

Rother District Council

Report to: Cabinet

Date: 17 July 2023

Title: Blackfriars Housing Project – Infrastructure Costs

Report of: Director – Place and Climate Change

Cabinet Member: Councillors Jeeawon and McCourt

Ward(s): All

Purpose of Report: To update Members on the latest financial position for the Blackfriars Housing project.

Decision Type: Key

Officer

Recommendation(s): It be **RESOLVED:** That the Chief Executive and the Section 151 Officer be granted delegated authority, in consultation with the Portfolio Holder for Finance and Governance to:

- 1) negotiate and complete an interim Working Capital Agreement (WCA) for £8m and to develop the terms of a main Development Loan Agreement and related documentation for the balance of funding (maximum of £80[m] less any advance via the WCA) with Rother DC Housing Company; and
- 2) should the £8m Working Capital Agreement financing facility need to be extended ahead of the Development Loan Agreement being finalised, that this can be undertaken subject to receipt of a formal request from Rother DC Housing Company up to a maximum of £10m in total.

Reasons for

Recommendation(s):

- To capture the legal terms of the debt invested by Rother District Council in Rother DC Housing Company and the project to date in a format that can be more easily enforced and secured.
- For viability reporting and related input to continue without a delay that could lead to further costs down the line.
- To enable Rother District Council and Rother DC Housing Company sufficient time and funds to finalise the terms of the main Development Loan Agreement that will ultimately replace the interim Working Capital Agreement.

Introduction

1. The site known as Blackfriars has a long history, with the principal of development at the site first being established in the 1960's. It represented 89%

of all the homes allocated in Battle as part the 2006 Rother District Local Plan, and accounts for 46% of all the home development relied upon by the Battle Civil Parish Neighbourhood Plan (2021).

2. There have been several attempts to develop the site with the Council working proactively with developers to bring forward a scheme. The most recent of these was the 2007 Countryside Properties scheme which failed to progress due to financial unviability. The site is approximately 16 hectares (40 acres) in size. Rother District Council (RDC) owned 50% of the site at the outset of the project and acquired the remaining land parcels necessary to complete the project under compulsory purchase order throughout 2020 and 2021.
3. In February 2018, RDC was informed that it had provisionally been awarded £3.24m in grant funding by the Ministry for Housing, Communities and Local Government (MHCLG) as part of Housing Infrastructure Fund (HIF) marginal viability fund to finance the construction of the road and related infrastructure necessary to develop 200 homes. Three key features of the bid were the ever-growing housing need in the Battle area, the lack of alternative development delivered since the adoption of the 2006 Local Plan, and the strategic importance of the Blackfriars site to delivery in the area.
4. In late 2019, Homes England's Panel increased the grant funding to £8.7m following acceptance of RDC's demonstration of uplift in costs. At this point the total cost of the infrastructure scheme was valued at £11.5m. The total scheme costs were identified at £78.5m (inclusive of the housing construction costs) and showed a marginal surplus of £3.5m (assuming all 200 homes were disposed of). Without this funding and without the intervention of RDC, the site would remain unviable and undeveloped, depriving the Battle community of over 200 much needed homes.
5. The site has planning permission for the delivery of 220 homes. Outline planning permission for the homes and full planning permission for the road was granted in December 2020 (RR/2019/604/P) with full reserved matters approved in April 2021(RR/2020/2307/P).
6. In August 2020, a tender exercise was undertaken for the construction of the road infrastructure. A contract was awarded to Breheny Civil Engineering in December 2020 for the contract sum of £4.1m to construct the road with additional provisional sums of £650k factored in as very high-level estimates for potential design-related changes. This was not a fixed price contract and is being managed under the New Engineering Contracts (NEC) contract terms. In normal practice for a road of this complexity, a contract would be awarded following the completion of a technical design that had been approved by the local transport authority. This contract was awarded without a full technical design to meet strict funding deadlines from Homes England.
7. The 2019 cost appraisal only budgeted £3.8m for the main contract creating a budget gap of £1m. In addition to this, land acquisition costs exceeded the original allocated budget by approximately £1.4m. Still representing a surplus of £1.1m, the scheme remained viable with HIF funding.
8. The housing on the site is to be delivered by Rother DC Housing Company (RDCHC), the arm's length housing delivery vehicle of RDC. RDCHC undertook a separate procurement, in line with its internal procedures, for the construction

of the 200 Homes and entered in to contract with Wates Construction Ltd in January 2022. It is also currently anticipated that the development will deliver up to 120 affordable homes, significantly above the 35% planning policy minimum.

