Part A - Appendix 1

PSP Warwick LLP

e2 – Examine – Redevelopment of Riverside House and Covent Garden

December 2015

Public Sector Plc™

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Version 3 – Minor edits to update financial analysis following development of e3 report. 12.1.16
Version 4 – Minor edits following points raised by D Elliott 5.2.16
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1. Introduction

A key objective for Warwick District Council is the achievement of significant revenue savings in the operation of its office accommodation, together with gains achievable from the introduction of new ways of working in efficient new office space and to avoid maintenance liabilities of circa £1 million on Riverside House.

In order to achieve this outcome, a strategic review of the Council's asset base within Leamington has been undertaken. The outcome of this review was to confirm that the Council should be located in Leamington and that by moving closer to the town centre, the opportunity to bolster trade and footfall in the town was a key component in delivering broader benefits from any office move. The current site, Riverside House, is outdated, located on the outer fringes of the town centre and, helpfully, located in a high value residential area of the town. Redevelopment of this site for residential use will help generate a significant capital sum to contribute towards the cost of the new office space. Within the town centre, two sites were considered suitable; Covent Garden and Chandos Street. Both are currently occupied by car parks, surface parking on Chandos Street and a five-storey decked car park on Covent Garden together with some surface spaces.

Whilst Chandos Street is slightly closer to the centre than Covent Garden, it offers greater scope to drive value and provide complementary uses to support the town centre than Covent Garden which is slightly further away from the centre. Further, the decked car park at Covent Garden is no longer fit for purpose and studies of it have concluded that it is unsafe, poorly designed and with limited future life, on which basis it needs to be demolished and a replacement car park constructed. This requirement exists beside the need to provide a new office building and is linked only by the fact that Covent Garden is deemed to be the best location for the new office building and the entire site can be optimised if a comprehensive approach is taken to its redevelopment.

This paper does not seek to further explore the background to the proposed use of individual sites, rather it sets out how redevelopment of the Riverside and Covent Garden sites can help facilitate the delivery of the new office building and multi-storey car park.

2. Site development proposals

The project comprises two primary sites; Riverside House and Covent Garden. A third site, Chandos Street, can be linked to the project, but, since it is the subject of a development agreement with a third party and since substantial further work is required to establish the optimum mix of uses on this site, it is considered appropriate to bring forward a proposal that is not contingent upon its inclusion at the outset. Affording flexibility around the redevelopment of this site will allow the project to proceed without the need to wait for decisions to be made on the site. It can be opted in later if appropriate, or developed independently.

It is intended that Riverside House is redeveloped in its entirety, but in two phases.

The site covers some 4.3 acres, but is compromised by the presence of an underground drainage culvert on the eastern side of the site and a flood plain on the lower, southern, part of the site. However, it is highly appropriate for residential development, sitting, as can be seen from the image above, in the midst of a well established and high value residential area of the town.

An initial capacity study has been undertaken to establish the potential of the site for residential development. A copy of the plan produced is shown below.

It is important to note that this is not a fully resolved masterplan, but it does give a good indication of capacity and suggests that the site might be capable of supporting a net area of circa 110,000 sq ft in a mix of units. The plan shows 26 town houses and 67 flats and uses the fall across the site to minimise the impact of the apartment blocks on the surrounding properties.

