BABERGH DISTRICT COUNCIL

COMMITTEE: CABINET	**REPORT NUMBER: BCa/22/4**
FROM: CLLR JOHN WARD LEADER	**DATE OF MEETING: 8th June 2022**
OFFICER: EMILY ATACK ASSISTANT DIRECTOR - ASSETS AND INVESTMENTS	**KEY DECISION REF NO. CAB355**

BABERGH FORMER HQ SITE DEVELOPMENT

1. PURPOSE OF REPORT

1.1 This report provides an update and review of the redevelopment of the former HQ Site in Hadleigh, because of significant market changes in the construction sector, it is no longer possible to start on site in July 2022 as intended. A copy of the development plan is attached as appendix A, showing the main phases.

1.2 This report reviews the options available at this time and recommends option 2 is progressed, increasing the peak debt to £7m so that phase 1 of the development can commence prior to the expiry of the planning consent in September 2022. Phase 2 will be reviewed further following progress of phase 1.

2. OPTIONS CONSIDERED

The options that have been considered are: -

2.1 **Option 1 – Freehold Disposal of the site.**

The Council could look to sell the HQ site on the open market with the benefit of planning consent, however the planning consent is due to lapse if not implemented by September 2022. Informal marketing advice has been received recently which identified a negative land value based on the current planning consent but suggests that a maximum gross capital receipt of circa £500,000 could potentially be achieved. It is likely that any third party would seek to increase the density of the scheme and to mitigate the costs of development, which could result in a less favourable scheme than currently consented.

Whilst this option would enable the Council to receive a capital receipt this would need to be offset against development costs incurred by Babergh Growth to date (circa £320k) and any future control over the delivery of the site could only be gained through the Council's regulatory powers. This would not guarantee that development would be forthcoming in the near future, as seen with other former HQ sites across the County.

2.2 Option 2 – Increase Peak Debt Threshold to align with current market conditions

In December 2018, Cabinet and Council approved capital funding of £3.77m against the development capital expenditure costs of £12.8m. Current development capital expenditure following tendering the works is anticipated to be £11m for phase 1 and likely to exceed £12.8m for both phases due to significant price inflation in the construction market.

Due to market changes it is no longer possible to deliver the development within the authorised peak debt threshold. The authorised peak debt threshold would need to increase to £7m to progress the scheme. Increasing the peak debt threshold would enable the build contract to be awarded for phase 1 before the expiry of the tender period, thus reducing further potential for price increases and a start on site to occur before the expiry of the planning in September 2022.

Phase 1 is currently forecast to make a small loss (£250k) but potentially could break even if the construction contingency isn't required. Phase 1 would provide 41 new homes. Phase 2 would be reviewed once phase 1 has progressed, to manage exposure to market conditions. Phase 2 comprises two elements, 4 properties on Corks Lane (Phase 2a) which is anticipated to deliver a profit of £300,000, and 4 properties on Bridge Street (Phase 2b) which need to be reviewed further and as such for this purpose we are currently taking a cautious approach and assuming no profit attached to these properties. On this basis Phase 1 and phase 2a currently show a break-even development with the potential for a small profit (c. £50-100k), further profit could subsequently be available from phase 2b.

Option 3 – Progress Phase 1 with lower peak debt threshold by agreeing to deliver 13 properties to the Housing Revenue Account (HRA) for affordable housing.

The scheme could be delivered within a peak debt threshold of £5.25m if 13 properties are delivered to the HRA for affordable housing. The HRA would pay for the properties on a drawdown basis against works completed on site (similar to the process for acquiring S106 homes on other schemes). This would improve the cashflow of the development and reduce the need to increase the peak debt threshold to the full amount set out in option 2, however this would reduce the viability of the development further.

The affordable properties would cost the HRA in the order of £2.7m (build cost) this shows a negative Net Present Value of c.£500,000 for the HRA, ordinarily the HRA only acquires/builds units which show a positive Net Present Value. This option would however deliver much needed modern affordable properties in the heart of Hadleigh.

The Council delivered Angel Court, in Hadleigh, a fully affordable scheme, providing 19 homes last year, providing a mix of affordable rent and shared ownership homes. All of the shared ownership homes have now been sold or reserved and the scheme is well occupied.

