

## Summary Sheet

### Committee Name and Date of Committee Meeting

Cabinet – 18 March 2019

### Report Title

Site Cluster Programme Amendments

### Is this a Key Decision and has it been included on the Forward Plan?

Yes

### Strategic Director Approving Submission of the Report

Anne Marie Lubanski, Strategic Director for Adult Care, Housing and Public Health

### Report Author(s)

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### Ward(s) Affected

Boston Castle  
Dinnington  
Maltby  
Valley

### Report Summary

The Site Clusters programme, approved by Cabinet in July 2017, is an innovative development model that is increasing and accelerating the amount of new housing in Rotherham and providing a range of additional benefits to Rotherham, including specialist accommodation and extensive employment and training opportunities. The programme is progressing very well and all seven sites are now under construction and delivering to the agreed construction programme. Following the opening of the Braithwell Road show home in October 2018, demand is proving to be high and the projected combined income from selling the 83 houses on the open market and sales receipts from shared ownership homes is now forecast to be higher than originally reported.

At the point of reporting to Cabinet in 2017, the total scheme cost could only be estimated. The sites are extremely challenging and extensive ground remediation work has been necessary to make them developable. Other unforeseeable costs have arisen from utilities diversions and an industry-wide increase in the cost of materials and labour. The report to Cabinet in July 2017 stated that in order to protect the Council from exposure to a situation where the amount exceeds the amount authorised, the development agreement provides the Council with the ability to reduce the number of units built on the final site.

The Council must now decide whether to reduce the programme to ensure the original budget is not exceeded, or to increase the budget to enable all 217 homes to be built, and Rotherham to receive the full range of benefits afforded by this innovative partnership. The report recommends the latter approach. The Council and its Employer Agent, Rider Levett Bucknall, have challenged and scrutinised all costs presented by Wates and a range of efficiencies has been identified. The remaining risks have been analysed and a realistic maximum price has been calculated.

If Cabinet decides to increase the budget, there are two further options to consider. One option is that the Council could continue with the current contractual arrangements. If any savings are identified, the final cost could potentially fall below the revised budget figure. However, the Council would bear the costs associated with any further risks that materialise for example as a result of the UK's exit from the European Union or adverse weather conditions.

Alternatively, the Council could renegotiate the contract to a fixed, guaranteed maximum price contract, which would ensure no further risk of cost increases for the Council. This is the recommended approach.

The report sets out the implications of each of these options. The figures are set out in the confidential Appendix 1. The report also recommends that Cabinet approves the new funding profile (Appendix 2).

## **Recommendations**

1. That approval be given to the proposed revised funding profile for the Site Clusters Programme as set out in Appendix 2, which includes an overall increase to the project budget and a net additional impact on HRA reserves of £4.99m, and recommend to Council that the Capital Programme is revised accordingly.
2. That officers be authorised to renegotiate the contract with Wates to a fixed maximum price contract, subject to the cost being containable within a revised funding envelope as set out in Appendix 1.

## **List of Appendices Included**

- Appendix 1 Financial information (Exempt)
- Appendix 2 Summary of cost and income profile (Exempt)
- Appendix 3 Revised cost broken down by site (Exempt)

**Background Papers**

Report to Cabinet and Commissioners' Decision Making Meeting – 10 July 2017 – 'Site Cluster II'

**Consideration by any other Council Committee, Scrutiny or Advisory Panel**

Overview and Scrutiny Management Board – 13 March 2019

**Council Approval Required**

No

**Exempt from the Press and Public**

While the main report is public, the appendices are exempt under paragraph 3 (Information relating to the financial or business affairs of any particular person (including the authority holding that information)) of Part I of Schedule 12A of the Local Government Act, as they contains sensitive commercial information with regards to the Council's contracts.

