Initial viability and business case for development on Kesteven Street

Lincolnshire County Council & Willmott Dixon
November 2015

urbandelivery

Contents

1 Introduction

Background to commission

1.1 After the completion of the East-West route through Lincoln City Centre, Lincolnshire County Council (LCC) will have development plots in their ownership adjoining the new route. The new route is being 'development future proofed' through the inclusion of utilities infrastructure. With growing optimism in the national and local economy the time would appear to be right to investigate development of these sites.

1.2 Ideas about what goes on those plots is still at an early stage but with office development seen by LCC as the preferred choice in order to promote economic growth. Part of this commission will be to sense check if office development would be the optimal use on these sites.

1.3 LCC stated at the outset of this commission it is open to exploring different delivery and funding structures. This commission considers which structure would be most appropriate if LCC were to instigate development.

Purpose of the report

1.4 This report covers the First Phase of feasibility work. The report is an initial exploration of development opportunities on Kesteven Street; providing a recommendation on type of development, viability and delivery routes.

1.5 As part of this report we have undertaken the following tasks:

- We have reviewed existing policy, strategy documents, previous viability studies and proposals for developments adjoining the site (Notably the East-West road link and the transport hub). This is summarised in **Section 2.**
- We have completed desk based property market research and completed consultations with several stakeholders to begin to understand the demand for commercial and residential property in Lincoln. Through this analysis we have filtered possible end uses and provided recommendations on the types of uses that may be viable. This is summarised in **Section 3**.
- CPMG architects have completed an assessment of the physical potential of the site, including consultation with Lincoln City as the Planning Authority. CPMG has completed indicative designs showing the form and massing of development for 3 options. This is summarised in **Section 4.**
- We have completed an options appraisal on delivery routes and made recommendations on which would be most beneficial to LCC. This is summarised in **Section 5.**

- We have completed initial financial appraisals of Options for development in **Section 6** and undertaken a sensitivity analysis of the results in **Section 7**.
- We have provided a concise summary of our analysis and the recommended next steps in **Section 8**.

Further work required

1.6 The reader should note that this first phase of work is an initial exploration only. It should not be relied upon with regards committing to any form of development. Further work will be required ahead of development taking place. For instance:

- Further work in evidencing demand
- Full legal due diligence on the land ownerships
- Technical due diligence on planning aspects, flood risk, geo-physical, habitat, utilities etc
- Detailed design work and resulting cost estimates
- Legal due diligence with regards state –aid and procurement of the investment structures proposed

Further information

1.7 If you require further information on this report please contact Anthony Everitt, contact details below.

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2 Background information and Development assumptions

Introduction

2.1 This section provides more background information that has informed the design feasibility work and financial appraisals later in the report.

Route of the road and development plots available

2.2 Figure 1 highlights the route of the new East-West road along Tentercroft Street and the development plots available. There are three parcels of land identified as available for development.

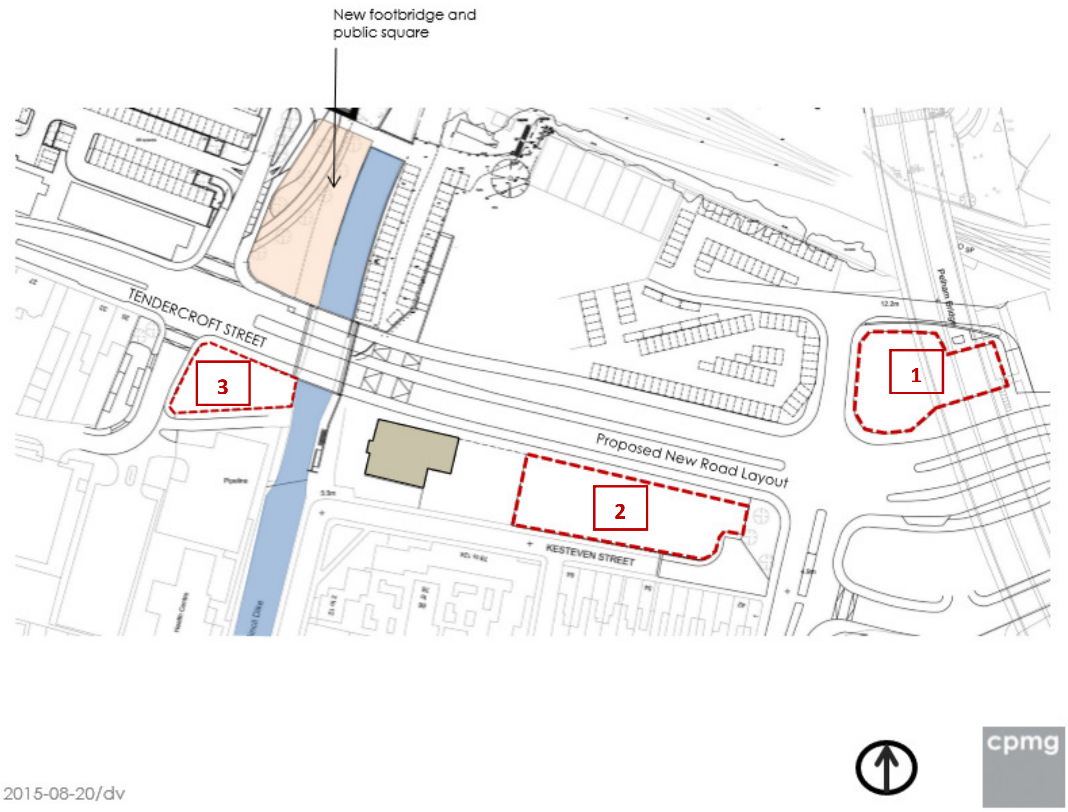
2.3 The sites are along the new East-West route, within close proximity (to the South of the railway station) of the public transport interchange being constructed. The area is on the periphery of the city centre but will grow in prominence once the East-West link and public transport interchange are completed.

2.4 **Plot 1** – is the easterly most plot and is in the shadows of the Pelham Bridge fly-over. The plot due to highways easements would not allow development. However the plot is included in this feasibility study as it could provide car parking to service the development on the other plots, specifically Plot 2.

2.5 **Plot 2** – Is to the East of the existing Wyvern House office building owned and operated by LCC. To the immediate north will be the new East-West route. Across Tentercroft Street to the North is the old Coal Yard which is earmarked for development but with no firm plans established. South of the site is Kesteven Street which is bordered by traditional terraced housing. The residential area to the South of the site is one of the most deprived areas in Lincoln. The ambition has long been for renewal / regeneration of the residential area but there are no developed plans at the time of this report. Plot 2 is the most substantial of the plots.

2.6 **Plot 3** – Is to the west of Sincil Dyke and bordered by Tentercroft Street to the North as part of the new East-West route, a day nursery across a small access road to the West and the car park for the local health facility to the South. Facing the site across the other side of Tentercroft Street will be the new pedestrian footbridge to the railway station and a public square. There is an aspiration for major development to take place on the Tentercroft Street surface level car park opposite but no plans are yet formalised.

Figure 1 – Sites considered for development



Physical constraints and development assumptions

2.7 As this is an early stage feasibility study much of the technical due diligence on the barriers for development has not taken place. In order to complete this early stage report we have made the following assumptions:

- All land is in the ownership of LCC and development is unfettered by easements, covenants or any other land ownership issues (with the exception of the known easements on Plot 1).
- There are no abnormal ground conditions, although owing to the predominant ground conditions across Lincoln City a piling foundation solution is assumed for any development.
- It is assumed there are no flood related barriers to development owing to the precedent set by the Wyvern House development. It is acknowledged however the proximity of Sincil Dyke and the development will require a flood risk analysis at the next stage of feasibility.

- It is assumed there are no other utility or sewer related impediments to growth. We have been advised that utility infrastructure will be put in place at the same time as the road to facilitate future development of these plots.

Planning policy and planning considerations

2.8 While the Local Development Framework is being prepared, the Local Plan will continue to be the main planning document for Lincoln. Once the Local Development Framework is adopted it will replace the Local Plan. The Local Plan earmarks this site as part of the larger Tentercroft Street/Kesteven Street area and states that planning permission will be granted for:

'development providing a substantial amount of housing, as part of a mixed-use development including small shops (Class A1), and/or food and drink outlets (Class A3), and/or business units (Class B1); Alternatively, planning permission will be granted for a major leisure development (Class D2), either alone or in association with any of the above uses.'

2.9 The Kesteven Street site is a small part of this wider site so our interpretation is that any of the above uses would be acceptable on the site but it is unlikely the Kesteven sites could provide a mix of all of the above.

2.10 Urban Delivery and CPMG met with Lincoln City Council's Planning Manager as part of this work. Key outcomes of that discussion are below:

- A social housing scheme in that location would not be desirable
- A residential only scheme owing to the pending wide and busy road that will be developed would not be desirable (certainly not at ground level), although residential could form part of the development mix
- Office development would be preferred, but other suggested uses could be considered
- Retail trade counters should not be considered as they would not be an aspirational development for this key gateway site and traffic/parking would be an issue
- The gateway location to the city centre means the design must be strong / aspirational. It has a job to do in marketing Lincoln
- Reasonable sized massing to provide prominence would be desirable, but designed to be sympathetic to residential uses on Kesteven Street.
- Any development would benefit from active frontages
- A substantial tower would be unacceptable owing to the views of the Cathedral
- Given how close the scheme is to the public transport interchange and the city centre, car parking would not be a requirement from a planning perspective

3 Potential uses

Introduction

3.1 It was clear early in the project that from an economic development and planning perspective there was a clear preference for an office development. Despite this we did explore other uses and quickly agreed that an office development on these sites would be the most appropriate use. This Section provides the rationale that for this conclusion.

Owner occupier residential development

3.2 In our preliminary discussion with LCC officers it was considered that residential should not be a predominant use but that it could form part of the development mix. LCC officers thought residential should be considered if it facilitated (cross-subsidised) commercial development.

3.3 The views of the cathedral and castle from the upper floors of development would put a premium value on residential development. However the site would still be on the periphery of the city centre and adjacent to a low-value housing estate. We did strongly consider the use of residential as part of the development mix and developed an option with a residential block on the Western Plot (Plot 3). When we looked at the costs and values associated with residential development we concluded that a residential development cannot guaranteed a significant subsidy for the commercial development. This Option and development value is explored in Appendix 1.

3.4 It is conceivable that a developer would pay a positive land value if he assumed he could deliver the scheme at lower costs than we have modelled and he speculated on a continuing rising market. LCC could therefore market Plot 3 and seek to sell to a developer (this remains a valid option open to the Council).