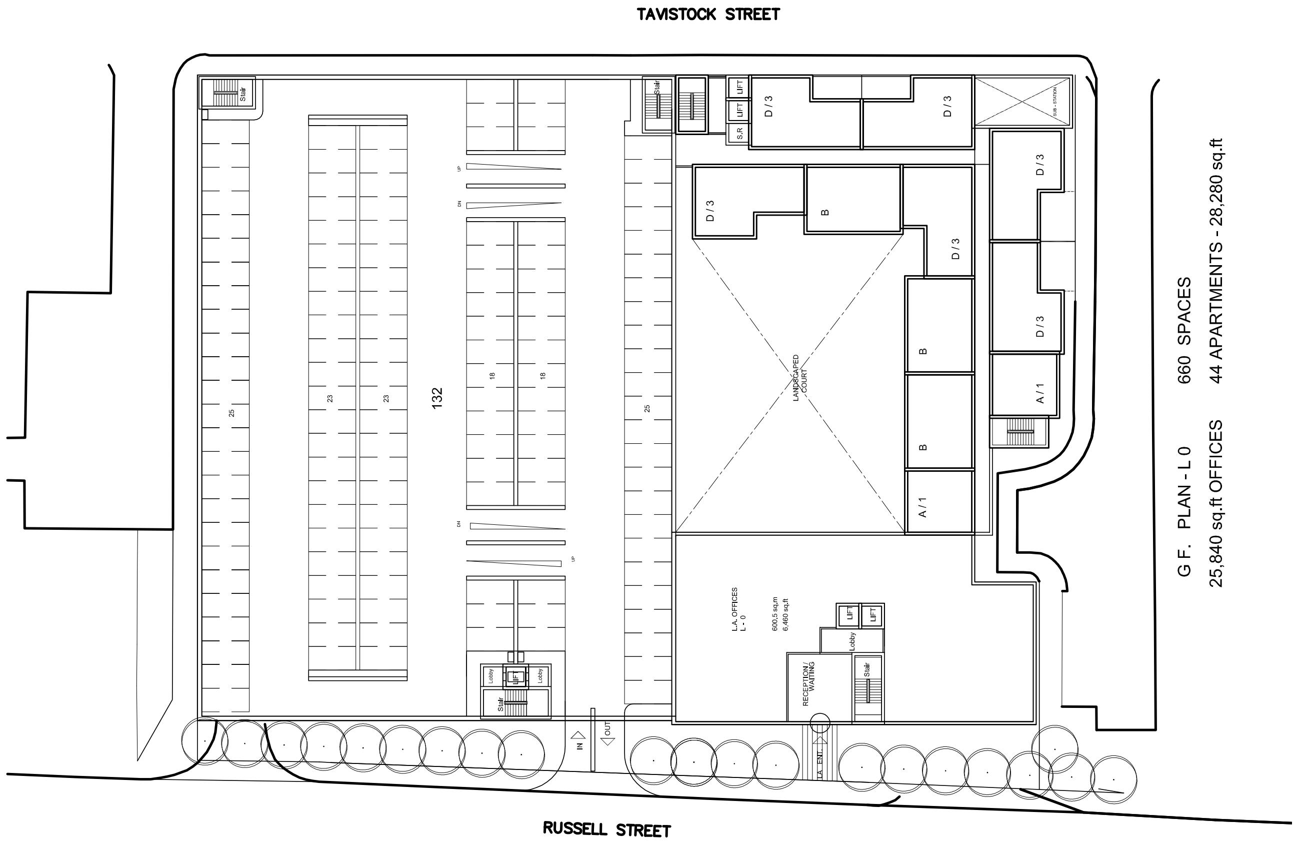
Block B, to the east of the site is envisaged as the first phase of development of the site and is capable, subject to the culvert move, of being delivered whilst Riverside House remains in use. Block A can only be brought forward once Riverside House has been vacated and demolished.

A similar exercise has been undertaken on Covent Garden. The image below shows the site, which measures approximately 1.6 acres in area.

The requirement for this site is more complex. In addition to accommodating office space in the region of 28,000 sq ft net, it also needs to contain a re-provided multi-storey car park. This car park needs, ideally, to provide 500 spaces to replace those lost from the previous car park, together with an additional 150 spaces to allow for the Chandos Street car park to be closed without an overall loss of spaces within the town centre. Further, to cross-fund the new office building, an element of enabling development is desirable if this can reasonably be accommodated on the site.

Preliminary discussions have been held with the planners who gave support in principle to the redevelopment of the site. The optimal form of development is based upon a perimeter block reinforcing the strong grid layout in the town and a maximum height of four storeys (noting the five storeys of car parking broadly equates to four storeys of built space).

