

Subject:	King Alfred Development
Date of Meeting:	6 December 2018
Report of:	Executive Director Economy Environment & Culture
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Ward(s) affected:	Central Hove (directly) all others indirectly

FOR GENERAL RELEASE**1. PURPOSE OF REPORT AND POLICY CONTEXT:**

- 1.1 At its meeting in January 2016, the Policy & Resources Committee supported the findings of the Final Tender evaluation process and approved the appointment of Crest Nicholson, in partnership with the Starr Trust, as Preferred Developer ("the developer"). At the time of appointment, it had been anticipated that rapid progress could be made such that the Development Agreement ("DA") would be entered into by mid-2016. On that basis, the planning application was to be submitted in the first half of 2017, with works expected to commence later that year.
- 1.2 This report advises of developments since appointment, of progress made towards finalising the terms of the DA, but where ongoing financial viability challenges have caused delay, and where the scale of the current viability gap is such that the developer is seeking the Council's agreement to revise the terms of the DA. It advises of the developer's final proposals aimed at addressing the viability gap, agreement to which would secure its willingness to enter into the DA and commit the resources needed to immediately commence the next stages of work.
- 1.3 The report also sets out the key issues arising from the developer's proposals, summarises the options open to the Council at this time, and seeks Members' agreement to the most appropriate way forward.

2. RECOMMENDATIONS:

That Policy Resources & Growth Committee:

- 2.1 Agrees that officers should continue to negotiate a final Development Agreement with Crest Nicholson with a view to entering into the Development Agreement before the end of January 2019;
- 2.2 Notes the draft Affordable Housing Provisions included at Appendix 1, and that these are subject to ongoing negotiations, and notes that this is an amendment to Crest's Final Tender;

- 2.3 Notes the intention for officers to prepare and issue a ‘standstill letter’ advising Bouygeus Development of the change, in line with procurement regulations;
- 2.4 Notes that there will be a further report brought to the Committee in January 2019 to agree the final Development Agreement;
- 2.5 Agrees to explore alternative options for the delivery of the redevelopment of the King Alfred site, including delivery of a Sport & Leisure complex for Hove, if the development agreement is not agreed by the end of January 2019.

3. CONTEXT/ BACKGROUND INFORMATION:

- 3.1 Redeveloping the ageing King Alfred Leisure Centre has been a priority for many years and successive Administrations. The current King Alfred Development project was initiated in 2012, and was led by a cross-party Project Board. The Board was instrumental in the development of the project, from setting the development objectives, reviewing financial viability, and considering the procurement route, to agreeing detailed arrangements and documentation at key stages of the process. Individual Project Boards were dissolved in 2016, since which time the project has been overseen by the cross-party Strategic Delivery Board (SDB). The SDB meets on a regular basis and, as with all major projects, has been updated on the King Alfred’s progress and challenges at key stages.
- 3.2 Prior to embarking on the procurement the Council undertook extensive work aimed at presenting an attractive and deliverable opportunity to the market; a route that learned from the previous unsuccessful attempt by recognising the need for flexibility and pragmatism. The procurement process that began in 2014 was considered to build in such flexibility. The Council’s requirements were structured such that developers had considerable freedom, but a central requirement was that proposals were financially viable.
- 3.3 In setting out on the current project it was agreed that the project’s primary objective was the delivery of a new, modern sports facility in the west of the city, whether on the existing site or elsewhere. This was to be mainly financed through the enabling development, predominantly new housing, and the Council specified that 20% of these units must be affordable. This compared to the 40% affordable housing target specified in Planning Policy. In specifying a minimum of 20% affordable in its role as landowner, the Council considered at that time, it to be both appropriate and achievable, and the Council’s financial modelling at that time showed this to be viable, if challenging.
- 3.4 The King Alfred Development opportunity was launched in October 2014 through a competitive dialogue procurement process, the initial stage of which required interested parties to submit a Pre-Qualification Questionnaire (PQQ). The PQQ was accompanied by a Memorandum of Information, which contained important background and supporting information, key among which were the Council’s development priorities, the public sports and leisure facility requirements, and expectations of the development partner.

- 3.5 Evaluation of the 6 PQQs submitted in November 2014, resulted in the shortlisting of two bidders, namely Bouygues Development and Crest Nicholson with the Starr Trust. The shortlisted bidders were found to have the skills, resources, and experience necessary to deliver a complex project of this nature, and both then engaged in a 8-month period of ‘Competitive Dialogue’ with the Council, culminating in submission of Final Tenders in August 2015. Final Tenders were assessed against the evaluation criteria set out in the Council’s ‘Invitation to Participate in Dialogue’ (ITPD) document.
- 3.6 The evaluation findings were reported to the Policy & Resources Committee in January 2016. The Committee supported the Evaluation Panel’s assessment of Final Tenders and agreed the appointment of the Preferred Bidder. Following a 10-day contract standstill period (Alcatel period), Crest Nicholson was appointed Preferred Bidder in February 2016.