3.5 Given the aspiration from LCC is for the East-West link to unlock economic development, in consultation with LCC officers it was agreed residential should be discounted as an option owing to it not facilitating the commercial development.

3.6 ***Recommendation*** –discounted

Affordable Housing

3.7 The area south of Kesteven Street is already dominated by social / affordable housing and officer's conclusions were that these sites should not be a target location to develop further affordable housing. The provision of affordable housing would not facilitate commercial development and could even lessen occupier demand should office accommodation be promoted in this area.

3.8 ***Recommendation*** – discounted

Student housing

3.9 There is a high-level of student accommodation in Lincoln and a view was expressed as to whether the city would reach saturation point with the pipe-line of development already established.

3.10 There is a clear ability to compete with other private student accommodation providers through provision in this area, if it is delivered at the right price and quality. The close proximity to the city centre, public transport and because it is within walking distance to University of Lincoln would make this a suitable location. The demand and rental values would likely make this use commercially viable and return a positive land value (although we have not carried out any appraisals).

3.11 By providing this use on LCC land it would compete with the private market elsewhere, it would not stimulate economic development and it would preclude safeguarding the site for future commercial development. For these reasons in consultation with LCC officers this options was discounted.

3.12 ***Recommendation*** – discounted

Private rented sector housing

3.13 In looking at all residential tenures we did consider the merits of looking at bespoke accommodation targeting the private rented sector. In nearly all circumstances the sales values required to make PRS commercially attractive to institutional investors need to be lower than the presiding market values. We therefore concluded that if the viability for the market-sale scheme (see Appendix 1) was only marginal it is unlikely a PRS scheme could be made to work.

3.14 ***Recommendation*** – discounted

Live-work accommodation

3.15 As there was an appetite for office accommodation and residential as part of a mix of uses we did look at the concept of live-work accommodation. We considered the possibility of providing terraced offices with their own front door with living accommodation at the upper floors.

3.16 CPMG completed early stage ideas about what this may look like (see Appendix 4). The design of this accommodation, in the aesthetics of the urban form, was viewed very positively in discussion with both City Council planners and the LCC client team.

3.17 The idea was discounted for the following reasons:

- There is little known demand for the product and the attractiveness to commercial investors would be lessened versus traditional offices.

- The scheme would be dependent on grant funding (as demonstrated in Appendix 2) yet the number of jobs it would create would be significantly lower than a traditional office building. The scheme would be less competitive in bidding for grant funding.

3.18 Despite the live-work concept being discounted on viability grounds the concept of terraced office accommodation was taken forward as a variant to diversify the type of offices that could be offered.

3.19 ***Recommendation*** – Discounted

Extra-care housing

3.20 Extra-care housing and other types of retirement living developments are in great need and city-centre locations are becoming more popular across the country. LCC and other stakeholders may well want to consider these sorts of uses for other city centre development opportunities. For the Kesteven Street development however it was felt that not promoting the site for economic development uses would be an opportunity missed. Extra-care may be considered but only if commercial development could not be delivered.

3.21 **Recommendation** – discounted

Office development

3.22 Office development was the clear preference of both Lincoln City Council's economic development and planning officers and the LCC client team. The location of the site is viewed favourably for office development owing to its city centre gateway position and proximity to the new transport interchange. The delivery of Wyvern House has set a precedent for office development on the East-West route.

3.23 The nature of the sites we have looked at means that office development could be built in blocks and phased or alternatively brought forward together. The quantum of development brought forward as a first phase is a key decision LCC will need to make and the options appraisals undertaken in this report should help inform that decision.

3.24 At this early stage we have undertaken a preliminary examination of demand. We strongly recommend that a more detailed demand analysis is undertaken at the next stage of feasibility work. A summary of the findings to date is explored below.

3.25 Wyvern house is well occupied and anecdotal evidence suggests the space is in high demand.

3.26 Tenants in Wyvern House are increasingly demanding more intensively managed space. Managed work space normally requires a critical mass of 20,000 sqft+ for the delivery of managed office services to be financially viable. The delivery of more office space adjacent to Wyvern House has the potential to offer the critical mass so that managed office services could be offered across the buildings.

3.27 Other publicly owned managed workspace across the city is very well occupied (Greetwell Place Phase 1 is 95% occupied, the Terrace is 100% occupied). These levels of occupancy for managed workspace, from our experience in other cities, is exceptionally high and would indicate that there is not enough supply (all be it this requires further investigation).

3.28 Anecdotally Officers talk about professional service firms having located out of Lincoln City Centre wanting to return. In discussions with both Lincolnshire Business Growth officers and some potential end occupiers there is clear demand from larger professional services to have a Lincoln base as they try to get a foot-hold in the Greater Lincolnshire market. Firms with known demand include: Willmott Dixon, Gleeds, CPMG, Morgan Tucker, BFP Consulting, Rizk McCabe, Crouch Perry Wilkes. It is conceivable that this demand could result in significant parts of a new office building being pre-let in advance of LCC starting the main construction work. This demand should be explored further.

3.29 Whilst the location may be attractive to a HQ office building car parking could be an issue. The fact that a development would require grant funding also makes timing of development complicated, as a HQ occupier would require a bespoke building and that could not be built speculatively. Coinciding capturing a HQ requirement with the timing of a successful grant application would be highly improbable. There is also state-aid related complications with using grant to build offices for a defined, large end user. We would not recommend that LCC waits for a HQ requirement if it wants to move forward development within reasonable timescales.

3.30 We discussed the commercialisation and innovation park strategies with the University of Lincoln. The conclusion was the target market for the University would be for spin-out companies, companies with large R&D activities and companies aligned to and affiliated with the specialisms of the University. A more general office development should therefore not compete with what the University is trying to achieve. It will be important for LCC to continue the clear distinction of what they would be offering on Kesteven Street and not duplicate any of the University's activities. We are confident this could be achieved.

3.31 It is not straightforward to assess the development values you would put to new office buildings in this location owing to the lack of comparable developments. However premium rents do not appear to exceed £140 per sqm in Lincoln and yields (ranging from 7%-10%) reflect the secondary nature of Lincoln as an office location. At this rental value and yield it would be impossible to make a traditional commercial development viable without grant subsidy. This is demonstrated in Appendix 2. Whilst we would expect growth in these premium rental levels as the market rises and good quality modern stock is delivered it is still unlikely for some considerable time for rents to increase and yields to contract enough to make speculative multi-tenanted developer led commercial offices viable.

3.32 Despite an office scheme requiring grant our initial discussion with both LCC officers and GL LEP suggest there is a reasonable chance this could be obtained (See Section 5).

3.33 LCC Officers based on their experience of Wyvern House and other locations in the city would expect new office developments on Kesteven Street to achieve a maximum rent of c.£135 per sqm. We would consider this to be a cautious expectation and we would expect rental values to grow between now and the completion of the building owing to the transformation of the East-West route, the completion of the public interchange and the continued growth of the national and local economy. We would expect this location and the quality of the new space delivered to attract a premium rental level. Despite this we have adopted a basic rental value of £135 per sqm in subsequent appraisals in order to be cautious at this stage rather than presenting an optimistic scenario.

3.34 In summary we believe there is likely to be strong demand for offices in this location. We would advise that LCC looks at the whole of the South Kesteven sites, including the existing Wyvern House, as a campus of offices. LCC should look at providing a series of blocks which cater for diverse needs (spanning from start-ups, serviced office space, own front door office space and expansion space for growing companies or units to cater for larger firms requiring satellite offices). The quantity and specification for this space should be informed by a more detailed assessment of market demand at the next stage of feasibility.

3.35 **Recommendation** – Commercial offices, funded with an element of grant, is recommended as the predominant use in any development.

Public sector uses

3.36 In our discussion with LCC officers we ruled out the need for public sector uses on the site (police, fire, schools, GP surgeries etc).

3.37 We discussed the possible demand for office accommodation from LCC itself and this was discounted owing to their long-term desire for a more concentrated campus of accommodation in Lincoln. The timing, with the devolution agenda making the future of what Local Authorities will look like going forward uncertain, would also prohibit LCC committing to any major new office building at this time.

3.38 We discussed possible demand with the University and the conclusion was that it does not currently have a need for student accommodation, academic buildings or commercial premises in the Kesteven Street location. Towards the end of this commission we were however informed that the University had made known the possibility of requiring c.1,000 sqm of office accommodation for back-of-house functions. This possible demand should be explored further and could be instrumental in removing some of the demand risks from LCC should it move forward office development.

3.39 **Recommendations** – office development could cater for public sector need and the needs of the University of Lincoln should be explored further.

Retail

3.40 The site is close to the town centre, although officers at LCC and Lincoln City expressed views that the site would be too peripheral for high-street retail to be considered. Due to the access issues larger format retail was also discounted (supermarkets, bulky-good stores, trade-counters etc).

3.41 With the growing prominence of the East West route, pedestrian link to the train station and proximity to residential and commercial uses we did considered it appropriate that a smaller format convenience or A3 café use should be considered as part of the development mix. The rental values and yields would preclude this being a value generating use to close the viability gap but it would add diversity, active frontages, generate footfall and add local amenities to enhance an office development.

3.42 **Recommendation** – Small convenience or A3 store could form part of a development mix, but would be ancillary to main uses.

Leisure

3.43 Big box leisure uses would not be appropriate for the site owing to highways and site constraints. The location owing to its proximity to the station and city centre could accommodate a smaller budget gym which are becoming more popular nationally. This could form part of a development mix.

3.44 There are merits of the site for a small budget hotel. We are advised that the aspiration is to include a hotel as part of any development on the Tentercroft Street car park. For this reason we did not investigate the possibility further on the Kesteven Street sites.

3.45 **Recommended** – a small leisure use in the form of a budget gym could be considered as part of a development mix. This should be investigated further with regards market demand.

Industrial units

3.46 There is strong demand for industrial units with strong take up at Council owned stock. There was a clear steer provided by the City's Planning Officer that industrial units would not be an appropriate use on this site. We questioned whether trade-counter uses would be acceptable and a view was expressed that the bulky design would not create an attractive gateway and the highways implications may be prohibitive.

3.47 **Recommendation** – discounted

Summary

3.48 The result of the above analysis is that development on Kesteven Street should be predominantly offices with the possibility of A3, small retail offering some active frontages.

4 Physical form of development

Introduction

4.1 Based on the aspirations of LCC to generate economic development and the analysis in Section 3, CPMG architects has completed some indicative proposals for the scale and massing of office development on Kesteven Street. This Section shows these initial ideas. It includes:

- Option 1 - An Option for an office block development on the Eastern site (Plot 2).
- Option 2 – A variant option for office development on the eastern site (Plot 2) including a terrace of offices and a smaller traditional block
- Option 3 – A development of offices above A3 uses at ground floor on the western site (Plot 3).

