



Priestley Road Campus and Plot K Basing View Update Councillor Izett, Portfolio Holder for Property and Development

Report to	Cabinet
Ward(s):	Eastrop and Popley
Key Decision:	Yes

Confidential Appendix 1: Finance Report

Confidential Appendix 2: Updated s123 Commentary – Cushman & Wakefield

Confidential Appendix 3: Updated Risk Register – February 2019

Papers relied on: Cabinet Report 5 December 2017

Cushman and Wakefield Investment Report

Foreword - Cllr Izett, Cabinet Member for Property and Development

It is necessary to return to Cabinet for approval for additional capital budget to pay for higher costs than forecast in the original construction cost plan and to enable the agreement entered into with Eli Lilly to proceed on a viable financial basis. The significant value and benefits to the borough of continuing to proceed with the new HQ for the company at Basing View remain and it is important therefore that solutions are found urgently so that we can meet our commitments as a council and the proposed transaction can proceed.

It is disappointing that the original construction costs forecast have been exceeded following further due diligence investigations. It is, however, in nature of major development construction projects that sometimes unexpected and in some instances, unforeseeable, problems emerge after initial cost estimates have formed the basis of a conditional agreement. Original Cabinet approval to the project was given in February 2018 in response to Eli Lilly's urgent internal funding approval timetable when the cost of costs of the enabling works and construction of the new building were at an early stage and required considerable further work to achieve cost certainty. Cabinet approval was made subject to the final cost of the new office building and that is why a cap was inserted. We do of course rely on the development expertise of our appointed development partner, Muse, who will now assume the risk of any further cost movements.

The request for additional funding therefore follows intensive further due diligence work over many months and tough negotiations in order to achieve a way forward for this important project on a basis that still provides for a good financial return for the borough. In achieving this outcome I would wish to express thanks to our colleagues at M3 LEP who, in recognition of the long term benefits of this development, have offered additional funding support.

Recommendation to Cabinet :

It is recommended that:

- (i) Cabinet notes the reasons for the increases in development costs and the proposed additional funding of part of this increase by the council as investor, the developer and the tenant.**
- (ii) Cabinet notes that for the purpose of section 123 of the Local Government Act 1972 the new development continues to represent best consideration for the council's land holding.**
- (iii) Cabinet recommends Council to agree an increase of £1.2 million in the council's capital budget, comprising £0.5m additional BDBC investment and £0.7 million LEP loan, for the investment in a new office building on Basing View with a revised capital budget of**

£24.3 million, funded from a lease surrender premium, capital receipts, LEP grant and loan and the use of £8.9 million from Property Investment Strategy funds.

- (iv) Subject to Council approval of the additional budget, Cabinet approves the release of the budget in accordance with the confidential financial appendix 1.**

Background, corporate objectives and priorities

This report accords with the council's Budget and Policy Framework and directly supports the Council Plan priorities of improving economic vitality and increasing skills and employment through the regeneration of Basing View to retain and create high value office based jobs.

Main considerations

1 Executive Summary

- 1.1 In December 2017 Cabinet approved forward funding for the enabling of Plots K and K1 on Basing View, the development of a new 45,000 sq ft HQ office building on Basing View for one of the longest standing employers in the Borough, Eli Lilly, and a new multi storey car park to service both plots. In addition Cabinet approved the surrender of Lilly's existing Long Leasehold interest in its campus on Priestly Road to enable it to move to Basing View.
- 1.2 A capital budget of £23.1m was approved comprising of lease surrender premiums, capital receipts, a LEP grant and loan and the transfer of £8.9m from the Property Investment Strategy Fund.
- 1.3 When the deal was originally agreed in February 2018, and in accordance with the provisions of the Development Agreement, the council's development partner, Muse produced an initial appraisal. Lilly required the deal to be concluded in this timescale to ensure funding for the development was secured from a global re-structuring budget; at the time the design was not finalised and the budget based on a consultant's cost plan.
- 1.4 Since this time Muse has undertaken detailed design work, secured a planning consent and obtained contract sums from its own construction contractor, Morgan Sindall Construction who, under the terms of the Development Agreement, can be appointed. The construction cost and the associated design fees have unexpectedly changed and caused the overall cost of the project to increase by £1.9m.

In Q3 2018 Muse made the council and Eli Lilly aware of the cost overrun since which time extensive due diligence and value engineering has been undertaken by Muse and its team of consultants. This process has been

rigorously and closely monitored by the council officers and its retained consultants. A comparable process has been undertaken by Eli Lilly.