Crest Nicholson Final Tender Scheme

- 3.7 Crest’s Final Tender satisfied all ‘Pass/Fail’ criteria, key among which was ‘Financial Deliverability’, which asked “Is the Council satisfied that the Bidder’s proposal can be delivered without additional capital and/or ongoing revenue support, beyond that agreed during the Competitive Dialogue Process?”
- 3.8 It also satisfied each of the ‘Mandatory Bid Requirements’ that tenders were required to incorporate as a minimum as follows:

Variable	Requirement
Site Boundary	The existing King Alfred Leisure Centre Site
Public Sports and Leisure Facility	Meet or ideally exceed the “Minimum Requirements” set out by the Council
Residential Units	Minimum of 400 units
Affordable Housing	20% of the total number of residential units, delivered across the site

- 3.9 Crest’s final tender was awarded the highest overall score against the evaluation areas set out in the ITPD, and summarised below:

Evaluation Area
Public Sports and Leisure Facility
KALC Site Enabling Development
Deliverability
Financial Offer
Contract

- 3.10 As stated above, at the time of their appointment, the Crest tender was financially viable, albeit at a profit level of 20.6% compared with Crest's desired profit level of 22.5% on Gross Development Value (GDV). Crest provided written confirmation that it was content to proceed on this basis as it was confident in its ability to improve on this position as the project progressed. Its target profit requirement remained 22.5%.
- 3.11 Crest's scheme exceeded the Council's Sports Centre minimum specification agreed by the Policy & Resources Committee in 2013 and as set out in the ITPD in 2015, and this was reflected in the evaluation score. The c12,000 sqm proposed sports centre includes three swimming pools; a 25m eight-lane competition pool, a smaller teaching pool, plus a leisure pool. Movable floors for changing depths in the competition and teaching pools are features included. The sports hall has space for eight badminton courts compared to five in the current centre. There will be a 120-station gym, plus 15 spinning bikes. Also included are a crèche, gymnastics centre, three-rink indoor bowls, dedicated martial arts dojo, quiet studio, sauna, and a café.
- 3.12 The enabling development included 565 flats (20% of which were to be affordable) in five main blocks, the highest of which would be some 18 storeys, ancillary commercial/retail space, community space, a new public square, and a 362 space basement car park, 200 spaces of which would be dedicated to the sports centre.
- 3.13 When appointing Crest in January 2016, it was anticipated that the terms of the DA could be finalised within a matter of months, something that would allow the DA to be entered into by mid-2016. Although recognised as an ambitious timetable, this would have seen submission of the planning application in the first half of 2017, with the development commencing towards the end of the same year.

Development Agreement

- 3.14 Draft Heads of Terms for the DA were issued to bidders during the dialogue process. These were discussed as part of that process, leading to the preparation of bespoke drafts of the DA, which bidders submitted in the form of a mark-up within their Final Tenders. This enabled some progress to be made prior to appointment, but detailed legal and commercial discussions with the Crest team commenced in earnest in February 2016.
- 3.15 The January 2016 report to the Policy & Resources Committee advised that the final form of the DA would be approved by the Policy & Resources Committee before it is entered into. The latest position is outlined in paragraph 3.48 below.

Financial Viability (2016/17)

- 3.16 Shortly after appointment, and in parallel with legal negotiations, Crest updated its development appraisal to take account of current costs and values, cost changes identified through engagement with sub-contractors and supply chain, and changes to phasing and construction methodology. These adjustments resulted in a significant worsening of financial viability; a gap at that time of c£20m.
- 3.17 In October 2016, Crest proposed changes to its Final Tender scheme with a view to bringing the project back to a viable position. Proposals at that time included an increase in the number of housing units, an increase in building heights, reduced level of affordable housing, delayed delivery of the sports centre, the need for a Council loan and increased grant funding. Extensive negotiations between October 2016 and March 2017 succeeded in reducing the extent and impact of Crest's proposed variations but the proposed package remained significantly different from Crest's final tender. Among the items successfully reinstated through negotiations by officers was the need for Crest to maintain provision of 20% affordable housing on site. As a 'Mandatory Bid Requirement' of the procurement process, something Crest's final tender demonstrated, it was concluded that to depart from this was unacceptable.
- 3.18 The Council was nevertheless sufficiently concerned at the scale of Crest's other proposed changes and the procurement issues and risk involved, that the Council sought the advice of James Goudie QC.

Queens Counsel (QC) Opinion No.1

- 3.19 In March 2017, the Council instructed James Goudie a leading QC, specialising in procurement law, to provide a legal opinion on the procurement implications raised by the developer's package of revised proposals. Advice from counsel was sought on whether entering into a revised contract with Crest would be in breach of procurement regulations and leave the Council open to challenge.
- 3.20 Counsel's advice was that under the Competitive Dialogue procedure, the Council does not have much flexibility to negotiate changes to final bids. There is only limited scope for such changes in order only to clarify aspects of the winning tender or confirm commitments. This must, however:
- not have the effect of modifying "substantial aspects" of the tender;
 - not "risk" distorting competition; and
 - not cause discrimination.
- 3.21 Counsel further advised that the changes sought by the developer at that time were probably "on the wrong side of the line" and it was very doubtful that they could have been accepted by the Council without breaching procurement regulations.