4.2 Very early stage artists impressions can be found in Appendix 3.

4.3 CPMG produced options for a live-work scheme on the eastern site and a residential and A3 scheme on the western site. Both schemes were rejected on grounds of viability and not delivering the aspired economic development outputs (as discussed in Section 3). These can be seen in Appendix 1 and Appendix 4.

Option 1

4.4 CPMG has demonstrated that Plot 2 could accommodate a 3 storey building of c.1,776 sqm GIA. Key design features of their initial concept designs are:

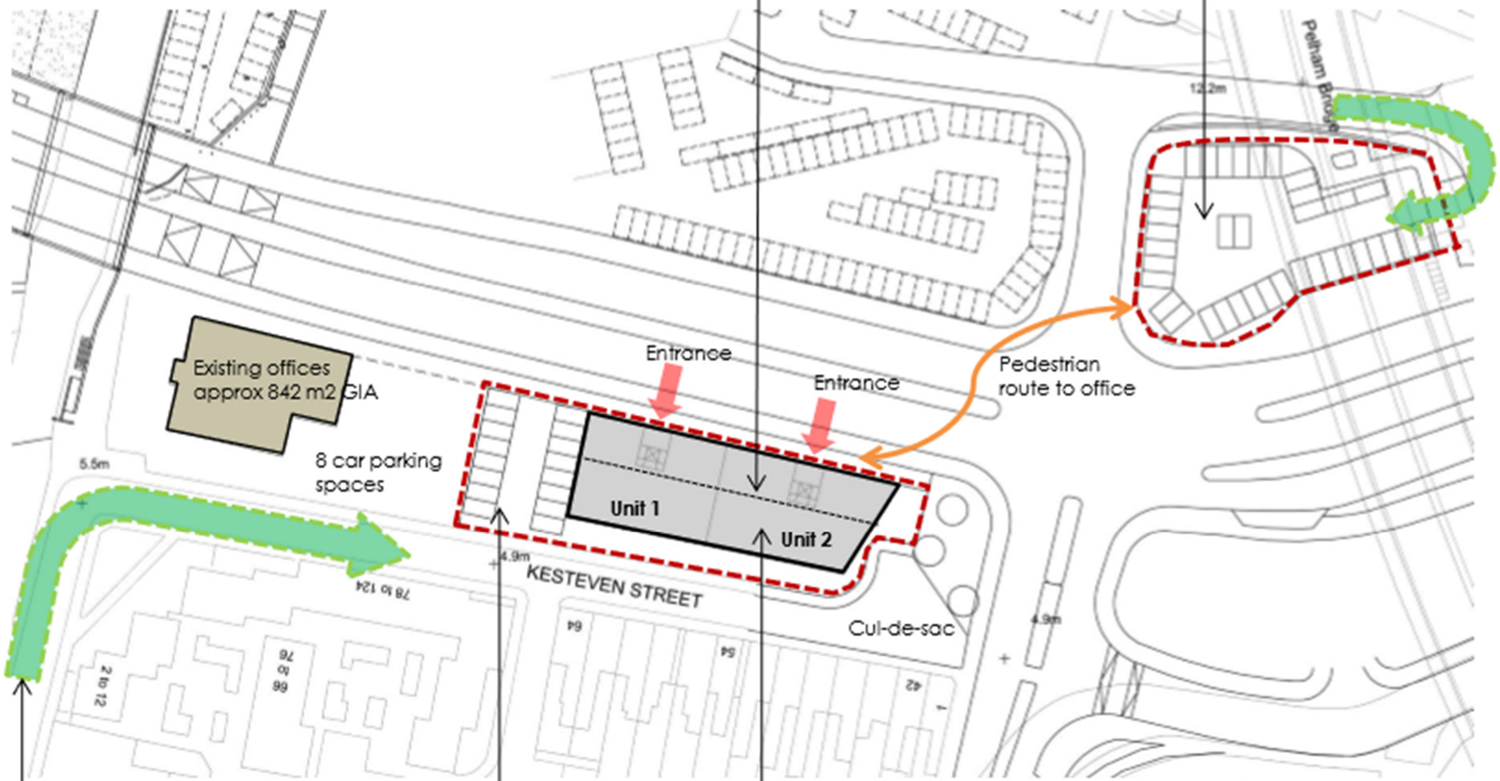
- The site is not easily accessed and this could reduce demand from professional service firms. Although the very close proximity of public transport, city centre car parking, and prominent frontages may compensate for this.
- Car parking is delivered by providing 16 visitor and disabled spaces adjacent to the building in a traditional office car parking layout. The land under Pelham Bridge is used to provide a further 37 spaces which it is anticipated could be used for staff.
- The block could be split into two, with two entrances which would allow for greater subdivision.
- The third storey offers an opportunity for meeting space / premium office space with attractive views across with city.
- It is assumed the building should not exceed 3 storeys owing to the proximity to housing.
- The entrance is on the new East-West route.
- The building is close to the roadside to create a prominent and attractive new addition to the city centre gateway.

Option 1

– 2 No of Office units, 3 storey, double core,

Line of third floor foot print

Overflow parking associated with proposed site.
Approximately 37 spaces



Primary vehicular access/egress to proposed site

16 car parking spaces

3 storey, dual core
712 m2 GIA per floor plate at first and second floor
352 m2 GIA third floor

Total of 888 m2 GIA per office unit.

Allowable Car parking based on Planning guidance of 1 space/ 30m2 GIA
Total GIA 1776m2= 59 spaces

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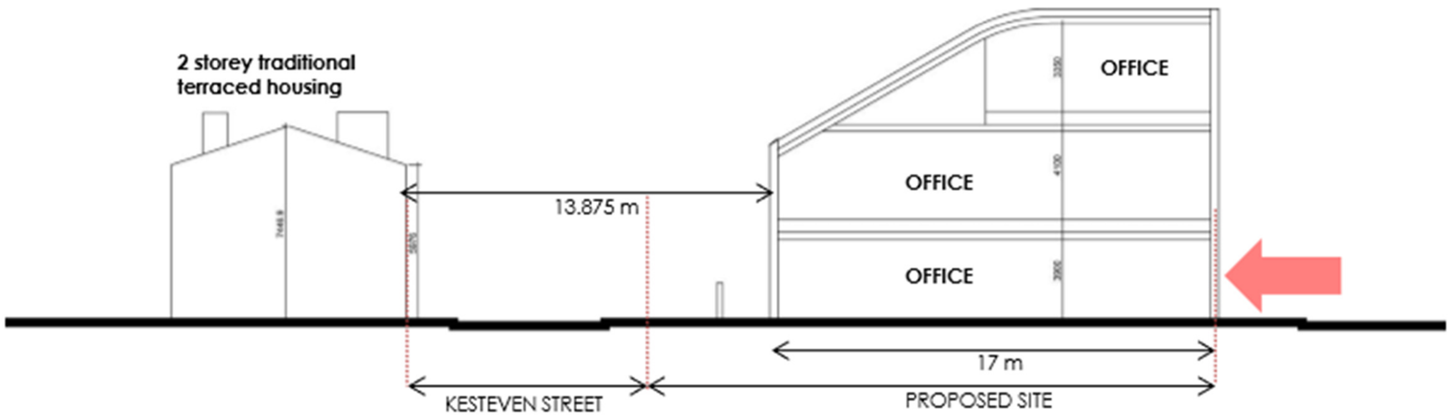
Option 1

KESTEVEN ST SITE: SECTIONS



Option 2

4.5 Option 2 shows what a variant office scheme would look like if it included terraced offices and a smaller traditional block. The design demonstrates that both an office block of 1,185 sqm GIA and terraced offices totalling 914 sqm GIA could be delivered on the site. Key design features of this are:

- Car Parking on site (20 spaces) is provided through spaces accessed directly off the high-way on Kesteven Street. Whilst this is an acceptable form of parking for housing development it is not standard for offices. This solution will require dialogue with highway officers to judge whether it would be appropriate.
- 37 car parking spaces are assumed on the site under Pelham Bridge.
- The terraces and offices are delivered as two separate blocks with pedestrians able to walk between the two blocks.
- Entrances are on to the new East-West route.
- Each terraced unit has its own front door and is over 3 storeys.
- Both blocks offer the potential of attractive views on the upper floors across the city.
- The terraced units would offer something distinct from the existing office stock in Lincoln, they would however be less efficient in terms of usable space.

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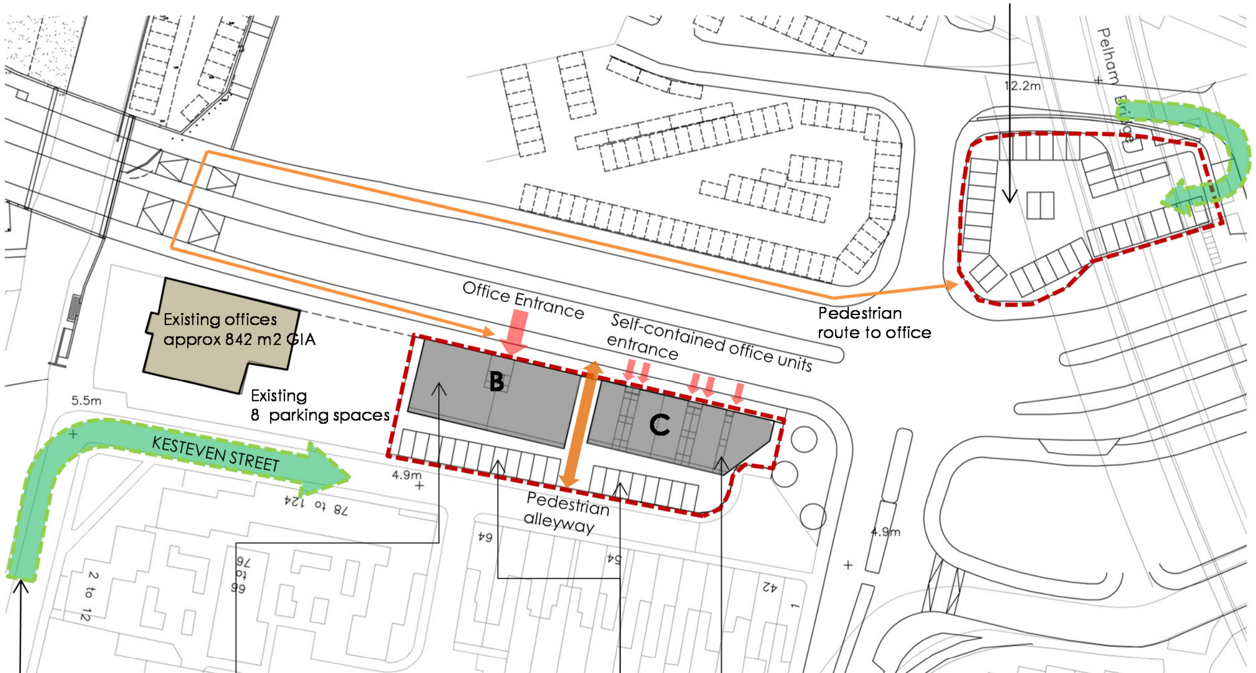
Option 2

