Leicestershire County Council

CABINET – 15TH SEPTEMBER 2023

AIRFIELD BUSINESS PARK DEVELOPMENT PROPOSAL - FINAL PHASE

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PART A

Purpose of the Report

1. The purpose of this report is to advise the Cabinet of the development proposals for the revised final phase of Airfield Business Park in Market Harborough (Harborough District) and to seek approval for the allocation of resources necessary to support the submission of a planning application for light industrial units covering a further 105,974 sq. ft. of the site, to proceed to tender to construct the final phase of the scheme covering most of the site and, subject to the outcome of that tender exercise, for the Director of Corporate Resources to proceed with the development.

Recommendations

2. It is recommended that:

(a) £16.5m be allocated from the Investing in Leicestershire Programme for the further development of 105,974 sq. ft of Airfield Business Park ('the development') as detailed in this report and the appended indicative Masterplan, subject to the satisfactory outcome of the tender exercise referred to in b) below;

(b) That a tender exercise be undertaken for the construction of part of the development:

(c) That the Director of Corporate Resources be authorised

i. to undertake all necessary preparatory work to enable the submission of a planning application for the proposed development;

ii. following consultation with the Cabinet Lead Member for Resources, to consider the outcome of the tender exercise in respect of the development and determine whether to proceed with the development;

subject to (ii) above, to select a preferred contractor(s) and enter into such contracts and undertake such work as is necessary and appropriate to enable the development to be delivered.

Reasons for Recommendation

3. The development of the Council-owned land will support the delivery of both new business accommodation, completion of the final development phase of a brownfield site, generation of local job opportunities, support the local economy and delivery of income generating assets.

4. Undertaking a formal tendering exercise will ensure that the Council secures the most competitive build cost price.

5. The delegation to the Director of Corporate Resources, following consultation with the Lead Member for Resources, is sought to enable the development to proceed immediately, subject to a satisfactory outcome to the tender exercise.

Timetable for Decisions (including Scrutiny)

6. The Scrutiny Commission will consider a report on the proposed development at its meeting on 6 September and its comments will be reported to the Cabinet.

7. Subject to approval by the Cabinet, it is intended that a planning application will be submitted to the County Council as planning authority in October 2023.

8. Subject to planning permission being granted and the successful outcome of the tender exercise, it is intended that the development will be completed by January 2026 unless market conditions indicate that revisions to the scheme are required.

Policy Framework and Previous Decisions

9. The County Council’s Medium Term Financial Strategy (MTFS) is the key financial plan for the Authority. The latest MTFS for the period 2023/24 to 2026/27 was agreed by full Council on 22 February 2023.

10. The capital programme included an initial allocation of £8.4m for this scheme. The plan also included an allocation for new investments totalling £37m over the term of the MTFS period and this will be used to fund the increase in funding requested. The increase in funding required for this particular scheme is due to:

    a. An increase in construction costs since the original scheme was brought forward for approval in March 2021.

The industrial element of the scheme has increased in floor area from 84,000 sq ft to 105,974 sq. ft and the proposal now includes two drive-thru units.

11. The expected maximum holding of the Investing in Leicestershire Programme (IiLP) remains at £260m, subject to satisfactory business case, as per the approved IiLP strategy.

12. The County Council's Strategic Plan 2022-26, supported by the Enabling Growth Plan, sets out the Council's objectives for the rationalisation and utilisation of its assets, maximisation of capital receipts, facilitating the delivery of affordable and quality homes and building a strong economy, generating economic growth.

13. The Council's Investing in Leicestershire Programme Strategy (the latest iteration of which was agreed by the full Council as part of the MTFS in February 2023) requires this Fund to be used to add to the Council's portfolio of land assets to:

- Support the objectives of the Council's MTFS, Corporate Asset Management Plan, Strategic Plan, its Economic Growth Plan and the County-wide Local Industrial Strategy.

- Support growth in the county and its economic area of influence and ensure there is a more diverse range of properties and land assets available to meet the aims of economic development.

- Maximise returns on Council-owned property assets.

- Support the delivery of front-line services through increased income generation from existing investments, or through capital investments that will reduce operating costs.

- Maintain a diverse portfolio of energy efficient and sustainable direct property and other investment assets which support economic growth and environmental sustainability.