3.22 In April 2017, the Council therefore advised the developer to reconsider its position with a view to delivering the scheme in accordance with its successful final tender, without which it would not be possible to proceed. Crest accordingly further reviewed its development appraisal and held detailed discussions with the Council and the then Homes & Communities Agency (HCA) to explore potential opportunities for HCA financial involvement, with a view to enabling Crest to revert to its final tender scheme. In July 2017 the HCA identified the then newly launched 'Housing Infrastructure Fund' as a potential source of grant funding to unlock the development. At that stage this was effectively seen as the final opportunity to proceed with Crest.

Housing Infrastructure Fund

- 3.23 The Housing Infrastructure Fund (HIF) is £2.3 billion of government funding available to Local Authorities, £300m of which is available to 'Marginal Viability' projects such as the King Alfred. HIF guidance states that £10m is the maximum amount typically available to individual projects. HIF funding is expected to be the final piece of the funding package that finally unlocks the development, and which allows it to proceed at pace thereafter.
- 3.24 In August 2017, officers met with the developer to consider the opportunities presented by the HIF and the basis on which a robust application could be presented. The Council emphasized that genuine financial viability would firstly need to be demonstrated to the Council's satisfaction, subject to which, based on HCA advice, a bid for c£15m would be considered; 50% above the standard grant threshold and reflective of the HCA's desire to enable the project.
- 3.25 In September 2017, the Council and Crest exchanged letters setting out respective positions and to confirm i) the requirements for submitting a HIF bid and ii) the process thereafter. The Council stressed to Crest its unwillingness to support an application to secure HIF funding only to find that there was any prospect of the project still remaining unviable or that Crest was unwilling to proceed.
- 3.26 Crest's letter to the Council of 25th September 2017 confirmed the extent of the viability gap, gave confidence in their development appraisal and confidence as to Crest's continuing commitment to the project, and was considered sufficient for the purposes of the Council submitting the HIF bid. The application for £15.2m was submitted as the Council's priority bid on 28th September 2017.
- 3.27 On 1st February 2018 the Ministry of Housing, Communities and Local Government announced that the King Alfred was among the successful bids and at £15.222m it was the second highest award in the country. A period of financial clarification followed and this was concluded in June 2018, with formal confirmation of grant funding expected by July 2018.

- 3.28 Following several months delay on the part of the HIF, the Council received formal confirmation of HIF funding from Homes England on 11th September 2018. The offer of £15,222,601 is subject to conditions and legal exchange of the Grant Determination Agreement (GDA), completion of which is required by 31st December 2018. The GDA, which is yet to be issued as it is reliant on completion of related matters, including satisfaction of pre-contract conditions, will set out the formal contractual arrangements, including standard conditions of funding, eligible expenditure, outputs to be delivered, monitoring information, clawback arrangements etc. The legal agreement will be between Homes England and the Council. The Council will therefore require Crest to indemnify the Council.
- 3.29 The Council and Crest met with Homes England on 13th September, to discuss the terms of the offer, particularly the deadlines associated with conditions, both Pre and Post-Contract. The timetable is known to be tight, something the HIF delay has exacerbated, with HIF funding required to be expended by 31st March 2021. Whilst the timetable can still be met, any further delay to concluding the DA and to Crest immediately commencing detailed design and the planning application process, will jeopardise HIF funding and therefore the project. Homes England is agreeable to modest adjustment to project milestones to reflect project delays but has reiterated the significance of the 31st March 2021 deadline for spend.
- 3.30 The latest HIF milestones, updated by Crest in November 2018, serve to highlight the already challenging timetable, something that has been increasingly truncated. Even if it was possible to enter the DA in December 2018 the very earliest date that demolition would commence, something that requires everything from this point to run to schedule, is November 2020, with construction of the basement car park starting in February 2021. This demonstrates that any further delay, whether due to viability, inaction, or unforeseen circumstances, risks the loss of HIF funding as a consequence of which the project is unviable.

Viability Gap (September 2018)

- 3.31 In August 2018 Crest advised the Council that it was preparing updated financial appraisals to take account of build cost inflation since submission of the HIF bid. Crest presented the updated appraisals to the Council on 19th September. These identified a new and significant viability gap, which Crest initially presented as an additional public funding requirement (i.e. either additional HIF grant funding or additional Council capital contribution). The Council immediately advised Crest that no further public funding was likely, especially at this late stage, and of the risks posed by further slippage.
- 3.32 A senior level meeting was held on 2nd October, a meeting at which Crest advised that it was undertaking a further review of build costs and values in the hope of improving the financial position. The Council wrote to Crest on 4th October advising of the need for urgent attention and setting a deadline of 24th October for response. Crest was asked to provide written confirmation of Crest's continued commitment, a firm willingness to enter into the DA by the end of 2018, and to promptly progress the planning application in accordance with the programme requirements set by Homes England and the Council. The Council's letter also reiterated that Crest should continue to work on the basis of no more

than the £8m capital contribution from the Council (this is the basis on which the procurement was conducted). Further, on the 8th October, Homes England advised that “The current funding for the King Alfred project is over the maximum already and no further funding would be available.”