The sketch below shows how these uses might be accommodated on the site.



This shows a total of 660 parking spaces, 25,800 sq ft of office space and circa 28,000 sq ft of residential space that can be treated as enabling development.

As noted earlier, no detailed work has been undertaken on the potential development of Chandos Street. To the extent that it is considered, some provision has been made to assess its potential value in order to paint a fuller picture of the overall financial impacts of the project. It is important to consider it since, by providing additional parking space on Covent Garden and at a cost to that project it is, effectively, providing a significant benefit to the future redevelopment of Chandos Street since it will not have to re-provide 150 public parking spaces as part of any development proposals for the site. This will greatly enhance the viability of any proposals for the development of the site.

3. Development strategy

A substantial part of the project revolves around the phasing and cashflowing of the works necessary to both deliver the new buildings and drive capital out of the value creating elements of the scheme. The LLP is proposing to work closely with the Council in facilitating the delivery of its objectives. The LLP's focus is on achieving a commercially viable solution to the project whilst, at the same time, supporting the delivery of the re-provided elements (office and car park), that arise as a consequence of the redevelopment of the sites.

The project is complex, large scale and costly. It will involve significant resourcing, funding and expertise. By taking a strategic approach to the project, the LLP can achieve outcomes that are at least as good commercially as the other options open to the Council whilst, at the same time, achieving them significantly more quickly since the LLP is established and has a detailed understanding of the requirements of the project.

Provision of the new office building could cost circa £8.4 million and the new car park, perhaps a further £8 million, with enabling costs of up to £2 million. This capital needs, ideally, to be found from the value that might be released from Riverside House and the residential block at Covent Garden. Given that these two sites provide less than three acres of net developable land, it can be seen that this is not a simple task and could certainly not be achieved from straightforward disposals of the sites. The LLP needs, therefore, to provide a value added strategy for the creation of capital as well as co-ordination of a multi-phased delivery programme.

The basis of the proposition is as follows;

- The LLP will seek a suitable development partner for the Riverside House site which will be brought forward in two phases, as highlighted above.
- The LLP will work with the Council to specify and design the new office building and multi-storey car park.
- The LLP will develop the residential block at Covent Garden (directly or in joint venture) such that it can be built concurrently with the other elements on the site.
- The delivery of the entire Covent Garden site will be managed by the LLP. It is noted that some elements of this are likely to be the subject of compliant procurement exercises since they relate directly to the requirements of the Council.
- Chandos Street can be disposed of once the new car park is opened. How this happens will be the subject of further discussion and agreement.

The financial strategy for the project is as follows;

- The Council will borrow to fund the replacement of the multi-storey car park since it would have had to do this in any event and since it is linked to the office project only on the basis that it will be built concurrently with it.
- The LLP will fund all enabling works (masterplanning, planning, tendering, demolition, utility works etc) and construction of the new office building. It will also fund, or make provision for the funding of the Covent Garden residential block.
- The Riverside House and Covent Garden residential sites will be committed to the LLP with nil attributed value on the basis that the LLP will provide back the completed new office building (subject to a maximum cost of £8.4 million) at no cost to the Council.
- Receipts from the development of Riverside House and Covent Garden will flow to the LLP. Once all costs have been met (including the enabling costs, construction of the office and residential block, Facilitation and Development returns to PSP and interest on loans from PSP to deliver the scheme) any net upside will be shared equally between the partners.
- The Council's share of any upside can cover the cost of interest on their loan for the construction of the multi-storey car park and to reduce the capital borrowing.
- The receipt from Chandos Street, however this is achieved, can go to further reduce the borrowing for the car park loan.

The detail of this is set out further in the attached Heads of Terms and associated financial analysis set out below. It should be noted that this approach is significantly simpler than the previous proposals and provides a greater degree of de-risking for the Council since it seeks to provide the office building without cost risk to the Council and provides for an upside share of the overall outcome should greater levels of income be achieved or elements delivered for lower cost.