## Site Cluster Programme Amendments

### 1. Background

- 1.1 Approval was granted to commence the construction stages of the “Site Cluster Project” at the Cabinet and Commissioners’ Decision Making Meeting on 10th July 2017. The Clusters programme is the largest Council-led build programme in decades and will deliver 217 high quality homes across seven Council-owned sites, to meet a wide range of needs. Specialist accommodation for foster families and adults with autism are included.
- 1.2 This is an innovative scheme and has attracted interest and positive attention from other local authorities, the Sheffield City Region and Homes England. These seven sites had been redundant for several years and with the exception of Braithwell Road, it is unlikely that they would have been developable without the clustering approach. This has allowed the Council to provide affordable homes in areas where they are needed.
- 1.3 In addition to the New Homes Bonus and Council Tax income that will be generated to the Council’s General Fund by the 217 homes, the Clusters programme will generate other significant benefits for Rotherham:
  - 18 apprenticeships and training / upskilling of 51 people
  - Engagement with local schools (experience / site visits / workshops)
  - £21m spent through local supply chains
  - £65k contributed to local charities
  - 1258 hours of Wates volunteering locally
  - Visually improved seven long term vacant sites and removed associated antisocial behaviour problems
- 1.4 The programme includes 83 homes for sale, and expert legal advice confirmed that this was an acceptable use of HRA resources provided it would not result in a detrimental effect on the HRA. The income from sales receipts from these homes is now projected to exceed original targets and exceed the construction costs for the Braithwell Road site, therefore justifying the decision to deliver houses for sale to support wider Council house building.
- 1.5 The original proposed tenure breakdown was as follows:
  - 98 new council houses
  - 83 new homes for outright sale
  - 24 shared ownership homes, and
  - 12 rent to buy homes

A slight adjustment has been made to this in that the 12 original 'rent to buy' homes will now be delivered as shared ownership. The July 2017 report to Cabinet and Commissioners' Decision Making Meeting included a recommendation that authority to determine the tenure mix for 21 of the homes (provisionally identified as rent to buy or shared ownership) be delegated to the Assistant Director of Housing Services, in consultation with the Section 151 Officer, and this was approved. The decision to convert the homes from rent to buy to shared ownership was taken for two reasons: Shared ownership produces more capital income to the Council, and rent to buy has proven to be a very difficult tenure to implement for local authorities. The new tenure breakdown is as follows:

- 98 new council houses
- 83 new homes for outright sale, and
- 36 shared ownership homes

1.6 The decision (to convert the 12 units) has resulted in an increase to the total projected capital income from shared ownership sales, although it also results in an annual revenue income loss to the HRA. The projected income from sales receipts for the 83 open market sale homes has also increased.

1.7 The original overall cost for the programme as originally reported to Cabinet in July 2017 was based on Wates' estimates at the time, and the report explained that this was subject to increases depending on unforeseeable factors.

1.8 As detailed in confidential Appendix 1, costs have increased and the main reasons, in order of impact (with the highest impact items first) are:

- Superstructure – bricks (labour and materials – a national industry wide issues not specific to Rotherham), revision to kitchen designs, increased screed costs
- External walls (major soil nailing requirements for four sites, retaining walls, utilities diversions that were unknown at the outset)
- Groundworks (unforeseen ground conditions, additional excavation, enhanced drainage design)
- Fees, preliminaries, overheads and profit and other costs (pre-construction prelims, additional prelims for brickwork contractor and S185 drainage diversion)
- Joinery (increased costs inc. internal walls, doors, fixtures and fittings due to market conditions and supply and demand)
- Compensation events (technical approval of drainage, live electrical supplies, live mains denoted incorrectly on existing plans)
- Pre development costs and Development Agency Model fees as a result of increased sales income
- Professional fees

- 1.9 The cost increases have been scrutinised and challenged by Rider Levett Bucknall (RLB), the Council's Employer Agent, the Council's Strategic Housing and Development Team and an independent third party, with all concluding that they are legitimate and consistent with cost increases experienced on other comparable projects. RLB has confirmed that without the inclusion of these abnormal costs, the overall figure is within the original estimate which represented "extremely good value for money".
- 1.10 In order to avoid any future cost increases, Wates' commercial team has been asked to produce a guaranteed maximum price (GMP) that reflects all known issues and includes all other associated costs payable by the Council, with the exception of professional fees to RLB, Legal and Planning services. The figure included in confidential Appendix 1 is based on information provided by Wates on 30<sup>th</sup> January 2019.
- 1.11 As part of the process of reaching the GMP, Wates were challenged to make a number of efficiencies such as completing earlier (thus reducing preliminary costs), foregoing overhead and profit margins on certain elements of the programme and achieving other savings through their supply chain. The resultant savings have been factored into the GMP.
- 1.12 There has also been an increase in development costs. This is due to an increase in pre development costs and also increased costs related to Development Agency Model fees based on the fact that Wates receive 3% of sales income, which has now increased. The Sales and Marketing cost will be fixed if the GMP option is approved.
- 1.13 While RLB will continue to scrutinise and challenge costs, this forms the basis of the new projected overall budget for the scheme, excluding only the RMBC funded professional fees, the sum for which has increased to reflect the increased cost of professional fees in relation to the revised project and includes RLB and Legal costs. It is anticipated that the total gross cost as set out in confidential Appendix 1 will be the maximum cost.

