

Item No	Classification: Open	Date: 9 July 2012	Decision Taker: Finance Director
Report title:		Heygate Estate – Demolition Business case	
Ward(s) or groups affected:		East Walworth	
From:		Director of Regeneration	

RECOMMENDATION(S)

That the Finance Director:

1. Approves the attached Business Case (Appendix A) for the demolition of the Heygate Estate and notes that a further report will be provided to the Housing Investment Board prior to the award of the demolition contract.

BACKGROUND INFORMATION

2. The cabinet on 22 November 2011 considered a report on variations to the Regeneration Agreement with Lend Lease. The report noted that it had become “apparent on financial, safety and reputational grounds that it will be beneficial to the council to bring forward the demolition of the Heygate estate”.
3. The cabinet agreed in principle to provide funding for an early start on the demolition of the Heygate Estate with Lend Lease project managing the work subject to the Finance Director agreeing a satisfactory business plan for the project and that funding is in place to enable the works to proceed using re-profiled regeneration funds from the Housing Investment Programme without detriment to the delivery of the *Warm Dry Safe* programme.
4. Phase 1 demolition was completed in July 2011. These works were funded from the Housing Investment Programme at a cost of £1.25 m. Under the terms of the Regeneration Agreement these costs are not recoverable from Lend Lease.
5. Prior to the cabinet decision in November the Housing Investment Board [HIB] had considered a proposed business case for the partial demolition of the remainder of the Heygate Estate. This proposal proposed that the council forward fund the second phase of demolition comprising Swanbourne, Kingshill and the maisonette block on Wansey Street. A phased approach has been re-appraised and the conclusions from this assessment are considered in the main part of the report.
6. In light of the November cabinet decision the purpose of this report is therefore to provide the Finance Director with an updated business case to support the provision of grant funding from the council to meet the costs of the demolition of all the remaining parts of the estate in a single phase.

KEY ISSUES FOR CONSIDERATION

7. A Business Case for the demolition works has been prepared and is appended to this report (Appendix A). It includes an outline scope of works, base cash flow, base programme and risk matrix which will be used to monitor the programme. This business case assumes a single contract for phase 2 and 3 is let rather than the phased approach which had previously been discussed at HIB. In summary the high level features of the business case are;

- The base case budget is currently estimated at £15.225m including a 10% contingency
- Budget estimates are based on Heygate phase 1 demolition outturn figures
- Works will be subject to competition and the invitation to tender will include survey information on asbestos, ground conditions, structural and mechanical and engineering issues
- The indicative cash flow forecast for the project is for this expenditure to take place during 2012-15 as follows;

2012/13	2013/14	2014/15
£1m	£7m	£7m

- Lend Lease are estimated to reimburse the council £15.692 m in 2015/16

8. The risk matrix attached as appendix F identifies a number of issues which could have implications for the project timetable leading to either increases in the budget, delay in expenditure being incurred, or delay in Lend Lease reimbursing the council. These risks include those associated with the timetable for the determination of the planning application and the process for securing vacant possession of the remaining leaseholders who are located in the area north of Heygate Street which is likely to require a Compulsory Purchase Order. There is also a risk that there are greater amounts of asbestos in the buildings than assumed in the base budget and that grounds remediation works are higher than anticipated. The base budget therefore includes a 10% contingency sum which is considered reasonable for this type of project.

9. The environmental impact regulations now encompass demolition works and therefore the environmental statement submitted in support of the Lend Lease outline application has to be formally agreed by the Local Planning Authority [LPA] before the buildings can be physically demolished. For the purposes of the business case Lend Lease have advised that their planning performance agreement with the LPA identifies October as the earliest possible date for a decision on the application. It should be noted that a valid planning decision can only be formally issued once the s106 agreement is completed and given the complexity and scale of this application this is unlikely to occur before the end of the year. Therefore a delay to this decision making process or a legal challenge could delay works from commencing in line with programme assumptions. However, activities associated with pre demolition surveys, disconnection of utilities, soft strip of buildings and tendering to select a contractor can all be undertaken in advance of the determination of the planning application.