- 3.33 Crest responded in a letter of 22nd October. The letter advised that the viability review was yet to be concluded and requested a meeting with the Council.
- 3.34 A further meeting with Crest was held on Friday 26th October. Crest’s Managing Director presented Crest’s final proposals and stated that if they were accepted by the Council, they would enable Crest to conclude and enter into the DA.

Crest’s Final Proposals

- 3.35 At the 26th October meeting, Crest set out a new proposal for addressing the viability gap. In support of this they explained that construction cost inflation (of around 4%) plus sale price flattening / reducing (-1%) had opened up a new viability gap of approximately £16m. Crest explained that should their final proposal not be acceptable to the Council then, given all that has gone before, they would have no other option but to withdraw from the project.
- 3.36 Crest reiterated its commitment to delivering a new King Alfred centre and explained that part of the reason for viability being so challenging is the high cost of meeting the Council’s requirement to build the leisure centre on this site – primarily due to the cost of having to provide basement parking, but also due to the Council’s mandatory requirement for 20% affordable housing on site.
- 3.37 Crest proposed closing the viability gap by securing a grant to deliver the affordable housing through a registered provider with funding support provided from Central Government’s Homes Programme. This approach would be outside of the planning process and would be secured through the development agreement with the Council as the landowner rather than as the local planning authority and would be agreed prior to the submission of any planning application.
- 3.38 The draft DA requires Crest to commit to deliver a minimum of 20% affordable housing as part of the scheme; this being a mandatory bid requirement, and on which basis Crest was selected as Preferred Bidder. Crest initially proposed removal of the obligation to deliver 20% affordable housing and replacing it with a ‘reasonable endeavours’ obligation to achieve a minimum of 20% affordable housing. This would be subject to a viability test at the post-planning stage prior to going unconditional.
- 3.39 As part of this, Crest would submit to the Local Planning Authority a planning application for a scheme with a very significantly reduced level of s106 affordable housing (possibly even 0%), subject to a full viability assessment through the planning process in the usual way. The 20% affordable housing target would then need to come as ‘additionality’ funded via a grant supported Housing Association. Crest formalised its proposal to the Council in its letter of 31st October.
- 3.40 The King Alfred Officer Team considered Crest’s proposal and responded in the Council’s letter of 1st November. The letter advised that “Because of the inherent

uncertainty as to the meaning of “reasonable endeavours”, changing the requirement from a full commitment to a “reasonable endeavours” or even an “all reasonable endeavours” would be the same as removing the commitment altogether. Because of this and because of the procurement regulations, the Council cannot agree to a watering-down of Crest Nicholson’s commitment to provide 20% affordable housing.” Also, that “It would amount to a material change that would necessitate a new procurement and therefore expose the Council to an unacceptable risk of a procurement challenge.” Crest was therefore asked to confirm that it is prepared to enter into the DA with its contractual commitment to the provision of 20% affordable housing.

- 3.41 Crest responded in a letter dated 9th November. In their letter they accepted the Council’s view on their “all reasonable endeavours” proposal and presented a revised approach in which they commit to provide 20% affordable housing “unless otherwise agreed with the Local Planning Authority (LPA) as part of the formal planning process and following an independently verified Financial Viability Assessment.”
- 3.42 It goes on to say “If the LPA agree the scheme cannot support 20% on viability grounds, then an affordable homes viability review mechanism would apply – and this would be undertaken on completion of the last unit. The review mechanism would enable an off-site affordable housing payment to be made from any remaining surplus proceeds up to an agreed level in lieu of on-site provision, subject to an overall cap of 20% affordable homes on the King Alfred site.”
- 3.43 The Crest letter also identifies two potential sources of funding that it considers is capable of assisting towards the 20% affordable housing requirement i.e. the Council purchasing affordable housing on site and grant funding available via leading Registered Providers as part of the Government’s Homes Programme.
- 3.44 Crest’s proposals, coming as they did relatively late in the day, lacked clarity. The King Alfred Officer Team therefore called an all-parties legal meeting for 21 November 2018 to advance the details of the proposals. The Council’s legal team amended the draft DA and returned the document to Crest as a means of formalising the working arrangements were this approach ultimately to be agreed. The broad principles behind the proposal are largely agreed with Crest, but further negotiation is required. A summary of the draft Affordable Housing Provisions is included at Appendix 1, which is an extract of the relevant sections of the DA together with some relevant definitions.

Crest Financial Appraisal

- 3.45 Crest’s latest appraisal, issued to the Council and Deloitte Real Estate, the Council’s Commercial advisors, on 20th November, highlights the current financial challenges. As stated earlier in this report, at the time of their final tender (August 2015), the scheme met the Council’s requirements, including the provision of 20% affordable housing, and was financially viable. Their updated appraisal, with the retention of 20% affordable housing, shows a current funding shortfall, on top of that previously addressed by HIF funding, of c£29m if Crest is to achieve its minimum profit threshold of 20% net margin. Crest submitted additional supporting financial information on 23rd November and this is subject to ongoing

review by the council's commercial advisors. The outcome of this analysis will form part of the next report to Committee.

