2007 and to Cabinet on 31 January 2007. In addition to the originally agreed annual commitment of £438,000 a projected additional revenue contribution of £337,000 per annum is now required (£159,000 in addition to the previously identified £178,000). The additional capital requirement remains at £1.58m. Given the material variation to these figures and the financial consequences of the additional resources now required over the lifetime of the project to make the scheme financially viable, Cabinet have referred the decision to full Council.

1.5 Following an Extraordinary General Meeting of the Board of Trustees on 1 February 2007 the FSCT unanimously resolved to highlight a number of concerns to full Council. The resolutions, which have been circulated to all Councillors in advance of the meeting, can be summarised as:

a) Any reduction in the facilities mix for Folkestone listed in the draft business case would not be agreed;
b) Concerns that the current proposals may not be financially viable and that alternative proposals should be considered;
c) The role of the FSCT in terms of contract monitoring and review needs to be clarified;
d) Issues relating to the outdoor facilities provision need to be clarified.

2.0 PFI/DBOM DELIVERY MODEL

2.1 The business case submitted to the DCMS at the end of June 2006 demonstrated that the project had become unaffordable to the Council and that without the potential to significantly increase the PFI credit allocation, an alternative means of delivery had to be found. The key issue was to secure the existing credits but on a slightly amended project. The DCMS also indicated that a further £1.9m (20% of the original credit allocation of £9.821m) could be made available if the project were to be financially viable. Discussions with the DCMS also indicated that a twin contract arrangement involving part PFI and part DBOM would be acceptable to them provided the council could continue to demonstrate that the project still delivered good value for money.

2.2 The draft business case has been developed on the basis that the new Folkestone Centre will be partly funded through PFI utilising an enhanced PFI credit allocation and Hythe via a DBOM contract.

2.3 Key elements of the financing of the project are the receipts from the sale of the Hythe Pool site and part of the existing Folkestone Sports Centre site. The anticipated value of these receipts together with the proposed capital contributions from Shepway District Council and Hythe Town Council amount to about 40% of the total scheme cost. Treasury rules do not normally permit this level of direct capital contribution by Councils towards a solely PFI scheme, other than in exceptional circumstances. The DCMS has given dispensation for the cap to be set at 20% for the PFI element of the Shepway project and the capital input to the Folkestone scheme is within the capped figure. The DBOM delivery model permits far greater flexibility and enables a greater range of project financing.

3.0 CAPITAL COSTS

3.1 The capital cost estimates, shown in Table 1 have been verified by quantity surveyors acting as technical advisors to Tribal Consulting. These are based upon current industry rates, inflated to reflect predicted construction industry inflation to a 2008 start on site. A contingency of 9% has also been included.

Table 1

	Folkestone £'000	**Hythe £'000**
Main building	8,215	4,826
Externals	1,924	904
Contingency	1,049	456
Professional fees	986	483
Fixtures, Furniture and Equipment	526	323
Total Capital Project Costs	**12,699**	**6,994**

3.2 The capital costs of the Folkestone scheme are not significantly different to those identified in the consultant's Stage 1 report. Capital costs under PFI are largely funded up front by the contractor who recovers these over the 30-year life of the project through the unitary charge. The impact of any movement in capital cost is therefore reflected through the revenue costs (the unitary charge) shown in section 4.

3.3 The capital contributions and the predicted capital-funding requirement for the Hythe DBOM scheme are shown in Table 2. The latter is based upon a reduced facility mix, omitting the four court sports hall as agreed by the partners. The overall capital funding requirement has not increased as a result of the Stage 2 work carried out by Tribal Consulting.

Table 2

	Breakdown £000	**Total £000**
Capital scheme costs		**7,000**
Financed from:		
Predicted receipt from Hythe Pool site	4,750	
Shepway DC contribution	500	
Hythe TC contribution	170	
Sub Total		**5,420**
Additional capital funding requirement		**1,580**

4.0 REVENUE COSTS

4.1 Folkestone

A summary of the affordability position covering the full 30-year period of the PFI contract is shown in Table 3 below.

Table 3

	Breakdown £'000	**Total £'000**
Annual Revenue Resource Requirement		**1,457**
Financed from:		
Existing PFI credits	713	
Additional PFI credit requirement	144	
Original budget provision	438	
Sub Total		**1,295**
Additional revenue requirement		**162**

4.2 The predicted shortfall (additional revenue requirement) of £162,000 per annum arises because the anticipated PFI credits plus the original budget provision is less than the unitary charge (annual revenue resource requirement).

4.3 Advice from the Council's consultant, informed by informal discussions with the bidders is that better value for money will be achieved by dealing with the management and maintenance of the outdoor facilities at Folkestone (ski slope, golf course, five-a-side football, tennis and skate park) outside of the PFI contract. The draft business case has been prepared on this basis. An allowance of £500,000 has been set aside from the anticipated capital receipt to be generated by the sale of part of the existing Folkestone Sports Centre site to finance the construction of a pavilion to service the outdoor facilities. Increasing the area of land available for sale could potentially provide sufficient capital resources to finance refurbishment of the outdoor facilities, currently estimated at £180,000. It is also possible that the ongoing management of the outdoor facilities will be self-financing. However, these capital costs and any ongoing revenue commitment for the management of the outdoor facilities have yet to be quantified. This work needs to be undertaken in order to further quantify the overall affordability position of the project.

4.4 Hythe

Under the DBOM delivery model, initial capital costs (Design and Build) are met at the outset. The Council's predicted ongoing revenue commitment (Operate and Maintain) has been assessed at £175,000 per annum over the 15-year term of the contract.

