East Herts Council Report

Council

Date of meeting:	18 January 2024
Report by:	Councillor Sarah Hopewell – Executive Member for Wellbeing
Report title:	Hertford Theatre Development
Ward(s) affected:	All Hertford wards

Summary – East Herts Council's Growth and Legacy project for the redesign and redevelopment of Hertford Theatre was first approved in July 2018. The initial contract award in March 2022 was for £18,881,880. Since then, the project has encountered a series of budgetary challenges resulting from rising inflation, and unprecedented increase in costs to labour and materials leading to an increased budget position for the development, which last stood at £24,105,000. More recent cost verification has shown that the project is now expected to cost £30,200,000 to complete in its entirety. This report sets out the scenarios available to the council for the development.

RECOMMENDATIONS FOR COUNCIL:

a) **To review the potential scenarios for the completion of Hertford Theatre, approving the recommended scenario and;**
b) **To authorise any associated additional funding (£6,095,000 to enable the completion of the Theatre development, as originally intended.)**

1.0 Proposal(s)

1.1 To increase the Hertford Theatre budget by an additional £6,095,000, allowing for the Theatre to be completed as originally intended.

2.0 Background

2.1 The Hertford Theatre Growth and Legacy project was first approved in July 2018. The main drivers for the project were to develop an enhanced offer to the community with the introduction of additional cinema screens allowing first release film to be watched locally, along with an increase in seating capacity for the theatre from 400 to 550, a new 150-seat studio theatre to allow for increased access and participation, a café also serving the Castle grounds and an improved community offer to engage untapped audiences.

2.2 The construction contract for Hertford Theatre was awarded to GPF Lewis (GPFL) in March 2022 to a value of £18,881,880. In April 2022, GPFL advised the council that due to unprecedented pressures on the supply chain and the increased cost of materials, they wanted to revise the tendered price. After several months of value engineering and descoping, the Project Board agreed to remove the Motte/Boardwalk, Studio-Theatre fit out and specialist technical loose fixtures and fittings from the contract, with a view to phasing it in later, whilst exploring other sources of funding.

2.3 Further costs were identified after it was confirmed that the IT infrastructure and Facilities Management (FM) costs would not be covered corporately outside of the project budget amounting to some £400k. In addition to this, the original contingency of 4.9% proved insufficient in the light of the impact of Environment Agency permit delays and constraints, requiring an additional contingency of £245,000 to be added to the fund.

2.4 External funding for the project was agreed through Hertford Town Council, who provisionally approved up to £325,000 of funding towards the development of the Studio element, subject to agreement to specific stipulations. A further request for an additional £150,000 funding from Hertford Town Council was rejected in July 2023.

2.5 A successful bid to the Heritage Lottery Fund for the scoping of the Castle Park project has the potential to deliver the Motte walkway and Boardwalk if the council bids for and is successful in securing funds for the next bidding round (delivery phase).

2.6 In May 2022, GPFL advised further difficulties in securing their supply chain against the tender price, resulting in a package re-procurement. An amended JCT Design & Build Contract was agreed in August 2022 and executed in October 2022 for an increased value of £19.2 million. Since then, GPFL have issued an Extension of Time Request and issued their Final Account tracker, outlining their view of the final contract balance as of 31st March 2023. This showed an additional increase to £22 million. Bristow Consulting, the project cost consultants appointed by the council, were asked for their professional opinion in respect of the additional costs and they advised the council to continue works while agreeing a Guaranteed Maximum Price (GMP).

2.7 In June 2023, the council met with Bristow Consulting and GPFL to address the concerns regarding increasing costs. GPFL were asked to review their GMP offer with a view to bringing it in line with Bristow Consulting's view of the expected costs. GPFL submitted their amended GMP in July 2023, with a new total of £25.17 million.

2.8 Bristow Consulting considered the offer and informed the council that they believed it to be unacceptable due to several inflated costs and spurious items listed. Based on their assessment, Bristow Consulting noted that they believed a fair offer would be in the region of £23.63 million. Since providing initial advice, Bristow Consulting conducted further assessment of costs and sought further advice. This resulted in the figure they believed to be acceptable being revised advising the council should seriously consider any offer up to the value of £24.5 million.

2.9 The GPFL GMP offer of £25.17 million was rejected and GPFL were advised of the figure Bristow Consulting, at the time, believed to be fair - £23.63 million. In response to this, GPFL submitted a revised GMP offer in August 2023 of £24.43 million – within the revised cost envelope of £24.5 million advised by Bristow Consulting.

