Waverley Borough Council

Report to: Council

Date: 29th August 2023

Ward(s) affected: Godalming Central & Ockford

Report of Director: Strategic Director - Place

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Report Status: Part Exempt

69 High Street, Godalming

Executive Summary

1.1. In February 2022, Full Council approved the acquisition of 69 High Street, Godalming as a General Fund mixed use asset to support the Council's aspirations contained within the Corporate Strategy 2020-25, including:

- To bring forward affordable housing, in this case in Godalming town centre, and
- To deliver a positive contribution to Godalming by preserving the integrity of the high street

1.2. The purchase was completed in May 2022, and in November 2022 the Executive noted a "mixed use" Project Initiation Document (PID) to:

- progress the design optimisation scheme, in line with corporate priorities, to optimise housing numbers, and
- ensure the site – in the central high street – does not remain vacant and development of the scheme is done at pace.

This report describes the outcome of the Stage 1 (RIBA stage 0-2) work in that PID.

1.3. For the reasons described, it is proposed to progress work in two stages, with priority given to accelerating completion of the commercial element while development work continues in parallel on the residential element for completion at a later date.

1.4. The financial prospects for this project as a whole have been adversely affected by the severe macro-economic climate, and especially cost inflation and high interest rates. Consideration has also been given to the relative net benefits of progressing the residential element under the Housing Revenue Account (HRA) rather than the General Fund (GF). While the payback timescales overall have extended accordingly, it is still estimated that both elements of the project will ultimately be revenue positive.

1.5. As detailed in the Asset Investment Strategy potential exit options have also been evaluated.

1.6. Having considered the report and annexes at its meeting on 1 August, the Executive agreed to progress the project. Specifically, the Executive resolved:

- To approve the phasing of the project.
- To approve the Outline Business Case and project timeline for the Phase 1 of the revised project (Exempt Annexe 1).
- To delegate to the Strategic Director of Place, in consultation with the Lead Portfolio Holder, the submission of a new planning application for the commercial unit, including

demolition to facilitate delivery and preparation for the prospective housing.

- To delegate authority to the Executive Head of Assets to enter into a long-term (15 years) commercial lease for 69 High Street.
- To delegate to the Strategic Director of Place to:
    - Approve the commencement of tender process for construction contracts, including those of the professional team.
    - Approve the appointment of contractors following appropriate procurement subject to the appointment being within the identified budget.
    - Approve the entering into any related contractual documentation (including collateral warranties and novation agreements) related to the development of the project.
    - Approve the entering into any agreement (including paying any necessary sums provided they are within the project budget) with any utility or related provider to ensure the connection, moving or management of any services to facilitate the project.

1.7. In order to progress the project as set out above, the Executive further resolved to recommend to Council that the necessary budget be approved as set out in Exempt Annexes 2 and 4.

Recommendations:

The Executive recommends to Council:

2.1 the approval of a budget of £230,000 (Exempt Annexe 2), to be met from the Asset Investment Reserve, to progress phase 1 of the revised project. This will be to deliver the commercial element of the project to RIBA Stage 4 (the detailed design stage) and to enable the submission of a planning application for the commercial unit.

2.2 the approval of an overall capital budget of £1.96 million (including the £230,000 referred to above), as per the breakdown in Exempt Appendix 4, to cover the anticipated cost of the capital works to the commercial unit, with delegation to Executive to approve the final budget once tender returns for the construction contract have been received.

Reason(s) for Recommendation:

3.1. 69 High Street, Godalming was purchased as a General Fund mixed use redevelopment project to support the Council's aspirations contained within the Corporate Strategy.

3.2. It aligns with the Government guidelines around 'Investment for Service Purposes' being expenditure on assets that form part of the Council's public service which also support the corporate priorities.

3.3. Since the property was bought, macro-economic factors including build cost inflation and increased borrowing costs have adversely impacted the financial landscape. The redevelopment options have been revised accordingly, and are in line with the Council's Asset Investment Strategy. Further consideration has been given as to how the Council might best look to progress the delivery of the scheme to achieve the strategic objectives. The recommendations in this report will enable the scheme to progress towards delivery of the project.