KESTEVEN ST SITE – 5No Self-contained office units, 3 storey . 6 Office Units, 3 storey.
Overall GIA 2099m2 (22593sq ft)

Overflow parking associated with proposed site.
Approximately 37 spaces



Primary vehicular access/egress to proposed site

3 storey single core office units.
395m2 GIA(4252 sq ft) per floor plate

GIA Total
1185 m2 (12755sqft)

Building B
12 car parking spaces

Building C
8 car parking spaces

5 No of 3 storey self-contained office units.
Ground Floor office units area – 58 m2 GIA(624sq ft)/unit
Total – 290 m2
First Floor – self contained office units
62 m2 GIA (667qft)/unit
Total – 312m2
Second Floor –self contained office units
62 m2 GIA (667qft)/unit
Total – 312m2
GIA Total 914 m2 (9838sqft)

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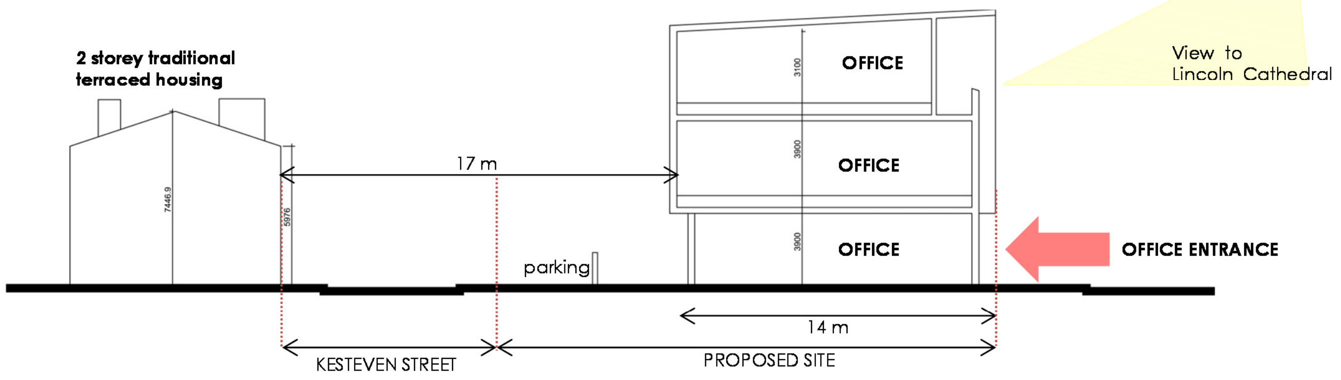
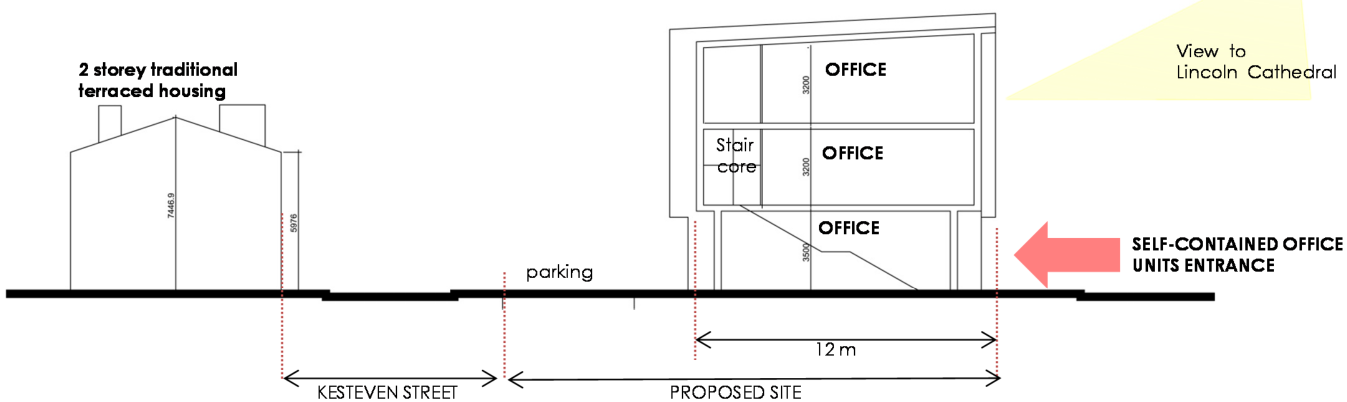
Option 2 - KESTEVEN ST SITE : SECTION THROUGH OFFICE BLOCK



Option 2 - KESTEVEN ST SITE: SECTION THROUGH TERRACED OFFICES



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Option 3

4.6 Option 3 demonstrates how a block of 271 sqm GIA retail space at ground floor and 1,344 sqm GIA of offices could be accommodated on the site.

4.7 The architect's opinion of the Western Block is that the site has real potential to make a positive impact on the street-scape. The building is the focal point of the new pedestrian route away from the station, will be highly visible from the station and over the new foot bridge and is in front of the new public space created to the north of Tentercroft Street.

4.8 The prominence of this space requires something special to make a statement about both Lincoln as a city but also the immediate area of transition associated with the new East-West route.

4.9 Key features of the proposed design include:

- 12 car parking spaces delivered on site. The offices will have access to public car parking across the road on Tentercroft Street and is directly opposite the new transport interchange so it was felt the lack of parking would not deter demand (although this requires further testing).
- The core/access of the building is located at either end of the block allowing flexibility as to how the retail space on the ground floor is subdivided.
- The building is consciously pushing the boundaries on height, at 5 storeys, to ensure the new building creates a landmark.
- The height of the building offers spectacular views across the city from the upper floors.
- An entrance at the eastern end of the building allows the new offices to relate to the existing Wyvern House.
- An outdoor seating area is included adjacent to Sincil Dyke to complement potential A3 uses.

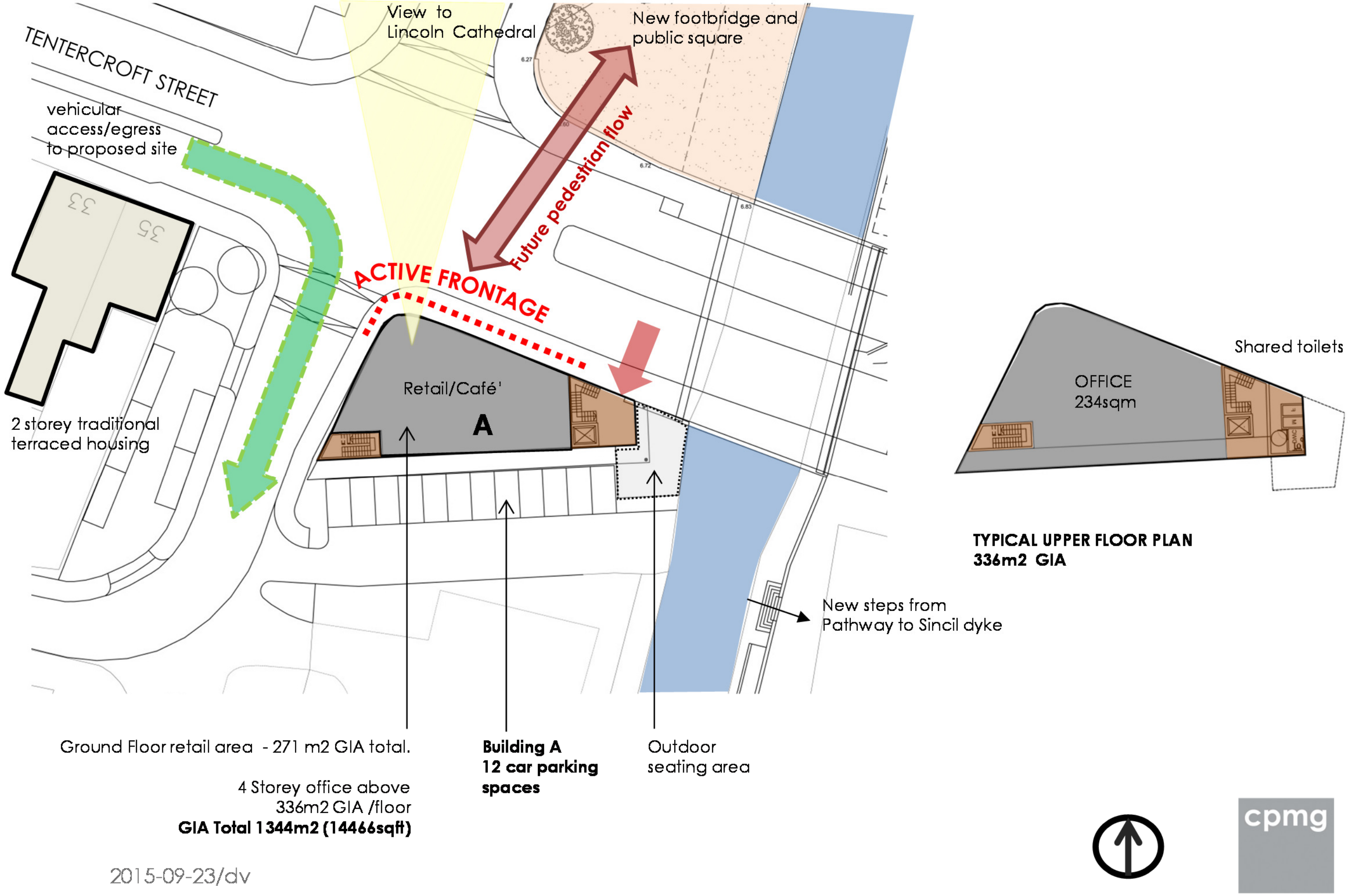
Summary

4.10 This initial design work is only exploratory and much more detailed research will be required on the demand, physical constraints and viability to inform the final designs. The final design solutions are therefore likely to alter from those presented in this report. These initial designs do however demonstrate the potential of the sites to accommodate attractive office buildings that will make an attractive gateway to the city centre.