- Support the Council's strategic objectives by working with partners to maintain momentum in the development of strategic sites and renewing existing employment sites and premises where there is demand thereby addressing areas of market failure.

- Contribute towards the development and implementation of a Net Zero Carbon 2030 Plan for the Council by reducing demand for energy and increasing the generation and use of renewable energy.

- Channel new investment into schemes that:

    - Maximise the potential to address economic and social market failure.
    - Improve property assets for a direct strategic/policy purpose.

- Enhance the value and marketability of property assets enabling capital receipts to be used to support improved service delivery.
- Manage investment risk by investing in diverse sectors.
- Support the Council in maximising the benefit from its financial assets in a risk aware way (not including standard treasury management activity).

14. On 23rd March 2021 Cabinet considered a report regarding the proposals for the development of Airfield Business Park. The Cabinet agreed, inter alia, that £9.5m would be allocated for the development from the Corporate Asset Investment Fund (now repurposed as the Investing in Leicestershire Programme) subject to the satisfactory outcome of the tender exercise for the construction of part of the development. The Cabinet authorised the Director of Corporate Resources to undertake the necessary work to enable submission of a planning application, determine whether to proceed with the development and enable the delivery of Phase 3 and 4. The comments of the Scrutiny Commission, which had considered the matter on 15th March 2021 were reported to the Cabinet.

Resource Implications

15. The MTFS allocations, if approved by Cabinet, will bring the overall portfolio of the IiLP to the expected maximum holding of £260m, subject to satisfactory business cases.The expectation is that the returns (both revenue income and capital growth) generated by the IiLP will have a meaningful impact on the Council's funding gap.

16. The Airfield Business Park development would have a maximum capital cost of £16.5m. This figure includes costs associated with preparing and submitting the planning application, fees, construction of two drive-thru Units, a 60,000 sq. ft industrial unit and 16 light industrial units ranging from 1,500 sq. ft to 3,500 sq. ft plus contingencies. The development is expected to generate an income of approximately £1,075,000 per annum once the scheme is completed. This is in addition to the £550,000 per annum and capital receipt of £802,465 which the previous phases generated.

17. A specific provision exists for IiLP development in the capital programme.

18. Further information relating to the proposal and financial estimates and risks are provided in Part B of this report.

19. The Director of Law and Governance has been consulted on the content of this report.

Circulation under the Local Issues Alert Procedure

20. The report has been circulated to Mr. Phil King CC (Market Harborough West and Foxton).

Officer(s) to Contact

Declan Keegan, Director of Corporate Resources
Corporate Resources Department
Tel: 0116 305 7668   Email: declan.keegan@leics.gov.uk

Jon Bennett, Head of Strategic Property Services
Corporate Resources Department
Tel: 0116 305 6926 Email: jon.bennett@leics.gov.uk

PART B

Background

21. The land at Airfield Business Park has been economically unproductive since the land was transferred out of the control of the British Army (who superseded its use as RAF Market Harborough) in the 1950's. Part of the land was subsequently developed as HMP Gartree but the rest remained undeveloped until the 2000's when the first phase of Airfield Business Park was developed.

22. The County Council acquired 15.5 acres of land at Airfield Business Park in 2016 as an opportunity to support the local economy through regeneration of a brownfield site. The strategy was to redevelop the former airfield to deliver commercial premises which would not only meet demand in the market from local businesses but also attract new enterprises into the region.

23. Upon acquisition of the site the County Council simultaneously sold 2.5 acres of land to a local manufacturer in order to support economic growth, enabling the firm to develop a 30,000 sq. ft industrial unit to expand their existing bespoke furniture business based in Market Harborough.

24. The site is located adjacent to the A508 Harborough Road north of Market Harborough and has been identified as a Key Employment Area and allocated for B1 (now class E), B2 and non-strategic B8 development in Harborough District Council's adopted Local Plan.

25. In July 2018, the County Council secured planning permission to build 80,000 sq. ft. of industrial units on 5.42 acres of land (12 units for B1/B2/B8 use) on part of the site.

26. Works on these units began in February 2019 and were completed in December 2019, at an overall cost of £6.85m. This development phase was valued in October 2022 at £8.8m.