An important component of the overall delivery strategy will be the production of a viability based approach to affordable housing. The two residential development elements are being promoted in order to create a pool of capital sufficient to fund the delivery of the new office building and, potentially, part of the car park cost. The project is, therefore, not without a series of exceptional costs at significant levels. In order to release value from Riverside House, it is necessary to build a new office building on Covent Garden and in order to build the office building there it is necessary to build a new multi-storey car park. Both sites include substantial structures to be demolished, together with inevitable utility, culvert and flood mitigation costs. It is considered, therefore, that a robust viability case can be made to remove or mitigate the level of affordable housing required in order to deliver on the broader objectives. It must be borne in mind that these objectives are to save revenue costs for the Council in order to avoid making service cuts which offers ongoing benefits to the community in the district. It is recognised that the provision of affordable housing will be a sensitive issue, but it is envisaged that a robust and compliant viability case can be made and, as a result, the scheme would provide a maximum of 20% affordable housing and, potentially, less. This issue will be explored further once the project moves to the next stage.

4. Expenditure requirements

Project expenditure will take place on a phased basis. This will reflect the approach outlined above.

In the first instance, and subject to approval of this proposal, expenditure will focus on the works necessary to bring forward the phased development of Riverside House and design, planning and tendering of the Covent Garden scheme. Conclusion of this phase represents a crucial gateway point in the project. By this stage, there should be a clear indication of the level of potential income from Riverside House and the Covent Garden residential scheme. Planning permission should be secured meaning that the delivery of both the cost based and revenue creating elements can be confirmed. Lastly, tendering of the construction contract will mean that there will be a clear picture of the overall commerciality and viability of the scheme. Once this gateway is passed, the expenditure moves to the construction of the agreed works.

Phase 1 expenditure is noted below and comprises two elements.

Item	Requirement	Scope	Cost estimate
Masterplan and planning application for Riverside House			
1	Architect		
2	Planning consultant		
3	Planning lawyer		
4	Technical consultancy		
6	Landscape architect		
7	Lawyers		
8	Surveys		
9	Planning fees		
10	Agent		
11	PR and Media consultant		
12	Contingency		
		Sub-total	£350,000

Design of office, residential block and car park at Covent Garden			
1	Architect		
2	Planning consultant/lawyer		
3	Building services engineer		
4	Structural engineer		
5	Space planner		
6	FM Consultant		
7	Cost manager		
8	Project manager		
9	Technical consultancy		
10	Landscape architect		
11	Surveys		
12	CDM		
13	Planning fees		
14	Contingency		
		Sub-total	£825,000
		Total	**£1,175,000**

These costs will be met by the LLP and will be subject to a 18% Facilitation Return to PSP on the expenditure as part of the overall commercial analysis.

Phase 2 expenditure comprises four elements; site-wide clearance and enabling works, the new office building, the replacement multi-storey car park and the residential block. Costs for these elements are as follows.

Site-wide clearance and enabling works

Item	Requirement	Cost
1	Demolition and site clearance/remediation	£500,000
2	Utilities and other enabling works	£400,000
	Total	**£900,000**

These works will be funded by the LLP and are subject to a Facilitation Return to PSP of 18% on expenditure. Interest at 5% per annum, compounding will also be incurred.

Construction of new office building

Item	Requirement	26,100 sq ft NIA at £160/sq ft build including Cat A fit-out
Delivery of new office building		
1	Road/site works	
2	Construction	
3	Construction contingency at 5%	
4	Professional fees at 5% (most inc above)	
	Sub-total	
Category B fit-out (at £75/sq ft) and relocation costs		
1	Fit-out works	
2	Fit-out contingency	
3	Professional fees at 14%	
4	Furniture	
5	IT Infrastructure and equipment (allowance)	
6	Move CCTV centre	
7	Relocation costs	
	Sub-total	
Category B fit-out (at £75/sq ft) and relocation costs		
1	Employer's agent	
2	Quality monitoring	
3	Construction legals	
4	Planning supervisor	
	Sub-total	
	Total	**£8,651,925**

The build and fit-out figures above have been provided by Arcadis and inflated to Q4 2016. The LLP will fund these costs up to a maximum of £8.6 million. It is envisaged that the fit-out works will form part of the base build construction contract. These costs will be subject to a 18% Facilitation Return to PSP. Interest at 5% per annum, compounding will also be incurred. Subject to costings, it is suggested that a BREEAM Excellent building would help to maximise the operational savings for the building. This will be explored at the design development stage.