Option 3

TENTERCROFT ST SITE: Retail space at ground floor, 4 storey of office units above

GIA overall – 1615m2 (17384 sqft)



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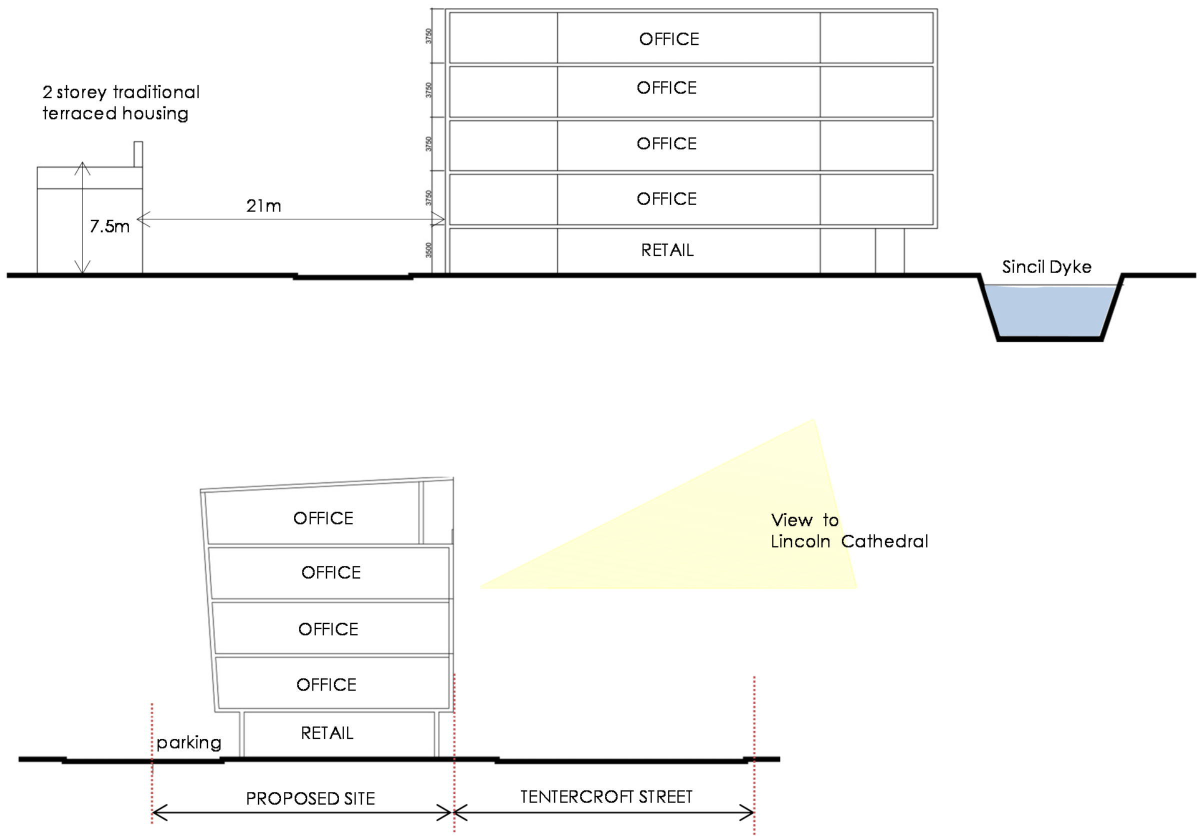
Option 3
SECTIONS THROUGH BUILDING



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5 Delivery structure options

Introduction

5.1 This Section looks at the delivery structures available. The delivery structure proposed, via consultation with the LCC officer team, is for LCC to directly develop the sites using a mixture of grant and PWLB funding and to retain ownership of the buildings once completed. This will require grant funding to be obtained for a scheme to be viable, we therefore provide a brief commentary about grant funding at the end of this Section.

5.2 In order to move forward the project in the timescales required for a grant application (an expression of interest for Growth Deal Round 3 could be required within this calendar year) we suggest using Willmott Dixon under the SCAPE Framework offers a sensible mechanism of doing this, we expand on this at the end of the section.

Option 1 - No public sector intervention – sell the site and leave it to the market

5.3 LCC could put a design brief together and even achieve planning permission for office development on Kesteven Street before marketing the sites for sale. The development appraisals we have undertaken (see Appendix 2) demonstrate that a viable development would not exist without grant. The appraisals also demonstrate that even with 50% of costs covered by grant there is still unlikely to be a speculative development that a private sector developer would move forward with.

5.4 **Recommendation** – we recommend this option is rejected on the basis of being unviable

Option 2 - LCC develop out sites using Grant

5.5 This Option would see LCC developing out the sites themselves, retaining ownership and managing the buildings. LCC would fund the development through a mixture of grant funding and PWLB borrowing (see Section 6 for more information on PWLB borrowing).

5.6 Through a process of elimination we suggest this as a suitable delivery structure. Section 6 demonstrates that a strong business case could be built for securing the grant and for LCC investing through PWLB into the scheme. Financially this performs better than Option 3, is simplified versus the Ortus structure (Option4) and other Options are unlikely to be viable.

5.7 **Recommendation** – selected as viable option

Option 3 - Private sector delivery using grant and LCC take a headlease

5.8 Under this Option a developer would deliver the buildings and most likely sell them on as investments. The developer would have 50% of the delivery costs paid for by grant and secure LCC as headlessee which will make the investment more attractive to investors.

5.9 Under this Option LCC would reduce the investment yield of the final building through entering into a long-leasehold. This lease to be most impactful would need to be 20 years+. This would lower the yield from 8%+ down to circa 5.5%.

5.10 Under this Option, LCC through the headlease, would still carry all demand risk on the building yet they would not have any long-term financial interest (residual value) in the building.

5.11 This could be an attractive option to LCC if there were reasons it did not want to incur the debt of the project themselves, however discussions with LCC Officers suggest this is not the case.

5.12 This option would take longer to deliver owing to the need to procure the developer, who then in turn would need to procure a contractor. It is unlikely this structure would be ready to submit a grant application this year.

5.13 ***Recommendation*** – discounted owing to lengthened timescales of delivery and lower financial performance relative to Option 2

Option 4 - Ortus funding solution

5.14 This Option would see LCC contract via SCAPE to deliver the buildings but the costs of delivery would be paid for by a consortium of private investors who would acquire a long-leasehold of the building. LCC would then enter into a [20 year] sub-lease guaranteeing index linked fixed rental payment to the investors. LCC would manage the building and sub-let to occupiers. It would be anticipated that the rental income LCC receive would exceed the rental payments it would owe investors, subject to good levels of occupancy.

5.15 The cost of delivery funding would be made up of one third equity provided by the investors and two thirds debt lent by LCC. The interest charged by LCC on the loan to the investors would provide a margin above LCC's cost of borrowing. The rental payments made by LCC under the lease would be cheaper than LCC funding the project through Prudential borrowing for the first few years but this benefit erodes each year and reverses before half way through the lease term.

5.16 Under this Option LCC would have an option to buy the building back from the investors after 5 years at a level which is slightly less than the investors paid for the delivery costs. The investors would be prepared to do this due to their ability to benefit from the capital allowances associated with the construction of the building.

5.17 For projects of significant scale and with equipment and fittings that attract enhanced capital allowances the savings of the Ortus structure can be substantial to the Local Authority versus a structure like Option 2. Through indicative financial modelling we would anticipate the overall savings assuming LCC did re-purchase the building in Year 5 (as measured by the reduction in prudential borrowing) to be circa £200,000 to LCC after all fees are paid. If this option was chosen more detailed modelling would be required.

5.18 **Recommendation** – this structure is more complex than the simplified Option 2. It would require additional legal and due diligence work. In discussions with LCC Officers a preference was expressed to move forward assuming the more traditional delivery routes (Option 2). Although we would advise that the Ortus financial model is updated as the project evolves in case the benefits of the Ortus structure grow.

Grant

5.19 All viable delivery options considered would require grant funding. As part of this study we did consult with the Greater Lincolnshire LEP about the possibility of attracting grant funding into a scheme on Kesteven Street. The conclusions of this consultation are below:

- A new bidding round for a Growth Deal Round 3 is anticipated after the Chancellor's Autumn statement (due on November 25th 2015), this is likely to be the next opportunity to secure grant funding.
- It could be the case that there are few deliverable projects in the GL LEP area that would bid in this round. The GL LEP would therefore welcome applications from schemes such as Kesteven Street.
- A bid would need to be in excess of £1m.

5.20 In discussions with officers and other stakeholders we have also concluded the following with regards attracting grant funding:

- In speaking to stakeholders in Lincoln we did not feel there would be opposition to any Growth Deal bid for offices on Kesteven Street, although we would recommend on-going dialogue as the project evolves to avoid any conflicts arising.

- LCC in recent history have a strong success rate in Growth Deal bids.

- LCC do not know of many competing bids and do not expect the GL LEP area to be heavily oversubscribed.

- We are advised by LCC officers that it is standard for grant to cover 50% of the development costs for projects like those on Kesteven Street. LCC suggested we should assume 50% grant in any financial appraisals. If there are generous revenue surpluses owing to the level of grant being proposed then LCC could consider offering a revenue sharing mechanism to the GL LEP. This should be discuss with the GL LEP during the next stage of work.

5.21 Our own observations based on our previous experience and the above consultations are as follows:

- There is a strong possibility of a Kesteven bid for Growth Deal funding being successful.
    - The project would deliver strong economic outputs and be pivotal in the transformation of a key gateway to Lincoln City Centre (see the Economic Impact Assessments in Section 6).

  - The alignment with the GL LEP's Strategic Economic Plan could be demonstrated.
  - LCC could demonstrate deliverability because they control the land, the road works have made the sites 'development ready' and LCC has access to finance themselves.
- A critical element of succeeding in a grant application will be demonstrating demand for space. Whilst this report indicates there is likely to be demand, at the next stage this will need documenting in more detail.
- To succeed in a Growth Deal bid, which could be required in this calendar year, LCC will need to create momentum and progress swiftly with the next stages of the project (these tasks are outlined in Section 8).

SCAPE Framework

5.22 As outlined above the success of this project will be driven by the ability to attract grant to the project. Attracting grant to the project through the anticipated Growth Deal Round 3 will be dependent on undertaking several tasks immediately which will need a professional team in place.