## **2. Key Issues**

- 2.1 The key issue is that the original budget estimated in the July 2017 Cabinet report is insufficient to complete the programme. The causes of the increases have been outside the Council's or Wates' control: The majority of the ground remediation and utilities diversion works could not have been foreseen until work was underway, and the rise in the cost of bricks and labour reflects wider market forces in the construction industry.

- 2.2 As set out in the original Cabinet report in July 2017, the risk of cost increases could be mitigated by reducing the number of homes built on Rother View Road in Canklow. The programme could be reduced by up to 70 Council houses, thus remaining within the original budget envelope. However, this would have a negative impact on overall value for money for the Council and would fail to address local housing needs. It would also result in the Council having to hand back grant from the Shared Ownership and Affordable Housing Programme to Homes England, reducing Homes England's confidence in the Council as a delivery partner and potentially jeopardising future schemes that are reliant on grant funding such as the town centre housing programme. In addition it would impact on the net revenue rental income for HRA. The implications are set out in further detail in section 4.
- 2.3 This report recommends increasing the HRA budget to allow the scheme to be completed, and fixing the price with Wates to guard against any further increases.

### **3. Options Considered and Recommended Proposal**

- 3.1 **Option 1:** Reduce the number of units built on Rother View Road, Canklow. Ceasing work on these sites (MC2 and MC3).

#### 3.1.1 Advantages

- This option would ensure that expenditure does not exceed the original Cabinet approved budget.

#### 3.1.2 Disadvantages

- Leaving sites redundant (and therefore vulnerable to antisocial behaviour, causing blight to neighbouring communities)
- Failing to deliver much needed homes to meet specific local housing needs – 70 Council homes for rent
- Reduction in overall value for money as the expense incurred by the Council to date would be divisible by a lower number of properties
- Damaged relationship with Homes England, potentially jeopardising future schemes that are reliant on grant funding support (such as the town centre housing programme), and the handing back of £2.1m of grant funding which further impacts on the affordability of the overall project
- Adverse impact on estimated net rental income previously factored in to HRA business plan

#### 3.1.3 This approach is not recommended.

- 3.2 **Option 2:** Propose a revised overall budget that reflects all known costs and risks as at the end of January 2019 to enable the programme to be completed, proceeding with the existing contract.

### 3.2.1 Advantages

- The majority of the risks are now understood and it is possible that costs could be driven down, which would reduce the Council's expenditure on the project.

### 3.2.2 Disadvantages

- Costs could increase beyond this figure and a further budget increase request could be necessary. It would open the Council up to covering not only site related risks but also economic risks emanating from uncertainty and outcomes of EU Exit, which could be significant.

3.2.3 This is not recommended as option 3 would offer a greater degree of protection to the Council's interests.

3.3 **Option 3:** Revise the contract with Wates to a fixed, guaranteed maximum price (GMP).

### 3.3.1 Advantages

- This would protect the Council from any further risk and cost increases
- The impact of the UK's exit from the European Union cannot be predicted with certainty and without a fixed price the Council would bear all the risk. There has recently been an emergency meeting of the UK's main contractors amid concerns that 70% of all construction materials presently come in from Europe, that could lead to significant delays and cost increases on major projects after the UK leave the EU.
- The Council's external advisors Rider Levitt Bucknall have confirmed that the level of risk built in by Wates is not excessive given the potential risks, however they will assist the Council to negotiate to further reduce the proposed fixed price.

### 3.3.2 Disadvantages

- The Council could potentially pay for risk elements (included in Wates' proposed fixed price) that do not materialise.