10. In February 2010 the council's Executive authorised officers to proceed with a Compulsory Purchase Order to secure vacant possession of the estate. There are currently 4 leaseholders remaining on the site although only two of these directly occupy units. The current programme for the CPO process anticipates that an order will be published in July and that an inquiry could be held to consider objections by the end of the year. This programme if adhered to would see the order confirmed by spring 2013 allowing the demolition works to be implemented in line with the base programme in the business case.
11. In addition to the 4 leaseholders there are three further interests that are not currently in council control as follows;
 - a. The first of these is the Crossway's Church on New Kent Road who own the freehold of their site. Discussions with the church to identify an alternative site suitable for a new facility are progressing well.
 - b. There are 2 commercial units within central buildings that are still occupied. The leases for these expire in November 2013 and will not be renewed. This constraint has been built into the proposed phasing plan within the business case.
12. Some changes to the Regeneration Agreement [RA] will be required in order to give effect to the cabinet decision. These will take the form of a trigger mechanism to enable the council to call for Lend Lease to carry out the demolition of the estate subject to funding being in place for this. A further report will be made to HIB prior to the award of the contract to enable a final review of budget implications to be made. In addition the changes to the RA will ensure that the costs associated with the demolition of the estate will be refunded by Lend Lease at the point at which they draw down the Heygate land and the scheme goes unconditional. These changes are currently being discussed with Lend Lease with a view to completing the revisions of the RA by end of July 2012.

Alternative Funding Options

13. As noted in the background section of the report a phased approach to the demolition has been considered. A phased approach cannot commence any earlier than the full demolition recommended in this business case. This is because the environmental statement submitted with the Lend Lease planning application still has to be agreed before demolition can commence. A two phased approach would require additional procurement and legal processes to appoint the main contractors and sub consultants. It would involve two mobilisations. It would represent a less coordinated approach to utility disconnections and diversions. Inevitably this would require a longer programme, and would be less efficient than a single phased approach. As a consequence the available evidence suggests that this option would cost the council more and would not represent value for money when compared with the single phased approach recommended in the business case.
14. An alternative to the council funding the demolition would be for Lend Lease to raise finance for the project from the commercial market. A review of this option has concluded that this would cost around £3m more than the recommended option. This is based on finance costs of 8% p.a compounded over the three year period for the

works [2012/13-2014/15]. Under this arrangement these costs would be channelled through the development account adding to the overall project costs. The effect of this would be to potentially reduce the overage available to the council once Lend Lease costs and profit have been deducted from the final account. It is therefore considered that this option which involves higher costs does not represent best value for the council when compared to the option recommended in this business case.

Business Case Conclusions

15. The November 2011 cabinet decision makes clear that the main driver for bringing forward the demolition of the estate is to address safety concerns. Council forward funding of the works is considered to be the only effective way by this objective can be achieved. These costs will be reimbursed to the council in full [including indexation] by Lend Lease once the scheme goes unconditional. This is currently expected to occur in 2015/16. This requirement to reimburse project costs with indexation will act to incentivise Lend Lease to maintain cost discipline. Lend Lease have submitted an outline planning application for the Heygate site and are on programme to comply with conditions within the Regeneration Agreement and thereby meet this programme. In the unlikely event that Lend Lease were unable to proceed to an unconditional scheme the council would be in possession of a 23 acre cleared site in a central London location with the benefit of planning consent. In these circumstances the council could proceed to dispose of the site and use the receipts to replenish the capital programme.
16. As detailed in the financial section below funding to commence these works is available now and would not impact on the council's ability to deliver its Safe , Warm , Dry commitments. Alternative funding options have been considered but it has been concluded that none of these offer best value to the council when compared with the preferred option recommended in this report. A commercially funded approach is likely to cost around £3m more. Revenue savings are expected to total £2m over the three years. When coupled with the preferred option this represents a cost avoidance of £5m when compared with alternative options.
17. Drivers Jonas Deloitte [DJD] are retained by the council to review and monitor project costs. Having considered the business case material supplied by the council DJD are of the opinion that the conclusion the council has reached to fund the demolition of the Heygate Estate is a sensible one. DJD have further confirmed that they agree with the conclusion that of funding that Lend Lease can procure would be likely to exceed the costs of funding by the council. The report from DJD is attached as Appendix G.

