Executive Report

Ward(s) affected: Onslow

Report of Director of Community Services

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Midleton Industrial Estate Redevelopment

Executive Summary

The Midleton Industrial Estate comprises approximately 5.7 acres within the Council's freehold ownership. The Estate is divided in accordance with the long leaseholds previously granted. The units are typically 1970s warehouses of steel portal frame construction approaching the end of their economic life. The Executive approved a business case for the redevelopment of the Midleton Industrial Estate on 24 January 2017, as part of the 2017-18 capital programme report. Officers have been pursuing a phased development of the Estate in line with when existing leases expire.

This report outlines progress with the delivery of the project, including the current spend and the works completed to date as well as the remaining scope of works to be delivered during 2019-20 and 2020-21. The Executive is asked to approve the transfer of £5,500,000 from the provisional capital programme to the approved capital programme in order to complete phases two and three of the redevelopment.

Recommendation to Executive

(1) That the sum of £5.5 million be transferred from the provisional capital programme to the approved capital programme to enable the continuation and completion of the design and construction of phase two and three of the Midleton Industrial Estate redevelopment, as detailed in this report.

(2) That the Corporate Property Manager, in consultation with the Lead Councillor for Finance and Assets, be authorised to progress the design and construction of phase two and three.

<u>Reason for Recommendation:</u>
To progress the next phases of redevelopment of Midleton Industrial Estate to enhance both the capital value and rental income of the Council's property holding.

Is the report (or part of it) exempt from publication? No

1. Purpose of Report

1.1 The purpose of this report is to provide the Executive with an update of the Midleton Industrial Estate redevelopment programme carried out so far (phase 1), and to seek approval for transfer of the necessary funds to continue to progress and deliver phases 2 & 3 of the project.

2. Strategic Priorities

2.1 The recommendations supports the delivery of the Corporate Plan 2018-23 which list the following priority under Innovation:

"Redevelop Midleton Industrial Estate to provide modern units equipped with the latest technology for new and expanding businesses."

3. Background

3.1 In accordance with the Council's Asset Management Framework, the Council continues proactively to look at opportunities to enhance both the capital value and rental income of the Council's property assets.

3.2 Midleton Industrial Estate lies adjacent to Guildford Business Park and, over the medium term, has significant potential for redevelopment (see Appendix 1 - Location Plan).

3.3 The entire Midleton Industrial Estate comprises around 5.7 acres. The Estate is divided in accordance with the long leaseholds previously granted. The units are typically 1970s warehouses of steel portal frame construction approaching the end of their economic life. There has been a strategy in recent years to buy back units, which were let on long leaseholds to enable redevelopment for continued industrial use. The plan is to demolish the older style units to create suitable development plots as leases expire.

4. Current position

<u>Phase 1</u>

4.1 Since the last report to the Executive in July 2018, Phase 1 has been progressing with the demolition of Unit 11 and the associated outbuildings. A planning application for the construction of an industrial building totalling 832 sq.m. split down the centre to form two 416 sq.m. units was approved in May 2019. Please see Appendix 2 – Design & Access Statement. The design allows for flexibility should there be a requirement for a larger unit.

4.2 After a tender process, successful contractor, Dartmouth General Contractors Ltd, was appointed. They are currently on site with practical completion of the scheme anticipated for end of April 2020.

<u>Phase 2 & 3</u>

4.3 Officers are now turning their attention to Phases 2 & 3 which shall be a single planning application but developed in two phases due to current lease termination dates. Phase 2 will be the demolition and redevelopment of current units 13-15. Phase 3 will be the demolition and redevelopment of unit 12 and yard. Officers have appointed the design team for these phases and are awaiting detailed designs. An initial draft sketch is attached at Appendix 2 to give an idea of the current plans. In summary, the following will be provided:

Unit	No. of Units	Size (GIA)	Est. Rent psf	Est. Rental pa	Total Income
Phase 2					
A	2	900	£13.00	£11,700	£23,400
C	6	1,800	£12.00	£21,600	£129,600
D	1	6,000	£11.50	£69,000	£69,000
D yard	N/A	14,500	£2.00	£29,000	£29,000
					£251,000
Phase 3					
A	2	900	£13.00	£11,700	£23,400
B	4	2,400	£12.00	£28,800	£115,200
					£138,600
					£492,180

4.4 All units in Phase 2 should be vacant by February 2020 and phase 3 by July 2020. There are on-going discussions with affected tenants with a view to minimising disruption to their businesses.

4.5 Demolition will commence shortly after vacant possession. The intention is to commence the procurement exercise for the construction partner in parallel with the planning application to enable the redevelopment to start at the earliest opportunity.

5. Current demand/supply for industrial space

5.1 The Council commissioned an initial study by Lambert Smith Hampton (LSH) to provide some recommendations as to the type and scale of development that would be appropriate, bearing in mind the current industrial market.

5.2 This advice has been updated through the various stages of the project. The most recent advice provided, specifically in relation to Phases 2 & 3, is that there is more than sufficient demand to support a small unit scheme on site to provide a broad range of unit sizes from, say, 1,000 – 5,000 sq. ft. (93-465 sq.m.). LSH added that depending on what development plots come forward, the Council should give consideration to medium range units circa 5,000 – 10,000 sq. ft. (465-929 sq.m.) again, constructed in a terrace or terraces.

5.3 LSH reconfirmed that the majority of demand is for units up to 10,000 sq. ft. (small to medium size units) but the focus is probably on smaller units in this range i.e. up to around 5,000 sq. ft. (465 sq.m). Generally speaking, the smaller the size, the higher the demand.

