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District Executive – 7<sup>th</sup> August 2008

## 9. Foundry House and Mill Lane Change in Consideration Payable to Council

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### Purpose of the Report

To note that the emerging scheme design and current economic circumstances currently experienced in the property market have had an effect on the asset value of the Foundry House and Mill Lane site and to seek approval to accept the revised offer of the Cornhill Group (Zero C) for the purchase of Foundry House and Mill Lane, to enable the development to proceed.

### Recommendation

That District Executive is asked to authorise officers to:

- (1) accept the revised offer of £555,000 (£155,000 for Foundry House and £400,000 for the remainder of the site) together with overage clauses as described in the report.
- (2) enter into a legal agreement binding Cornhill to develop the site in accordance with the submitted plans, schedule of build, and development brief.

### Background

Members will recall that at the District Executive meeting held in October 2008, Cornhill was selected as the approved development partner to achieve the Council's ambitions for this site. The offer was £940,000. In March 2008 this offer was agreed by mutual consent to be reduced to £804,000. This was as a consequence of this council's wish that a grant from the Housing Corporation was not sought as this would result in an increased amount of rented accommodation being provided, which in turn would reduce the overall scheme viability. This was agreed and dealt with as a Portfolio Holder's decision in accordance with the council's constitution at a meeting of the Portfolio Holder for Yeovil Vision, Tony Fife, the Portfolio Holder for Strategic Housing, Ric Pallister and the Leader, Tim Carroll.

Since January 2008 there has been turbulence in the banking sector and borrowing has become more difficult and in the ensuing credit crisis the property market, particularly in the residential sector has collapsed. The implications are that many previously viable property development schemes particularly those with substantial residential content are no longer going forward. This affects a number of key sites and commercial developments in and around Yeovil.

### Report

The Foundry House and Mill Lane officer group, headed by the Head of Area Development South, and advised by our retained consultants Alder King have been meeting monthly to progress the legal agreement, the site construction details and public realm works.

We are working towards a planning application in July, with an on site start in November 2008. Cornhill (Zero C) have advised that they have invested over £80,000 in design works and site investigation. They have also held a public exhibition on the 13<sup>th</sup> May 2008.

At the officer group meeting on the 1<sup>st</sup> June, Cornhill submitted an open book reappraisal of development costs and profit. This reflected their assessment of current market conditions.

The revised appraisal reflects changes to the scheme through emerging scheme design and an anticipated 5% reduction in sales income. This, once the developer profit and site construction costs are taken into account, reduces the site value to £555,000, made up of £155,000 for Foundry House and £400,000 for the remainder of the site.

The revised offer now comprises;

- Initial payment of 10% (£55,500) on signature of legal agreement.
- Balance of monies payable on Date of Site Entry, and on satisfaction of the Pre-Conditions precedent.
- Overage to become payable after a 15% developer profit on cost has been taken. This means that the first £250,000 profit after the developer profit is to be paid to SSDC
- Profit thereafter split 50/50 between SSDC and the developer.
- Overage in its entirety on Foundry House is shared 50/50 between SSDC and the developer; if Zero C do the refurbishment.
- Any reductions in build costs mean SSDC getting 100% of cost savings

### **Evaluation of Offer**

The important difference between this and the revised offer agreed at the Portfolio Holders meeting mentioned earlier in the report is that a reduced initial payment is being offered to reflect the market conditions and increased risk and the developer's need to cover costs and proceed with this project in a viable manner.

The offer however does potentially allow the council to recoup the difference between the previous offer of £804,000 and the current offer of £555,000 by way of overage, as per the above, through an improvement in market conditions. Overage is to become payable on the sale of the last unit, whether commercial or residential if the developer has secured their 15% profit on cost. This overage will be £250,000 if the scheme is able to create this level of profit due to an upturn in the market and hence prices. Above that we share the profit. The longest date for overage to be paid if applicable is 3 years after practical completion.

In order to ensure that this offer reflects best value to SSDC, Alder King has scrutinised the revised appraisal.

The bill of quantities has been separately reviewed by Alder King's in-house Project Manager who believes that the cost appears to be in the right cost range for a development of this size, nature and value and provides a good basis for assessing the overall financial viability of the scheme.

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Zero C have commissioned a sales and marketing report, submitted to SSDC to confirm current residential sales values. This housing market appraisal has confirmed the reduction in sales value.

The overall view of Alder King, endorsed by the officer team, is that that under current market conditions this offer is realistic and still represents best value for the council. Furthermore and most importantly it enables the scheme to proceed.

The prognosis if the scheme does not proceed, is for a further reduction in value of the site in the short term. Hence the recommendation is to accept the revised offer. There are in the current climate risks associated with this development, but the only way to avoid these is to not proceed until market conditions improve. This is not recommended.