3.3.3 Overall this approach is recommended.



#### **4. Consultation on Proposal**

- 4.1 Detailed discussions and meetings have been held between Housing and Finance officers to ensure a shared understanding of the cost increase and options for proceeding. Latterly, RLB have attended meetings to advise on risk and contract issues.
- 4.2 Detailed breakdowns of the different works packages and cost reports have been provided to Finance representatives by Wates and Rider Levett Bucknall.
- 4.3 Ward Members have been fully briefed on the contents of this report.

#### **5. Timetable and Accountability for Implementing this Decision**

- 5.1 There is a detailed programme of works for each of the sites which is ongoing. The Assistant Director for Housing has overall accountability for the Clusters programme and progress is monitored through the Housing and Regeneration Programme Delivery Board.

#### **6. Financial and Procurement Advice and Implications**

##### **6.1 Option 1**

- 6.1.1 The overall cost of option 1 would reduce by virtue of removing the number of units built on Rother View Road, Canklow and would bring the project back within the budget previously approved. However, this would also mean handing back £2.1m of grant funding to Homes England and resulting reputational damage.
- 6.1.2 In addition this would also adversely impact on the net rental income already factored into the HRA business plan by circa £194k per annum. This equates to a sum of circa £5.814m over 30 years (at current prices).

##### **6.2 Option 2**

- 6.2.1 It is estimated that the overall cost of option 2 would be the same as the fixed price option. However, the potential future risks identified by Wates would likely pose the same risk for the Council and as such these would need to be built in to a contingency sum. This would invariably take the overall cost up to the same price as the fixed price option.
- 6.2.2 There is a risk that costs could increase even beyond this sum. In particular the Council's Employer Agent (RLB) has advised that the biggest potential risk may relate to the uncertainty around EU Exit. Many of the materials used on the build of these properties are sourced in the EU and there is concern on any impact on the supply chain post the 29<sup>th</sup> March.

### **6.3 Option 3 (recommended option)**

- 6.3.1 This would give the Council the certainty around the maximum cost of the project and protect the Council from potential future risk. There is a risk that the figure currently provided by Wates could change between the date of writing and the Cabinet approval date as any other factors become known. In addition RLB would continue to support the Council in negotiating this price down further.
- 6.3.2 There is a risk under this option that Council could end up paying more than it would if it proceeded with the existing contract. What the Council gets with this option is greater certainty.
- 6.3.3 Approval of this option would require an increase in the project budget, which can be partially offset by the increase in income from sales receipts. The net impact can be accommodated within the Housing Revenue Account budget, but it is possible that this may impact on the delivery of future projects. If the level of net sales income is less than currently projected, this would potentially mean a greater call on the HRA reserves for any shortfall.
- 6.3.4 The funding profile approved in the original reports in July 2017 / December 2017 assumed a mix of funding sources. The reports did not include details of the capital receipts from outright sales and shared ownership sales. However, the HRA Business Plan relies on this capital sales income as a funding source for the HRA. If this income is not used on this project it significantly reduces the HRA revenue balance and leaves a shortfall on funding for the capital programme in future years.
- 6.3.5 A revised funding profile is shown in confidential Appendix 2. This now includes the use of all the capital receipts from the outright sales and shared ownership sales on this project. However sales revenue can only be utilised once actually received and thus there is a time lag with costs being incurred in advance of income received. It is therefore proposed that HRA revenue reserves are temporarily utilised until the capital receipts are received. Any capital receipts from this project that were not realised in time to fund this particular project will then be available for future HRA capital schemes.
- 6.3.6 Confidential Appendix 3 shows the revised cost per site.

### **6.4 Applicable to all options**

- 6.4.1 The tenure of 12 units has been changed to shared ownership (from rent to buy). This revision avoids the possibility of potential right to buy opportunities after only a short tenancy.

6.4.2 The change of tenure of 12 units to shared ownership (from rent to buy) delivers a one off capital receipt (factored in to the revised budget and funding profile) but does also result in an annual reduction of revenue income to the HRA.

6.5 Regulation 72 of the Public Contracts Regulations 2015 provides a mechanism for dealing with the modification of contracts during their term. In the context of this specific contract, it is the professional opinion of the procurement team that this modification would not be defined as substantial in accordance with Regulation 72(1)(e) – predominantly on the grounds that the modification changes the economic balance of the contract in favour of the Council, in a manner that wasn't provided for in the initial contract.