Exemption from publication

4.1 Yes, part of the report (Annexes only).

The Annexes are to be treated as exempt from the Access to Information publication rules because it contains commercially sensitive information regarding the financial viability of the scheme and is therefore exempt by virtue of paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972 as follows: Information relating to

the financial or business affairs of any particular person (including the authority holding that information).

Purpose of Report

5.1 This report updates the Outline Business Case for the whole development project and recommends the option to progress at this stage with a phased development. It details the overall timeline for the whole site development with a detailed timeline for the next phase.

The updated Outline Business Case can be found at Exempt Annexe 1.

5.3 This report also seeks the relevant authorities and associated budget of £230K required to progress with the programme of work, including submission of a planning application and detailed design, to enable the procurement of a build contractor in January 2024.

A breakdown of costs associated can be found in Exempt Annexe 2.

Strategic Priorities

6.1 The project pursues the Council's Corporate Strategy 2020 – 2025 which includes the following key priorities that relate to this project:

- "We will optimise the availability of housing that meets the needs of local people at all income levels, and which is sustainable and energy efficient".

  "We will support new and existing businesses and seek to attract new enterprises and employment opportunities, focusing on economic, social and environmental values".

Background

7.1 In March 2022 Full Council approved the acquisition of 69 High Street, Godalming, as a General Fund long-term development asset:

- To bring forward affordable housing, in this case in Godalming town centre, on a brownfield site, and
- To deliver a positive contribution to Godalming by regeneration of an empty commercial unit on the High Street.

These are in compliance with the permitted objectives under the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, the Government's rules around Local Authority investment in assets and the Council's own Asset Investment Strategy.

7.2 While the property benefitted from an existing planning permission for conversion to eight new homes behind and above a ground floor High Street commercial unit, following the acquisition and consistent with the Council's approval, Officers have been working to optimise the design to convert the building into a mixed-use development that increases the housing numbers and allows for an improved scheme overall. This involved commissioning a team of consultants to conduct the RIBA stage 0-2 analyses contemplated in the November 2022 PID. This work included testing the original planning permission against the best use of the site.

7.3 However, since the property was acquired the macro-economic environment has deteriorated materially. For example, construction costs have risen by an average of 4.9% (Building Cost Information Service Construction Data [BCIS] Q2 2023 estimate of Tender Price Inflation), on an already inflated market. This has resulted in a negative impact on the overall financial viability on construction schemes generally, including those being undertaken by this Council and this project. Moreover, other supply chain pressures (on the supply as well as the cost of materials and labour) as well as rising interest rates have also created profound fiscal adversity.

7.4 Nevertheless, the initial assessment work has been completed to include allowances for the adverse economic situation, and the project now needs to move into the next detailed design phase.

7.5 The Design Team's options analysis is attached at Exempt Annexe 3 (RIBA Stage 1 report) which presents 3 options:

(1) to develop the existing planning permission for the whole site;
(2) to complete a new planning permission for the whole site that better optimises the site as described above, and
(3) to a phased development of that new planning permission.

This analysis has been supplemented by (i) further work relating to validating and updating the cost estimates (Exempt Annexe 5) and (ii) further validation of financial viability, including testing against 3 additional options identified by officers:

(4) to pause the whole project;
(5) to exit (sell) the asset as is, and
(6) to develop the site with the express intention of an exit (sale) on completion.

7.6 The phased development of the new scheme (option 3 above) is the preferred option as it allows for both elements of the site to be developed as intended, but allows the commercial element to be brought forward first to better secure the prospective tenant. The rear of the site will be cleared at this time to allow that site to be prepared for the residential development in due course. A summary of the financial impact of this option is attached at Exempt Annexe 4.

7.7 The proposed overall development is described on page 11 of Exempt Annexe 3 but to summarise:

- the commercial element would now contain one single unit over 2 floors, separated from the residential element. While this compares to 2 units in the extant permission it is considered an improvement because the proposed unit will be wholly separate from the residential units and will utilise the High Street frontage fully. Such a re-configuration of the commercial space would also better support current market interest by food and beverage operators seeking a presence in Godalming in this location. The

previous owner was already in discussion with a preferred national restaurant provider to lease the commercial unit. They remain keen subject to the project progressing at a pace that aligns with their own business plan and timeline to be open and operating in the town in 2025. Officers remain keen to secure this interested party as a potential tenant to enter and complete an Agreement for Lease before the end 2023, and

- the proposed residential element increases from 8 to 9 the total number of units, comprising includes 1 no. 3 bed fully accessible house, 2 no. 2 bedroom houses, 3 no. 2 bedroom apartments, and 3 no. 1 bedroom apartments. This is also an improvement on the extant planning permission because the units will be independent of the commercial space.