27. There has been strong market interest in the development, with all twelve of the new units occupied and the rents achieved in line with expectations. The scheme received high levels of interest even during the Covid lockdowns and a number of lettings were secured during this time, emphasising the scheme's attractiveness as a business location during what has proven to be a challenging economic period.

28. The economic benefits have been assessed in terms of the outputs of the scheme having regard to Central Government's assessment of Rural Productivity and Gross Value Added (GVA). Productivity measures are often used to indicate how well a country uses its human and physical resources to generate economic growth. GVA measures the contribution to the economy of each producer, industry or sector. An assessment of such measures has indicated a contribution to the local economy in the region of £6,810,000 for

the development completed thus far having regard to the number of jobs created.

29. Five of the tenants who moved into Airfield Business Park took space to expand their existing Leicestershire-based operations. The Council has also been successful in attracting five new businesses from outside of the County. All of the Council's Airfield Business Park tenants have continued to trade successfully throughout the Covid lockdowns and none have triggered their break options which fell due upon expiry of the third year of their leases.

30. There are a number of rent reviews which fall due in 2023, one of which has now been concluded at a rent reflecting an increase of 8% on the passing rent agreed, and demonstrating positive rental growth.

Proposals for further development

31. As a result of the success of the last phase of the development, a planning application was submitted to the County Council in August 2021 for 34 individual units ranging from 1,500 sq. ft to 10,000 sq. ft to meet the market demand at the time.

32. Due to substantial increases in construction costs since the original planning application was submitted in 2021, it became apparent that the scheme proposed was no longer viable and a revised strategy and masterplan has been developed to ensure this phase of the scheme is viable.

33. Consideration has therefore been given to the potential to develop a further 105,794 sq. ft. on 7.69 acres of the site: - 102,194 sq. ft of E class (light industrial) units and 2 drive-thru units fall under a Sui Generis Use Class. An indicative masterplan has been produced setting out the proposals and is appended to this report.

34. Planning permission for 16 individual units with sizes ranging from 1,539 sq. ft. up to 10,010 sq. ft. (offering a broad range of grow-on space in which tenants can expand to compliment what has already been developed on site) is currently being sought.

35. The intention is to submit a planning application for this revised scheme and proceed to tender for the construction of the development in a single final phase. This tender will seek to obtain a price to build a single unit extending to 60,000 sq. ft to meet a specific occupier requirement, as well as the 2 drive-thru units again to meet specific occupier demand.

36. The proposal to develop a 60,000 sq. ft industrial unit and the 2 drive -thru units are to satisfy specific occupier requirements and Heads of Terms for Agreements for leases extending to 10 to 15 years have been agreed. Securing these operators on a pre-let basis significantly reduces the commercial risk to the County Council as the 3 deals represents 65% of the annual rental income for this part of the scheme.

37. The sizes of the 16 smaller units have been designed with regard to the market demand experienced in the last phase of development, which highlighted a substantial demand for smaller units (up to 3,500 sq. ft.) which can offer existing tenants the opportunity to move into larger accommodation as their businesses expand in the future.

38. As this is a Council-led development, the scheme will ensure the Council's ambitions for sustainability are met where possible. This will include ensuring the chosen construction strategy incorporates sustainable construction methods such as the use of photovoltaic panels, electric car charging points, insulation and the use of best practice construction methods.

39. Public Health considerations are always considered when County Council schemes are proposed and the Council looks for ways in which schemes can be improved health-wise such as ease of walking to the scheme or cycling. For this proposal, cycle shelters will be incorporated into the design to encourage sustainable travel and support travel to the wider Airfield Business Park which has the benefit of a designated cycle route which links to the residential development currently under construction to the east and south of the site.

40. Pre-application consultations have been held with the County Council as Highway Authority in order to ensure access, parking and wider highways infrastructure designs are acceptable and any impact of the development on the local highway network is reduced.

41. It is intended that the planning application will be submitted in September 2023 subject to Cabinet approval being secured. Pre-application advice has been sought from County Council planning officers on an informal basis. It should be noted that this advice should not be seen as indicative of the outcome of any eventual planning application process which will need to follow usual procedures taking into account all relevant and material planning considerations.