QC Opinion No.2

- 3.46 On 8th November 2018, the Council instructed James Goudie QC to provide a legal opinion on Crest's final proposals and the procurement and state aid implications. The opinion says that if there was a procurement challenge based on the proportion of affordable housing, the Council would have a reasonable prospect of success defending such a challenge if the commitment to provide 20% affordable housing was replaced with a reasonably robust alternative, such as linking the requirement to the decision of the LPA and having a mechanism to deliver any gap between 20% and any lower requirement of the LPA. He further advised that the Council should serve a further standstill letter because the Council has modified the terms of the contract and therefore the previous standstill was premature.
- 3.47 In relation to state aid, Counsel considers that there may be State Aid and identifies that this raises the question whether there would be an exemption from the requirement to obtain approval from the EU Commission. He gives the example of the General Block Exemption Regulation which might negate any State Aid risk by allowing the providers of the 'aid' to follow a quick notification procedure. At the time of writing officers are following up on Counsel's suggestion and are exploring exemption routes with their specialist external legal advisors. The report to Committee in January will include an update on the State Aid risk and the steps the Council will take to mitigate it.

Timetable

- 3.48 The priority since the February 2018 HIF announcement has been progression of the DA. All-party legal meetings have continued throughout 2018, the most recent of which was held on 21st November, with further meetings planned in the lead up to the committee meeting. The DA is now nearly finalised following progress made during November 2018. The latest version of the DA was issued to Crest's lawyers on 23rd November and, at the time of writing, officers are waiting for their feedback. It is proposed that a further report will be brought to Committee in January. The purpose of this would be to get authority from Committee for the final DA.
- 3.49 Subject to the Council's agreement to Crest's proposed approach to the delivery of affordable housing, and the finalisation of terms for the DA shortly thereafter, the indicative timetable for the continuation and delivery of the project is as follows:

Event	Timescale
1. Update PRG Committee on progress and secure agreement to proceed and finalise the DA	6 th December 2018
2. Council issues Standstill (Alcatel) letter	Mid-December 2018
3. Terms of DA finalised	By end of December 2018
4. Crest Board approval to enter DA	December 2018/January 2019
5. Expiry of standstill period (30 days)	Mid-January 2019
6. Report final version of DA to PRG Committee and secure approval	24 th January 2019
7. Enter into DA	End January/Early February 2019
8. Crest commences detailed design and planning consultation	February 2019
9. Planning application submitted (12 months from entering DA)	Feb 2020
10. Planning application determination	Mid 2020
11. DA goes unconditional	Second half of 2020
12. Enabling works and demolition commences	End 2020/Early 2021
13. Construction commences	Early/Mid 2021
14. New public sports and leisure centre completed	2024
15. First residential units completed	2024
14. Development completed	2025/26

- 3.50 This timetable differs from Crest's assumptions used for the purposes of the HIF milestones shown in paragraph 3.30 and further demonstrates the challenges to achieving the HIF programme for spend.
- 3.51 The final DA will have to include clear performance milestones in the early stages of the project to ensure that upon signing any agreement Crest move quickly towards preparation and submission of a final scheme and a planning application. We will seek to insert dates into that agreement that will allow the city council to terminate if key dates are not met.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS:

- 4.1 In the 3 years since appointment of the developer, in response to their early stage identification of additional costs, the Council has considered a range of proposals put forward by the developer aimed at bringing the project back into viability. During an initial 18 month period, detailed analysis of various proposals confirmed that, having completed a 'Competitive Dialogue' procurement process, options were limited as, following appointment, the expectation is that the developer will deliver its final tender. It has however been possible to accommodate modest adjustments that have improved the position, and where the award of HIF funding was to be the means by which the selected scheme could be delivered.
- 4.2 The fact that a new funding gap has arisen at such an advanced stage is disappointing but should be viewed in the context of an economic outlook whereby construction costs have been increasing but house value decreasing. This project relies on a significant surplus being generated from the sale of the housing to fund the new leisure centre. It is therefore very sensitive to the

changing economic conditions. Since September 2018, when the developer advised the Council of the latest financial position, the Council and developer continued to review the opportunities aimed at addressing this, within what were known to be significant constraints. Those discussions confirmed that, in view of the results of the earlier analysis, the passage of time, and the increasing time pressures brought by the HIF funding, there were three potential outcomes:

- a) Crest Nicholson commit to deliver the scheme consistent with its final tender, enter into the DA on this basis by the end of 2018, and immediately commence the detailed design process towards submission of a planning application by the end of 2019.
- b) Crest is unwilling to enter into the DA on the required basis, and within the required timeframe, and either advises the Council of its withdrawal from the project or the Council considers it is necessary to terminate Crest's Preferred Bidder status, or
- c) The Council agrees to revised terms relating to the delivery of 20% affordable housing on site as a means of unlocking the development.