Finance Implications

18. The baseline budget for the Heygate demolition is estimated to be a total of £15.225m including 10% contingency. A revised baseline cash flow has been produced by Lend Lease which shows how this total is expected to be spent on a monthly basis throughout the duration of the programme. This total sum comprises two elements as follows;
 - a. An initial tranche of funding of £1.020m to meet initial project costs which are needed to prepare the blocks for demolition and to produce the specification, methodology and technical drawings which will form the tender documentation for the works. This tranche of funding will in part be used to

undertake asbestos, engineering, ground conditions and structural surveys and to disconnect utilities.

- b. A larger second tranche of monies totalling £14m which is the estimated costs of the demolition of the estate including fees. The actual cost of this phase of works will be subject to a competitive tender process. Officers and DJD will participate in this exercise and will review tenders to ensure the council is securing best value for its funding.

19. At this stage the council is only fully committing to fund the initial tranche of costs that will be incurred by Lend Lease. The revised Regeneration Agreement will include a trigger that will enable the council to require Lend Lease to carry out the demolition of the estate. It is therefore only at the point at which this mechanism is triggered that the council will be formally committing the bulk of the project funding. A further report will be made to HIB prior to the award of the demolition contract to ensure a final review of the implications for the Housing Investment Programme [HIP] can be made. Under the current baseline programme this is expected to occur in spring 2013 subject to planning consent and vacant possession.

20. The indicative cash flow forecast for the project is for this expenditure to take place during 2012-15 as follows;

2012/13	2013/14	2014/15
£1m	£7m	£7m

21. Sufficient funds are available from the HIP to meet the initial tranche of funding which is scheduled to be spent in 2012/13. This expenditure will not have an impact on the delivery of the Warm Dry Safe programme.

22. The HIP is currently forecast to be able to fund the forecast level of expenditure for 2012/13 and to partially fund the estimated 2013/14 costs. As noted above the council will only formally commit to these costs if it triggers the demolition clauses within the RA. Balances in the HIP permit cashflow of expenditure using a combination of existing budget allocations and a balance of £5m already set aside to support demolition costs in future years. Therefore the implications for the HIP [and the delivery of the Warm Dry Safe programme] will need to be reviewed before the clauses are triggered to ensure that the costs can be met.

23. Expenditure in 2014/15 will need to be considered as part of the capital refresh. Based on successful completion of the agreed demolition programme [and subject to the contract going unconditional], reimbursement of costs from Lend Lease to the council including an agreed indexation rate will occur in 2015/16.

24. The cash flow forecast also includes an estimated forecast of repayments that Lend Lease are expected to make to the council once the scheme has gone unconditional. This has been calculated on the basis of forecasts regarding building cost inflation. The actual repayments will be based on actual TPI rates as they apply during the works programme. The TPI at repayment index figure in the cash flow will therefore vary depending on when the demolition costs are repaid by Lend lease. In

the baseline cash flow the total amount repayable by Lend Lease is £15.692m in 2015.