42. It is envisaged that the following indicative timescales will apply in terms of delivery and receipt of income for the Council should the proposal be approved by the Cabinet and permission be granted by the Development and Control Regulatory Board (DCRB) in due course:

September 2023	Commence formal marketing
October 2023	Submission of a planning application to the County Council as the Planning Authority
March 2024	Planning application considered by DCRB
September 2024	Completion of procurement exercise
January 2025	(Subject to planning permission being granted) construction commences

February 2026 Practical completion of the scheme

February 2026 First occupation of units

Financial Estimates

43. The cost estimate is currently £18.5m. This includes construction costs, professional fees, marketing, letting costs and a 10% contingency of construction cost. Land acquisition costs of £2m were incurred upon acquisition of the site in 2016 which forms part of the financial appraisal to determine the overall NPV but not required as a resource to fund the next phase of development.

44. The contingency against the construction cost element at 10% is considered appropriate given that significant due diligence has been completed with respect to ground conditions and construction cost inflation given that the cost plan prepared by the appointed Quantity Surveyor assumes commencement on site in January 2025.

45. A net initial yield of 4.3% is expected to be achieved in Year 1 assuming a scheme cost (including land value costs) of £18.5m having regard to an assumed gross annual rental income of £1,074,870 and net rent in the year of year of £798,000 reflecting rent free periods. The net initial yield being the current net rent, net of costs, expressed as a percentage of the capital value, after adding notional purchaser's costs. The yield in year 2 once rent free periods have expired is 5.8%.

46. Of note is that the Council acquired the land in 2016 at a cost per acre of £290,000. The land proposed to be developed is now considered to be worth in the region of £420,000 per acre. If the County Council was to dispose of the site in the current market it would expect to achieve a capital receipt in the region of £3.2m.

47. The proposed scheme would generate a net initial yield of 5.5% which excludes capital growth and is similar to the rate of interest the Council could expect to achieve from short term deposits, noting that once the short-term deposit is expired it needs to be deposited at the prevailing rate which could be lower. Retaining the capital within the Council's reserve fund would also not secure the £1.075m annual rental income which the proposed scheme is predicted to generate.

48. The rationale for developing the proposed scheme includes developing high quality units which will generate job opportunities in the local market (current prediction is that the scheme will generate in the order of 20 jobs and 15 apprenticeships during the construction phase and 240 post construction), aiding economic growth and support local businesses through the provision of sustainable and high quality units from which to expand their businesses in line with the IiLP's Portfolio Management Strategy.

49. The rationale behind developing smaller units as referred in the Masterplan as Blocks H1, H2 and H3 is to address an area of market failure. The private sector rarely develops starter units as they do not generate the most advantageous returns given the increase in construction costs of delivering a number of small units as opposed to larger ones. The units serve to attract businesses in the Strategic Economic Plan priority sectors.

50. The Council is informed by its retained commercial agents that there is still strong demand post-Covid for industrial premises particularly in relation to the small to medium sized units which are proposed. This is borne out of ongoing discussions with two firms looking to agree a pre-let in relation to the units proposed.

51. The risks associated with development of the proposed scheme are mitigated by the pre let opportunities being explored. Whilst the construction of a unit extending to 60,000 sq. ft is mitigated during the term of the initial lease, there is confidence that the occupier views this location as a long-term proposition given that they are consolidating 4 other of their operations located elsewhere in the town and are likely to remain in occupation far beyond the initial 10-year term agreed. In any event, the building will be designed and constructed to enable flexibility in terms of the accommodation and enable the unit to be split into a number of smaller units if demand at the time so requires.

52. If the tenant does vacate, and the County Council is required to split the unit into smaller units to meet market demand, the cost of dividing the units will be recouped through the increase in rent per sq. ft which will be justified in offering smaller units.

53. The risks associated with the development of two drive-thru units will equally be mitigated by entering into pre-let agreements and history has shown that occupiers of such units remain in occupation, renewing their leases beyond the initial 15-year term agreed.

