

Report to: Leader's Decision Report

Date: 20/04/2020

Subject: Ed City Update

Report of: David Burns, Assistant Director Growth

Responsible director: The Strategic Director for the Economy- Jo Rowlands

Summary

The Council's Cabinet on April 29th 2019 and Full Council on 15th May 2019 approved entering into a master development agreement (MDA) and associated documents with Ark and its subsidiary companies for the delivery of the Ed City project. The Cabinet and Council also approved the capital budgets required to deliver the scheme. The development will create a new mixed-use education hub on the site of Ark Swift Primary School at Australia Road in White City. The development includes a new school, Youth Zone, new adult education facilities, a new nursery, an office for education charities, and 132 homes 50% of which are affordable.

Ark have completed the planning process and procurement of a main contractor, through their subsidiary Ed City Developments Limited, as agreed under the terms of the MDA. Following Ed City Developments Ltd. Completion of a competitive, two stage tender process a final contract price is now near agreement. This contract price is above the original budget agreed by Cabinet and Full Council and so approval is being sought to increase the project budget.

The increased construction costs are due to a number of factors including:

- Expected changes to enhanced building regulations and proactive specification increases to reflect this, including provision of sprinkler systems throughout
- Advice from NHBC insurers and their requirements for building fabric and balcony systems to improve fire protection
- Additional design work and time delay as a result of design changes, leading to increased project fees
- Higher than forecasted build cost inflation

Officers have prioritised improving health and fire safety since the original designs were approved, and are recommending an increase in budget to accommodate this.

Separately from the increase in cost, the Council has opted to substitute right to buy funding for GLA grant funding. While this increases the cost of borrowing on this scheme and reduces the overall NPV, there are wider benefits to the affordable housing programme and the cost is compensated for elsewhere in the programme.

Recommendations

That the Leader

1. Approves an additional £6,176,142 to the General Fund capital budget funded by borrowing, giving a total capital budget of £65,202,000 for the construction of 132 residential units and associated professional fees and development management costs funded by the General Fund.
2. Approves a further £3,591,908 borrowing to fund the development in place of right to buy funding in order to release it to other parts of the development programme that haven't secured GLA affordable housing grant as part of the Building Homes for Londoners grant programme.

Wards Affected: White City

H&F Priorities

Please state how the outcome will contribute to our priorities – delete those priorities which are not appropriate

| Our Priorities | Summary of how this report aligns to the H&F Priorities |
|----------------------------------|---|
| Building shared prosperity | The development includes facilities that will benefit a wide range of the local population, as well as much needed affordable housing |
| Creating a compassionate council | The Youth Zone will create a safe space for young people to gather, learn and play. |
| Taking pride in H&F | The specifications are to the highest safety standards reflecting the Council's priority to keep its residents safe |

Financial Impact

Base Position

- Full financial implications of the development are in the 15th May 2019 Full Council Report that approved the original £59m budget.
- Following on from the original approval the Capital Programme Monitor & Budget Variations, 2019/20 (Third Quarter) approved by Cabinet on 3rd February 2020, transferred the affordable housing development budget to the General Fund capital programme. This was on the basis that the development site for the scheme is currently General Fund land. On completion the affordable homes will be transferred to the HRA at an appropriate value and the private units would be sold at market value to a council owned subsidiary company. Providing there is no significant housing downturn this should leave no general fund debt associated with the housing part of the development.

Capital Budget and Funding Impact

- To offset the impact of reallocating right to buy receipts (RTB) to other development schemes, GLA affordable housing grant can be claimed instead. However, as the level of GLA grant per unit is less than the level of right to buy funding that could be applied it will result in more borrowing being required to fund the development. The impact of this and the £6.2m increase in costs to the funding of the project is below (all figures in £,000s):

| | Original Budget | Revised Budget | Variance |
|---------------------------|-----------------|----------------|--------------|
| Total Scheme Costs | 59,026 | 65,202 | 6,176 |

| Scheme Funding | Original Budget | Revised Budget | Variance |
|----------------------|-----------------|----------------|--------------|
| Grant | | 4,168 | 4,168 |
| RTB Receipts | 8,938 | 1,178 | -7,760 |
| Borrowing | 50,088 | 59,856 | 9,768 |
| Total Funding | 59,026 | 65,202 | 6,176 |

- These figures are for the residential construction cost only. The approved contribution of £3,694,000 for the construction of the youth facility and the approved contribution of £2,111,000 for the construction of the nursery remain the same. This brings the total budget for the project to £71,007,000
- The net effect is that the council will need to borrow an additional £9.8m to deliver Education City.

General Fund Revenue Impact

- During the development period there will be no revenue budget impact from the increased borrowing as for assets under construction interest costs can be capitalised and no revenue provision is required during the development period. Once the development completes interest costs can no longer be capitalised and are required to be charged to revenue budgets.
- It is planned these costs will not be borne by the general fund.