4.3 Should the Council determine that it is either unable or unwilling to revise the terms of the DA as requested by Crest, the Council would need to terminate the current project and its relationship with Crest, and begin the process of considering alternative delivery routes. This would result in a significant delay to the project and a much longer timescale to delivering a new King Alfred leisure centre when compared to the proposed timetable for continuing with Crest in para 3.49.

5. COMMUNITY ENGAGEMENT AND CONSULTATION

5.1 Agreement to conclude the DA with Crest will secure their agreement to commence the detailed design and consultation process leading to submission of a detailed planning application. Crest proposes three stages of consultation during that 12 month period, a process that will involve residents, users and stakeholder groups, and sports governing bodies. Crest's team fully appreciate the importance of this stage, are experienced in this area, and are committed to ensuring an effective process.

6. CONCLUSION

6.1 At the time of Crest's appointment the scheme was viable, albeit only marginally. Had Crest been able to advance the scheme in line with the originally anticipated timetable, with building works commencing in 2017, there was a reasonable prospect that it could have been delivered successfully. Three years on, having faced annual financial challenges which the award of HIF funding was expected to address, options to keep the project on track are now extremely limited. Not for the first time the project has reached a critical juncture, but unlike those earlier points, the latest viability gap and Crest's final proposals to address it, represent the final opportunity to move forward with Crest and its scheme.

6.2 The existing King Alfred Leisure Centre, acknowledged as approaching the end of its useful life at the time the Council embarked on the current exercise,

continues to deteriorate. It is more important than ever that a long-term solution is found. The Council has therefore been committed to exploring all potential opportunities to progress the current project, especially given the resources and time spent on it since Crest's appointment. It is however mindful of the European public procurement regime, state aid, the process, options and experience since Crest's appointment, and the latest specialist legal advice received.

- 6.3 There is a pressing need to either conclude the DA and enter into contract, or pursue an alternative approach. This urgency is driven by the prolonged period since appointment, service and political pressures, and the additional demands of the HIF process.
- 6.4 The legal advice is that the procurement issues raised by Crest's final proposals are manageable, subject to the Council taking appropriate measures. This is on the basis that the Council would have reasonable prospects of success if there was a procurement challenge based on the proportion of affordable housing if it replaces the commitment to provide 20% affordable housing with a reasonably robust alternative, such as linking the requirement to the decision of the LPA, and having a mechanism to deliver any gap between 20% and any lower requirement of the LPA.
- 6.5 This is positive, offering as it does a potential way forward but, should Members agree that it is appropriate to go down this route, and subject to the final terms of the DA, it is critical that the Council remains confident that the Crest scheme is truly viable and that Crest is committed and able to deliver it. The Crest appraisal clearly demonstrates that the scheme cannot currently support 20% affordable housing, or indeed anywhere near that percentage. In supporting the more flexible terms, the Council would be accepting that Crest's planning application could conceivably deliver no affordable housing. Whilst the proposed viability mechanism is designed to incentivise Crest to deliver affordable housing, there is no guarantee that this will be achieved. Future financial conditions remain uncertain, and it is possible that financial viability may worsen. Were this to be the case, Crest would have few other routes to explore, as a consequence of which they may again approach the Council with a view withdrawing from the project on the grounds that it is not viable, or seeking to reduce costs in other ways such as reducing the sports centre specification. The Council has to date been very firm that it is not prepared to reduce the sports centre specification as it would be contrary to the procurement process.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

- 7.1.1 The original scheme proposed by Crest and approved by Policy and Resources Committee in January 2016 included a leisure centre that exceeded the council's minimum specification, delivery of 20% affordable housing and was close to the developers desired profit level of 22.5%. At that time the development appraisal showed a profit of 20.6%. As part of this scheme the council will contribute £8m funded through borrowing with the financing costs of £0.73m per annum being met from revenue savings from a new leisure centre.

- 7.1.2 In August 2017 the development appraisal was reviewed and increased costs identified creating a funding gap. Subsequently a bid was made to the Housing Infrastructure Fund (HIF) on a marginal viability basis for £15.2m reflecting a developer's profit level of 20%. The bid was successful but includes a tight timescale for delivery to ensure the HIF funding remains secured. The council are the accountable body for this allocation.
- 7.1.3 Since the successful HIF bid, Crest has completed a further review of the development appraisal which reflects further cost increases and residential values reducing, including the omission of ground rent income as a result of proposed changes in legislation, creating a further funding gap. This appraisal includes both the £8m council contribution and the £15.2m from HIF and shows a developer profit level of 7.4%, approximately £29m below the 20% profit requirement and is a level that is too low for a commercial developer to proceed.
- 7.1.4 Therefore for the development to be successful a combination of cost savings and increasing values will be required. If the current appraisal did not include affordable housing then the developer profit would increase to 12.4%, £19m below the 20% profit requirement, which is still below a viable commercial level and therefore Crest will need to identify further cost savings or additional revenues to make the project viable even without affordable housing.
- 7.1.5 The leisure centre specification is assumed to deliver at least £0.73m savings per annum to fund the council contribution and therefore any variation of the specification as a result of cost savings measures will need to be assessed for its revenue impact and compliance with the procurement procedures. Other options include reviewing the number of enabling housing units and or improving the building efficiency.
- 7.1.6 If the Development Agreement is entered into then the council would not be liable for transferring either the HIF funding or the council contribution until the project goes unconditional which is subject to a viability test following a successful planning consent.