2.10 A full cost review of non-construction costs was also undertaken in July 2023 which identified an additional shortfall in the budget of approximately £1.4 million. This was due unexpected increases in costs to non-construction packages since the original budget had been agreed. Non-construction costs are currently expected to be in the region of £5.5 million.

There is a risk that these costs could increase further should any additional, unexpected cost increases be experienced. The items contained within the non-construction costs are detailed in appendix A.

2.11 Officers have worked with GPFL and Bristow Consulting to explore all opportunities to reduce the final cost of the theatre project.

2.12 Taking in to account the final GMP offer from GPFL, alongside the current estimate for non-construction costs, the total spend would come to approximately £30,200,000 – approximately £6 million over the current budget.

2.13 The increased cost in the GMP is largely due to an increase in the material and labour costs associated with construction. East Herts is not alone. These issues have been widely experienced with capital developments throughout the country, with notable examples in Manchester where the budget required for the Aviva Studios development almost doubled, and Kingston, where plans for a new leisure centre had to be revised due to budgetary pressures (Kingston.gov.uk, n.d.). Both council's cited inflation and the rising costs of construction and labour as having a significant impact on the budgets to complete the developments.

2.14 Following discussion with the Executive as well as our cost consultants and senior officers, it was agreed to ask GPFL to omit the Studio from the final GMP offer until further member agreement had been obtained.

2.15 Members of the Hertford Theatre Board have been involved in various discussions and scenarios around the project and views have been sought prior to any decision being taken.

2.16 A full review of the Hertford Theatre business plan was undertaken in March 2023 by Barker Langham, who compiled the original and subsequent business cases. The updated business plan showed a completed Hertford Theatre would generate an annual surplus of at least £110k, with a £1.2 million surplus over 10 years. This business plan was reviewed and updated by the Head of Strategic Finance and Property in November 2023, to test various scenarios around completion of the theatre and the effects of not completing various elements. The business planning also sought to establish the amount of borrowing that could be sustained while still ensuring the theatre could repay its borrowing costs and generate a minimum return of £500k annually on the council's investment.

2.17 As a result of this, modelling showed that with the full fit out and completion of the Theatre including the Studio, the Theatre could start to return an income to the Council by Year 2 provided that the Council's overall borrowing could be reduced by up to £6m. This reduction could be achieved through the sale of some EHDC assets. The Head of Strategic Finance and Property Officer holds a list of EHDC assets and approximate values. The exact assets need to be identified, verified and agreed by Members.

2.18 Hertford Theatre recently received a £25K project award from Arts Council England to continue to develop "The Listening

Project" as part of its Learning and Well-being offer. The project is financially supported by ACE (Arts Council England), Shared Prosperity Fund and Hertford Regional College.

2.19 As well as working to deliver several key pilot events with local educational organisations, part of the aim of the project is to further understand models of governance for this part of the theatre's work (specifically the Learning and Well-being offer) which, in turn, could facilitate the opportunity for further external funding to be accessed. This could help ensure the future, long-term life of this offer and potentially an expansion in years to come without seeking any further funding from the council.

3.0 Reason(s)

3.1 The Hertford Theatre redevelopment has encountered significant budgetary pressures due to inflation and unprecedented increases to costs of construction, materials and labour. As a result, an additional £6,095,000 funding is required to be able to complete the development as intended. This will allow the theatre to open fully, covering borrowing costs and allowing the council to begin making a return on its investment.

4.0 Scenarios

4.1 Accept the final GMP from GPFL and authorise an additional £6,095,000 of funding to allow the Hertford Theatre development to be completed as originally intended.

RECOMMENDED as this is the only scenario that allows the theatre to maximise income and make a return on the council's investment in future years.

To ensure viability and to maximise income in future years, it is proposed that up to £6m worth of council assets are sold to reduce the council's overall borrowing. Debt is a corporate cost and is not attributed to assets in the statement of accounts. For the purposes of business planning debt costs can be considered to ensure that investment in assets do provide a return. Whilst debt is a corporate cost, we do keep a record of which assets the debt is attributed to for the purposes of calculating Minimum Revenue Provision and for monitoring the performance of investments against their business plan. The report on the Budget and Medium-Term Financial Plan, which Council will consider on 28 February 2024, shows the importance of achieving the minimum £6 million in capital receipts from asset sales to the council remaining financially sustainable. The report suggests further asset sales of £4.6 million to fund the capital programme and avoid borrowing in the future.