5.23 Through the SCAPE Framework, LCC would be able to access the supply chain of Willmott Dixon and Willmott Dixon has advised that they could have a full design team mobilised within 2 weeks if instructed by LCC. Conventional procurement routes would not be able to achieve this.

5.24 The SCAPE Framework also provides greater cost certainty for the Authority at an earlier stage in the project.

5.25 The SCAPE Framework will reduce the overall delivery timescales through eliminating the need to procure via OJEU the design team and the principal contractor role.

5.26 Under SCAPE Willmott Dixon are still required to seek 3 quotes for all major work packages ensuring LCC will receive a competitive price. Willmott Dixon's own fees are set by SCAPE and have already been subject to a competitive process.

5.27 It is for these reasons that we would suggest contracting with Willmott Dixon offers a sensible mechanism of building early momentum in this project and demonstrating deliverability to the grant funders.

Summary

5.28 We recommend that LCC considers directly delivering the office buildings and retaining ownership of them. The project will require grant funding and LCC will be well placed to secure this by evolving the project ahead of a call for bids for the next round of Growth Deal funding.

5.29 The use of the SCAPE Framework will provide a mechanism under which a professional team can be assembled quickly and evolve the design and overall business case ahead of a grant application.

6 Development, financial and economic appraisal

Introduction

6.1 Based on the work in previous chapters we have taken forward the following options to complete indicative financial and economic appraisals:

- Option 1 - Delivery of a traditional office block on the Eastern Site (Plot 2)
- Option 2 – Delivery of a mixture of own front door terraced offices and more traditional offices on the Eastern site (Plot 2)
- Option 3 – Delivery of an office block above A3 uses on the Western Site (Plot 3)
- Option 4 – Delivery of both Option 1 and Option 3
- Option 5 – Delivery of both Option 2 and Option 3

6.2 All Options assume a delivery structure that involves LCC directly developing the buildings, 50% of the costs paid for by grant with the remainder paid for through PWLB borrowing. We assume LCC retain ownership and use the revenue generated to service the debt.

6.3 At this stage of initial exploration we have not looked into detail with regards the optimum size of office units, nor the specification of the building in the context of market demand. At the next stage we would recommend the use of an agent with an in-depth understanding of the local office demand to input into this work.

6.4 The results of this appraisal work should only be used in the context of whether there is likely to be a deliverable project and whether the next stage of feasibility is warranted. The costs and values used are indicative only and are likely to alter as the project progresses. We strongly recommend that these appraisal are updated as the project progresses and that in their current form are not relied upon to commit to the construction stage of the project.

Managing the buildings once operational

6.5 For simplicity at this early stage of evolving the project we have assumed the following for all options:

- The completed buildings are managed by LCC.
- A service charge on all occupied space is sufficient to cover costs for all management and maintenance (including a sinking fund for major repairs to common areas and building fabric). LCC make no net profit from the service charge.

- There is a cost of £43 per sqm incurred by LCC on vacant space to cover contributions to common areas, maintenance and sinking funds and possible empty rates liability. This is a high-level figure and more detail will be required to accurately estimate this amount.
- There is no inflation assumed on rents received over 25 years (this is unlikely to be the reality and therefore the long-term income streams will be underestimated in our model). With inflation currently c.0% we felt it appropriate to take this prudent approach.

Prudential borrowing

6.6 We assume the delivery costs not covered by grant is funded through Prudential Borrowing via the Public Works Loan Board (PWLB). This borrowing is assumed to take place upon completion of the building, which means LCC cashflows the development from reserves until this point.

6.7 We have assumed under all options that PWLB borrowing is taken out as an annuity over 25 years at a fixed rate of interest. This ensures that LCC will have complete certainty once operational what the costs of servicing the associated debt will be. This also means that over time the cost of servicing the debt in real terms will fall assuming there is inflation in the economy.

6.8 There are a number of rates that may be available to LCC. We have modelled the standard new loan rate as published by PWLB as at 30th September 2015 of 3.08%.

6.9 LCC could alternatively apply for a preferential rate as a LEP sponsored project. This could result in a 0.4% discount on the listed rate. LCC would need to apply to the LEP for this rate, the total borrowing in a LEP area is capped and each application is judged on its merits.

6.10 We understand that the LEP already has an investment fund that can be loaned to projects such as that proposed on Kesteven Street. Funding from this source could provide an even greater discount on the listed PWLB rates.

6.11 In the next stage of work we would expect dialogue with the GL LEP to discuss the approach to securing the debt required and what preferential rates could be achieved. For caution at this moment we have assumed no preferential rate. In Section 7 we look at the impact on the cashflow should a preferential rate be achieved.

Financial modelling

6.12 To assess the financial performance of the development options, for Options 1-3, we have completed a financial model which has a bespoke input sheet, development appraisal, 5 year and 30 year cashflow (including an assessment of the LCC Internal Rate of Return and Discounted Cashflow). Options 4 and 5 have been derived through combining the financial results of the Option 1-3 appraisals.

Economic Appraisal

6.13 We have completed an economic impact assessment for each of the options. In accordance with HM Treasury Green Book Guidance and the English Partnership Additionality Guide we have examined the gross jobs created and then calculated the net additional jobs taking account of the leakage, displacement, multiplier and deadweight impacts.

6.14 To calculate the gross number of jobs we have used an assumption of 1 job per 12 sqm NIA for Office space and 1 job per 19 sqm NIA for retail space (in accordance with the HCA / Deloitte Employment Density Guide 2010).

6.15 We have also assumed 1 years employment for every £100,000 spent on the delivery of the project, and assumed that 10 years employment is the equivalent of 1 FTE position.

6.16 We have assumed the following assumptions across all options to calculate the net additional jobs:

- A leakage of 25%
- A displacement effect of 12.5%
- A 25% composite supply chain and income multiplier
- Zero deadweight (acknowledging nothing would happen on these sites without public sector intervention as evidenced from the development appraisals)

6.17 In order to monetise the benefits we have assumed that the public sector willingness to pay for job creation is a proxy for the benefit to society of those jobs. In our experience typically grant funding contributes somewhere between £15,000 and £30,000 per job. We have used £22,500 as a mid-point.

6.18 To compare the costs and benefits we have created a discounted cashflow (using 3.5% as the discount rate) of the following items:

- The benefits:
  - the market value of the asset created
  - the monetised value of net additional jobs created
- The costs:
  - The LEP grant funding
  - The PWLB funding required

Option 1 – Eastern Block traditional office scheme

6.19 For the Eastern block under option 1 we have assumed:

- A 3 storey office block.

- The development will have 16 car parking spaces adjacent to the development and a further 37 available on the site under the fly-over
- The 3 storeys of offices will deliver 1,776 sqm GIA of office space
- The GIA:NIA ration for the office uses will be 80%

Opt 1 - Delivery costs

6.20 The costs used to derive the delivery costs are as follows

- The majority of pre-construction work takes place between January 2016 and September 2016

- The construction starts on site on October 2016 and is completed in March 2018.

- Construction cost £ per sqm GIA of £1,502 for the office space

- £2,000 cost per car parking space

- A 11% contingency (consisting of 3% design contingency, 3% client contingency and 5% site constraints. This is a high-level of contingency but we consider this a prudent amount given the uncertainties surrounding the project at this early stage)

- 0.5% SCAPE fee

- 15% professional fees (including all other survey work, bid preparation, marketing and letting)

6.21 Using these assumptions the estimated costs of delivering Option 1 is c.£3.55m. It is assumed 50% (£1.77mm) of this would be funded through grant and the remainder funded through PWLB.

Opt 1 - Inputs and assumptions used – income

6.22 Assumptions used to derive the income stream from the development are as follows:

- £129 per sqm (NIA) Rent on the office accommodation
- Occupancy rates as per the table below, with Year 5 representing a steady-state average over 25 years (note we expect occupancy rates would exceed these levels but have used these figures to build in contingency in the income model)

	Office
Year 1	40%
Year 2	60%
Year 3	80%
Year 4	80%
Year 5	80%

- A cost to the Council for holding the vacant space of £43.04 per sqm (note this is an indicative estimate only for use in modelling, we recommend a more detailed look into the holding costs is undertaken at the next stage of feasibility)
- In Year 25 the Council will retain the asset which will have a value. The value is calculated assuming a 10% yield which is greater than the yield one would expect today and reflects the increased risks some investors associate with older buildings. Note this is not a formal valuation and should not be used as such.

Opt 1 - 30 Year cashflow

6.23 Based on the above assumptions a 30 Year cashflow for Option 3 has been estimated. A summary of the key outputs is provided below. It demonstrates in the steady-state the project is estimated to create a revenue surplus for LCC and the return on their investment at 6.69% is healthy (all be it less than a private investor would expect for a project with this risk profile).

Metric	Value
Steady state income per annum	£146,763
Steady state costs per annum	£112,847
Steady state surplus per annum	£33,916
Cash surplus over 25 years, excluding residual value (£m)	£0.79
DCF (£m)	£0.79
IRR	6.69%

Opt 1 - Economic Impact

6.24 Based on the above assumptions an early-stage Economic Impact Assessment has been undertaken for Option 1. A summary of the key outputs is provided below:

EIA Measure	Value
Gross jobs	96
Grant per gross job created	£18,404
Net additional jobs	79
Grant per net additional job created	£22,435
Total benefits (£m)	3.79
Total costs (£m)	3.55
Net present value of benefits minus costs (£m)	0.07

6.25 The table above shows that both the cost per gross job and net additional job is in-line with projects we would expect to be competitive in attracting grant funding (i.e. between

£15k-£30k). Although further dialogue with the LEP should be undertaken to get greater clarity on their expectation in this regard.

6.26 The appraisal also demonstrates a positive NPV of the public sector investment which suggests at this early stage there is merit in exploring this proposition further. This suggests that when the social value of job creation is added to the commercial value of the development then the benefits exceed the costs of delivery.

Option 2 – Eastern Block variant office scheme (terraced offices plus office block)

6.27 For the Eastern block under Option 2 the development assumed is to be two smaller office blocks. One comprising a 3 storey office block with one core and 5 3-storey office units with their own front doors. It is also assumed:

- The development will have 20 car parking spaces adjacent to the development and a further 37 available on the site under the fly-over
- The offices will deliver 1,185 sqm GIA of office space in block one and 914 sqm for the terraces
- The GIA:NIA ratio for the office uses will be 80% for the office block and 75% for the terraces (this will need to be explored in more detail in the next stage of feasibility)

Opt 2 - delivery costs

6.28 The assumptions used to derive the delivery costs are as follows

- The majority of pre-construction work takes place between January 2016 and September 2016
- The construction starts on site on October 2016 and is completed in March 2018.
- Construction cost £ per sqm GIA of £1,502 for the office space. Note we have not distinguished between the costs of delivering offices in terraces or in a single block, this will require further investigation at the next stage.
- £2,000 per car parking space
- A 11% contingency (consisting of 3% design contingency, 3% client contingency and 5% site constraints. This is a high-level of contingency but we consider this a prudent amount given the uncertainties surrounding the project at this early stage)
- 0.5% SCAPE fee
- 15% professional fees (including all other survey work, bid preparation, marketing and letting)

6.29 Using these assumptions the estimated costs of delivering Option 2 is c.£4.18m. It is assumed 50% of this would be funded through grant and the remainder funded through PWLB.