Allocating 13 homes for affordable purposes within the scheme would reduce the viability of the scheme further and would result in a loss of approximately £250,000. This is therefore unlikely to be a viable option without further subsidy.

2.3 Option 4 – Do Nothing

This is not a viable option. The property has been vacant since 2017 and would be an under-utilised asset if no further actions were progressed. There is full time security on site to mitigate the risks of anti-social behaviour in the area. The costs for security are approximately £110,000 p.a.

The property is not capable of being occupied without considerable expenditure and as such doing nothing would result in the property remaining vacant and under-used. It would fail to deliver any benefits either financial, social or economic for the community and increasingly become a magnet for anti-social behaviour with further deterioration of the listed buildings within the property.

The recommended option to enable housing delivery at the former HQ site within Hadleigh, is Option 2. This option enables the Council to deliver housing in a timely manner prior to the expiry of the tender validity period and planning consent and mitigate further construction cost increases in a highly inflationary construction market. It will control the quality of the housing and support further housing delivery within the district.

2.4 Option 5 – Alternative phasing of development to minimise peak debt threshold

Alternative phasing has been considered including extending the period of construction to keep the peak debt below the agreed threshold, however this is not a viable option as contractors will not agree to a fixed price on this basis and there would be increased costs of site set up for the longer period as well as inflationary pressures, which could result in significant losses for Babergh Growth and its shareholder and ultimately would delay the completion of the whole development.

2.5 Option 6 – Alternative mixed-use development

Alternative developments have been considered including retaining some office/ commercial uses within the development. Office/commercial uses would require more car parking to be delivered to serve this use compared to residential units and as such this would reduce the overall built area and the gross development value of the scheme, whilst build costs would be high in terms of creating additional car parking and refurbishing and upgrading any commercial space to meet current standards. This option is less financially viable than the current consented scheme, a high-level appraisal has indicated a negative return to the shareholder in the order of minus

£1.4m, compared to breakeven or small return if phase 1 and 2a are delivered as set out in option 2 above.

An alternative development could not be delivered under the current planning consent and as such a new planning application would need to be submitted. Progressing this option would delay any start on site for at least a further circa 12 months whilst the scheme was re-designed, consulted on and planning obtained as well as incurring further professional fees and holding costs. Due to the current market conditions any alternative scheme would also require an increased peak debt threshold. This option is therefore not viable at the current time.

3. RECOMMENDATIONS

That Cabinet :-

3.1 Approves the increase in peak funding threshold for Babergh Growth Ltd to £7m for use to deliver the redevelopment of the former HQ site in Hadleigh.

3.2 Authorises the Section 151 Officer, in consultation with the Monitoring Officer and the Leader, to negotiate and vary the necessary legal agreements between Babergh District Council and Babergh Growth Ltd to enable the delivery of housing on the former HQ site within Hadleigh.

REASON FOR DECISION

To enable and support the delivery of housing within the district and support the economic prosperity of Hadleigh as a key market town.

4. KEY INFORMATION

4.1 In September 2016 Full Council made the decision to relocate from the HQ buildings at Corks Lane, Hadleigh to Endeavour House as the current HQ was not fit for purpose to fulfil modern local government functions with Mid Suffolk District Council.

4.2 In April 2017 Executive Committee gave approval for the appointment of a design and planning team following a full and compliant procurement process. The appointment of the design and planning team was required to support the team with developing options for the future use of the existing headquarter building and associated car park sites at Corks Lane Hadleigh and to develop a programme of work which will ensure the successful delivery of a developed design for the site, that would enable the determination of a detailed planning application for the site.

4.3 In December 2018 Babergh Cabinet and Council agreed to setting up a Commercial Joint Venture Vehicle to deliver the redevelopment of the former HQ building and agreed a peak debt loan facility of £3.77m to the commercial vehicle for this purpose. This peak debt threshold was based on the options

appraisal and estimated construction cost at that time. Babergh Growth Limited was incorporated in March 2019. The summary of the original business case background is illustrated in Appendix C.

4.4 The Development Agreement and Finance Agreements between Babergh District Council and Babergh Growth Limited were completed in March 2021, following the receipt of planning consent. To date £319,117.74 plus VAT has been paid to Babergh Growth Ltd in line with the development agreement to cover additional design and planning fees and further site and building surveys required to bring forward the development.