5.0 CONCLUSION

5.1 The draft business case shows that the Council would be required to find significant additional resources, over and above those originally envisaged, to address the affordability gap identified at the conclusion of the Stage 2 analysis undertaken by Tribal Consulting. The predicted capital and revenue contributions required are shown in Table 4 below:-

Table 4

	Original Estimate £'000	**Business Case £'000**	**Change £'000**
Folkestone PFI			
Capital	**500**	**500**	**0**
Revenue			
Original Revenue Contribution	438	438	0
Additional Revenue Contribution	-	162	162
Annual SDC Revenue Contribution	**438**	**600**	**162**
Hythe DBOM			
Capital Contribution	**5,250**	**6,830**	**1,580**
Management Contract	Included above (part of £438,000)	175	175
Total SDC Contribution Required			
Capital	**5,750**	**7,330**	**1,580**
Revenue	**438**	**775**	**337**

5.2 The figures shown in Table 4 are estimated projections, which may be subject to change once bids are received. There is potential for costs to increase for a number of reasons and these are highlighted in the risk management table.

5.3 At procurement stage, bidders will be required to take a view on predicted user numbers and participation targets which will impact upon income and therefore be reflected in their bid submissions.

5.4 During the course of procurement and as the project progresses through financial close to a projected opening date of December 2009, it is possible that other sport and leisure facilities in the district will become operational. Should this be the case, such facilities could have an impact upon user numbers and income for the proposed new centres, and therefore the affordability position.

5.5 Council needs to consider whether or not the predicted capital and revenue contributions provide an affordable means by which to deliver the its strategic priority of improving opportunities for sport and leisure.

6.0 RISK MANAGEMENT ISSUES

6.1 A summary of the perceived risk is shown below:

Perceived risk	Seriousness	Likelihood	Preventive action
Council is unable to identify additional budget	High	High	Incorporate all known information in Medium term financial planning and budget strategy and report any change to members at the earliest opportunity

Perceived risk	Seriousness	Likelihood	Preventive action
Capital costs increase significantly over and above those identified in the draft business case.	High	Medium	Establish robust estimates and subject these to ongoing review
Income is reduced significantly as a result of fewer users e.g. due to other facilities coming on line	High	Medium	Establish robust estimates and subject these to ongoing review
Once quantified, the capital and revenue costs for the outdoor facilities at Folkestone could further increase the project's affordability gap	High	Medium	Establish robust capital and refurbishment cost estimates and carry out financial modeling of management options.

6.2 Council should note that there is a detailed risk register for the project, which contains all of the perceived risks (financial and otherwise) relating to the project in its entirety.

7.0 LEGAL/FINANCIAL AND OTHER CONTROLS/POLICY MATTERS

7.1 Legal Officer's Comments (TG)

Any PFI Project is complex legally, the more so in a three way partnering arrangement. This may lend itself to additional risks in terms of timetable and costs overrun. There are factors in this project that are outside the control of parties, including movements in the property market and increases in construction costs and exposure to such risks becomes greater, if there is timetable slippage.

7.2 Finance Officer's Comments (CS/KB)

The Council has already committed towards a unitary charge (annual revenue contribution) of £438,000. Following revision of the projections, the revenue sum now required to close the affordability gap is £337,000 (£159,000 in addition to the previously identified £178,000). If Council resolve to find the additional revenue contribution required to close the funding gap, this will be included within the Council's Medium Term Financial Strategy.

There are still elements of the scheme, which remain uncertain. As outlined in section 4.3 at the present time the external leisure facilities have been taken out of the PFI element of the Folkestone scheme and will be managed through a separate management contract. The capital costs of refurbishing these facilities and the ongoing revenue commitment of running and maintaining them, have yet to be accurately quantified.

In addition, there remains uncertainty regarding the value of the land holdings to be sold at Folkestone and Hythe, and a possibility that costs could rise again during procurement, once bidders have the opportunity to review usage levels and the facilities mix.

The Council's Medium Term Financial Strategy has already identified a shortfall of funding in 2009/10 of £100,000, within this figure an efficiency target of £100,000 has already been incorporated. In addition to this financial pressure, the Cabinet must consider other known cost pressures such as the re-tendering of the waste contract during 2008, the financial implications of the revaluation of superannuation fund, potential equal pay claims and the uncertainty of future settlements and job evaluation costs. These financial pressures, together with the ongoing revenue commitment to the Leisure PFI/DBOM scheme will need to be addressed over the coming 2 years and a robust savings plan identifying where costs are to be driven out of the authority needs to be drawn up, and achieved before the unitary charge becomes payable in 2009/10.

At the present time, the scheme is not financially viable unless the Council is able to demonstrate significant reductions elsewhere within its budget. The Council will need to make a capital contribution of £7.33m (£5.75m current commitment, plus an additional £1.58m) and an ongoing revenue commitment of £775,000 per annum (£438,000 initial commitment, plus an additional £337,000) to make this scheme financially viable.

7.3 **Diversities and Equalities Implications (KC)**

The provision of improved opportunities for sport, leisure and culture, including leisure facilities, which are modern and clean and accessible to all, is one of the Council's current strategic priorities.

8.0 CONTACT OFFICER AND BACKGROUND DOCUMENTS

Councilors with any questions arising out of this report should contact the following officer prior to the meeting:

Colin Paine, Project Manager
Telephone: 01303 853379 Email: colin.paine@shepway.gov.uk

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

None.