- The appropriation of the affordable housing to the HRA and sale of the private rented homes to the SPV on completion will result in a reduction in general fund debt equivalent to the affordable housing appropriation value being transferred from the general fund to the HRA and the capital receipt from the sale of the private rented homes. As long as the combined value of the appropriation and sale is less than the associated debt the general fund will be left with no residual debt and therefore no financing costs. The current appraisal and valuation estimates indicate a 75% loan to value for the private rented units based on their advised open market value in today's prices which suggests their sale can clear the debt attributable to their construction.

HRA Revenue Impact

- There will be no impact to the HRA until the affordable housing is appropriated on completion. Once transferred the revenue impact will be determined by and is inversely related to the appropriate appropriation value and therefore debt transferred at the time. The HRA business plan approved on February 3rd, 2020 prudently assumed the transfer is at net cost. Based on the increased debt this would worsen the business plan position, but this can be absorbed within the current approved business plan.

Revised Scheme Appraisal Performance

- The impact of the increased development costs and borrowing to the financial performance of the development as measured by net present value¹ (NPV) is below (all figures in £,000s).

| Tenure Type | Original Budget | Revised Budget | Variance |
|----------------------------------|------------------------|-----------------------|-----------------|
| Private Rented | 4,667 | 1,423 | -3,244 |
| Affordable Rent | -5,483 | -6,847 | -1,364 |
| Intermediate/ London Living Rent | -701 | -743 | -42 |
| Total | -1,517 | -6,167 | -4,650 |

- The appraisal model that measures the performance assumes a long-term future disposal of the private rented units. The proceeds from such a disposal will be below their open market value due to transaction costs and the need to apply a discount when selling them in a bulk sale as rental investment properties. The level of the discount assumed in the appraisal is very much on the prudent side and the performance will improve if a lower discount is achieved.
- If the application of right to buy receipts were maximised (i.e. in place of GLA grant) it would reduce the borrowing requirement and improve the project NPV by £1.5m.

¹ **Net present value (NPV)** is the difference between the **present value** of cash inflows and the **present value** of cash outflows over a period of time. **NPV** is used in capital budgeting and investment planning to analyse the profitability of a projected investment or project.

- Whilst the scheme performance will worsen by agreeing the changes to the budget and funding, if the budget is not agreed then the council would incur an estimated £2.3m of abortive costs (as set out in paragraph 15 of the detailed analysis). This would be an unbudgeted charge to council revenue budgets.

Legal Implications

The exempted legal implications appended to the 29 April 2019 “Education City Development” Cabinet Member report are still applicable to the project. The increase in budget sought by this report does not alter the previous exempted legal implications.

There are no further legal implications.

Implications verified by: Grant Deg, Legal Services tel. 07798588766

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Background Papers Used in Preparing This Report – *All Published*

Cabinet report April 29th 2019
Full Council report May 15th 2019
Capital Programme Monitor & Budget Variations, 2019/20 (Third Quarter) 3rd
February 2020

DETAILED ANALYSIS

Proposals and Analysis of Options

1. The April 29th 2019 Cabinet report set out the approvals required and the strategic rationale for the Council entering into a MDA with Ark schools and its associated subsidiary companies for the delivery of the Ed City project.

2. The report set out the property and legal procurement considerations, including extensive advice from Trowers and Hamblins on the appropriate procurement procedure.
3. The report also approved the capital budgets for the project. The total budget requirement to deliver the development was £64,831,000. This is made up of:
 - £59,026,00 for the construction of the residential units
 - £3,694,000 for the construction of the youth facility
 - £2,111,000 for the construction of the nursery and adult education facilities.
4. This included all fees, overheads and associated interest costs. This budget was based on the pre-tender estimate provided by Gleeds acting on behalf of Ark on the project (but with a duty of care to the Council).
5. Under the terms of the master development agreement, Ark through their subsidiary Ed City Development Limited, are to deliver a design and a planning permission, and to procure and manage the development of the project through to completion.
6. A tender process was completed under a two-stage procurement strategy by Ark on the Council's behalf under the terms of the MDA, and Bowmer and Kirkland were recommended as the preferred contractor. They were appointed by Ed City Developments Limited under a pre-construction services agreement to complete RIBA Stage 3 and Stage 4 design while a final contract sum was agreed.
7. During the design development process in 2019 the team reviewed the designs to reflect recent recommendations to change building regulations in respect of fire safety (although as of today building and planning regulations have yet to formally change). At the same time the council and the design team, alongside the preferred insurer and warranty provider, reviewed the original specification and design standards.
8. This resulted in a number of specification improvements that will increase fire protection in the development, and anticipate future changes in regulation. This includes:
 - Sprinkler system throughout
 - Improved fire protection to balconies and associated material
 - Compliance review of internal layouts to produce improved fire escape routes in flats
9. The Council has adopted a prudent approach and concluded that health and fire safety is a key priority, and so it is recommended that the additional budget is approved for these changes.
10. An analysis of the changes is shown below, in relation to the different cost elements for the construction of the residential units. Note that no increases

are proposed to the Nursery, Adult Education and Youth Zone costs as these elements are fixed in the MDA and Ark will pick up any increases in costs. These are not shown below.