A re-run of the evaluation criteria used to assess this bid against the other original bids has been undertaken. This shows that the revised terms do not impact on the ranking of the firms and therefore the revised Cornhill (Zero C) offer still reflects Best Value to SSDC.

It should be noted that Alder King hold accredited status which enables them to value assets for the public sector with the same status as the District Valuer.

## Risk Analysis

A comprehensive legal agreement covering a wide range of issues and risks has been the subject of detailed negotiation between SSDC and Cornhill and once complete it is under this building agreement that the development will take place.

The risks identified below stem from undertaking the development. There are risks with not undertaking the development now. All the time Foundry House is empty, despite having security mechanisms in place, it is a target for arson and vandalism. As landowner we would be exposed to the risk of having to put right damage caused, or incur the possibility of a reduced valuation on the building.

If this revised arrangement is not concluded, it would follow that the site would have to be re-marketed. This process would involve significant cost in terms of national advertising and consultancy support similar or excess of the cost of the initial marketing exercise.

Finally if we remarket the site in the current economic climate, there is every likelihood that there would be less interest than previously and that the offer to the council would be further devalued.

Risk	Mitigation
<b>Reputation</b> If the scheme does not progress it will send a negative message The public has expressed their agreement to this development through the development brief and public exhibition.	The legal agreement controls the delivery of the project in the most effective way possible with a 4 year long stop date by which the agreement becomes invalid.

<b>Corporate Plan Priorities</b>	
<p>Yeovil Vision This project is a critical success factor in the Yeovil Vision delivering a range of publicly endorsed benefits.</p> <p>Economy A number of other developments will take their lead from this one, which if it does not proceed will lead to the lack of investment in this part of Yeovil.</p>	<p>The building agreement is strong tool in ensuring the development takes place. The developers have a good reputation, and are committed to the scheme. The changed consideration figure enables the development to go ahead.</p>
<b>Financial</b>	
<p>If the project does not proceed the council will have the liability of Foundry House. The site will have to be re - tendered for and in the current climate is likely to not return a positive financial sum.</p> <p>The developer may pay the deposit and not then start work therefore the council may not receive the balance.</p> <p>The overage may not be delivered.</p>	<p>The legal agreement ensures the council receives a deposit of £55,000, and an assured sum of £555,000 on Entry to Site, and allows for the difference of £250,000 between the original offer and this one to be made up if markets improve and or costs decrease. The risk of Foundry House is transferred to Cornhill</p> <p>This is covered by the legal agreement, which puts them on an obligation to start work and proceed diligently with a view to completing within 15 months; otherwise they are in breach of contract.</p> <p>This is dependant on the market and wider economic circumstances</p>

### Financial Implications

In the report to District Executive in October 2007, Members were informed that Foundry House has a capital budget allocated of £319,000 but due to the nature of the work after listing an overspend has occurred. The overspend currently stands at £49,000 for fees and security. However it is likely that there will be further expenditure incurred on fees and security of £15,000 up until the completion of the contract.

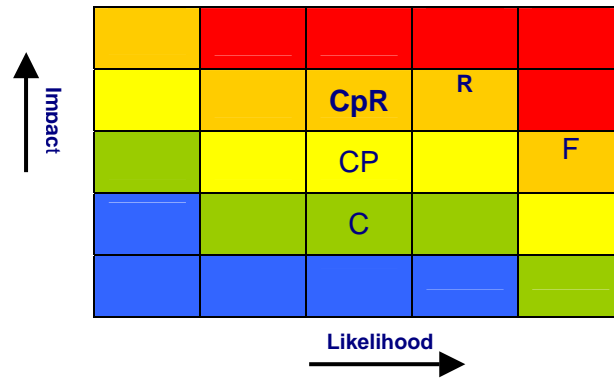
The sale of Foundry House will generate a capital receipt of £555,000. However it is recommended that the overspend of approximately £64,000 is met from the proceeds arising from the land sale.

This will result in a net increase to capital receipts of up to £491,000, which will be required to be set aside to offset the net loss in car park income.

It should be recognised that the difference between the revised figure of £805,000 and what is now offered of £555,000 is an overage, to be paid to council of the first £250,000 of developer income after 15% developer profit taken. Therefore, there is a high risk that the overage income may not be received.

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## Risk Matrix



## Key

Categories	Colours <i>(for further detail please refer to Risk management strategy)</i>
R = Reputation	Red = High impact and high probability
CpP = Corporate Plan Priorities	Orange = Major impact and major probability
CP = Community Priorities	Yellow = Moderate impact and moderate probability
CY = Capacity	Green = Minor impact and minor probability
F = Financial	Blue = Insignificant impact and insignificant probability

## Implications for Corporate Priorities

The project delivers on the Economic and Yeovil Vision Priorities

**Background Papers:** *Reports to DX Oct*  
*Report to Management Board April 08*  
*Project Team minutes*  
*Building Agreement draft*