

Preliminary business case for Horsham District Homes Limited

Dukes Square, Horsham

Construction of 8 homes for affordable rent

Executive Summary

The Council owns a public car park known as Dukes Square which is behind the Drill Hall, Denne Road, Horsham.

There are two buildings within the curtilage of the proposed development site, the MT garage, which is a redundant store and at end of life, and the QM Studio, which is an older style building used by a popular local charity.

The whole of the site has been looked at in a comprehensive way, with a view to understanding and releasing the full potential of the site. However the site is not fully available because of the QM studio use, which would need to be relocated to achieve a comprehensive development solution.

Therefore, it is proposed to approach the site as a phased development with a small scheme of 8 units on the MT garage site comprising phase one and a second phase on the land occupied by the QM Studio should that site become available in the future.

Phase one is straightforward to deliver. Phase two is more complicated because to secure planning consent, policy 43 of the local plan would require the relocation of QM Studio to suitable alternative premises. This would have a significant cost and without a cost-effective alternative solution, a unit would have to be built for QM studio on the site, which would increase construction costs by at least £750,000.

A summary of the illustrative finances for phase one is set out below:

Transfer value for Phase One*	£1,560,000
Net rental income	£62,400 pa
Yield	4%
Market value of the homes	£2,130,000
Ratio of transfer value to market value	73%

*To be financed with s106 commuted sums

This is a small unit scheme in a town centre location and therefore the cost of construction is high. The ratio of transfer value to market value is higher than other developments undertaken by Horsham District Homes (73% compared to an average so far of c62%) and the yield is sharper at 4% (compared to an average so far of 4.6%).

The opportunity to develop phase 2 will continue to be monitored and that part of the site would be brought forward in the future if circumstances allow.

Location

The site comprises land in Dukes Square, Horsham, which is currently used as a car park, as identified on the location plan in appendix 1.

The close proximity of the site to Horsham town centre and easy rail access to London and the south coast makes this a popular area for households on the affordable housing list.

The current affordable housing list for Horsham District has 748¹ households with 458 households identifying Horsham as an area of choice; of these 144 households are seeking 1-bedroom homes and 104 households 2-bedroom homes.

The Site

The land is owned freehold by Horsham District Council.

There is a restriction on the title of this land in favour of the previous owner, the Ministry of Defence (MOD), which means that it can only be used for community purposes, or for affordable housing and/or temporary accommodation. If it were to be developed for market housing, then 90% of the enhancement in the land value would pass to the MOD. This covenant depresses the value of the land and makes the site ideal for development as affordable housing.

In accordance with s123 Local Government Act 1972, the Council is under a duty to obtain the 'best value reasonably obtainable for the land' and an independent valuation will be secured by the Council prior to a disposal for transparency purposes. However, this land is worth less than £2m and is therefore within the threshold of the Local Government Act 1972 General Disposal Consent, which allows the Council to approve a disposal at an undervalue provided that the disposal is likely to contribute to the social, economic or environmental well-being.

The Council has the power to give financial assistance relating to the acquisition, construction or management of any property as privately let housing where the Council is not the landlord. However, the Council will need to obtain Secretary of State consent under s25 of the Local Government Act 1988 to exercise this power. A s25 application will be necessary in the event that the agreed transfer value is less than the market value of the land for social housing, as in those circumstances a gratuitous benefit will have been created. At this stage it is not expected that the transfer value will be less than the social housing market value, but this will need to be revisited before the transfer takes place and appropriate steps will be taken to obtain Secretary of State consent if required.

At this stage, the residual value of the site (which will establish the transfer value of the land from HDC to HDH) may change, because the proposal is at feasibility stage and further work is required to achieve cost certainty and reduce financial risk.

Development Opportunity

This is an urban site, presently used as a car park. The site has a narrow access via a single car width road leading from Denne Road into the site and the cost of improving this access has been included in the appraisal.

¹ Figures correct at 12th September 2022

Business Case for HDH – Dukes Square: Appendix 1

There are a number of occupied buildings around the perimeter of the site, which will continue to operate during the construction phase. These include aged care facilities. This means that access will be required across the site for the duration of the works, including access for emergency services, deliveries and some parking.

There are two possible phases for the redevelopment of the site, one utilising MT Garage only and the other utilising the site occupied by QM Studio.

a) Phase One – Immediate opportunity

The MT garage. This is a portal frame building with corrugated cement board cladding. The building is at end of life and is operationally redundant. There are no barriers to demolishing this building.

b) Phase Two – Recommended to be undertaken at an undetermined future date

QM studios. This is a brick-built building with a corrugated cement board roof. Although the building is towards the end of its physical life, it is fully utilised for community purposes. The occupier, QM Studios, have fitted out the building and operate a charity which provides community music recording services and practice facilities, with a focus on people with learning disabilities. The charity is successful, with strong local support. This use is captured by policy 43 of the Local Plan and would therefore need to be relocated, in the close vicinity, before the building could be released for redevelopment. The cost of this means that phase 2 is not viable at the present time.

