Officer summary of the financial and property issues raised by the report

Methodology

1. The consultants, DCA, have responded to the brief which, in summary, scoped the work as follows:
   - A two stage approach: Stage 1 being ideas focused, looking at problems and opportunities and identifying options for the redevelopment and operation of NEH; and Stage 2 providing detailed viability testing of one or more options.
   - Market research into supply and demand for workspace in the digital media sector (and the wider creative industries) and the impact of clustering (based on comparator work). Market and competition analysis.
   - Assessment of the added value impacts (economic and social) of the partnership and how any proposal meets the partners' joint and individual goals, to include a future trend analysis of the HE sector to help specify the University of Sussex's role in the development.
   - Assessment of the medium and longer-term financial viability of any proposal to include capital costs and funding, revenue costs and income streams, risk assessment and management/mitigation and sensitivity analyses.
   - Advice on governance structures for development and operation.

2 Summary of Key Recommendations

The report makes the following key recommendations:

- 'Do nothing' is not a workable option and does not offer financial or risk savings over time.
- Pursue option D for the building; refurbishing, providing new cladding and systems and creating networking, R&D and showcase facilities.
- The report outlines not only the very strong added value that the building can bring to the sector but also the value the sector can bring to the building and recommends the provision of network and innovation spaces. It outlines structures for how these spaces might be run, to be explored further amongst the partners, and makes a clear recommendation that such spaces should be included in any development brief, including suggested amounts of floorspace.
- Whilst the report does not rule out a single Community Interest Company (CIC) to develop and manage the building, it does highlight potential issues around risk sharing and governance. The report suggests it would be simpler, and expose the city council to less risk, to seek a development partner that shares the interest in and has experience of sector focused managed workspaces. This developer would take responsibility for bringing in the investment necessary to realise the project. The partners would need to agree a process and structure that retains control and bring forward a development brief to inform a formal tendering process.

3 Recommended Development Option

The report outlines the six broad future options for the development of the building that have been considered:

A Do Nothing	Building declines due to increasing dilapidation. Regeneration outputs compromised. Economic outputs decline. No Research/Innovation benefits.
A Do Nothing	• Short term capital cost is low • Income to City Council declines over time • Potential complete closure or substantial renewal cost in time
B Tidy up	Building condition stabilised in short term, in medium term significant investment required. Regeneration outputs compromised. Economic outputs decline. No Research/Innovation benefits.
B Tidy up	• Short term capital cost in the order of £2m • Income to City Council stable over time or may grow slightly • Potential complete closure or substantial renewal cost in time
C Renewal	Building refurbished and systems renewed, cladding and other major dilapidations resolved. Regeneration outputs enabled. Economic outputs stable. No Research/Innovation benefits.
C Renewal	• Short term capital cost is significant - c £7.5m? • Income to City Council grows by increased occupation • Lifecycle costs manageable into future
D Develop current	Building refurbished and systems renewed. New brand/focus on digital-media-creative sector. Network, showcase and R&D facilities. Regeneration outputs delivered. Economic outputs increase. Significant research/ innovation benefits.
D Develop current	• Short term capital cost is significant - c £9.5m? • Income to Project grows by inc. occupation/increased rents • Lifecycle costs manageable into future • Project management/animation costs covered from income
E Develop Additional	As D plus additional new development on adjacent site/roof.. Regeneration outputs delivered. Economic outputs significantly increase. Significant research/innovation benefits.
E Develop Additional	• Short term capital cost is very significant overall - c £26m? • Income to Project grows by inc. occupation/increased rents • Development yield/sale contributes to capital costs of NEH • Project management/animation costs covered from income
F Replace	Building demolished or sold for other purposes. Regeneration outputs enabled? Economic outputs decline. No Research/Innovation benefits, no contribution to sector development.
F Replace	• Capital yield likely to be limited • No contribution from building income to sector development

4 The report makes it clear that there are a number of risk factors with options A and B ('do nothing' or 'tidy up'). Investment in the façade and services of the building will become imperative in the medium term at least. Investment in fit out will be restricted by the leaking façade, leading to compound problem of increasing voids, restricted rents and less finance for further fit out. This would impact both the business model and economic potential of the building. Also outlined in the report there are environmental and regeneration risks from a do nothing option, with the city council in a position of having to defend the poor environmental performance of the current building and being the owners of the building at which the regeneration benefits from the New England Quarter effectively stop. In terms of legal implications the main issue would be relating to repairing covenants and insurance.