Construction of replacement multi-storey car park

Item	Requirement	Gross cost
1	650 spaces at £15,000 / space all inclusive	£9,750,000

This is an all inclusive estimate and will be tested further during the design development stage. However, it exceeds the allowances provided by Arcadis, thus presents room for betterment. This cost will be funded by borrowing by WDC and, hence attracts no Facilitation return. Interest will be incurred by the Council on this loan and accounted for outside the overall project budget, but recovered from the forecast profit share.

Construction of new residential block

Item	Requirement	Cost
1	Construction of 36,000 sq ft gross at £120/sq ft	
2	Fees at 10%	
3	Construction contingency at 5%	
4	Other costs at 5%	
	Total	**£5,236,364**

The LLP will fund these costs, subject to a Facilitation Return of 18% to PSP to reflect the development risk of delivery of this element of the project. Interest will be incurred, as noted above.

This gives a gross expenditure as follows.

Phase 1 works	£1,175,000
Phase 2 works	£24,538,289
Total	**£25,713,289**

Of this amount, the Council will provide £9.75 million by way of borrowing to fund the construction of the car park and the LLP will provide £15,963,289 by way of a loan from PSP to fund the balance.

As noted above, a key gateway is passed to move from Phase 1 to Phase 2. A significant level of cost will be incurred in order to complete the Phase 1 works. It is assumed, therefore, that both parties will commit to start the Phase 1 works on the basis that both fully intend to see the project through to completion. The decision to move to Phase 2 will be made at the point at which the key commercial assumptions made here remain valid and the project can be delivered as envisaged.

In the event that the position at the close of Phase 1 does not support the commercial case then the following steps can be taken; firstly, the partners will work together to seek to mitigate those issues that are causing the problems. If the scheme cannot reasonably be made to work, then the project will not proceed and the costs incurred will be the liability of the LLP. If this is the case, then the partners will commit to work together to find ways to mitigate these costs, such as the development of other assets or reconsidering the development of the sites included in this project. In the event that either party chooses unilaterally to withdraw at the end of Phase 1, then they will be liable for the whole of the costs incurred.

5. Profit drivers and value assumptions

The sketches contained in Section 2 show how, illustratively, Riverside House and Covent Garden might be redeveloped for residential use. Riverside House contains approximately 110 units comprising 60,000 sq ft of town houses and 50,000 sq ft of apartments. Covent Garden contains circa 30,000 sq ft of apartments.

The appraisal, left, shows the potential gross receipt from Riverside House on the basis of the costs and values noted above. Crucially, it assumes a reduced level of affordable housing, as highlighted previously, and the disposal method explained below.

In order to maximise the capital receipt achievable from Riverside House, it is proposed to deliver this in joint venture with a house builder partner. This will be on the basis that no land payment is made upfront, but the capital value of the land rolled into the delivery of the project and a share of the proceeds from sales is secured by the land owner. Accordingly, there is no developer's return required against the cost of land purchase which at, say, £10 million, would add circa £2.2 million of additional cost to the project.

This deferred consideration model has been used very successfully in Southend where the best offer secured a 34.5% share of the sale of market units giving a gross receipt in excess of three times the value that would have been achieved from a sale of the site with planning permission. Such a level might not be realistic here and that proportion will be a key metric used to test potential bidders on. However, it will generate better returns than a straight disposal with the trade off being that receipts are generated later than they would be if the site was simply sold.

The appraisal, left, shows the performance of the residential block at Covent Garden. This is modelled on a similar basis, with a reduced level of affordable housing and on the assumption of no upfront land payment. However, in this instance, it is intended that the LLP deliver this block and so the land value attributable will be taken up with the provision of the new office building.