Finance Officer Consulted: James Hengeveld *Date:* 26/11/18

Legal Implications:

- 7.2.1 The legal implications are set out in the body of the report. If the recommendations in this report are accepted by Committee, officers will serve a standstill letter on Bouygues setting out the change to the affordable housing commitment in Crest's Final Tender.
- 7.2.2 A procurement challenge must be brought within 30 days (although this can be extended for 'good reason'). The contract will therefore not be executed during the 30 days following the delivery of the standstill letter to ensure that the risk of challenge from Bouygues has passed.
- 7.2.3 One critical matter that was not determined during the course of the procurement was how the Council could be protected if the developer walked away from the development before building the sports facility. The Council has broadly agreed with Crest (but is awaiting confirmation of the detailed drafting) that the Council

will have a restriction over one of the residential blocks (A2) to prevent the residential units being sold before the sports centre is built. A certain number of units will be released from the restriction as certain development milestones are reached.

- 7.2.4 At the time of writing this report, the DA is at a near final stage, but is not yet finalised and officers are awaiting detailed comments from Crest's legal team on the latest draft of the DA that was returned to them on 23 November 2018. Schedules and ancillary documents to the DA are yet to be agreed, notably the form of parent company guarantee and the HIF Indemnity Agreement. The Sports Centre Specification, Design Protocol and longstop dates are also outstanding.

Lawyer Consulted: *Alice Rowland* *Date:* 26/11/18

Equalities Implications:

- 7.3 There are no specific equalities implications arising from this report, but the provision of sports facilities that are accessible to all sections of the community are important to increase participation and subsequently improve health and well-being.

Sustainability Implications:

- 7.4 The developer will be required to meet the council's objectives around sustainable development in relation to policies within the Submission City Plan. Sustainability was emphasised in documents issued during the procurement process, was a focus during dialogue and considered as part of the evaluation process, for both the sports and leisure centre element and the wider enabling development. Crest's final tender provided extensive details of its sustainability proposals and these would be taken forward as the design is further developed.

Any Other Significant Implications:

- 7.5 All significant implications are dealt with in the body of the report.

SUPPORTING DOCUMENTATION

Appendices:

1. Draft Affordable Housing Provisions (extract from draft DA and subject to further negotiation)
- 2.

Documents in Members' Rooms

None

Background Documents

1. Policy & Resources Committee report 11 July 2013
2. Policy & Resources Committee report 21 January 2016

APPENDIX 1

KING ALFRED DEVELOPMENT

DEVELOPMENT AGREEMENT (Draft as at 27 November 2018)

Provision relating to the provision of Affordable Housing

Selected Definitions

"Affordable Housing" means housing subject to restrictions in respect of occupiers or rent or sale price or tenure or carrying any subsidy for land or cost or housing required to be transferred to or managed by a local authority or registered provider or other association or charity (and for the avoidance of doubt this shall include low cost intermediate shared equity and any form of affordable housing as defined in Annex 2 of the National Planning Policy Framework 2012 (and any replacement or successor planning framework, policy or statute) and any form of Discount Market Rented Units).

"Affordable Housing Shortfall" means the difference between the Deliverable Percentage and 20% (by unit number) of the residential units built as part of the Final Approved Scheme.

"Affordable Housing Units" mean the units of Affordable Housing either within the Development or on a specified off-site location acceptable to the Council (as local planning authority) or to be provided by the Developer as a planning gain contribution under the Planning Agreement.

"Affordable Housing Viability Threshold" means 20% of the Net Profit to be achieved by the Developer.

"AH Viability Assessment" means the Affordable Housing financial viability assessment referred to in Clause 4.40.

"AVR" means an Affordable Housing viability review to be carried out in accordance with Clauses [4.42 to 4.49] inclusive.

"AVR Expert" means the firm of [Accountants/Surveyors] who will carry out the AVR as appointed in accordance with Clause 4.41.

"Deliverable Percentage" means the percentage of Affordable Housing that the local planning authority determines should be provided on Site as part of the Application; as provided for in clause 4.39.

Extracted Provisions

- 4.39 The Developer shall procure, in pursuing the Application that the allocation of Affordable Housing on the Site as part of the Development shall be 20% of the total number of Residential Units unless such percentage is varied or modified by the local planning authority and in which case the Developer is to notify the Council of the Deliverable Percentage once it is notified of it by the local planning authority.
- 4.40 If the Developer considers that the Deliverable Percentage means that the Affordable Housing Viability Threshold will not be met the Developer shall within ten Working Days deliver to the Council an up-to-date AH Viability Assessment together with an explanation (having regard to the content of the AH Viability Assessment) as to why it believes that

the Affordable Housing Viability Threshold will not be met in all the then prevailing circumstances and confirming the percentage of Affordable Housing that the Developer will be able to provide on the Site in order to meet the Affordable Housing Viability Threshold.