7.8 The legacy approvals contemplated the further option to develop the residential element within the HRA rather than the General Fund and for the time being is that assumption has been adopted. However, that tenure, along with the number and type of units, will still be re-assessed again when taken forward by the Housing Delivery Team at a later stage and the final decision will be taken as best fit the circumstances at that time.

7.9 Housing officers are in support of the change from the previous planning permission granted, as it would better suit the affordable housing needs of the town. Waverley is one of the least affordable local authorities in England, based on house price to income ratios (para 8 Housing Affordability Study 2021). There is an urgent need to build more affordable homes, as set out in the Council's Affordable Homes Delivery Strategy 2022-25. The Housing Affordability Study underpinning this strategy demonstrates a net requirement of 65 social or affordable rented homes per annum in Godalming.

7.10 The initial cost of the development works, as defined in the feasibility report, and subsequent testing of the costs by a second Quantity Surveyor, has been input into the Council's financial appraisal model and this is detailed in section 10 below.

7.11 The report referenced above, and detailing the updated cost assessment that supports the financial appraisal, can be found at Exempt Annexe 5.

7.12 In line with the Council's Asset Investment Strategy:

- where appropriate, assets must have an exit strategy to ensure that where there is a risk of change in market/obsolescence the Council ensures value for money is being achieved in line with the corporate objectives, and
- asset performance will be monitored to ensure results are being delivered and to consider if the assets meet the needs of the Council. Underperformance may trigger the exit strategy.

The financial appraisal includes an analysis, summarised at Exempt Annexe 4, that indicates that the best value for money is achieved through completion of the revised scheme as proposed.

Consultations

8.1 The decision to acquire the property was approved by Full Council in March 2022 (see background papers). Since then, consultation with Councillors has continued via the Asset Investment Advisory Board; Executive Briefing meetings and the Executive itself in November 2022.

8.2 Going forward the project will be overseen by the newly formed Asset, Regeneration and Sustainable Executive Working Group.

8.3 A comprehensive communications plan will be developed as the project progresses to ensure that residents and other stakeholders, including Godalming Town Council and the Chambers of Commerce, are informed of the proposals and consulted as appropriate as designs for the housing element of the scheme are developed.

Key Risks

9.1 The current conditions in development and construction markets are volatile with construction prices suffering high rates of inflation. The phasing of the build will need to be assessed to best mitigate against further inflationary risks, and Value for Money achieved through the procurement of a build contractor.

9.2 Under the CIPFA Prudential Code, and in line with the Council Capital Strategy, the Council's capital investments must be assessed for affordability to ensure that the total capital investment of the Council remains within sustainable limits. The Council's financial capacity to absorb losses without unmanageable detriment to local services is mitigated through the Council's borrowing strategy and cash management.

9.3 The Council has a prospective tenant for the retail element of the scheme. The development needs to be progressed at pace to provide the clarity that they are seeking around programme to secure that tenant. Should the Council not secure this interested Party, it will need to seek an alternative tenant which may be challenging in the current economic climate and would result in the Council incurring continuing holding costs for the asset. It is proposed that in order to secure the commercial tenant that an agreement for lease will be entered into prior to completion of the necessary works. At the point the agreement for lease is entered into, the Council will have a contractual obligation to complete works and deliver the agreed development within a defined timescale. This will expose the Council to enhanced development risk (in terms of narrowing options to mitigate any inflation) but mitigates the longer-term revenue risk the decision to enter into contract will need to balance these risks.

Financial Implications

10.1 Funding arrangements for the original acquisition complied with the permitted financial objectives of the CIPFA Prudential Code at the time, the Government's rules on Local Authority investment in assets and the

Council's Asset Investment Strategy. The business case included a financial model that supported an acquisition price of £2,195,000 plus costs.