By reducing the borrowing hypothecated to the theatre by the £6 million and further reducing the overall borrowing total for the council by applying accumulated Minimum Revenue Provision, borrowing costs will fall sufficiently for the Theatre project to meet remaining borrowing costs and return the planned £500k profit contribution to the MTFP by year 3, and the profit contributed to the MTFP grows each year so that the £3m from earmarked reserves is repaid by year 10. The council has the option to vary the repayment of the earmarked reserves should Members wish to use all the available surplus to meet savings targets or to prioritise the repayment of external debt in order that the Old River Lane Arts Centre becomes affordable again.

The summary business plan results are shown in the table below:

Subjective Analysis	**25/26**	**26/27**	**27/28**	**28/29**	**29/30**	**30/31**	**31/32**	**32/33**	**33/3**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£00**
Theatre Operating Surplus	(1,807)	(1,912)	(1,986)	(2,106)	(2,236)	(2,280)	(2,326)	(2,372)	(2,42
Less:									
MRP and Loan Interest	1,445	1,416	1,386	1,357	1,327	1,297	1,268	1,238	1,20
Repayment of earmarked reserves			100	249	409	483	558	634	56
Contribution to theatre reserve									14
Contribution to MTFP	**(362)**	**(496)**	**(500)**	**(500)**	**(500)**	**(500)**	**(500)**	**(500)**	**(50**

NOTE: It will be imperative that the Theatre is run as a commercial enterprise in order for the predicted profit to be realised.

4.2 Accept GPFL's revised GMP omitting the Studio Theatre fit out.

NOT RECOMMENDED. This would still require borrowing of £4,700,000 and, as identified by the recent review of the business plan, would render Hertford Theatre unable to cover borrowing costs or offer a return on investment and would fail to deliver the £500k surplus so that has to be added back to the total costs of this option as this will mean an additional £500k savings requirement from 2025/26 onwards.

In this scenario the theatre would, over a 10 year period, cost the council £7.5 million. Debt charges will be higher as the ability to make Minimum Revenue Provision will fall as additional savings to be met by the council's other services.

The summary business plan results are shown in the following table:

Subjective Analysis	**25/26**	**26/27**	**27/28**	**28/29**	**29/30**	**30/31**	**31/32**	**32/33**	**3**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£**
Theatre Operating Surplus	(1,513)	(1,602)	(1,670)	(1,772)	(1,883)	(1,920)	(1,959)	(1,998)	(2
Less:									
MRP and Loan Interest	2,216	2,216	2,216	2,166	2,166	2,116	2,116	2,065	2
Repayment of earmarked reserves									
Contribution to theatre reserve									
Loss of £500k MTFP Saving	500	500	500	500	500	500	500	500	

Pressure to MTFP	**1,203**	**1,114**	**1,046**	**894**	**783**	**696**	**657**	**567**

Should the council wish to pursue this scenario, officers recommend commissioning a consultant to help develop a charitable arm to the theatre. Developing a charitable arm to the theatre would widen the options for bringing in funding to complete and operate the studio theatre. Previously, a study into alternative sources of funding for Hertford Theatre was conducted by Kane Moore.

The Head of Strategic Finance and Property advises Members that this is not a prudent option to select. The loss of income and the resulting additional savings will place a huge strain on the ability to meet statutory service levels and balance the budget over the medium term if a shock event occurs. The revised savings targets are shown in the table below:

	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000
Original Savings Target	3,551	3,551	3,855	4,159
Non-completion of Studio Theatre pressure	1,203	1,203	1,064	894
Revised Savings Target	4,754	4,754	4,919	5,053

Given the high risk of the council's operating environment and the potential for real terms reductions in government grant the revised savings targets would mean the council would have no room for manoeuvre and significantly increase the risk of a section 114 report in the public interest having to be issued.

4.3 Complete the minimum construction required and do not open the Theatre until suitable funding can be found to complete the fit-out.

NOT RECOMMENDED as this would still require additional borrowing to complete and mothball and offers no opportunity for Hertford Theatre to cover the cost of borrowing or make any return on the council's investment. In addition to this, it is likely that GPFL would take legal action for loss of profit, and redundancies would be required for theatre staff, generating additional costs for the council. This would create an additional saving requirement of at least £2,336,000 for the council. This includes the loss of income to the council £500k annually, plus the borrowing costs (MRP and interest) In addition to this we would need to pay insurance, empty business rates, security patrols which would likely increase costs to in excess of £2.7m. The savings requirement in 2025/26 would increase to £6.3m.