| Approved | | | | |
|----------------------|-------------|-------------|-------------|-------------|
| Summary | LAR | INT | PRS | All Tenures |
| Construction | £11,380,385 | £11,325,920 | £21,393,694 | £44,100,000 |
| Design Fees | £ 1,562,675 | £ 1,626,729 | £ 3,028,850 | £ 6,218,254 |
| Project Costs | £ 1,225,180 | £ 1,310,311 | £ 1,797,133 | £ 4,332,624 |
| Overheads | £ 113,804 | £ 113,259 | £ 213,937 | £ 441,000 |
| Contingency | £ 569,019 | £ 566,296 | £ 1,069,685 | £ 2,205,000 |
| Capitalised Interest | £ 291,835 | £ 364,951 | £ 1,072,649 | £ 1,729,435 |
| Total | £15,142,898 | £15,307,467 | £28,575,949 | £59,026,313 |

Proposed

| Proposed | | | | |
|----------------------|-------------|-------------|-------------|-------------|
| Summary | LAR | INT | PRS | All Tenures |
| Construction | £12,979,637 | £13,480,893 | £22,089,197 | £48,549,728 |
| Design Fees | £1,959,422 | £2,272,932 | £3,605,339 | £7,837,693 |
| Project Costs | £803,792 | £821,229 | £1,564,433 | £3,189,454 |
| Overheads | £129,796 | £134,809 | £220,892 | £485,497 |
| Contingency | £519,185 | £539,236 | £883,568 | £1,941,989 |
| Capitalised Interest | £712,043 | £831,820 | £1,654,231 | £3,198,094 |
| Total | £17,103,876 | £18,080,919 | £30,017,660 | £65,202,455 |

Increases/Decreases

| Summary | LAR | INT | PRS | All Tenures |
|----------------------|------------|------------|------------|-------------|
| Construction | £1,599,252 | £2,154,973 | £695,503 | £4,449,728 |
| Design Fees | £396,747 | £646,203 | £576,489 | £1,619,439 |
| Project Costs | -£421,388 | -£489,082 | -£232,700 | -£1,143,170 |
| Overheads | £15,992 | £21,550 | £6,955 | £44,497 |
| Contingency | -£49,834 | -£27,060 | -£186,117 | -£263,011 |
| Capitalised Interest | £420,208 | £466,869 | £581,582 | £1,468,659 |
| Total | £1,960,978 | £2,773,453 | £1,441,712 | £6,176,142 |

11. The costs have increased overall by 10.5%. The primary increase is to base construction costs, reflecting the additional specification. It also reflects inflationary pressure in the construction industry that has been observed nationally. However, design fees have also increased to reflect the necessary work to improve the design, and the additional time required to produce them.

12. Some costs have decreased – project costs have been re-allocated, and some elements have not been required as anticipated, and CIL payment has reduced from when originally calculated. Client contingency has reduced to

3% - in effect part of this has transferred to the construction cost, but 3% reflects a prudent level when moving into the construction phase. Interest costs have increased due to the forecasted requirement to borrow an additional £9.8m.

13. Once the contract price is agreed, it is then fixed for the duration of the build contract. Any variations that the Council wishes to make in the future would be required to come from the contingency budget.
14. This outcome is the culmination of a 9 months design and negotiation process with the contractor. Although the construction contract sum is £4.49m above the original tender estimate, this is lower than the original tender submission – officers have worked to reduce it down to its current level. The increase is largely driven by the increase in safety specifications in response to changing regulations and insurance advice. Had we not done this then the price would have reduced further.
15. The other increases in costs have been driven by time (inflation and additional fees) – this is largely a direct result of the department for education's delays in agreeing the s.77 consent that is required, which has taken over two years and has been outside of our control.
16. The increase in capital budget will have no effect on the General Fund revenue budget – all interest is capitalised, the affordable housing is appropriated into the HRA and the private rented will be owned by a housing company, with all revenue costs contained within.
17. The development team has learned lessons from this process, and is factoring in this level of specification into all of its future housing designs. In particular design briefs and specifications include from the beginning the following:
 - Automatic Water Fire Suppression Systems or Sprinklers
 - Separate Water supply for firefighting:
 - Fire fighting lifts - Where lifts are installed, at least one lift per core should be a suitably sized fire evacuation lift, adequate to evacuate people who require level access.