Opt 2 - Inputs and assumptions used – income

6.30 Assumptions used to derive the income stream from the development are as follows:

- £129 per sqm (NIA) rent on the traditional office accommodation and £135 per sqm for the terraced accommodation (assuming a premium could be charge for the street frontage and niche design). This will require further investigation in the next stage of feasibility.
- Occupancy rates as per the table below, with Year 5 representing a steady-state average over 25 years.

	Block 1	Block 2
Year 1	40%	40%
Year 2	60%	60%
Year 3	80%	80%
Year 4	80%	80%
Year 5	80%	80%

- A cost to the Council for holding the vacant space of £43.04 per sqm (note this is an indicative estimate only for use in modelling, we recommend a more detailed look into the holding costs is undertaken at the next stage of feasibility)
- In Year 25 the Council will retain the asset which will have a value. The value is calculated assuming a 10% yield which is greater than the yield one would expect today and reflects the increased risks some investors associate with older buildings.

Opt 2 - 30 Year cashflow

6.31 Based on the above assumptions the 30 Year cashflow for Option 2 has been estimated. A summary of the key outputs is provided below. It demonstrates in the steady-state the project is estimated to create a revenue surplus for LCC and the return on their investment at 6.36% is healthy (all be it less than a private investor would expect for a project with this risk profile).

Metric	Value
Steady state income per annum	£171,684
Steady state costs per annum	£132,547
Steady state surplus per annum	£39,138
Cash surplus over 25 years, excluding residual value (£m)	£0.92
DCF (£m)	£0.77
IRR	6.36%

Opt 2 - Economic Impact

6.32 Based on the above assumptions an early-stage Economic Impact Assessment has been undertaken for Option 2. A summary of the key outputs is provided below:

EIA Measure	Value
Gross jobs	111
Grant per gross job created / safeguarded	£18,845
Net additional jobs	91
Grant per net additional job created	£23,035
Total benefits (£m)	4.39
Total costs (£m)	4.18
Net present value of benefits minus costs (£m)	0.02

6.33 The table above shows that both the cost per gross job and net additional job is in-line with projects we would expect to be competitive in attracting grant funding. The appraisal also demonstrates a positive NPV of the public sector investment.

Option 3 - Western block

6.34 For the Western block the development assumed is 4 storeys of office accommodation above A3 accommodation. Other assumptions used are:

- The development will have 12 car parking spaces and an outdoor seating area
- The ground floor retail / A3 area will be 271 sqm GIA
- The 4 storeys of offices will deliver 1,344 sqm GIA of office space
- The GIA:NIA ration for the office uses will be 80%
- The GIA:NIA for retail will be 80%

Inputs and assumptions used – delivery costs

6.35 The costs used to derive the delivery costs are as follows

- The majority of pre-construction work takes place between January 2016 and September 2016
- The construction starts on site on October 2016 and is completed in March 2018
- Construction cost £1,200 per sqm GIA for the A3/retail space and £1,502 for the office space
- £2,000 per car parking space (12 spaces)
- External seating area costing £15,000
- A 11% contingency (consisting of 3% design contingency, 3% client contingency and 5% site constraints. This is a high-level of contingency but we consider this a prudent amount given the uncertainties surrounding the project at this early stage)
- 0.5% SCAPE fee
- 15% professional fees (including all other survey work, bid preparation, marketing and letting)

6.36 Using these assumptions the estimated costs of delivering the Option 3 development is c.£3.07m. It is assumed 50% of this would be funded through grant and the remaining funded through PWLB.

Inputs and assumptions used – income

6.37 Assumptions used to derive the income stream from the development are as follows:

- £129 per sqm (NIA) Rent on the office accommodation £137 per sqm (NIA) Rent on the A3 space
- Occupancy rates as per the table below, with Year 5 representing a steady-state average over 25 years (note we expect occupancy rates would exceed these levels but have used these figures to build in contingency in the income model)

	A3	Office
Year 1	50%	40%
Year 2	85%	60%
Year 3	85%	80%
Year 4	85%	80%
Year 5	85%	80%

- A cost to the Council for holding the vacant space of £43.04 per sqm (note this is an indicative estimate only for use in modelling, we recommend a more detailed look into the holding costs is undertaken at the next stage of feasibility).
- In Year 25 the Council will retain the asset which will have a value. The value is calculated assuming a 10% yield which is greater than the yield one would expect today and reflects the increased risks some investors associate with older buildings.

30 Year cashflow

6.38 Based on the above assumptions the 30 Year cashflow for Option 3 has been estimated. A summary of the key outputs is provided below:

Metric	Value
Steady state income per annum	£142,666
Steady state costs per annum	£97,007
Steady state surplus per annum	£45,659
Cash surplus over 25 years, excluding residual value (£m)	£1.15
DCF (£m)	£0.90
IRR	7.69%

Economic Impact

6.39 Based on the above assumptions an early-stage Economic Impact Assessment has been undertaken for Option 3. A summary of the key outputs is provided below:

EIA Measure	Value
Gross jobs	83
Grant per gross job created	£18,530
Net additional jobs	68
Grant per net additional job created	£22,641
Total benefits (£m)	3.34
Total costs (£m)	3.07
Net present value of benefits minus costs (£m)	0.07

6.40 The table above shows that both the cost per gross job and net additional job is in-line with projects we would expect to be competitive in attracting grant funding.

6.41 The appraisal also demonstrates a marginally positive NPV of the public sector investment which suggests at this early stage there is merit in exploring this proposition further.

Options 4 and 5

6.42 In assessing Options 4 and 5 we have combined the financial and economic appraisal of Option 1 and Option 3 for Option 4 and Option 2 and Option 3 for Option 5. The results are outlined below.

30 Year cashflow

Metric	Option 4	Option 5
Steady state income per annum	£289,429	£314,350
Steady state costs per annum	£209,854	£229,553
Steady state surplus per annum	£79,575	£84,796
Cash surplus over 25 years, excluding residual value (£m)	£1.89	£2.02
DCF (£m)	£1.65	£1.63
IRR	7.05%	6.84%

Economic Impact

6.43 Based on the above assumptions an early-stage Economic Impact Assessment has been undertaken for Option 4 and 5. A summary of the key outputs is provided below:

EIA Measure	Option 4	Option 5
Gross jobs	179	194
Grant per gross job created	£18,462	£18,710
Net additional jobs	147	158
Grant per net additional job created	£22,530	£22,867
Total benefits (£m)	7.13	7.73
Total costs (£m)	6.62	7.25
Net present value of benefits minus costs (£m)	0.14	0.10

Business Rates

6.44 It is important when completing the economic appraisal to not double count the impacts. We have assumed the public sector willingness to pay for job creation already accounts for additional revenue that could be generated associated with this economic activity (i.e. tax income).

6.45 It is none the less important to remember that in the era when Local Authorities retain business rates uplift an increase in business activity will have a positive impact on Local Authority revenue.

6.46 Due to some of the uncertainties surrounding alterations to the business rate retention scheme, and the base-line re-setting mechanism associated with this, we have not included the business rates uplift in the financial cash-flow for LCC in the core financial appraisal, as this cannot be relied upon.

6.47 However Appendix 5 does outline the potential financial benefit to both LCC and Lincoln City Council. This is outlined in the tables below.

Retention of business rates assuming 50% are retained locally

	Option 1	Option 2	Option 3	Option 4	Option 5
Uplift	£82,906	£88,227	£56,904	£139,810	£145,132
Retained locally	£41,453	£44,114	£28,452	£69,905	£72,566
Retained by Lincoln City	£33,162	£35,291	£22,762	£55,924	£58,053
Retained by LCC	£8,291	£8,823	£5,690	£13,981	£14,513

Retention of business rates assuming 100% are retained locally

	Option 1	Option 2	Option 3	Option 4	Option 5
Uplift	£82,906	£88,227	£56,904	£139,810	£145,132
Retained locally	£82,906	£88,227	£56,904	£139,810	£145,132
Retained by Lincoln City	£66,325	£70,582	£45,523	£111,848	£116,105

	Option 1	Option 2	Option 3	Option 4	Option 5
Retained by LCC	£16,581	£17,645	£11,381	£27,962	£29,026

Summary and conclusions

6.48 The table below draws together the key outputs of the modelling for each option.

	Option 1 - East block offices	Option 2- East block variant offices	Option 3 - West block A3 & offices	Option 4 Options 1 & 3	Option 5 – Options 2 & 3
Office space delivered NIA (sqm)	1,421	1,634	1,075	2,496	2,709
A3 Space delivered	0	0	217	217	217
Net additional jobs	79	91	68	147	158
Grant (£m)	1.78	2.09	1.53	3.31	3.62
£ grant per job	£22,435	£23,035	£22,641	£22,530	£22,867
Total costs (£m)	3.55	4.18	3.07	6.62	7.25
Prudential borrowing (£m)	1.75	2.06	1.50	3.24	3.55
Costs per annum of servicing prudential borrowing (£m)	0.10	0.12	0.09	0.19	0.20
Income per year in steady state (£m)	0.15	0.17	0.14	0.29	0.31
Annual surplus (£m)	0.03	0.04	0.05	0.08	0.08
IRR of RBC investment	6.69%	6.36%	7.69%	7.05%	6.84%
DCF of investment (£m)	0.79	0.77	0.90	1.65	1.63

6.49 Acknowledging that at the next stage there is much more work to do in order to provide certainty on the inputs in the financial and economic appraisals, the results above would lead us to conclude.

- The appraisals suggest that any of the above options would have merits in proceeding
- All options are estimated to provide LCC with a surplus after servicing the associated debt
- All options would be in-line with expectations with the number of jobs created and the grant level modelled (i.e. they would be competitive in applying for grant funding)
- The traditional office model performs marginally better in the cost : benefit analysis than the terraced office building owing to the higher density of jobs created. Although

the difference is not overly significant and LCC should consider other factors such as diversifying the office-mix, urban design and market demand before making a decision.

