

# FAREHAM

## BOROUGH COUNCIL

### Report to the Executive for Decision 07 September 2020

<b>Portfolio:</b>	Policy and Resources
<b>Subject:</b>	Covid-19 Impact on Daedalus Investment Projects - Faraday Industrial / Business Units
<b>Report of:</b>	Director of Planning and Regeneration
<b>Corporate Priorities:</b>	A dynamic, prudent and progressive Council

#### **Purpose:**

As a result of the Covid-19 impact, and in light of a changing economy the proposed capital investments at Daedalus have been reviewed to help determine the future financial implications for the Council. This report addresses the proposed capital investment on Faraday Business Park.

#### **Executive summary:**

At the 7 January 2019 Executive it was agreed to fund the construction of new industrial / business units at Faraday Business Park and the appointment of a contractor for the development to be delegated to the relevant Director following consultation with the Executive Member for Policy and Resources.

#### **Recommendation:**

Following consideration of the potential impact(s) of Covid-19, it is recommended that the Executive agrees:

- (a) to continue funding of £5 million, as agreed by the Executive on the 07 January 2019, to construct new industrial/ business units at Faraday Business Park, and
- (b) the appointment of a contractor for the development is delegated to the Director of Planning and Regeneration following consultation with the Executive Member for Policy and Resources.

#### **Reason:**

To fund the further development of Daedalus in line with the adopted Vision generating a positive revenue for the Council.

#### **Cost of proposals:**

The capital budget for the proposed scheme is as approved on 7 January 2019.

**Appendices:**

**A:** Architect perspective view of development.

**B:** Confidential – Lambert Smith Hampton update addendum to November 2018 report.

**Background papers:**

**Reference papers:**

Daedalus Vision and Outline Strategy.

Review of the Council's Vision and Strategy for Daedalus.

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## BOROUGH COUNCIL

### Executive Briefing Paper

<b>Date:</b>	07 September 2020
<b>Subject:</b>	Covid-19 Impact on Daedalus Investment Projects - Faraday Industrial / Business Units
<b>Briefing by:</b>	Director of Planning and Regeneration
<b>Portfolio:</b>	Policy and Resources

#### INTRODUCTION

1. At the 7 January 2019 Executive it was agreed to fund the construction of new industrial / business units at Faraday Business Park and the appointment of a contractor for the development to be delegated to the Director of Finance and Resources following consultation with the Executive Member for Policy and Resources.
2. This proposal was and remains in accordance with the Council's Vision for Daedalus – to provide a thriving employment led development.
3. Positive revenue generating schemes are required to cross subsidise airside operations and contribute to the Councils revenue income.
4. Since the Executive of the 7 January 2019 the project has been designed, obtained planning consent and the construction contract tendered.
5. It is forecast that the project continues to be deliverable within the original capital budget approved at Executive on 7 January 2019.
6. As a result of the Covid-19 pandemic this paper assesses any implications of Covid-19 on this proposal.

#### COVID-19 IMPLICATIONS

7. Covid-19 has impacted upon the global economy. The recovery will differ by sector and vary by region.
8. A dedicated report on Covid-19 impact and recovery proposals within the Borough is to be considered at this Executive meeting.
9. In accordance with the August Executive report on Covid -19 recovery Plan Objectives and Framework all major capital schemes are being reviewed.

## COVID-19 IMPACT ON TENANT MARKET AND DEMAND

10. The Council's property advisors have provided an update to their report of November 2018. They consider "a range between 10,000 – 20,000 sq ft to be the "sweet spot" to accommodate enquiries in the market". They further report "to date, with one or two exceptions, there has been no perceptible reduction in rents and lease terms in transactions they have been involved with" and that "the fundamental market principles still remain notwithstanding the Covid-19 implications, and we believe a speculative scheme at Faraday Business Park will be successful and attract occupiers within a realistic timeframe to achieve a viable and profitable outcome".
11. Practical completion of the units is programmed for Summer 2021 with a 10-month construction period allowing further time for businesses to recover and plan.
12. The Council has flexibility to either let or sell the completed units and has wider ability to be flexible on terms than commercial developers to the benefit of occupiers.
13. Existing businesses seeking to expand, or contract are having to look at locations outside of the Borough, whilst potential new occupiers are being frustrated by the lack of quality stock available.
14. The Stubbington Bypass is currently programmed to complete in late 2021/early 2022 improving road links to this area of the Borough.
15. Officers believe there is still a good level of demand for the proposed units.
16. The construction sector has rapidly adapted, and reports indicate numerous contractors' staffing levels are back at pre Covid-19 levels.