5.2 Land for industrial development is in short supply in the Borough. This, coupled with the lack of new development in recent years, means that existing industrial buildings are also in short supply. There is a low vacancy rate with stock shortages apparent across all the size ranges.

5.3 The shortage in supply, particularly of small units, can be further demonstrated by the lack of availability in respect of the Council owned Enterprise Units. The three schemes (Foundation Units and Enterprise Units at Slyfield and Enterprise Units at Ash Vale) are at 100% occupancy. These schemes comprise a total of 58 units, but current availability is nil.

6. Financial implications

6.1 The original capital estimate for the whole scheme was £14,907,000. There is currently £11,057,000 still in the provisional capital programme with £3.85 million having been transferred to the approved capital programme to enable the demolition of vacant properties and the delivery of phase 1 of the project. It is now hoped that there will be savings on the original estimate for Phase 1 and projected spend is now only £2.4 million.

Officers request the transfer of an additional £5.5 million of the budget from the provisional capital programme to the approved capital programme, to enable the delivery of phase 2 and 3 of the project.

6.2 The anticipated cost allocation is:

Phase 2/3	£ 6,700,000.00
Contingency	£ 250,000.00
	£ 6,950,000.00

6.3 The project risk contingency will not form part of the construction contract and will only be used if circumstances warrant.

6.4 The investment will improve the Estate generally and will not only make it more lettable but also generate a long-term and more sustainable income stream.

6.5 Officers have carried out a high-level financial appraisal of the proposed development of Phases 2 & 3 based on both the projected costs and income streams reflecting current market conditions. The appraisal indicates an initial yield of 5.18% and an Internal Rate of Return of 6.17%. These returns are in-line with the remainder of our portfolio and the local market for such properties. The development will also increase the capital value of our overall commercial property portfolio.

7. Equality and Diversity Implications

7.1 No specific equality and diversity implications have been identified.

8. Consultations

8.1 Officers have discussed the scheme with existing tenants. There will be formal consultation as part of the planning process.

8.2 Ward councillors and the Lead Councillor have been informed of the redevelopment programme.

9. Risk management implications

9.1 The project attracts a range of risks, which include:

Planning risk

9.2 Phases 2 & 3 of the scheme will require planning permission. Officers have already engaged with planners as part of the pre-application process.

Construction cost

9.3 The construction cost could increase but project quantity surveyors have allowed a suitable contingency in the cost allocation.

Construction Market risk

9.4 The volatile nature of the market makes it difficult to predict accurately the level and response to an individual procurement exercise.

Possession

9.5 All tenants of properties identified in phase 2 and 3 have either been given notice to quit or are due to be served notice in line with their leases. It is assumed that all tenants will comply with their contractual requirements.

Property Market risk

9.6 The property market can always go down as well as up and given current domestic issues, such as Brexit, there could be a decline in demand. In addition, circumstances in the property market can change very quickly. For example, another developer could undertake a small unit development elsewhere so there is less of a need for small units, or the various 20-30,000 sq ft units currently available may become let and so the demand may be for a larger unit. This is considered to be a low risk having regard to current demand patterns and the lack of supply. However, officers are further mitigating the risk by ensuring that there are a range of unit sizes and all units are flexibly designed so that they can be spilt or combined to provide smaller/larger spaces as required. Officers will also look to pre-let the units so far as possible.

10. Legal Implications

10.1 Buildings are a major source of the UK’s greenhouse gas emissions. The Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 (SI 2015/962) (MEES Regulations) apply to local authority landlords and require a minimum energy efficiency standard (MEES) to be met before properties can be let in certain circumstances. Properties rated F or G (the lowest ratings) are called "sub-standard" in the MEES Regulations. In future, the current E rated benchmark may be reviewed upwards.

10.2 The MEES Regulations mean that, since April 2018, the Council as landlord, may not grant new leases of non-domestic property, if the property is sub-standard and from April 2023, a landlord will not be able to continue to let a sub-standard non-domestic property.

10.3 The units in Phase 2 & 3 have a MEES rating which ranges from D to F. Unit 13 (rated F) falls outside the lawful MEES categories and will require extensive improvements to bring it to the required statutory standard if this proposed development does not proceed.

10.4 The design and construction work for Phase 2 and 3 must be procured in accordance with the Council's Procurement Procedure Rules and in compliance with the Public Contract Regulations 2015.

11. Human resource Implications

11.1 The project will be managed within our existing resources with the support of external consultants, which has been allowed for in the budget.

12. Summary of Options

Do nothing

12.1 There is the option to do nothing in which case the existing units continue to deteriorate costing the Council further money to comply with lease terms and statutory requirements. The units are reaching the end of their economic life and will require significant investment if the Council wishes to re-let the vacant properties. The current outdated units are not attractive to prospective tenants and should the Council wish to re-let them, the level of rent to be expected will be very low.

Sell sites

12.2 The only other option is to demolish the existing buildings and simply sell off the sites. This would provide a capital receipt for the Council rather than much needed income. It is also unlikely to attract a better return than developing the site internally.

12.3 A sale would also mean a loss of control of the site. A private developer may not choose to provide much needed small industrial units. In addition, their design may not be as sustainable/energy efficient as the Council has planned.

13. Conclusion

13.1 Redevelopment of the Midleton Industrial Estate will create a more secure asset and investment for the Council by providing much needed industrial stock. It will encourage new businesses into the area and allow existing businesses the room to grow. It is therefore officers' recommendation to transfer the budget required from the provisional capital programme to the approved capital programme to enable continued delivery of the project.

14. Background papers

PR395 Redevelopment of Midleton Industrial Estate Business Case

15. Appendices

Appendix 1: Location Plan
Appendix 2: Design & Access Statement
Appendix 3: Outline sketch design