5 A cheaper renewal (option C) would overcome the legal issues arising from options A and B. However option C would not offer the potential to develop the facilities and services which will strengthen the sector, and it is questionable whether the profile of the building in the digital sector in particular would be sufficiently raised to support a shift in the building to that sector. If it does not the acute shortages of space that the sector needs to enable its continued growth will not be resolved. With the lack of improvements and provision to facilities in the building, rents would remain low and overall income would be constrained.

6 Option D emerges as the strongest option for the sector, providing the works necessary to secure the future of the building both physically and as a desired location for creative/digital media tenants. This demand would be created by providing business support in an innovative environment and this option allows the most scope for working with education partners.

7 Option E, building additional floorspace, could follow on from option D and would involve providing the highest quality accommodation for use by well established large digital media firms who want a Brighton presence to benefit from and feed into the Brighton digital media scene. This option can be further explored once a successful project in the existing building has become established and proved the demand.

8 The option of pulling the building down and rebuilding it, option F, may have some appeal by providing a more modern building, though recladding the existing building could have a similar effect in terms of external appearance and attract much less planning risk and issues concerning business interruption. Moreover, the costs involved in demolition and rebuilding of a similar sized building would preclude anything other than providing new grade A floor space aimed at the very top of the market. Key to this project is the concept of providing an assortment of rents. It is not viable to build new office floorspace and let it at cheaper rents. It would also mean that the existing informal network of companies that have sprung up within New England House would be dispersed across the city and would take years to evolve again elsewhere. It is likely, therefore that the shared interests of the sector, the Council and its partners will be served best by retaining and developing the current building as opposed to demolition.

9 Shared Facilities

Breaking the building up into 'let space,' 'network space' and 'innovation space,' the report lists the type of uses and potential returns that might be expected for the latter two shared spaces under option D. However, the benefits are not just in terms of rental from the innovation and network spaces (they are more valuable as let offices) but from the perception of the building they create and so the impact they have on rents and vacancies for the let space. DCA's market research suggests there would only be frictional voids (i.e. short voids between tenancies as one tenant moves out and another moves in) for this type of facility. The report outlines how this network and innovation space might be managed and run, though this would need to be agreed with the partners and any further development partner we might seek. The report also outlines the positive impact on reducing empty business rates and service charges through a more fully occupied building (p.63).

10 Existing Tenants

The report deals with the issue of how to turn NEH from an existing mixed building with c.49% Creative and Digital tenants into a predominantly digital and creative focused facility. The report accepts that throughout the transition the best financial and economic proposition is for the building to be kept as full and busy as possible. The most effective model for transition would therefore be a phased approach with natural wastage as the guiding principle to reduce non-target sector tenancies. Where any non-digital/creative tenants are looking to move on the city council can provide them with assistance in their premises search through contact with local agents, property market intelligence and the Commercial Property database.

11 Rents

Much of this work is predicated on the basis that improving the offer of NEH will improve the income by both increasing the amount of space and increasing the average rents. However, the project has always envisaged maintaining the affordability of New England House and is based on the intention of maintaining a range of affordable rents on different floors. The report also accepts that there is a ceiling price that the sector cannot go over without impacting on affordability.

12 **Financial Implications**

NEH currently contributes a net budget surplus of circa £400k pa, inclusive of empty business and service charges for void units. This surplus is built into the council revenue budget.

Significant investment will be required should the council seek to finance the redevelopment itself and capital investment options are limited primarily to borrowing, whilst the likelihood of current partner investment is negligible. The levels of additional income generated from each option vary and these are detailed below alongside the estimated cost of borrowing over a 25-year period and any additional management costs and reductions in voids for business rates and service charges. It should be noted that option B (tidy-up) is not classified as capital investment and would therefore be required to be funded through existing revenue budgets. Option B is not predicted to contribute additional rental income. Options A and F incur no direct capital investment as such and create no additional income.

	Option C (Renewal) £000 Annual	Option D (Develop) £000 Annual	Option E (Additional) £000 Annual
Additional rental income	140	720	1,800
Reduction in void service charge & NNDR	70	150	100
Total additional income	**210**	**870**	**1,900**
LESS Cost of borrowing	530	670	1,830
LESS Additional management costs	0	107	165
Net savings / (deficit)	**(320)**	**93**	**(95)**

This table is based on a model of council borrowing to fully finance each option. The report however outlines that there are other options for raising capital that can be explored more thoroughly. Options C, D & E will involve a degree of disruption to the operations of NEH which may create short term cash flow pressures to the operation of New England House.

The costs associated with the capital costs and income projections are indicative and further detailed work will be required on the assumptions within each option.