- 1.5 The construction project has three main elements; the enabling works, the office building and the multi-storey car park. Muse now has fixed price sums for the cost of the enabling works and the office building from its construction contractor. The car park design is still subject to a minor design variation which is being addressed through the planning process so the cost has not yet been fixed but Muse confirm that the provisional sum will be adequate to meet the cost.
- 1.6 Through on-going design and procurement processes the project has much greater cost certainty. When the construction contracts are let the construction cost risk will be borne by Muse and its contractor.
- 1.7 Extensive and exacting negotiations have been undertaken with all parties, and in particular, Muse, Morgan Sindall Construction (including its sub-contractors and supply chain) and Eli Lilly. As a result of this process, contributions to fund this cost increase have been secured from all parties to the transaction. Consequently, Muse has provided an updated appraisal which demonstrates viability.

2 The Proposal

It is proposed to proceed with the funding of the transaction on the revised terms and in accordance with the Finance Report at Confidential Appendix 1 which also sets out the quantum of cost overrun and the contributions to meet these.

2.1 The main heads of cost overrun are:

2.1.1 Car park design and regulation

The original appraisal scheme assumed the use of an off the shelf naturally ventilated multi storey car park; early market testing substantiated the initial budget. As detailed design progressed it became apparent that due to site constraints and fire regulations the car park design would need to be re-designed to take into account additional fire measures. Although the original scheme secured planning permission, due to a more rigorous approach to Building Control following a multi storey car park fire in Liverpool, Muse established that the consent was not implementable.

Muse consequently appointed a specialist car park design consultant who has designed an alternative scheme that is now the subject of a minor, section 73 planning amendment. This is under consideration by the local planning authority and is understood will be determined within the statutory timescale by April 2019.

2.1.2 Sewer Diversion

Initial asset reports provided by the relevant statutory bodies, and which were relied on for planning, indicated that there were no services running across

the site but there was a foul sewer on the eastern boundary. The original design was based on this sewer remaining in situ with the access road laid over it. Additional, subsequent ground surveys confirmed that the sewer, in fact, runs across the site and therefore has to be diverted at significant cost. Muse is finalising an Agreement with Thames Water to agree the design of the diversion

2.1.3 Changes in the façade specification

During the detailed design discussions on the façade it was identified that what had been specified in the original Agreement and then the subsequent planning application were different with the latter being a more expensive solution. A compromise solution has been identified which is more expensive than the original specification but less expensive than the design for which planning has been secured.

2.1.4 Ground Conditions

Muse developed the nearby John Lewis Partnership store and therefore had experience of the anticipated ground conditions. Ground investigation surveys, however, identified worse than expected conditions with an abundance of poor quality chalk. This has resulted in a re-design of the retaining wall and foundations with both requiring additional piling and the depth of the foundations almost doubling.

2.1.5 Professional Fees

Additional professional fees have been incurred in resolving all the above issues.

3 Key issues for consideration

- 3.1 Cushman and Wakefield, the council's retained consultant Chartered Surveyors have updated their s123 report and investment report. The new terms are still s123 compliant and the returns meet the council's objectives.
- 3.2 The council's Economic Masterplan for Basingstoke 2033 includes ambitions to fully regenerate Basing View to provide a business location of regional importance. The aim is to deliver new jobs and increased GVA in a thriving business park location by targeting inward investment and the provision of new commercial development of Grade A offices.
- 3.3 The Council Plan 2016 – 2020 includes an objective to 'create jobs and opportunities by supporting new and existing businesses and highlights work to proactively revitalise Basing View and attract new companies, together with existing occupiers, to invest in the business area resulting in increased take up of new office accommodation'. Retaining Eli Lilly in the borough as a major occupier is therefore supported by the Council Plan and the socio-economic priorities of the council.

- 3.4 In terms of the regeneration of Basing View, pre-letting a new office building makes a significant contribution to maintaining the current momentum created by the speculative development of The Florence Building which has been successfully fully let shortly after completing. This will engender confidence in existing businesses within Basing View to remain and grow and importantly encourage both further investment and new businesses to locate to the area.

4 Options Analysis

- 4.1 There are 2 options for the Cabinet to consider:

4.1.1 Progress with the transaction as proposed

- (v) The revised proposal enables retention of a global pharmaceutical company and safeguards the associated circa 400 high value, skilled jobs.
- (vi) The site falls within the recently designated Enterprise Zone and as such will generate Business Rates Income Growth estimated to be approximately £400,000 per annum. This income, managed by the Enterprise M3 LEP, will be available for future re-investment in the EZ following the repayment of LEP funding for the scheme.
- (vii) The proposal accords with the Council's objective for Basing View to be a primarily office-led regeneration project.
- (viii) The parking for both buildings on Plots K and K1 will be built as part of this transaction. The spaces associated with the office on Plot K will not be required until that building is developed. In the meantime the car parking spaces can be let on short term licences creating short term rent and rates income.