Phase One: Eight units

This is an eight-unit residential scheme, which can be achieved by redeveloping the MT garage only. This would involve demolition of the MT Garage and creation of a new two storey residential block comprising 8 flats; 2x2 bedroom units and 6x1 bedroom units. The ground floor units could be adapted for use by residents with restricted mobility.

The budget figures indicate that this would be viable. The total income generated by this scheme would be £62,400 pa net of allowances for repairs and management and the capital value would be c£1.56m assuming a yield of 4%. The cost of construction is estimated to be about equivalent to the capital value.

Phase one would not materially impact on parking in Dukes Square, apart from temporary loss of spaces during the contract period.

Summary of finances

Total project costs	Phase One
Number of units	8
Build costs – residential	1,250,000
Contingency	74,000
Fees	125,000
Finance costs	40,000
Developers Profit	71,000
QM Studio relocation	0
Total Project costs	1,560,000

Business Case for HDH – Dukes Square: Appendix 1

	Phase One
Purchase Price	1,560,000
Gross rental income	76,580
Net rental Income	62,400
Management costs	18.5%
Net Yield	4%
Transfer value of housing	1,560,000
Residual value of land	nil
Plus relocation costs for QM	
Net yield on total project costs	4.0%

Analysis of development options

The budget figures outlined above are initial appraisal figures only. There are cost risks in these figures, in particularly, the following:

- Demolition costs and presence of asbestos
- Services diversion and upgrade costs
- Ground conditions
- Negotiation in relation to any third-party rights over the site (including QM Studio)
- Planning conditions
- Water neutrality costs
- Sustainability costs
- Transfer value from Horsham District Homes to Horsham District Homes Holdings Limited
- Cost inflation and other normal construction risks

Many of these risks are development risks manageable through design or other adjustments to the project. Some of the risks, such as services costs and ground conditions, need to be identified at the design stage, as they can significantly impact on viability.

A yield of 4% is at the lower end of expectations and reflects the higher open market values in a town centre location. The average value of the affordable housing is £195,000 per unit compared to an average open market value (OMV) of c£266,000. The restricted value is 73% of OMV. The open market value figures are £345,000 for a two-bedroom flat and £240,000 for a one-bedroom flat.

Sustainability and water neutrality

Horsham District Homes will aspire to develop these units to an Energy Performance Certificate (EPC) rating of A, depending on technical and price feasibility. If an EPC of A cannot be achieved, the minimum level acceptable to the council is B. At a national level just 1% of new homes are EPC A and 81% of new homes achieve an EPC B rating. EPC A rated homes comprise 0.2% of housing stock (40,000 homes) and B rated homes comprise 2% of the existing housing stock at a national level. The properties will be all electric which is in keeping with future trends and will therefore be carbon neutral when generation of electricity is decarbonised.

Solutions for water neutrality are in the course of being identified.

Funding terms

It is recommended to fund the development by the Council making a loan to Horsham District Homes Limited equal to 95% of the construction costs, on a drawdown basis. The loan would be on the same terms as previously approved loans to the company, which have been made under the Agreement between the Council and Horsham District Homes, signed 27 January 2021. The headline terms would be:

Loan Amount	Up to £1.5m over the build period
Interest rate	currently 6.5% (agreed rate is 4% above base rate which is subject to change)
Repayment	Repayable to the Council on completion of the development and transfer of the land to Horsham District Homes (Holdings) Limited

The business case for the affordable housing company provides for the completed development to be sold to Horsham District Housing (Holdings) limited at a fair market price for affordable homes, which is presently estimated at £1.56m.

The transfer sum will be funded by s106 commuted sums, presently held by the Council for these purposes. When the transfer takes place between Horsham District Homes and Horsham District Homes (Holdings) Limited, the development finance will be repaid in full.

Recommendation

It is recommended to approve the site for redevelopment and to progress the proposal for phase one to create 8 affordable homes.

Based on the current budget estimates, Horsham District Homes will generate a net income of £62,400 per annum which would deliver a net return of 4% (following payment of loan interest to the Council) on the transfer value of the properties. The transfer sum of c£1.56m will be funded from commuted sums, which have been paid by developers to the Council for the provision of affordable homes.