25. Under the terms of the Regeneration agreement the council is responsible for the disconnection and removal of sub stations on the Heygate estate. These costs are not recoverable from Lend Lease. There are 4 substations within the area covered by the business case. The estimated costs of removing these are around £800k. These costs are not included in this business case cash flow forecast. It is anticipated that costs arising from the removal of the sub stations will be funded from existing approved HIP funds for the Elephant and Castle.
26. The early demolition of the Heygate estate will also result in potential revenue savings for the council. The projected expenditure for the Heygate estate for 2012/13 & 2013/14 is estimated at £1.5m. This figure includes a rebate of £0.5m received in 2012/13 in relation to Council Tax. These savings will arise from the cessation of ongoing safety, management, and maintenance and council tax obligations. The exact level of saving is difficult to quantify at this stage as it will be directly linked to the progression of the scheme detailed in this business case.
27. A separate funding agreement will be prepared in conjunction with legal covering the council's detailed financial administration requirements for the processing of invoices resulting from this project.

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Strategic Director of Communities, Law & Governance

28. The report to cabinet on 22 November 2011 referred to at paragraph 2 sets out the background to the variations to the original agreement with Lendlease. One of those variations was to change the programming of the demolition works in order to bring forward the regeneration of the earlier phases of the Elephant & Castle area pursuant to the Regeneration Agreement ("RA").
29. At that time it was noted that although variation of the RA brought with it an increased risk of legal challenge, it was thought that this risk was mitigated by various factors, including that the changes benefited not only Lendlease but also the council, and that the changes were to bring forward the regeneration programme, making it more likely that deadlines would be met, thus avoiding penalty payments having to be made by the council if these deadlines were missed.
30. This report notes at paragraph 24 that the repayment to be made to the council will be index linked, thereby mitigating against the council's loss in cash flow terms. The report further notes at paragraph 26 that early demolition will bring with it revenue savings for the council in terms of safety, management, maintenance and council tax obligations.

Finance Director concurrent AV/FR/190612


31. The finance director notes the financial implications of the report and that full reimbursement of all expenditure incurred by the council in relation to the business

case for demolition will be made by Lend Lease to the council once the scheme has gone unconditional.

32. The advice of DriversJonasDeloitte in support of the business case is noted. The amount quoted in the case effectively presents a base scenario, which could be subject to change as circumstances on site develop. The council therefore intends that it will always receive back from Lend Lease the full amount of cost incurred under the arrangement plus the agreed indexation factor, unless otherwise agreed in writing between the parties.
33. Within the Housing Investment Programme (HIP) the council has made a budget provision to meet the forecast project land assembly costs. This budget has capacity to meet the cost of the first amount due under the arrangement and further provision has been made in earmarked reserves to provide £5m of funding in future years.
34. It is acknowledged that the funding position in the HIP is such that further funding is likely to be available from existing balances as the demolition progresses, but that the formal agreement of this will be the subject of a further report prior to the demolition contract being let.
35. The cost of officer time required to manage the programme is containable within existing staffing establishments.

FOR DELEGATED APPROVAL

Under the powers delegated to me in accordance with the council's contract standing orders, I authorise action in accordance with the recommendation(s) contained in the above report.

Signature  Date...9.7.12.....

Designation ...FINANCE DIRECTOR.....

BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
Cabinet Report Regeneration Agreement Variations Nov 2011	http://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=302&MId=3817&Ver=4	

APPENDICES

No.	Title
A	Heygate Estate demolition Business Case
B	Base Case and Scope
C	Base cash Flow
D	Budget Summary
E	Base Programme
F	Risk Matrix
G	Report from Drivers Jonas Deloitte

AUDIT TRAIL

Lead Officer	Eleanor Kelly - Chief Executive	
Report Author	Jon Abbott, Elephant and Castle Project Director	
Version	Final	
Dated	9 July 2012	
Key Decision?	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES		
Officer Title	Comments Sought	Comments included
Strategic Director of Communities, Law & Governance	Yes	Yes
Finance Director	yes	Yes
List other officers here		
Cabinet Member	No	No
Date final report sent to Constitutional/Community Council/Scrutiny Team	9 July 2012	