54. The proposed rent per sq. ft for the industrial units compared to the most recent development phase has increased 25% from £8 per sq. ft. to £10 per sq. Ft. Such an increase in rents is to reflect continued demand being greater than the supply of industrial accommodation in the market and also reflective of the increase in construction costs resulting in the need to increase rents to enable viable development of new stock to be brought forward. This means that the existing units are expected to achieve higher rents at rent review or at new letting/lease renewal and this has been demonstrated having agreed one of the rent reviews which reflects an increase of 8% on the passing rent payable.

55. The estimated construction costs against those achieved for the last phase have increased. These costs will be tested by completing a competitive tender procurement exercise before it is determined whether this phase of the scheme should be progressed.

56. This tender exercise will be based on a fixed cost to limit cost overruns. The details of in-scope elements within the tender and construction contract will be carefully considered to also reduce the risk of cost overruns for the Council. If the tenders received are considered too expensive having regard to the returns required, then the Council will consider alternative options and further reports will be submitted to the Cabinet if the alternative options present a substantial change.

57. The Director of Corporate Resources has completed the standard appraisal for this project including scenario modelling. The base case includes the following assumptions:

    a. Development costs at £18.5m.
    b. Initial gross rent at £1.075m pa.
    c. Average annual rental increase of 2% (various scenarios modelled for this input). Rent reviews will be on a 3 year basis in practice for leases granted for a 6 year term and 5 year basis for leases granted for a term of 10 and 15 years.
    d. Assumed a rental void of 7.5% of gross rent. Based on experience of voids for large, diversified property portfolio (a mandate within the Leicestershire County Council Pension Fund) which experiences around the same level of voids currently. In addition, tenant break option triggers every 3 years would allow tenants to serve notice and it is prudent to assumes rent free periods at these times (various scenarios modelled for voids as a percentage of gross rent this input).
    e. Capital growth of 2% per annum is assumed and used for the terminal value at the end of the net present value calculation period. This assumption is deemed prudent given capital growth December 2000 to June 2023 data received from a UK commercial property manager. The long term increase over the time period (22.5 years) for UK distribution warehouses was 3.1% and 2.2% for UK manufacturing production units.
    f. £2.3m for dilapidations over a 25-year period is assumed. This is based on 0.5% of construction cost inflated by 2% pa.

58. The financial model assumes, despite all leases being granted on fully repairing and insuring (FRI) terms, that £2.3m will be spent by the County Council in relation to dealing with dilapidations and improving the units throughout a 25-year period as required. It is not envisaged that a sum to this level will be necessary, but it is deemed prudent to build in resources which may be potentially necessary to re-let vacant units.

59. The base case internal rate of return (IRR) and net present value (NPV) table is shown below highlighting the current NPV over 25 years at £1.65m. The positive NPV shown over various time frames assumes a terminal value which includes capital growth at 2%. The positive NPV allows the Council some flexibility in deciding on the right time to dispose of the site. The discount rate used is 6.09% and represents the interest rate that is used to convert future cash flows (income and expenditure) into a present value at the start of a project. The rate used is consistent across IiLP appraisals and offers simpler

comparisons across multiple projects. The rate includes the effect of inflation and is a long-term assumption. If inflation assumptions were to increase it would be feasible to assume a higher discount rate as is discussed later in the paper.

	15 years	20 years	25 years
IRR	6.8%	6.7%	6.7%
NPV £	1,353,566	1,428,631	1,652,443

60. A competitive tender exercise will be undertaken to de-risk these returns estimates and only if these are shown to be at an acceptable level will this next phase of the development proceed.

61. Were inflation to stay elevated and risk free rates of return were higher it would be feasible to assume discount rates used to assess projects could be increased. This would lead to lower net present values all other things being equal in the most prudent of scenarios. In reality, however there is a likelihood that rents would increase at a higher rate than the 2% pa currently assumed and costs and capital growth would also be higher.

62. In order to take this scenario into account an alternative scenario shown in the table below uses the same assumptions as the base case described but adjusts for the discount rate to be increased from 6.09% to 7%. Using 7% results in a negative NPV (£0.8m) over 25 years. Were capital growth to increase from the base case 2% to 2.5% then the NPV with a 7% discount rate would be (£36,000).

63. Finance colleagues have modelled the base case NPV over 25 years for two scenario changes, rental increases different to 2% pa and rental voids being different to the base case of a 7.5% rental void. The sensitivity of the NPV is shown below. Base case assumptions are shown in bold within the sensitivity tables below. Under the base case assumptions, a more pessimistic rental voids assumption at 10% of gross rent would still result in a positive NPV.