Unforeseen challenges with infrastructure design and key changes to the development environment

9. As outlined above, whilst the alignment and general design principles of the road were agreed for planning purposes in December 2020, the full technical design was a matter for the contractor, to be agreed and approved with East Sussex County Council as part of a section 38 road adoption agreement.
10. When developing the designs, it became clear that five keys pieces of infrastructure (two surface water drainage tanks and three land embankments) would require greater than anticipated levels of resilience and would therefore incur delays for design resulting in undefined increased costs.
11. Since embarking on what was already a marginally viable scheme, there have also been several significant changes in the economic and commercial environment in which the UK construction and civil engineering industry operates. These are primarily the consequence of unforeseen national and international events that are having impacts industry-wide (including the terms of the UK exiting the EU, the COVID-19 pandemic, world-wide inflationary pressures, and the September 2022 UK Budget announcements).
12. These external factors have seen significant increases to material costs across a range of supply-chains, increased costs related to labour, rising interest costs making borrowing more expensive and the increase in construction energy costs.

Non-Construction related additional costs

13. There was also non-construction related challenges that added to the overall scheme costs, and these are discussed in more detail within exempt Appendix A.

Loan Agreement

Loan/Working Capital Agreement (WCA)

14. To date RDCHC has been advanced c£3m to get the scheme to where it currently is, these are sunk costs and have been used for professional advice and support, company overheads and staffing costs to date. RDCHC have approached RDC for a further c£1m which would enable them to get revised plans completed to submit for planning approval and ensure the company could continue to operate through until the end of July 2023.
15. It is estimated that to enable RDCHC to continue to progress the scheme and to continue to operate the company between August 2023 and the end of March 2024, that a further loan facility of around £4m will be required based on the best available forecasts. This would represent total funding support of around £8m by the end of March 2024.

16. To date there has been no formal loan agreement signed by the parties to cover the initial £3m loan advance so it is proposed that this position is regularised with the advancement of the additional £1m that has now been requested and a further £4m to cover until the end of the current financial year, which totals £8m.
17. Based on advice received from RDC's legal advisors for the scheme (Bevan Brittan), the easiest way to quickly contractualise the existing and some limited future debt would be to develop a Working Capital Agreement (WCA) to cover a value limited financing facility to be agreed in [July], while a more detailed development loan agreement and accompany security documents are completed by the end of the year to cover future loan drawdowns. The WCA would be secured using a debenture including a floating charge and providing RDC with some level of security over the RDCHC assets.
18. Should the value of the WCA need to be increased this can be achieved through a simple letter from RDC to RDCHC, subject to relevant internal approval (to be delegated to Chief Executive and Section 151 officer in consultation with the Portfolio Holder for Finance and Governance).
19. If RDC proceed with the scheme as recommended, then there is a requirement to fund the additional cost identified. If approved this could be funded through a combination of capital receipts (£4.0m) and a transfer of £3.4m from the Mount View Street project, currently in the capital programme, as it now looks possible that this site can be brought forward without the need for direct RDC investment. It is however recommended that the Chief Executive and the Section 151 Officer be granted delegated authority, in consultation with the Portfolio Holder for Finance and Governance, to agree the most economically advantageous funding mix to finance the scheme deficit being forecast at the point the additional funds are required.
20. Officers have had discussions with Homes England regarding potential extensions to HIF funding and other funding avenues that might be available to the scheme to help re-attain viability. Homes England have made it clear that there is no further funding available, however they would consider options that could see only part of the scheme delivered for the remaining available funds. Although it is unlikely that this is feasible officers are exploring these complex options.