Options Analysis

Option 1 – do not agree the budget

18. This option is not preferred. This would result in the project being unable to proceed, as the MDA requires the Council to have adequate funding in order for it to go unconditional. Neither Ark nor the Council would be able to achieve the desired outcomes and benefits, including the school, affordable housing and youth facility. The Council would also have paid £1.9m in abortive costs to Ark, which would be written off against reserves, and a further costs of £400K in internal fees which would have to be written off.

19. It would also mean that the Council would not benefit from the long term income stream generated from the private rented units, and an opportunity to provide badly needed additional affordable homes in the borough would not be taken.

Option 2 – Revert to former specifications

20. This would produce a lower quality and less fire safe design. In addition, the warranty provider would not agree to provide cover, exposing the Council to additional risk during the operation of the units should there be any product or building failure. Even if this was adopted, the contract price has also increased due to inflationary pressure, and so the original approved budget would still not be adequate. This option is not preferred.

Option 3 – approve the increase in budget

21. This would allow the development to proceed, and produce a high quality mixed use scheme, with all the associated benefits. There is a clear need for re-provision of the school, adult education and nursery, and the educational benefits are clear. The additional housing will provide much needed affordable housing as well as the potential for a long-term income stream from the private rented units.

Substitution of GLA grant for Right to Buy

22. The original approval included the use of right to buy receipts to fund the social rented and intermediate units, up to £8.9m. However, the Council has been successful in bidding for GLA grant for social rented and intermediate products and so is able to apply the grant to this project. The average grant rate per unit is lower than RTB grant, which results in an additional borrowing need in order to fund construction. It also lowers the NPV performance, as a result of the additional borrowing.
23. However, this is offset by the overall affordable housing programme within the HRA business plan, which has a strongly positive overall NPV. Removing RTB grant from Ed City will allow it be allocated to other schemes which have a greater need for the grant, in particular schemes where there is higher cost non-residential included (e.g. school replacement) where greater private sale cross subsidy is required to cover the total scheme costs, or where there are 100% affordable housing schemes which require additional levels of subsidy to meet financial performance targets. It will also allow it to be used on schemes that do not have an allocation of GLA grant, so enabling more affordable housing to be delivered overall.

Covid-19 Contingency Planning

24. There is the risk that the Covid-19 emergency will affect the overall programme. The project team is working with the contractor to identify and mitigate the risks associated with delay, in particular to contract mobilisation.

This has been factored into the MDA with ARK and build contract documentation. The build contract is a fixed price, with client held contingency, and structures to manage delays.

25. ARK, Onside Youth Zone and the main contractor remain committed to delivering the development in its current form. The project team will continue to monitor market risks associated with the private rented element of the scheme. However, this is already substantially mitigated by both long term demand for private rented units and the timetable – the PRS units will not be completed until 2024.

Reasons for Decision

26. The recommendations are required to allow the project to progress and for build contracts to be signed.

Equality Implications

27. It is not anticipated that there will be any negative impact on any groups with protected characteristics, under the terms of the Equality Act 2010, from this proposed development.

Implications verified by: Fawad Bhatti, Policy & Strategy Officer, tel. 07500 103617

Risk Management Implications

28. The Council considers safety as a key requirement. As a result of the specification improvements, there will be an increased level of fire protection in the development, and also the proposals anticipate future changes in regulation that may arise following the Grenfell Inquiry. There are many opportunity risks and benefits that would be impacted if the recommended option is not approved. There remain significant pressures on affordable housing stocks due to years of underinvestment and austerity by national government.

29. A summary of key risks are identified below. The project has a detailed risk register.

| Risk | Mitigation |
|--------------------------------------|--|
| Further Cost Increase | The contract price will be fixed and inflation has been factored into the price. Any increases will only be the result of specification changes at a later date by the Council. Adequate contingency has been allowed for. |
| Contractor failure | The building contracts allow either party to step in and re-procure and complete the construction. |
| Ed City Developments Limited Failure | The Council has the right to step in and |

| | |
|---|--|
| | either take over the building contract or appoint another developer should ECDL fail for any reason. |
| Failure of Ark by fund their elements of the building contract. | This would be an event of default and the Council has the right to step in and complete the development. |
| Health and Safety on site and injury to employees or the public | Health and Safety compliance and approach was assessed as part of the tender process, and is a key contractual obligation as well as requiring the contractors to have appropriate insurance. |
| Delays as a result of Covid-19 | The programme is continually reviewed with the contractor and project team to reflect the emergency situation. The building contracts and MDA allow for amendments and delay associated with Covid-19. |

Implications verified by Michael Sloniowski, Risk Manager, telephone 020 8753 2587

Other Implications

None