4.5 There were considerable delays in achieving planning consent for the redevelopment of the site due to negotiations with third parties in relation to the adjacent cricket club site and the necessary mitigation measures required to ensure the sites could coexist successfully. Planning consent was granted in March 2021. However further planning amendments were required to deliver a market facing and deliverable scheme. Planning consent for the amended phase 1 scheme (49 units) was achieved in February 2022. The original planning consent has an 18 month start on site provision- requiring start on site by 9th September 2022.

4.6 The whole development comprises 57 new homes (23 new build and 33 converted within the existing building) providing 20 one bed homes, 20 two bed homes 10 three bed homes, 5 four bed homes and 2 five bed homes. The development has been split into two principal phases, the first being the delivery of the main HQ site comprising the main conversion and the second being new build properties at Corks Lane and Bridge Street.

4.7 Phase 1 of the scheme was tendered by Babergh Growth earlier this year following the receipt of the necessary planning amendments and listed building consents. Tender returns were analysed by Babergh Growth Company QS team and a recommendation to appoint the main contractor was made at the March board meeting. This was agreed by Directors subject to exploring phasing and cashflow drawdowns against the Council's peak of £3.77m to ensure the scheme was deliverable prior to appointing the contractor.

4.8 We are currently experiencing significant inflationary market pressures in the construction sector because of Brexit, the pandemic, rising inflation, and the war in Ukraine. This means that we are in a period of rapidly increasing costs, supply chain issues and uncertainty from the market.

4.9 The market has unfortunately changed considerably over the past few months with many contractors not engaging in competitive tendering or offering fixed price contracts. This has been completely unprecedented and mean that previous methodologies of phasing and controlling the flow of construction are now subject to either limited buy-in from the contracting market or are associated with the risk of inflation. This has resulted in a significant change of approach in the construction market.

4.10 Following the March board meeting, Babergh Growth Limited entered discussions with the preferred contractor and were exploring the potential content and value of a Letter of Intent to enable them to secure initial materials and make a start on site. Unfortunately, during these initial discussions, it became clear from the main contractor's supply chain that the quotations offered in the tender period had expired and given the significant and unforeseen inflationary pressures on the market, the sub-contractors, would not stand by their original tenders.

4.11 This resulted in an increase tender cost of c.£680,000. Babergh Growth have managed to identify opportunities to mitigate this increase, however, reviewing the contractors initial phasing plan against the cashflow, this exceeded Babergh Growth authorised peak debt threshold. Alternative phasing has been considered including extending the period of construction to keep the peak debt below the threshold, however the contractor will not agree to a fixed price on this basis and there would be increased costs of site set up for the longer period as well as inflationary pressures, which could result in significant losses for Babergh Growth and its shareholder.

4.12 Babergh Growth is therefore unable to award the construction contract at the current time as they do not have funds secured to deliver the project and are therefore seeking an increase in the peak debt threshold. The Contractor is only able to hold their current price until 10th June.

5. LINKS TO JOINT CORPORATE PLAN

5.1 The development of the former HQ site in Hadleigh supports the joint corporate plan by delivering new homes and supporting our local towns to thrive.

6. FINANCIAL IMPLICATIONS

6.1 The delivery of phase 1 of the Hadleigh former HQ scheme in line with option 2 outlined above requires total funding of approximately £11m over this phase of the scheme's development, with a peak cashflow required of £7m.

6.2 The funding required to meet the peak cashflow is through a loan to Babergh Growth. The Council will loan the company finances at 2% above base rate, in line with the current funding arrangements. The additional funding required to increase the peak debt threshold is within the approved capital programme, £3.66m for Babergh Growth and former HQ site and the remainder from the £6.3m approved regeneration fund.

6.3 **Table 1 - Cost of borrowing**

	Total £'000	2021/22 £'000	2022/23 £'000	2023/24 £'000	2024/25 £'000
Loan Amount	**7,000**	**319**	**2,227**	**2,227**	**2,227**
Cumulative Loan Balance		**319**	**2,546**	**4,773**	**7,000**
Borrowing Costs (2.22%)	325	7	57	106	155
Loan Repayment (4.22%)	-618	- 13	- 107	- 201	- 295
Net Profit	**-291**	**-6**	**-50**	**-95**	**-140**

6.4 The proposed funding arrangement, as detailed above, demonstrates the profiling of the funds required to deliver the Hadleigh former HQ redevelopment scheme. The Council will benefit through the provision of funds, in the form of a loan, to Babergh Growth a total income of £291K over the 4yr period. This interest is a development cost and if the scheme fails to make a profit will need to be absorbed by the Council.