10.2 Since the property was acquired in May 2022, the national macro-economic landscape has deteriorated: for example (i) construction costs have risen by an average of 4.9% (Building Cost Information Service Construction Data [BCIS] Q2 2023 estimate of Tender Price Inflation[1]), on an already inflated market, and (ii) interest rates have risen to prohibitive levels. This has resulted in a negative impact on the overall financial viability on regeneration schemes generally, including this project. Officers are keeping this impact and any future changes under review.

10.3 The Council primarily measures performance against criteria that are most relevant to a project's impact on GF and HRA revenue funds which are at the heart of the Council's financial resources and its ability to fund its services. When undertaking a financial appraisal for any asset-related project, the Council must assess the full revenue implications of undertaking the capital spend. Cashflows do not necessarily align with funding flows while some metrics commonly used in the commercial sector are insufficient for the Council's purposes. The most relevant criteria include:

- The impact of revenue and capital income and expenditure streams on the Council's funds. These may include external borrowing costs and, where appropriate, indirect and opportunity costs of internal borrowing. For example, for the General Fund Minimum Revenue Provision ("MRP", the annual charge to revenue for borrowing whether internal - use of surplus cash - or external) will apply in lieu of principal repayments, while for the HRA, a contribution to the major repairs reserve (i.e. "depreciation") should be considered in addition to cash flows, and
- Other regulatory requirements, including those over the Council's spending and borrowing powers, and the permitted uses of revenue and capital funds.

[1] 2Q2023 estimate of Tender Price Inflation | BCIS

10.4 The relevant and comparable time horizons for the analyses used for this project are:

- For the commercial element (i) the 4-year GF Medium Term Financial Plan and (ii) the 50-year MRP window (which aligns with the term of appropriate external PWLB debt in the GF and the estimated asset life), and
- For the residential element (i) the HRA 30-year Business Plan and (ii) the estimated asset life of 60 years.

10.5 As detailed in Exempt Annexe 4, for the commercial element:

- it is unlikely that the Council will borrow externally for the General Fund in the foreseeable future and the viability assessment for the Commercial element has therefore been run assuming internal borrowing for which the cost is the opportunity cost of interest foregone on treasury deposits;
- this position is kept under review as part of Treasury Management (the management of the Council's cash). Any decision to vary this strategy and borrow externally will be taken by the Executive Head of Finance (S151 Officer), based on forecast cash flow needs and in line with the Treasury Management Strategy;
- option 3 is estimated ultimately to be revenue positive both annually and cumulatively over the assumed life as outlined in Exempt Annexe 4, but
- even option 3 will require temporary bridge funding as also detailed in the Annexe. The Council has previously established reserves to meet this contingency, for example the Capital Cost Contingency reserve (in addition to the Asset Investment Reserve).

10.6 Also as detailed in Exempt Annexe 4, for the residential element:

- the current working assumption is that the net benefits of progressing this element in the HRA rather than the GF may outweigh the costs. The benefits rest primarily in lower development costs, while the costs lie in subjecting tenures,

rights and rents to external regulation. This assumption will be tested again when this element of the project progresses;

- HRA borrowing is assumed to be external out of caution, although internal borrowing may be possible;
- option 3 is estimated ultimately to be revenue positive both annually and cumulatively over the assumed life as outlined in Exempt Annexe 4, but
- even option 3 will require temporary bridge funding as detailed in the Annexe, and likewise the Council has previously established reserves to meet this kind of contingency.

10.7 It is important to remember that the acquisition of the property was undertaken in support of the corporate priorities and not as a commercial investment for gain or yield. As such the value will be gained in the long-term. The financial appraisals and sensitivity testing on the viability of the residential portion and the retail element, split accordingly, is appended at Exempt Annexe 4.

10.8 The initial design concept has been developed and costed to provide a high-level indication of development costs, and site surveys have been completed. To progress the project to RIBA stage 4 (the technical design stage) the Council is required to commit to funding the following:

- Design development (with relevant design team appointments) for the retail element only at this stage
- Procurement exercise to market test a preferred design option
- Cost consultants to assess construction costs
- Planning consultants
- External project manager to lead the Council through the options
- Extensive site and building survey work.

10.9 The budget required to deliver the above is £230K. Initial construction cost estimates an overall budget requirement to deliver the scheme is c. £1.96m. This includes contingency at 10%.

