Highways Option Appraisal
June 2019

1. Background

1.1. A 'high-level' options appraisal (OA) was carried out on the Highways in 2015 and the results reported to Property & Contracts SMT at the time. A refresh of this was carried out in February 2017 and again reported back to SMT. Both OAs noted that the most cost effective option was to carry out structural repairs to the blocks (which were built in 1962 and have already exceeded their original design life). Demolition and re-provision was not recommended due to the costs involved and the restricted size of the available site (c1.2 ha) for redevelopment.

1.2. Since then, a refurbishment project was initiated with Mears, and some enabling works began on-site but projected costs kept increasing. A visit to a national large panel system conference in London in late 2018 also highlighted significant concerns about carrying out refurbishment with tenants in situ (no other LAs were proposing to do this, disruption would be prolonged and significant). Other concerns were raised regarding the risks of costs increasing further once intrusive works began and of the likely lifespan of any strengthening works (works only warranted for 15 years).

1.3. At the same time, the lifting of the HRA borrowing cap has presented an opportunity to reconsider proposals for the Highways, as funding could potentially now be secured, via prudential borrowing, for the re-provision of the homes provided in these blocks.

1.4. This document provides details of a revised OA, carried out in Spring 2019.

2. Assumptions Used in the Options Appraisal

2.1. There are numerous assumptions underpinning the financial analysis used for the OA. All figures have been calculated over a 30-year period. These include:

- Rents for existing dwellings are based on current rents and rent policy (i.e. decreasing by 1% for 4 years from 2016/17) and then increasing at an assumed 2.5% p.a to reflect an assumed CPI+1%.

- New build rents assumed to be Council rents and therefore in line with the above.

- Maintenance costs per dwelling are based on average unit cost of £913 p.a. across all the LCC stock, as provided by Housing Finance for 2018/19. This has been inflated at 2.5% p.a. Whilst the average maintenance costs per unit might be lower in any new build stock there is no evidence base to support what this cost might be, and the use of an average cost per unit, over a 30-year period is deemed more prudent, and has been kept in all options.

- No lifecycle replacement costs have been factored in to any options (e.g. new kitchens, bathrooms, heating, lifts etc). Assumed to be covered from maintenance costs per dwelling and ongoing planned investment via the capital programme.

- Clearance and demolition costs, and associated rental loss and maintenance savings based on an assumed three year programme, emptying the units over the first two years with demolition in Year 3.

- Related homeloss and disturbance payments assumed to be £6,930 per dwelling (£6,300 statutory homeloss plus 10% for removals and storage, mail redirection etc).

- Demolition costs of £2,253,119 (inclusive of 10% contingency), provided by Corporate Property Management Team in May 2019, inflated at 2.5% p.a.

- New build costs are based on an average of £129,000 per unit, based on historic scheme costs that LCC have paid using a competitive tender process, as advised by Asset Management & Regeneration, plus 10% contingency. New build phased over 2 years after blocks are demolished.

- Refurbishment costs are based on the 2018 price schedule from Mears (Rev 2) at £10,258,722, inflated at 2.5% p.a. to 2021/2, plus 10% contingency, for the two blocks. Works phased over two years. Additional costs at £15k/unit, plus 10% contingency, added in for new kitchens, bathrooms and heating systems in each flat. A further £1m, plus 10% contingency, added for renewal of lifts in both blocks. OA financial model assumes no further strengthening works are required within the 30-year life of the OA model.

- The costs of buying back the two leasehold properties has been factored in to all options except Option 4 - Refurbishment, at an assumed £60k/unit, inflated at 2.5% p.a. plus 10% contingency. One unit has recently been valued at £65k (with a £2k reduction on the offer made due to a lack of storage heaters). This cost is included in the OA. Homeloss payments for the leaseholders are also included.

3. Options Considered

3.1. The OA considered four different options for the future of the blocks – a ‘managed decline’ of the blocks over the next decade, followed by demolition and no redevelopment (this is effectively the ‘do nothing’ option); pro-active clearance and demolition over the next four years, with no redevelopment (to establish a baseline cost position for taking action); demolition and redevelopment of 120 new units; and refurbishment of the existing blocks with tenants’ moved out. Refurbishment with tenants’ in-situ has been discounted to the reasons outlined in 1.2 above.

3.2. Each option has had a financial Cost/Benefit Analysis conducted for it. These are discussed in more detail in sections 4-7 below.

3.3. The recommended option is clearance, demolition and redevelopment of 120 new council housing units.

4. Option 1 – Clearance and Demolition Over the Next Ten Years (Managed Decline)

- Initial Capital Expenditure (CAPEX): - £0m (although repurchase of leasehold flats and demo costs c£3m in Yr9-10. Also assumes no homeloss payments to tenants)
- NPV - -£7.8m.

- Return on Investment (ROI) & Payback Period – This option provides an ROI of -77% and doesn't payback within 30 years (and won't ever payback due to ongoing lost rent). By Year 30 it has made a nominal net loss of £13.9m – due to the loss of rent for 120 units over 20 years, plus demolition and associated costs.

4.2. This option has been included to demonstrate that allowing the blocks to decline has a negative financial impact. It represents the 'do nothing' option but is not viable (due to impact on tenants, associated H&S risks etc) and is not proposed for further consideration.

5. Option 2 – Clearance and Demolition Over the Next Four Years (Baseline)

- Initial Capital Expenditure (CAPEX): - £3.2m. (repurchase of leasehold flats, homeloss and demolition costs).
- NPV - -£10.6m.
- ROI & Payback Period – This option provides an ROI of -81% and doesn't payback within 30 years (and won't ever payback due to ongoing lost rent). By Year 30 it has made a nominal net loss of £16.7m – due to the loss of rent for 120 units over 30 years, plus demolition and associated costs.