Considering the net cost of providing services is £21.6 million and after deducting:

a. the increased savings target.
b. the anticipated cost of the waste and recycling contract.
c. the grounds maintenance contract.
d. the parking contract.
e. the cost of Wallfields and the insurance contract.

There would be around £3.3 million to pay for all other services. In the opinion of the Head of Strategic Finance and Property the selection of this option would lead to a section 114 report in the public interest being made as the council could not meets its financial obligations.

4.4 Do Nothing.

NOT RECOMMENDED as this would result in a worse scenario than mothballing as GPF Lewis will almost certainly take legal action against the council as officers would have to stop payment due to there being no budget authorisation to make payment. In other words, pursing this option would precipitate an immediate crisis and force the Head of Strategic Finance and Property to make a section 114 report in the public interest as, by definition, the budget would not be balanced and the council's contractual obligations could not be met.

4.5 Other scenarios

Officers have worked closely with GPFL and Bristow Consulting to review a number of potential scenarios to reduce the overall cost of the theatre project. The following scenarios were identified but not considered possible:

- Removal of one of more cinema screens. This was not possible as the equipment for the cinema screens had already been purchased and installed. Not operating the smallest screen at the theatre would also have resulted in a net loss of £4.1 million over 10 years. This is made up of loss of ticket sales, catering and forgoing the expected surplus of £500k annually. There would also be no repayment to the reserves.
- Removal of the food and beverage offer. This was not possible as the catering equipment had already been

procured. Not offering a food and beverage offer at the theatre would also have resulted in a loss of profit of £6.4 million over 10 years as indicated by the business plan. This does not take into any associated losses relating to lost bookings for the venue due to a lack of Fand B offer.

5.0 Risks: Each scenario has associated risks

5.1 Completing the full development of Hertford Theatre (as 4.1) Additional funding of £6,095,000 will be required to complete the development. It is expected that this will carry reputational risk as significant additional funding has already been provided for the project which could be seen to be impacting the council's ability to invest in other capital works.

However, completing the development of Hertford Theatre in full, alongside asset sales to reduce overall borrowing, offers the council the best and only opportunity to cover borrowing costs of the project and begin generating a return on investment. This is essential in facilitating other capital works for the council and ensuring that savings targets do not become so large that financial obligations cannot be met. The cost of interest and MRP in 2025/26 is forecast to be £4.648 million after the £6 million from asset sales and the application of MRP balances has been undertaken to reduce the overall debt amount. Should the £6 million in asset sales not proceed, the revenue costs of servicing debt will increase by £500k to £5.148 million. Unless debt levels are brought down then the required savings will come from services either being reduced to the statutory minimum or being stopped altogether.

Members should note that where councils have overreached themselves and taken on too much borrowing then the government, and any appointed Commissioners, automatically seek to identify assets for sale to reduce debt (see Slough Borough Council, Thurrock Council, Birmingham City Council and Woking Borough Council Recovery Plans). For example, Slough BC have sold £215m worth of assets in 22/23 including a cinema and other investment sites, Thurrock BC have sold a library, their own civic offices as well as car parks,
Woking BC are considering selling their theatre, while Birmingham are considering selling their shares in Birmingham International Airport.

Whilst debt is notionally being reduced for Hertford Theatre, to ensure the profits from a commercial operation can meet the remaining borrowing costs, Members should not see this as a further subsidy solely to Hertford. Servicing Debt is as a corporate cost and not attributable to services under the Accounting Code of Practice and the Prudential Code. The key decision for Members is: will they accept further borrowing to maximise income, accepting that asset sales will be undertaken to reduce the council's overall borrowing levels, thus reducing the revenue costs of servicing that borrowing which itself will assist in protecting services.

5.2 Omitting the studio theatre fit out (as 4.2)

Omitting the studio theatre will result in Hertford Theatre not being able to cover borrowing costs or offer a return on investment. This would further impact the council's ability to invest in other capital works such as the Old River Lane Arts Centre in the future. In this scenario, officers recommend the development of a charitable arm, tasked with bringing in external funding to complete and operate the studio theatre. The development of a charitable arm to the theatre is expected to take up to two years, however, due to the need to implement a new governance structure and produce a full year of accounts which would be required in applying for a charitable status.