		Rent increase % pa				
		1.00%	1.50%	**2.00%**	2.50%	3.00%
Rental void of full rent, 1.5% to 10%	1.5%	£1578 k	£2108 k	**£2672 k**	£3272 k	£3909 k
	2.0%	£1500 k	£2027 k	**£2587 k**	£3183 k	£3816 k
	5.0%	£1032 k	£1539 k	**£2077 k**	£2650 k	£3258 k
	7.5%	**£642 k**	**£1132 k**	**£1652 k**	**£2206 k**	**£2794 k**
	10.0%	£252 k	£725 k	**£1228 k**	£1762 k	£2329 k

64. Construction costs are the highest individual cost line with the most uncertainty and as such a competitive tender process will inform the Council of more accurate financial returns. The appraisal will be re-run for the most up to date assumptions at that point.

65. The construction costs assumed in the financial model reflect current estimates of inflationary increases in such costs from the date of this report to January 2025 being the date the construction contract will likely be entered into ensuring the business case is robust.

66. Under the 25-years scenarios, an improved NPV is achieved as construction costs decrease. A competitive tender process has been chosen to maximise the chance of securing best value in terms of construction costs.

67. Tenants will be subject to due diligence assessments before lease agreements are signed. This will be based on financial credit checks and consultation with the relevant Council personnel when appropriate.

68. Alternative uses of resource have been considered and include:

    - Interest from depositing cash – at present the Treasury Management Policy allows the Council to deposit (lend) money for a maximum duration of 1 year. Rates have increased over the past 6 months, with borrowers offering up to 6% for a one-year term. It is important to note that when the term expires cash would then need to be re invested at the prevailing market rate. The Council's treasury management advisors suggest Bank of England base rates are expected to peak in the coming months and then reduce to between two to three percent over the next two to three years.

    - Borrowing from the Public Works Loan Board (PWLB), as the Council has done in the past. An option exists to redeem debt when the costs saved are favourable. The debt management office (DMO) publishes rates to redeem debt. As at the time of writing these range between 4.2% and 4.8%.

69. The proposed scheme is being funded from internal resources with no direct borrowing required to take this scheme to completion.

Conclusion

70. The land surrounding the Business Park is now the subject of residential development. The land to which the report refers has remained undeveloped and only now has a viable scheme been brought forward that completes the Business Park. The scheme is expected to provide 20 jobs during construction and 240 jobs when completed.

71. It is therefore recommended that that the proposal for the further and final development phase of 105,974 sq. ft of Airfield Business Park as detailed on the indicative Masterplan attached ('the development') and the financial costs and returns estimates as set out in this report be brought forward with an allocation of resources amounting to £16.5m subject to the satisfactory outcome of the tender exercise.

Equalities Implications

72. There are no Equality Implications directly arising from this report. Implications associated with the future development of the site such as planning applications for planning permission, will be subject to Equality Impact Assessments, as appropriate, prior to decisions being made.

Human Rights Implications

73. There are no Human Rights Implications directly arising from this report. Implications associated with the future development of the site such as planning applications for planning permission, will be subject to Human Rights Assessments, as appropriate, prior to decisions being made.

74. Environmental implications are referred to at paragraph 38 above.

Risk Assessment

75. This is a medium-sized project that requires upfront investment in order to generate future financial returns. The risks relate to the size of the financial obligations which the Council could potentially commit to. These will include consultancy fees, infrastructure design costs, funding, timing commitments and construction costs. Inevitably all of these bring a degree of risk.

76. So that financial risk can be mitigated, and best value obtained, advice has been provided by external consultants. The scheme will be tendered and if the cost of tender returns is unacceptable, the proposed scheme may be redesigned to reduce cost.

Background Papers

Investing in Leicestershire Programme ~ Portfolio Management Strategy 2023 - 2027
https://politics.leics.gov.uk/documents/s174713/Appendix%20H%20-%20Investing%20in%20Leicestershire%20Programme.pdf

Appendix

Indicative site masterplan for the final development phase of Airfield Business Park