## RISK ANALYSIS

Risk	Description	Impact & Mitigation
<b>Capital cost is greater than £5 million</b>	Capital costs exceed approved budget of £5 million	<ul style="list-style-type: none"> <li>• Scheme has secured planning consent. The construction contract has been tendered with returns being within the approved budget.</li> <li>• Long term borrowing rates have continued to drop and are at an all-time low.</li> </ul>
<b>2<sup>nd</sup> peak of Covid-19 extends building contract and or costs</b>	A further lockdown impacts on construction contract, programme or costs	<ul style="list-style-type: none"> <li>• Mitigated via contracts.</li> </ul>

Risk	Description	Impact & Mitigation
<p><b>Market for the units has changed</b></p>	<p>Covid-19 impact on potential tenants or purchasers has reduced demand</p>	<ul style="list-style-type: none"> <li>• The Council's agents have provided an update to their report of January 2019. Whilst the full impact of Covid-19 on the commercial property market is still being assessed, lettings within the area have completed within the pandemic and interest levels are recovering quickly.</li> <li>• Practical completion of the units is programmed for Summer 2021 (with a 10-month construction period) allowing further time for businesses to recover and plan.</li> <li>• The Council has flexibility to either let or sell the completed units.</li> <li>• Council has wider ability to be flexible on terms than commercial developers to the benefit of occupiers.</li> <li>• Financial modelling has incorporated Covid-19 impact.</li> </ul>

## **FINANCIAL IMPLICATIONS**

17. Approximately £300,000 has been spent to date on designing the scheme, obtaining planning consent and tendering the construction contract.
18. The financial modelling remains based on funding the capital expenditure through prudential borrowing, but the assumptions have been revisited in light of Covid-19.
19. The financial model now includes prudent impacts for Covid-19 in addition to the original prudent impacts previously included for Brexit. Both impacts are over and above those forecast by the Council's agents.
20. With the bank base rate at an all-time low, prudential borrowing rates have also dropped since January 2019. Notwithstanding this the modelling has been re-run at the same cost of borrowing for the sake of comparison and further prudence.
21. Taking the above into account the payback period has extended from 12.5 years to 14 years which Officers believe represents a suitable return.
22. The construction will be closely monitored by Officers to mitigate risks throughout the development period.

## ALTERNATIVE OPTIONS FOR THE COUNCIL

23. Having secured planning consent the Council could:

- Delay construction until the impact of Covid-19 has been fully assessed or
- Market the site for a third party to build out.
- Phase the development.

Options	Issues	Financial Implications
<b>Delay construction</b>	<ul style="list-style-type: none"> <li>• Likely to result in higher capital cost.</li> </ul>	<ul style="list-style-type: none"> <li>• Increased capital cost. Current estimates suggest circa 4% building cost inflation per annum which would be circa £0.20 million additional cost.</li> <li>• Revenue would be delayed. Opportunity to capitalise on current demand will be lost to competing schemes.</li> <li>• Risk of increase in number of competing schemes.</li> <li>• Risk of businesses not locating or relocating within the Borough due to lack of available premises.</li> </ul>
<b>Sale of vacant site to third party</b>	<ul style="list-style-type: none"> <li>• Council would lose revenue opportunity</li> <li>• Council would lose control of timing and quality of development</li> <li>• Council would lose proportion of development profit</li> </ul>	<ul style="list-style-type: none"> <li>• Council would not secure positive revenue flow.</li> <li>• Capital value would be less than those achievable if Council completes development themselves.</li> <li>• Funds have already been invested in the scheme securing planning consent and tendering of construction. This has de-risked the project.</li> </ul>

Options	Issues	Financial Implications
<p><b>Phased development</b></p>	<ul style="list-style-type: none"> <li>Phased delivery via two or more construction contracts will reduce immediate capital outlay</li> </ul>	<ul style="list-style-type: none"> <li>The Council's agents are of the belief that the scheme is too small to be phased and potential disruption could put Tenants off phase 1.</li> <li>The stand alone (F1) unit could be left out of the scheme but advice is this is likely to be the most marketable unit.</li> <li>Council's construction consultants have advised that phasing would result in: additional cut and fill works, 75% of the common areas would require constructing in phase 1, retendering of the construction contract leading to a delay to programme, increased costs per square foot, a splitting of liabilities between phases, additional interface works, an increase in construction programme and preliminary costs. Construction of a later phase would also disrupt the tenants on the first phase. The increased costs in phasing has been estimated at an additional £500,000.</li> </ul>

## CONCLUSIONS

24. This proposal has been presented to and is supported by the Daedalus Members' Working Group.
25. The Councils agents believe the fundamental market principles remain notwithstanding the Covid-19 impacts, and that a speculative scheme at Faraday Business Park will be successful and attract occupiers achieving a viable and profitable outcome.
26. The proposed units are suitable for a wide range of sectors.
27. The Council are forecast to make a better return by building the units than by selling the site with the benefit of the planning consent.
28. Construction of the units will allow the Council to assist businesses within the Borough and those wishing to locate into the Borough by providing new premises.
29. Phasing of the construction increases: costs, programme, disruption and will deter lettings of phase 1.
30. The recommendation is to proceed with construction of whole scheme as per Executive approval of 7 January 2019.

**Enquiries:**

For further information on this report please contact Grant Hobday. (Ext 4320)