PSP will seek a development return of 18% on expenditure, as noted above, with any surplus generated then flowing through to the broader commercial appraisal of the project.

This approach, again, seeks to maximise the benefit to the Council since it is able to participate in upside from the overall development, but will not be exposed to cost risk on the delivery of the office element, which will sit with PSP.

6. Delivery strategy

Delivery of the project will take place in phases. As proposed, a development partner will be sought for the delivery of the residential scheme at Riverside House. This itself will comprise two phases, a smaller element on the upper car park first with the remainder of the site being developed once the office building there has been vacated. This process will be managed by the LLP, but delivered by the preferred partner.

Delivery of the works at Covent Garden clearly needs to be undertaken under a single contract in order for it to be built in one go, cost efficiently and quickly. However, this opens up various procurement issues that will require careful resolution. The key issues to be addressed are that construction of the office building for the

Council is clearly the provision of a building to the requirement of the Council and is therefore likely to be caught by procurement regulations. However, it is being funded by the private sector and is, in part, ancillary to the redevelopment of Riverside House. However, part of the works, the construction of the new car park, will be funded by WDC and hence, clearly involve the expenditure of public funds.

The solution to this is likely to be that the construction contract will need to be procured on an OJEU compliant basis to cover all of the works whether they are funded by the LLP or WDC. Up to the point of commencing construction, all works will have been funded by the LLP and incurred ancillary to the broader land transactions involving release of land for residential development. This scenario was contemplated under the previous proposal and reviewed by both WDC's and the LLP's lawyers and considered to be an appropriate solution to the delivery of the project using a combination of private and public sector funding.

A suitable suite of legal agreements covering both the overall delivery of the project and site specific options will be required in order to deliver the overall package and these will be developed with the lawyers once the principles of the proposal have been agreed.

7. Financial analysis

This paper has set out in some detail the overall cost of delivering the project and the ways in which those costs will be met by the receipts that might be achieved from residential development. However, it is essential to understand how all of the component parts fit together into a single overarching commercial proposal. The details of this are set out below.

The analysis is expressed in two parts; the first part considers the cost of and value achieved from the two sites released for enabling development. This generates a gross receipt which is then distributed amongst the partners. The primary objective is to secure a large enough capital receipt to cover the cost of the new office building and associated works for the Council that have been forward funded by the LLP. PSP then receives a return based upon its investment in the project with surplus beyond this point shared equally by the partners.

Project costs

Phase 1 works attributable to Riverside House and Covent Garden enabling plot		
Apportioned budget	£500,000	
Phase 2 works on Covent Garden attributable to the enabling plot		
Site-wide clearance and enabling works	£150,000	
Construction of residential block	£5,236,364	
Apportioned interest	£383,630	
Gross costs	**£6,269,994**	

Income

Land receipts – Riverside House	£13,213,036	
Gross receipts – Covent Garden residential	£9,765,000	
Gross income	**£22,978,036**	
Project profit	**£16,708,042**	
Stage 1 distribution of receipts		
WDC office building and associated works		
Share of Phase 1 costs	£725,000	
Site-wide clearance and enabling	£750,000	
Construction and fit out office	£8,651,925	
Apportioned interest	£712,457	
Total WDC benefit	£10,839,382	(Equates to 64.9% of gross income)
PSP Facilitation Return at 18% of cost	£2,882,392	(Equates to 17.2% of gross income)
Remaining balance	£2,986,268	

Stage 2 distribution of receipts 50/50		
WDC share at 50%	£1,493,134	
PSP share at 50%	£1,493,134	

To set these figures in context it is helpful to understand the proportions in which the gross income is shared and the value of the return relative to the contribution of each partner.