- The development of the Western Block would deliver less jobs than the delivery of the Eastern blocks. However the financial returns are equally as strong for this block and the impact in terms of urban design owing to its more prominent position would be stronger.

- The benefits of delivering the whole scheme would have significant impacts in terms of creating a destination, economic benefit and potential financial returns. It does however come at a higher-level of borrowing and therefore a greater degree of risk.

- An uplift in business rates would improve the financial position of LCC to a modest amount with Lincoln City Council benefitting to a greater extent.

7 Sensitivities

Introduction

7.1 Below we show the sensitivity of the financial appraisal to key variables. The sensitivities we have tested are:

- Construction costs
- Rental levels
- Occupancy levels
- PWLB interest rates

7.2 To bench mark the sensitivities we have illustrated the impact on Option 5 (which is to build out both the terraced and traditional offices on Plot 2 and Offices above A3 on Plot 3).

Construction costs

7.3 The table below illustrates the key metrics should construction costs alter. The table shows that with a 10% increase in construction costs LCC would need to borrow £360,000 more (however this assumes the grant covers 50% of the increase in costs). The model shows that LCC would retain a revenue surplus. Note that if the costs were to increase by 10% but the grant remained fixed the surplus would reduce by a further £20,000 per annum but it would remain positive.

	Base assumption	minus 10%	minus 5%	plus 5%	plus 10%
Total costs (£m)	7.25	6.54	6.90	7.60	7.95
Prudential borrowing (£m)	3.55	3.20	3.38	3.73	3.91
Costs per annum of servicing prudential borrowing (£m)	0.20	0.18	0.19	0.22	0.23
Income per year in steady state (£m)	0.31	0.31	0.31	0.31	0.31
Annual surplus (£m)	0.11	0.13	0.12	0.10	0.09
IRR of RBC investment	7%	8%	7%	6%	6%

Steady-state occupancy

7.4 The table below shows the key outputs with regards LCC's revenue position should the level of steady-state occupancy vary relative to the 80% assumed in the financial modelling. It demonstrates that even if occupancy is as low as 60% LCC would still create an annual surplus. The model can be solved to show that occupancy would need to fall to 55% before LCC started making an annual loss after servicing the project's debt.

Occupancy	Base assumption (80%)	60%	70%	90%	100%
Costs per annum of servicing prudential borrowing (£m)	0.20	0.20	0.20	0.20	0.20
Income per year in steady state (£m)	0.31	0.26	0.29	0.34	0.37
Annual surplus (£m)	0.08	0.02	0.05	0.12	0.15

Rental values

7.5 The base model assumes that rents for the office space can be achieved at £129 per sqm for the traditional office space and £135 for the terrace offices. The table below examines the impact on LCC's annual revenue position in steady-state if the rental values for offices achieved vary. It shows that in isolation the financial position of LCC is not prejudiced by a 20% swing in the office rental values that could be achieved (i.e. it continues to make a surplus).

Occupancy	Base assumption	minus 20%	minus 10%	plus 10%	plus 20%
Costs per annum of servicing prudential borrowing (£m)	0.20	0.21	0.21	0.20	0.20
Income per year in steady state (£m)	0.31	0.26	0.29	0.34	0.37
Annual surplus (£m)	0.08	0.03	0.06	0.11	0.14

PWLB Interest rates

7.6 We have modelled 3.08% as the PWLB rate for a 25 year annuity. It is likely to be over 2 year before LCC take out the PWLB borrowing and therefore it is likely the rate would differ. There is also the possibility that LCC can access a preferential rate (0.4% discount) by applying to GL LEP. We therefore set out the impact of variations of the PWLB rate in the table below.

7.7 The table shows that the overall revenue position is not overly sensitive to variations in the PWLB borrowing rate with regards fluctuations of up to 0.5% in either direction. The rate would need to increase to over 6% (all other things being equal) before the revenue surplus was eroded.

Occupancy	Base assumption (3.08%)	2.50%	2.75%	3.25%	3.50%
Costs per annum of servicing prudential borrowing (£m)	0.20	0.19	0.20	0.21	0.21
Income per year in steady state (£m)	0.31	0.31	0.31	0.31	0.31
Annual surplus (£m)	0.08	0.10	0.09	0.08	0.08

Pessimistic and Optimistic scenario

7.8 The sensitivity tests undertaken above demonstrate the fluctuation of one variable. It is likely all variables will differ from the base model. We have therefore also tested a pessimistic scenario and an optimistic scenarios for Option 5. This assesses the revenue position for multiple fluctuations in the assumptions that underpin the financial appraisals.

7.9 The pessimistic scenario assumes the following versus the base case:

- Construction costs rise by 10%
- Occupancy falls to 70%
- Rental levels are 10% below expectation
- The PWLB rate is 3.50% and no preferential discount is obtained

7.10 The optimistic scenario assumes:

- Construction costs fall by 5%
- Occupancy is at 90%
- Rental levels are 10% higher than the base model
- PWLB rate achieve is 2.75% which includes a 0.4% discount

The analysis below shows that LCC's revenue position could become negative in the steady-state with multiple negative fluctuations in the base assumptions. The pessimistic scenario would see LCC losing £10,000 per annum. The optimistic scenario shows that it could achieve a surplus of £170,000 per annum.

	Base assumption	Pessimistic	Optimistic
Costs per annum of servicing prudential borrowing (£m)	0.20	0.24	0.19
Income per year in steady state (£m)	0.31	0.26	0.37
Annual surplus (£m)	0.08	-0.01	0.17

Reducing risks

7.11 The analysis above demonstrates that the LCC investment is not without risks. It is therefore in LCC's interest to transfer or reduce these risks prior to committing to the main construction contract. We would therefore expect LCC as the project progresses to look at the following risk mitigation measures:

- Evolving the design to give greater cost certainty
- Backing out the construction cost risk via a fixed-price contract with a contractor (note SCAPE offers this solution)
- Achieving an element of pre-lets ahead of committing to construction. This could be a sizeable pre-let from the University or a series of pre-lets from known professional service firms interested
- LCC achieves a preferential borrowing rate through applying to the GL LEP to provide further financial contingency

Summary

7.12 The sensitivity analysis demonstrates there are risks associated with this development. LCC should carefully consider its risks and attempt to mitigate them ahead of committing to the main contraction contract if it progresses with this project.

8 Conclusions and next steps

Conclusions

8.1 This report is an initial exploration of the type of developing that could be brought forward on the Kesteven Street sites, the appropriate delivery structures and the financial and economic viability. The conclusions and recommendations are based on early stage feasibility work and should only be used in deciding whether the project should progress to the next stage of design and viability modelling.

8.2 The conclusions of this work are:

- An office development would be acceptable on planning grounds on the Kesteven Street sites.
- Any scheme brought forward should be of high-quality design and create an aspirational gateway to the city centre.
- An office development in our view would be an appropriate use of the site
- Initial investigations demonstrate there would be demand for offices in this location from smaller companies and also larger companies requiring satellite offices to access the Lincolnshire market. There is also the possibility of the University needing an office space for back-office functions.
- An element of residential development could not be relied upon to cross-subsidise an office development.
- A small amount of A3, convenience retail or budget gym could provide active ground floor uses and would benefit the overall scheme.
- An office development would require grant funding to be viable.
- The sites are capable of accommodating 3 blocks of office development which could be phased.
- The site could deliver between c.2,500 – 2,700 sqm NIA of office space plus c.270 sqm NIA of ground floor A3/retail on the western block.
- The Western site (Plot 3) offers great potential to make an impact owing to its visibility from the new transport interchange, footbridge and new public space created on Tentercroft Street.
- Based on further analysis of market demand LCC should make a decision on how much office space to deliver in Phase 1.
- There is merit on moving forward with all the development in one phase, but this would come at a greater risk to LCC in terms of void risk.
- The total costs of delivering all plots would be £6.6m - £7.2m requiring £3.3m-£3.6m of grant and prudential borrowing.
- The economic appraisal shows that the project could create / safeguard net additional jobs at a cost of c.£23,000 per job.
- The economic outputs coupled with its deliverability places the project well to achieve grant funding at the next Round of Growth Deal funding (expected to be announced this Autumn).

- The financial appraisals demonstrate that it is probable that LCC would make a small revenue surplus after servicing its debts associated with the scheme once operational, assuming 50% of the delivery costs are met by grant.
- The financial model is sensitive to construction costs and rental income and therefore more evidence is required ahead of LCC committing to the construction of the project.
- It is possible to achieve further improvements to the financial model before committing to the project (a discount on the PWLB rates, construction cost savings etc) which would improve the revenue surplus LCC would generate from the project.
- To heighten the prospects of the project receiving Growth Deal funding the design work and market analysis will need to commence quickly.

Next steps

8.3 The list below summarises the key recommended actions for the next stage of feasibility:

- A more detailed market assessment should be undertaken to provide more certainty on market demand. This should comprise of the following:
    - An assessment of market activity in Lincoln to establish likely rental levels and take up of space
    - Dialogue with potential known occupiers
    - A recommendation on the specification of the building and the size of the units offered
    - Dialogue with University of Lincoln to understand if it does have a need for offices
- Procuring the professional design team
- Completing a suite of technical due diligence work including
    - A check of clean title and any legal impediments to development
    - A review of historic ground condition reports and an assessment of further would be needed
    - A Flood risk assessment
    - A review of utilities and sewers that service the site or that may be present on the site
    - Habitat and other environmental services that may be required to support a planning application
- Dialogue with high-ways officers to understand access to the site and the acceptability of the proposed car parking solutions.
- Evolving the designs through RIBA Stages 1-2 (including dialogue with planners) ahead of a grant application to provide more certainty on the quantity of accommodation that could be delivered
- Completing a more detailed cost plan
- Receiving a formal view on any state-aid implications with the proposals (this will be critical for the LEP / grant funder, it may also limit the amount of surpluses LCC are able to make and LCC should understand this at the earliest possible stage).
- Entering into dialogue with the GL LEP to ascertain:
    - Likely requirements from a Growth Deal application

    - Likely metrics upon which Growth Deal projects would be judged, including intervention rates
    - The possibility of achieving borrowing for the project via the LEP at better rates that the standard PWLB
- Updating the economic and financial models
- Based on the work listed above deciding on the quantity of development to move forward in Phase 1
- Completing all tasks that would be required for a grant application. including:
    - Documenting the rationale for intervention
    - Documenting the options appraisal work completed
    - Updating the financial and economic models
    - Providing a clear delivery programme, including: a resources plan, financial appraisal, risk assessment, timetable for delivery.

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