6.5 The delivery of this development scheme via Babergh Growth offers wider financial benefits to the public purse. These are set out in Appendix B and includes the original 2018 estimate and implications of options 1,2 &3.

7. LEGAL IMPLICATIONS

7.1 The Council entered into development and facility agreements with Babergh Growth Limited in March 2021 and as such there are legal contracts in place to provide the legal framework for this relationship. Babergh Growth Limited is a Joint Venture company between Babergh District Council and Norse Group.

7.2 The development of the Former HQ site is to be fully funded by Babergh District Council and any capital receipts will be retained by the Council. The objective of the development agreement is to deliver the development without incurring any losses. The development agreement can be terminated by the Council subject to all outstanding costs being paid. To date approximately £320,000 has been paid to Babergh Growth for consultancy fees.

8. RISK MANAGEMENT

8.1 Key risks are set out below:

Risk Description	Likelihood	Impact	Score	Mitigation Measures
If we didn't explore fully the development options for the former HQ site, and other sites, the Council may not achieve the	(2)	(2)	(4)	The recommended option will deliver high quality housing, in the most timely manner now that the scheme is in

best economic, social and financial outcomes.				a deliverable position.
Increasing the peak debt from £3.77m to £7m could result in other corporate growth priorities being potentially delayed until the debt is repaid. NB: there is no increase to the Council's planned debt, it is utilising the planned borrowing from the Babergh Growth Capital allocation within the approved Capital Programme.	(2)	(2)	(4)	The growth company would use the debt funding on the projects for open market housing for sale and as such this is a short-term borrowing facility. The Growth Company will pay interest for the loan.
Other project risks:				
Continued construction cost inflation	(2)	(3)	(6)	Progress scheme in phases and review each phase and market prior to progressing. Phases to be tendered separately. Phase 1 fully tendered and updated fixed price available until 10th June.

There is a market downturn which means that the viability position is altered for the project.	(2)	(3)	6	The Council could consider holding properties for private rent whilst the market recovers.

9. CONSULTATIONS

9.1 The approach that is being recommended within this report has been consulted on with the board members of Babergh Growth Limited.

10. EQUALITY ANALYSIS

10.1 Equality Impact Assessment (EIA) is not required as there are no equality issues arising from the contents of this report and the recommendations.

11. ENVIRONMENTAL IMPLICATIONS

11.1 The recommended option allows the Council to take control of environmental factors in the design and build of the proposed new housing and development facilities within the district.