Legal Implications

11.1 The Council's internal legal and procurement officers are providing support to the project team in relation to procurement of consultancy services and construction contracts to ensure compliance with the Council's legal duties including the Public Contracts Regulations 2015 and the Council's Procurement Procedure Rules.

11.2 In considering the Council's best use of resources, Members are entitled to consider the wider impacts of the scheme on the social environmental and economic benefits, as well as the core financial projections. If Members consider that the non-financial benefits outweigh any projected financial costs they can reasonably consider the scheme to be acceptable and proceed. That said Members should have regard to the impact of any financial loss on the Council as a whole and its formal duty to maintain a balanced budget.

Human Resource Implications

12.1 The project will require a multi-disciplinary team from across the Council including legal, assets, finance, project management, procurement and communications.

12.2 Internal resources will need to be supplemented by an external technical project management resource to oversee the project. This is factored into the funding request for this next stage of works.

Equality and Diversity Implications

13.1 Equality impact assessments are carried out when necessary across the council to ensure service delivery meets the requirements of the Public Sector Equality Duty under the Equality Act 2010.

13.2 An Equality and Diversity Assessment has been drafted to consider any impacts arising from the design of the Commercial building and will form part of any tender information for the Design Team. The design

will need to comply with relevant Building Regulations relating to accessibility.

Climate Change/Sustainability Implications

14.1 There are no primary climate change/sustainability implication in this report, climate and sustainability implications will be considered throughout the design phase and into construction to identify opportunities to deliver upon the Council's commitment to the climate emergency.

Summary of Options

15.1 The options available to the Council are captured within the Outline Business Case (Exempt Annexe 1) and, for options 1-3, the RIBA Work Stage 1 report (Exempt Annexe 3) and the Initial Appraisal and Cost Estimate (Exempt Annexe 5). Options 4-6 are summarised here:

Option 4 - Pause: The Council could decide to hold the asset whilst re-evaluating the options further. However, the project team has considered all options available at the present time and it is unlikely that these will vary considerably in the short- to medium-term. Should the Council progress with this option, it will incur holding costs such as Business Rates and utilities charges, as well as bear responsibility for ongoing maintenance issues that are likely to arise given the lack of investment in the asset in recent times.

Option 5 – Sell site "as is" with no development works: The Council could decide to divest of the asset. Under the Asset Investment Strategy, the option to 'divest' (sell) needs to be taken into consideration in capital spend decisions. An independent valuation of the site at the current market value has been undertaken by external property advisors which indicated a range of possible values, all of which suggest a decline from the original acquisition price. Since the original acquisition was financed from internal borrowing, a sale below this value would crystalise a funding gap in the Council's Capital

Financing Requirement, which is its underlying need to borrow, which would need to be funded.

Option 6 – Sell site once all development works are complete: The Council could decide to complete the works to deliver the whole scheme and then sell the enhanced asset, noting the anticipated value once developed. This is not a relevant option now, rather it is only a contingent option for the future as it would require a decision now to proceed on one of options 1-3 to proceed. The Council could consider it in due course and does not need to make a decision on it now.

Conclusion

16.1 In order to ensure that the Council's overarching objectives for the initial acquisition of 69 High Street Godalming are achieved, and that the Council is not exposed to undue financial risk, it is recommended that the Executive endorse the proposed approvals outlined in this report.

Background Papers

Full Council meeting, 22nd February 2022 - CNL102/21 - EXE 93/21 PROPERTY MATTERS - PROPERTY ACQUISITION.

Executive meeting, 29th November 2022 – EXE 62/22 69 High Street project Initiation Document

Appendices

Exempt Appendix 1: Outline Business Case and project timeline

Exempt Appendix 2: Budget breakdown for next stage development costs

Exempt Appendix 3: Ayre Chamberlain Gaunt – Feasibility Study & Options Appraisal

Exempt Appendix 4: Financial Viability Assessment

Exempt Appendix 5: Initial Appraisal and Cost estimate

Service	**Sign off date**
Finance / S.151 Officer	28/06/23 CK
Legal / Governance	30/06/2023 (Ian Hunt)
HR	29/06/2023 (JF)
Equalities	
Lead Councillor	27/07/2023
CMB	04/07/2023
Executive Briefing/	01/08/2023
Committee Services	17/8/2023