Gross benefits achieved		
WDC benefits (build + profit)	£12,332,516	(73.8% share of gross income)
PSP (Facilitation Return + profit)	£4,375,526	(26.2% share of gross income)

Contribution to project		Return on investment
WDC – Base land value (say)	£4,000,000	305%
PSP (loans to LLP)	£15,963,289	27%

The outcome for WDC on this basis is a fully fitted-out and occupied office building funded entirely from the value created from circa 3 net acres of residential development land. In addition, the project could also return an element of profit share, in this instance, £1.888 million which can be used to cover the cost of interest on the car park loan, any loss of income whilst the Covent Garden car park is closed and surplus profit to reduce the loan capital.

From the perspective of PSP, the profit share element is clearly generated at risk, further, the Facilitation Return is also at risk since, subject to approval to move to the delivery stage, construction of the Council's office building is underwritten, this return will reduce if it is not delivered within the budget whilst the Council gets the benefit regardless of the overall outcome of the project.

The scale of investment required from PSP is substantial. It should be noted, therefore, that the proposals set out above are subject to approval by PSP's board.

It is worth considering at this point the potential contribution of Chandos Street to the overall outcomes for the Council.

8. The potential impact of Chandos Street

However, the project is linked to the future development of Chandos Street through the provision of 150 additional parking spaces at Covent Garden to allow the Chandos Street car park to be closed. In its simplest terms, this has provided £2.25 million of benefit to any future scheme on the site since it will no longer have to fund the cost of relocating or re-providing these spaces as part of any scheme. This will significantly improve the viability of any scheme for this site.

It is considered that trying to resolve the future of Chandos Street within timescales that suit the delivery of the project outlined here will simply result in substantial delays in delivery of the project and the achievement of the revenue saving targets sought by the Council from the occupation of the new office building. It is proposed therefore, that Chandos Street is set to one side in the first instance.

Clearly, there are many issues to consider at Chandos Street, not the least being the extent to which it might be developed in a way which places regeneration and economic development benefits for the town ahead of the largest possible capital receipt for the site. At the present time there is no firm indication as to what the optimum outcome is considered to be. It is not appropriate, therefore, to attribute a potential capital receipt from this site to the overall commerciality of the broader project.

Any receipt generated, together with the upside profit share from the Covent Garden residential block, would make a contribution to clearing the loan capital for the construction of the new car park. If it is assumed, regardless of any other development proposals, that a new car park would have to be built and funded by the Council, then recovery of a proportion of these costs from the broader development projects is a highly positive outcome to what might otherwise have been a major financial blow for the Council.

9. Risk review

The proposal put forward by the LLP is intended to offer significant degree of risk mitigation to the Council. Unlike the previous proposal, subject to passing from Phase 1 to Phase 2, the Council is not required to take the risk on receipt of funds from the development of Riverside House or Covent Garden in order to achieve its objective of occupying a new office building. Its commercial risk is limited to the extent of surplus funds that might be achieved to reduce the cost of borrowing for the construction of the new car park, which is a cost that it would have to incur in any event, but has the potential to mitigate through this project.

In the early stages, and as a key component of Phase 1, the more specific risks that must be addressed will revolve around the planning process. The scale of works proposed, covering at least two sites, changing car park provisions, delivering circa 300,000 sq ft of new buildings in the town on a largely concurrent basis is change on a large scale for any town. To secure planning permission to achieve this, inclusive of viability analysis to support a reduction in affordable housing provision is critical in order to deliver the whole scheme. If planning permission cannot be secured for any component of it then the scheme will not be viable. On this basis, a carefully considered PR, media and stakeholder engagement strategy will be essential. The overall objectives will need to be carefully set out and the benefits carefully explained. This will need to run ahead of and in parallel with carefully managed consultation on the schemes as they are developed and taken through into the planning process.

The delivery of the project itself is, of course, subject to the normal array of project risks, namely cost escalation, market risk on disposals and potential delays. In large part, the first two of these can be minimised to a large degree through the works envisaged in Phase 1 of the project. Once the project is underway, a risk register will be developed to understand and manage out, as far as possible, potential risks to the successful completion of the project.

10. Programme

- Validation complete - 12 February 2016
- Members Board – 23 February

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