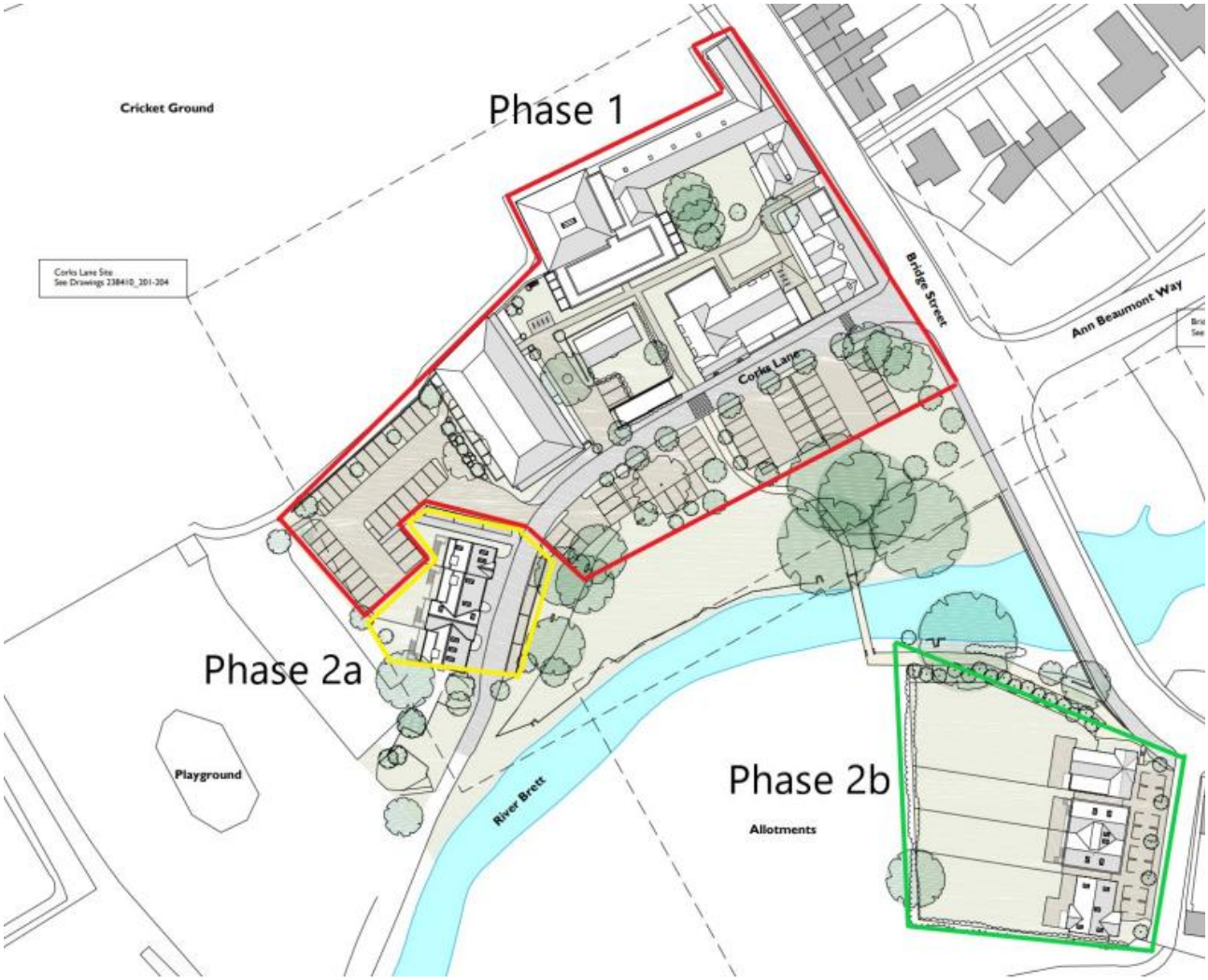
11.2 The scheme will benefit from a district heating network, meaning that all buildings are connected to a central source for heating and hot water. This can help to lower carbon emissions for the whole development and provide savings against energy bills and maintenance for residents. Due to the plant being centralised, space within properties can be optimised, creating better spaces for living.

11.3 Undertaking full refurbishment of the existing buildings will improve their efficiency and ensure they meet current building regulations, for example through enhanced insulation. The new build elements of the development will be built using a fabric first approach to optimise sustainability of the homes.

12. APPENDICES

Title	Location
(a) Development Plan- Phases	Attached
(b) Estimated return to the public purse appraisal	Attached

APPENDIX A


Cricket Ground
Phase 1
Corks Lane Site
See Drawings 238410_201-204
Bridge Street
Ann Beaumont Way
Corks Lane
Phase 2a
Playground
River Brett
Phase 2b
Allotments

APPENDIX B

	2018 ***Estimate***	**2022** **(Option 1)**	**2022** **(Option 2)**	**2022** **(Option3)**
Community Infrastructure Levy to BDC	*£196k*	Unknown	£200k	£200k
Receipt of Council tax [annual] to BDC	*£86k (pa)*	Unknown	£91k (pa)	£91k (pa)
New Homes Bonus to BDC	*£97k (pa)*	Unknown	£97k (pa)	£97k (pa)
Income to BDC Building Control &Planning	*£61k*	£24k (to date)	£61k	£61k
Shareholder profit to BDC (100%Share)	*£866k*	£0	£0	-£250k
Land value to BDC	*£0k*	£170k	£0k	£0
Private rent income	*£TBC*	N/A	N/A	N/A
Interest on loan repayments to BDC	*£104k*	N/A	£291k*	£105k*
TOTAL[return to the public purse]	*£1.400M*	£0.19m	£0.74m	£0.3m
TOTAL (without interest repayments)	***£1.3m***	**£0.19m**	**£0.45m**	**£0.2m**
*payable with breakeven/ profitable scheme only				