## **7. Legal Advice and Implications**

7.1 The use of HRA capital resources to build homes for open market sale is conditional on ensuring no detrimental impact to the HRA. This was confirmed by an independent legal expert and details were set out in the original report. Therefore any capital receipts from the sales will need to be identified and earmarked for future Council housing growth projects.

7.2 There are no legal obstacles to renegotiating the Wates contract to a fixed price contract part way through delivery. The original Tender process did not specify which risk share option within the NEC contract would be adopted, and therefore there is flexibility to allow the Council to make amendments to protect its financial interests.

## **8. Human Resources Advice and Implications**

8.1 None identified.

## **9. Implications for Children and Young People and Vulnerable Adults**

9.1 The completion of the specialist housing units for adults with learning disabilities / autism and children / young people is crucial in enabling the directorates to meet their strategic objectives.

## **10. Equalities and Human Rights Advice and Implications**

10.1 None identified.

## **11. Implications for Partners**

11.1 The Clusters programme is an innovative partnership between the Council and Wates with both parties committed to its success. The programme is being delivered and overseen by Strategic Housing and Development but continues to require an integrated approach across all directorates, working closely with Children and Young Peoples Services and Adult Care to align the development of specialist housing units to the identified housing needs of people with learning disabilities and young people living in care.

## 12. Risks and Mitigation

- 12.1 There is a risk that the sales values achieved will be lower than the valuation, however the success of the first phase of sales units on Braithwell Road indicate a healthy interest and it is anticipated that original income targets will be exceeded. (The agreement does allow Wates to sell the properties up to 5% lower than the agreed selling price, which if this became necessary due to changes in market appetite, would result in an income reduction to the Council).
- 12.2 If Cabinet approves the recommendation to convert the contract to a fixed, guaranteed maximum price, the risk of further increases is mitigated. These could be significant depending on the outcome of EU Exit negotiations.
- 12.3 While the Council's Legal and Procurement services have confirmed that it is acceptable to convert to a fixed price option due to the flexibility allowed within the original procurement process, there is potentially a risk of challenge from other bidders. Procurement Services consider this to be a low risk. Furthermore there is no evidence that Wates would receive an unfair advantage, as by converting to a fixed price would be undertaking a higher risk and therefore it is unlikely that any challenge received would be upheld.
- 12.4 If the Council chooses to make a change to the programme, for example to the design of specialist accommodation, this will result in a compensation event and potentially an additional cost, and any such additional costs will be accommodated within the revised proposed budget figure as set out in confidential Appendix 1.
- 12.5 The GMP figure indicated in confidential Appendix 1 may change between the time of writing the report and Cabinet meeting date as Wates are not legally obliged to honour this. RLB have indicated that this figure can be assumed to represent a maximum cost.
- 12.6 Various lessons have been learned from the Site Clusters Programme in respect of cost reporting and will be applied to future projects:
- a) The need to fully explore all options for sharing risk and reward in the NEC contract, and ensure the implications are fully explained in Cabinet reports. The option originally taken for the Clusters programme was for the Council to bear the risk of cost increases. This was to ensure the Council has full control over the programme and receives 100% of the surpluses on open market sale units, to be reinvested into further housing growth (thus complying with HRA ring-fence rules to ensure all sales receipts from open market sale units are invested in housing). The disadvantage is the inability to guarantee the final overall cost to the Council. Other NEC options (for example allowing for a sharing of risk and reward between the Council and contractor) would have been more expensive initially, and would likely have still necessitated a significant increase to the Council's budget as the major causes of the increases could not have been avoided, regardless of the form of contract.

b) A larger contingency should have been included in the original Cabinet report as 5% is low. Subsequent projects have allowed for a 10% contingency.

**13. Accountable Officer(s)**

Tom Bell – Assistant Director of Housing Services

Approvals obtained on behalf of:-

	<b>Named Officer</b>	<b>Date</b>
Chief Executive	Sharon Kemp	04/03/19
Strategic Director of Finance & Customer Services (S.151 Officer)	Judith Badger	04/03/19
Assistant Director of Legal Services (Monitoring Officer)	Stuart Fletcher	12/02/19
Assistant Director of Human Resources (if appropriate)	N/A	N/A
Head of Procurement (if appropriate)	N/A	N/A

*Report Author:* **Error! Reference source not found.**

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