However, delaying the completion of the studio theatre by two years is expected to increase the cost of the fit out from £1.3 million to over £2 million due to contractor re-mobilisation and the constrained site access. This increase excludes increases in inflation and rising labour costs.

It is expected that this approach will also carry reputational risk as the council will be seen to have already invested significantly over the initial budget and have failed to deliver the intended project.

5.3 Complete the minimum construction required and do not open (as 4.3)

This scenario would create significant financial risk as the theatre would not be able to operate and begin to pay back borrowing costs or offer a return on the council's investment. Savings requirements in 2024/25 would increase to £6.3m. As a result, it is unlikely the council would be able to produce a balanced budget in this scenario, which could result in a section 114 notice being issued.

Significant reputational risk is expected as the council would be left with an unusable facility which has already received significant investment. Further to this, the site would continue to generate costs in insurance, security patrols, empty business rates and utilities while generating no income.

5.4 Do nothing (as 4.4)

Failure to reach a decision on the way forward will effectively result in the council rejecting the final GMP offer from GPFL, while continuing with full opening and stopping all payments as there would be no budget provision. This would result in GPFL stopping work and suing the council for breach of contract. They would also seek the full costs incurred by them, loss of profit and compensation for damages. In this scenario it is not possible to provide a concrete figure for total costs as the final price would be agreed in court. Officers would anticipate GPFL seeking at least £24.43 million, based on the final GMP, in costs incurred as well as other compensation for other costs and breach of contract. There is also a strong possibility that the council may have costs awarded against it, meaning that the final figure could be substantial. As the council has very few reserves to cushion against substantial unexpected costs this would almost certainly lead to severe in-year spending pressures and the potential for the making of a second section 114 report in the public interest.

6.0 Implications/Consultations

Community Safety

No

Data Protection

No

Equalities

No

Environmental Sustainability

No

Financial

Financial implications are included in the main body of the report.

What is a S114 Notice?

Within the Local Government Finance Act 1988, Section 114 (3) dictates that: “The chief finance officer of a relevant authority shall make a report under this section if it appears to him that the expenditure of the authority incurred (including expenditure it proposes to incur) in a financial year is likely to exceed the resources (including sums borrowed) available to it to meet that expenditure”.

In general terms this means that for Local Government, it is the Chief Finance Officer or Section 151 officer who has the role under law of being the most senior financial advisor to the wider Council’s leadership on its financial plans. Uniquely across the public sector however, the CFO also has the power and responsibility to legally suspend spending for a period of time if they judge the Council does not have a balanced budget or the imminent prospect of one.

What Happens when a Section 114 Notice is Issued?

It means that no new expenditure is permitted, except for the funding of statutory services, including safeguarding vulnerable people, however existing commitments and contracts will continue to be honoured.

Council officers must therefore carry out their duties in line with contractual obligations and to acceptable standards, while being aware of the financial situation.

Any spending that is not essential or which can be postponed should not take place and essential spend will be monitored. The only allowable expenditure permitted under an emergency protocol would include the following categories:

- existing staff payroll and pension costs

- expenditure on goods and services which have already been received
- expenditure required to deliver the council's provision of statutory services at a minimum possible level
- urgent expenditure required to safeguard vulnerable citizens
- expenditure required through existing legal agreements and contracts
- expenditure funded through ring-fenced grants
- expenditure necessary to achieve value for money and / or mitigate additional in year costs.

The s.151 officer is the ultimate decision maker on what spending is allowed during this period.

Councillors have 21 days from the issue of a Section 114 notice to discuss the implications at a Full Council meeting and either set a lawful budget and cause the Section 114 notice to be lifted or request Government assistance. The Secretary of State has powers to appoint Commissioners and direct that all decisions in relation to functions that he specifies are taken by the Commissioners and the Council loses all powers in relation to those functions.

Health and Safety

No

Human Resources

Yes – Should the council opt not to open the theatre; the six existing Hertford Theatre staff would be at risk of redundancy.

Human Rights

No

Legal

Yes – The Head of Legal and Democratic services is a member of the project board and has been consulted with comments embedded within this report.

Specific Wards

Yes – All Hertford wards

7.0 Background papers, appendices and other relevant material

Appendix A – Non Construction Costs
Appendix B – Sample Business Plan

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