Conclusion

21. As outlined within Exempt Appendix A, there is currently a deficit forecast for the scheme. Further work will be undertaken over the coming weeks to firm up some of the outstanding figures so that officers can present a further options paper for Members consideration in September.
22. There is a requirement to formalise the WCA of c£3.0m already provided to the RDCHC as well as the additional c£1.0m now being requested to enable the company to submit the revised planning proposals and to trade until the end of July 2023. In addition, a further £4.0m is likely to be required to take RDCHC to the end of the current financial year (£8.0m in total), at which point a further loan drawdown will be required.

23. Based on advice received from RDC's legal advisors for the scheme (Bevan Brittan), the best way to achieve this would be to develop a WCA to cover a £8m financing facility to be agreed in July while a more detailed Development Loan Agreement completed by the end of the year to cover future loan drawdowns and consolidate the WCA.

Next steps

24. It is proposed that the following is undertaken by officers (Council and Housing Company) over the coming weeks to inform the options appraisal paper to come forward in September:
- Work with RDC and RDCHC to agree and finalise the terms of the WCA.
 - Continue to progress the finalisation of the main development loan agreement and accompanying documentation.
 - For RDCHC to work with the quantity surveyor to understand and challenge the proposed Wates housing construction costs.
 - For RDCHC to continue negotiations with Orbit to try and finalise the capital receipt expected from the disposal of the affordable housing element of the scheme.
 - To work on an options appraisal paper to bring forward to Cabinet and Full Council in September 2023.

Financial Implications

25. As contained within exempt Appendix A.

Risk Implications

26. There are a considerable number of risks associated with this scheme ranging from financial and reputational to legal and procedural. A high-level summary of these risks and their potential mitigation are contained within Appendix B.

Legal Implications

Working Capital Facility and Security

27. A WCA based on standard market terms along with a standard form debenture containing fixed and floating security are each being prepared in draft outline for agreement with RDCHC. These agreements are being prepared to document the interim terms of debt already incurred and that will be incurred as part of the project investment by RDC between now and execution of the main Development Loan Agreement. Having in place some registerable security will help to secure the interest of RDC in RDCHC.
28. The heads of terms for the main Development Loan Agreement are being prepared with input from the Council's legal advisors to ensure that they are substantially compliant with the market standard for such development finance.
29. Prior to incurring significant further legal costs the RDC legal team will seek an undertaking from the RDCHC legal team for its costs to date and going forward negotiating the various finance documents.

Human Resources Implications

30. None as a direct result of this report.

Other Implications

31. None as a direct result of this report.

Other Implications	Applies?	Other Implications	Applies?
Human Rights	No	Equalities and Diversity	No
Crime and Disorder	No	Consultation	No
Environmental	No	Access to Information	No
Sustainability	No	Exempt from publication	No
Risk Management	Yes		

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Appendices:	A	Scheme Cost Forecasts - Confidential	
	B	Risk Assessment	
Relevant Previous Minutes:	-		
Background Papers:	-		
Reference Documents:	-		

RISK SUMMARY

Risk		Likelihood	Impact	Risk Management
Infrastructure (RDC)				
1	Budget increases - Final delivery cost exceeds new budget approval.	Medium	Medium	£0.75m project contingency – close liaison with employers' agent and infrastructure contractor (Breheney). Road embankment designs with East Sussex County Council for consideration and approval.
2	Delays - Delays (weather etc) leading to further inflationary cost increases.	Medium	Medium	£0.75m project contingency.
3	Project resources - Overall programme resource and oversight not being in place leading to issues being overlooked and not adequately addressed in a timely manner.	Low	Medium	Overall programme resource (to encompass the entire scheme and Blackfriars housing delivery) to be considered by the Senior Leadership Team and addressed.
4	External grant funding - Homes England Funding change request not accepted resulting in no future drawdowns.	Low	High	Continuous engagement with Homes England.
5	Outcomes - The original outcomes anticipated from this scheme are not met.	High	Medium	Given the increased costs forecast for completion of the infrastructure scheme and the wider housing delivery there will be a cost to the Council as opposed to any financial return. The remaining outcomes in terms of accelerating affordable housing delivery, homes built to the highest environmental standards, developing affordable rented properties, targeting young/first time buyers, deliver and unlock stalled sites, development of interim accommodation for homelessness.
6	Scheme changes - Housing Company housing scheme re-design leads to additional changes to infrastructure scheme and a resultant increase in costs.	Medium	High	Ongoing dialogue with the Council's officers and Employers Agent and various parties from the Housing Company.
7	Support - That political support for the scheme to progress is not provided, resulting in abortive costs and reputational damage.	Low	High	There is ongoing engagement with Cabinet and the wider membership regarding the progression of the scheme and the challenges being faced.