4.1.2 Do nothing

- (ix) In the event that the council chooses not to proceed on the proposed basis the viability test within the Development Agreement would fail. Under the terms previously agreed with Eli Lilly, a short term lease would be put in place on the Priestley Road campus, owned by BDBC, with Landlord and Tenant breaks. There is a risk that, if the revised transaction was not approved, Eli Lilly could relocate from the borough.
- (x) The 2 sites on Basing View would not be developed and in the case of Plot K1 would not provide income for the council to fund its services and in the case of Plot K would not be readied for development of a further new office building to meet ongoing demand for Grade A offices in the borough.

- 4.2 Having regard to the available options it is recommended that Cabinet proceeds with the transaction as proposed.

5 Corporate implications

5.1 Legal Implications

N/A

5.2 Financial implications

- 5.2.1 Due to commercial confidentiality detailed financial implications are attached as confidential appendix 1.
- 5.2.2 As explained elsewhere in this report, there has been an increase in cost of the new development of £1.9 million and following extensive review and negotiation it is proposed that the council agrees to contribute £0.5 million and the LEP contributes 0.7 million via loan towards this additional investment with the balance being met by the developer and Eli Lilly.
- 5.2.3 The council's additional contribution can be funded from the use of £500,000 in uncommitted capital receipts generated from the sale of land for the hotel site on Basing View and by a loan of £700,000 from the Local Enterprise Partnership (M3 LEP). The terms of the loan are that interest will be charged at 2% and loan repayments will only be required when the council generates additional income from business rates growth from the enterprise zone i.e. Basing View.
- 5.2.4 The additional annual business rates from the new Eli Lilly office investment is expected to be approximately £400,000 and the council will receive 50% of this once the M3 LEP has recovered its Basing View grant funding of £3 million (with the other 50% going to the M3 LEP). It is difficult to estimate when this will be as it depends on the total amount of business rates income from Basing View but it could be in the region of 5 to 10 years, with the council loan then being repaid within a further 7 years. In the event that the loan is not repaid within 25 years the loan agreement states the council and the M3 LEP will then be required to renegotiate.
- 5.2.5 The additional council funding will increase the total capital budget for the investment from £23.1 million to £24.3 million and financial analysis has been undertaken which shows that this reduces the investment return from 5.9% to 5.6%.
- 5.2.6 This still compares favourably with the investment return of 4.6% previously achieved from the existing Priestly Road Campus Eli Lilly lease and reflects changes in the terms of the new lease, which involves more risk to the council mainly due to a shorter lease period with Eli Lilly of 15 years rather than 124 years and higher letting/void risk.
- 5.2.7 A review of the investment has previously been carried out by Cushman & Wakefield (CW) and this has been revisited following the increase in costs. The updated investment report concludes that this remains an attractive investment opportunity.
- 5.2.8 The council has a statutory duty to ensure that the revised transaction continues to represent best consideration for the council (as demonstrated by

a section 123 valuation report) and that the proposal is state aid compliant. The external valuation report that was produced, based upon the initial costings, has been therefore reviewed as set out in appendix 2 and the conclusion is that the restricted land valuation has not increased and therefore the transaction continues to satisfy best consideration requirements.

5.3 Risk management

5.3.1 An updated risk assessment has been completed in accordance with the councils risk management process and forms Confidential Appendix 3.

5.4 Equalities implications

5.4.1 None

6 Consultation and communication

6.1 The transaction is the subject of a confidentiality agreement.

7 HR implications

7.1 The current proposal has no human resources implications for the council.

8 Conclusion

8.1 Summary and reason for the decision

Further due diligence on the preliminary construction costs for the new HQ building for Eli Lilly has revealed increased project costs in a number of significant areas. In order to achieve a viable project cost plan the parties involved have carried out value engineering and further commercial negotiations. The revised proposed cost plan agreed will enable the project to proceed.

The revised proposal continues to provide an opportunity to increase the council's revenue return; generate a capital receipt to fund core services; safeguard highly valued local jobs with an employer synonymous with the borough; expand the council's property portfolio with a modern, well-let asset; continue the office-led regeneration of Basing View and bring forward a further significant site, K, for re-development.

8.2 The options considered and rejected

Do nothing

Date: 5 March 2019
Decision taken by: Cabinet

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Status	Part Exempt
Confidentiality	It is considered that information contained within this report contains some exempt information under the meaning of Schedule 12A of the Local Government Act 1972, as amended, and therefore cannot be made public.