5.2. This option has the lowest initial cost of those considered but is not recommended as it results in the loss of 120 social housing units, in direct contradiction to the Best Council Plan ambitions around housing growth. It does provide a baseline position for action though – dealing with the issues around the build life of the blocks by pro-actively emptying them and rehoming the current residents has an NPV cost of almost £11m over the next 30 years.

6. Option 3 – Clearance and redevelop with 120 units

- Initial CAPEX - £20.2m.
- NPV - -£12.4m.
- ROI & Payback Period - This option provides an ROI of -37% and doesn't payback within 30 years. By Year 30 it has made a nominal net loss of £9.8m.

6.2. This option has the highest initial costs of those considered, although it provides a 'better' ROI and less of a nominal loss than the clearance and demolition proposals modelled in Options 1 & 2.

6.3. However, what the cost benefit analysis for this option doesn't cover is the social and financial effects of this proposal over a longer period than that modelled here. Any new build properties would have a significantly longer expected life-cycle than the current Highways blocks (c60 years vs only 15 years warranted from the strengthening works in the refurbishment option) and therefore likely have significantly less major investment needs in terms of ongoing strengthening works etc. New build properties would also offer improved thermal efficiency, accessibility and space standards etc. New build units would also provide '*modern, fit for purpose homes and neighbourhoods*' in line with our asset management strategy priorities, as well as '*housing of the right quality, type, tenure and affordability in the right places*' as per the Best Council Plan. They could also potentially be let at higher rents if required.

6.4. Extending the cost/benefit analysis to 60 years shows that this option then has an NPV value of -£6.7m and it achieves a nominal payback in Year 44. By Year 60 it has made an ROI of 50% and a 'profit' of £18.2m. That said, there are ever more uncertainties extending a financial analysis over this length of time.

6.5. It is therefore recommended that the opportunities presented by the lifting of the HRA borrowing cap are explored to fund the development of new build housing to replace the number of units in the Highways blocks. New build archetypes and unit sizes to be informed by housing needs in the area(s) developed.

6.6. A more detailed prudential borrowing case could be also be established, demonstrating the case for utilisation of borrowed funds to finance the new build element. While that is outside the scope of this OA, indicative modelling of borrowing c£17m at 4.5%[1] over 25 years to fund the new build properties would cost c£28.7m total. Assuming a similar mix of units to those in the Highways, let at similar rents, and ignoring maintenance and lifecycle costs, this cost would be recouped around year 37, and the units would bring in c£64m rent over a 60 year period. This excludes/discounts the costs to the existing HRA of financing the clearance and demolition. We are effectively looking at two different proposals – 1) the use of HRA rental income to fund clearance and demolition of the existing Highways blocks (costs c£4m incl rent lost up to demolition) and 2) the utilisation of prudential borrowing to finance the replacement of these units with new build (borrowing costs recouped after c35 years – does not include impact of maintenance costs etc, just straight rental income).

6.7. It is worth noting that the Highways site likely cannot be redeveloped with the same amount of dwellings that are currently there. The site is only c1.23 ha in size. Council guidance on dwelling density recommends 30-40 units per ha. We don't own any of the adjoining land, so there aren't any viable opportunities to extend the site. Therefore to fully re-provide the 120 units would require development on an additional site(s).

7. <u>Option 4 – Undertake Refurbishment with Tenants Moved Out</u>

- Initial CAPEX - £16.2m.
- NPV - -£7.9m
- ROI & Payback Period – This option provides an ROI of -20% and doesn't payback within 30 years. By Year 30 it has made a nominal net loss of £4.1m.

7.2. Technically, this option provides the smallest financial 'loss' over the 30 years modelled. It also ensures the ongoing provision of 120 units of social housing. However, there are also no guarantees that the refurbishment would give the buildings an additional 30-years life – the strengthening works as proposed by Mears will have only been warranted for 15 years and further strengthening may be required as these old buildings continue to deteriorate structurally (albeit at a slower rate than if left un-refurbished). And then, even after the disruption of moving tenants out, and expenditure involved, the properties will still fundamentally be 1960's built, large panel system tower blocks.

[1] The Public Works Loan Board are currently offering 25 year fixed rate loans at below 3%. The last time the rate reached 4.5% was August 2011, although clearly Brexit may impact on interest rates in the future.

7.3. Carrying out the refurbishment with tenants' in-situ has been discounted from the options considered due to the disruption caused by drilling multiple holes for strengthening anchors in the walls, ceilings and floors of every flat – this is likely to go on for up to two years, creating significant disruption over an extensive period.

8. Conclusions

8.1. Looked at on a simplistic, and purely financial basis, over a limited 30-year cycle, then there is no great difference between the clearance and demolition, clearance and redevelopment and clearance and refurbishment options. All represent a net 'cost' to the HRA over the 30 years modelled and have an NPV of between -£8-12m.

8.2. This is not a purely financial decision though. The social and logistical challenges faced in re-housing all the existing residents exist for all options. Given this, it seems prudent to consider the potential for a more transformative future for the blocks and their residents. Clearance and redevelopment, as per Option 3, funded direct from the capital programme is a net 'cost' to the HRA of c£12m over a 30-year period, and would go on to pay for itself over a longer period. Utilising the financial freedoms that come with removal of the borrowing cap makes this an even more attractive option, with the new build costs covered by prudential borrowing. It would enable the re-provision of 120 new council homes (on this site and in neighbouring areas) that address local housing needs, meet current standards and would have a considerably longer lifespan than two refurbished tower blocks. **Option 3 Clearance and Redevelopment is therefore the recommended option for the Highways.**