Risk		Likelihood	Impact	Risk Management
8	Reputation - The Council's reputation is negatively impacted if the infrastructure scheme is not delivered.	Low	Medium	The recommendations contained within this report should enable the completion of the infrastructure element of the project.
9	Land transfer - The required land transfer/disposal is not completed, preventing the Housing Company from commencing construction.	Low	High	Officers are aware of this requirement and are currently considering the timing of the transfer.
10	Clawback of funding - The additional funding request to deliver the infrastructure element of the scheme is not approved and a loss is incurred on the expenditure to date, with the Homes England funding being withdrawn.	Medium	Low	Whilst there is currently a deficit forecast on the infrastructure element of the scheme this is less than the Housing Infrastructure Fund (HIF) grant allocation (£8.7m).
11	Loan facility - There are risks to the Council in providing a loan funding facility to a company that currently holds no assets.	Medium	High	A Capital Funding Agreement and Loan Funding Agreement are being drafted by the Council's solicitors Bevan Brittan, this will be back up by a debenture that provides the Council with security over the lenders assets once developed.
	Housing Company			
12	Income receipts - Registered Provider receipt not realised.	Medium	High	Agreement on value to be finalised this summer with Registered Provider.
13	Income receipts - Open market sales receipt not realised.	Medium	High	Ongoing monitoring of projected receipts based on current market forecasts.
14	Budget increases - Final delivery cost exceeds budget forecasts.	Medium	High	Updated cost forecasts based on the revised design plans have been received from the housing contractor. These are currently being assessed and challenged before a final budget is approved.
15	Revised planning approval - Delay in achieving new planning approval leads to additional inflationary costs.	Low	High	Pre-planning consultation completed; redesigned plans scheduled to go to committee in October 2023.
16	Delays - Delays (weather, planning decision) etc) leading to further inflationary cost increases.	Medium	Medium	£2.5m contingency.
17	Planning rejected - Failure to achieve new planning approval resulting in lower income generation.	Low	High	Pre-planning consultation completed; redesigned plans scheduled to go to committee in October 2023.

Risk		Likelihood	Impact	Risk Management
18	Liquidation - Failure of the company.	Low	High	Ongoing company and cashflow monitoring.
	Lack of loan funding Loan funding agreement - agreement resulting in cashflow and funding uncertainty for the HCo.	Low	High	Working Capital Agreement to be agreed as part of this report, supported by the more detailed Loan Funding Agreement by the end of the year.
19	Interest rates - Borrowing costs continuing to increase, further impacting on viability.	Medium	High	Ongoing monitoring of interest rates.
20	Abortive costs - If the scheme does not progress, there is the risk of a potential claim by Wates if the contract to build the housing is not completed. A conservative estimate of this cost is c£5m and is based on 10% lost profits etc based on a £50m contract.	Low	High	The recommendations contained within this report should enable the completion of the infrastructure element of the project which would then enable the housing delivery.
21	Lack of overall viability – the Directors have a duty to not act recklessly and only act in the best interests of the company. If the scheme is not viable from a housing company perspective the scheme will not progress.	Medium	High	Ongoing modelling and viability assessment. Planning re-design submitted to increase income.