- 4.41 If the Council agrees with the content of the AH Viability Assessment (or where the Parties disagree then following a referral by both or either Party of the matter in disagreement to the Expert under Clause 45 the Expert confirms and agrees the content of the AH Viability Assessment as issued by the Developer) that the Deliverable Percentage is such that the Affordable Housing Viability Threshold will not be met, then the provisions of Clauses 4.42 to 4.49 inclusive shall then apply and the parties shall jointly appoint an AVR Expert.
- 4.42 [If the Deliverable Percentage is significantly less than 20% the Council shall be entitled to a period of up to twenty Working Days to consider whether or not it wishes to determine this Agreement.]
- 4.43 If the Deliverable Percentage is less than 20% so as to give rise to an Affordable Housing Shortfall and the Council has not exercised its right to terminate this Agreement pursuant to Clause 4.42, the Developer shall immediately use reasonable endeavours to convince the local planning authority that Affordable Housing provision on the Site means that the Affordable Housing Viability Threshold for the Developer cannot be met and as such, suitable alternatives should be explored, including the acceptability of making a payment, in accordance with Clause 4.44 to Clause [4.48] inclusive, in lieu of the provision of the Affordable Housing Shortfall.
- 4.44 Where this Clause 4.44 applies, then forthwith on completion of the sale of ninety-five per cent of the total number of Residential Units on the Development, an AVR shall be carried out by the AVR Expert within ten Working Days of that event occurring so as to determine the final Net Profit for the Development and such surplus monies as remain after the Developer has deducted, from the Net Profit, its 20% sum as referenced in the definition of Affordable Housing Viability Threshold and where a surplus still remains then the provisions of Clause 4.46 and 4.48 shall operate sequentially and in that order.
- 4.45 To enable the AVR, the Developer shall make available to the AVR Expert all records relating to the Development and the sales of Residential Units together with an updated Financial Appraisal and any information supporting such Financial Appraisal.
- 4.46 In the circumstances set out in Clause 4.43 where the local planning authority accept such approach and a payment is to be made in lieu of the provision of Affordable Housing on Site, then the Developer shall forthwith pay to [the local planning authority] a payment in accordance with Clause 4.47 in respect of such number of Residential Units as equals the Affordable Housing Shortfall.
- 4.47 Where this Clause 4.47 applies, the sum to be paid by the Developer shall be the lower of: (i) a sum equivalent to the open market value of the Affordable Housing Shortfall that is calculated but still permits the Affordable Housing Viability Threshold to be achieved and (ii) the full balance of the surplus funds referred to in Clause 4.44.
- 4.48 If following any payments made pursuant to Clause 4.46 and/or Clause 4.47 there still remains a balance of surplus funds referred to in Clause 4.44 then any remaining surplus monies shall be applied as follows:
 - (a) the Developer shall be entitled to then deduct a further sum equal to a maximum of 2.5% of the Net Profit to be achieved by the Developer (that sum being the balance of the 22.5% set out in the Financial Appraisal); and

- (b) any surplus funds thereafter remaining will be split equally between the Developer and the Council in accordance with the terms of the Revenue Overage Deed.
- 4.49 In circumstances where the local planning authority will not accept a single payment referred to above in lieu, but will accept a partial payment, or where the Council decides (in its absolute discretion) that it wishes to add to its Affordable Housing stock as an alternate to the payment in lieu (in whole or part referenced above) then the Council may purchase any or all of the Residential Units in the Development as represent the Affordable Housing Shortfall) at a comparable open market block discount as agreed between the Parties so as to be designated for Affordable Housing with such purchase terms being on the Developer's standard terms for sale of the Residential Units on the open market, but at a total price for the relevant amount of Residential Units that is calculated so as to allow the Developer to achieve as a minimum the Affordable Homes Viability Threshold.
- 4.50 The Parties agree that they would expect the above to be recorded in detail following negotiations with the local planning authority in a Planning Agreement or failing that in a separate collateral agreement as between the Parties so as to ensure the proper enforceability of these provisions and the election that the Council could make under Clause 4.46, 4.49 and 4.51.
- 4.51 The Developer will (as and when required by the Council following Clause [4.41] being satisfied) and whether as part of a Satisfactory Planning Permission or otherwise contact at least 1 registered provider of Affordable Housing (approved of and nominated by the local planning authority) in the locality of the Site to discuss that provider taking an allocation of Affordable Housing on the Site amounting to a maximum of 20% in number of the aggregate number of Residential Units and the Developer shall provide to the Council in a timely fashion such detail of those discussions and settled heads of terms as it shall have, and act in an open and honest way in any such disclosures with a view to trying to maximise the number of Affordable Housing Units that can be delivered via the process of obtaining a Satisfactory Planning Consent, but subject to the Affordable Housing Viability Threshold being met.
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