Audit Committee – 9th November 2015

Old Square Redevelopment Project – Lessons Learned Report

1. Summary of report

1.1 In April 2013, Cabinet resolved that the Council should take on the delivery of the first phase redevelopment of the Old Square shopping centre, with the necessary amendment to the capital programme approved by Council in May 2013. These decisions meant that the Council's role changed to that of landlord and developer, and a budget of £7.843m was approved through the amendment of the capital programme to enable delivery of retail units for Primark and Mid-counties Co-operative.

1.2 Following the decisions of Cabinet and Council, it was agreed that a briefing would be provided for Audit Committee outlining the project's strategic risks, and this was held in July 2013. Now that the project is largely complete, Primark has opened, the Co-op is currently being fitted out and the project is approaching financial closure, it is appropriate to report back to Audit Committee to explain the lessons learned from the project, including its governance and its financial and risk management.

2. Recommendations

2.1 That the lessons learned from the project, including the governance arrangements and its financial and risk management, are noted.

3. Background

3.1 As noted above, in April 2013, Cabinet resolved that the Council should take on the delivery of the first phase redevelopment of the Old Square shopping centre, with the necessary amendment to the capital programme approved by Council in May 2013. These decisions meant that the Council's role changed to that of landlord and developer, and a budget of £7.843m was approved through the amendment of the capital programme to enable delivery of retail units for Primark and Mid-counties Co-operative.

3.2 The Agreements for Lease with both tenants included target completion dates of the 2nd June 2015 for handover of the units to both tenants. Furthermore, both tenants required prior notification of anticipated completion dates, which could be amended under the terms of the contracts, but which both included delay costs if the agreed dates were not achieved. Ultimately, the units were handed over to the tenants on the 7th April 2015 for Primark, and the 24th April 2015 for the Co-op, both well within the target completion date. The new service yard, access tunnel and small retail unit SU02 on the Old Square mall were also handed over to Zurich Assurance on the 24th April 2015. Primark opened its unit for trading on the 6th August 2015, and is understood to be trading very well, whilst the Co-op's unit is currently under-going its fit-out following changes to the proposed layout.

3.3 There remains one or two outstanding items to resolve post handover which need to be concluded before the final cost of the project can be resolved. However, due to robust project management and the pain-gain mechanisms contained in the NEC Option C contract, the final cost is likely to be in the region of £7m. The project therefore has been delivered on time and well within budget.

3.4 Whilst the Council is not unfamiliar with delivering large scale capital projects, these are generally undertaken to deliver the Council's own services, for example road schemes or school construction projects, and the primary relationship is with the contractor. The particular challenges associated with delivering this project were the additional relationships with Zurich Assurance, Primark and the Co-op, and the commercial approach of these partners. As such, there is a broad range of lessons that can be learned from the management of this project which may be applicable to other large scale projects undertaken by the Council.

4. Analysis of lessons learned

Overview

4.1 Fundamentally, the Council now has a more thorough understanding of how developers, contractors, tenants and other partners approach development and investment. Some of the lessons learned from partner organisations are noted below. The Council has acted as developer, taking on the risks of the development, and dealing with unknown items (eg asbestos, cathodic protection, etc) as they arise. There is now a better appreciation amongst officers of the risks inherent in the development process and particularly for the private sector. However, it should be noted that a unique set of circumstances were presented to the Council at the time, and it is unlikely that the Council would have sufficient capacity to deliver such a complex project in the future.

4.2 The construction industry is very much dependent upon collaborative working and relationships – the interaction between the Council, Pick Everard and Morgan Sindall at project manager level was critical to the relatively smooth delivery of the project. This interaction relied upon often daily contact, with weekly site meetings to review progress, in excess of 150 project risks, compensation events and any other site issues in a timely manner. Relationships have also been good with the tenants, in particular Primark.

Lessons for the Council's team

4.3 The Council does not possess the necessary resources to deliver a project of this complexity without external support – it would not have been possible to deliver on time and within budget without the project manager Paul Gibbs, and the rest of the team at Pick Everard. Paul Gibb's initial estimation of the construction cost was extremely accurate and enabled the Council to budget accurately.

4.4 The Council increased the certainty of delivering the development by taking the innovative step of using powers under section 237 of the Town and Country Planning Act 1990. These powers allow local authorities to override third party rights that could prevent the development taking place, such as restrictive covenants, easements and rights of light, subject to paying compensation to the person with the benefit of the rights. The use of these powers is not widespread and it was the first time the Council has used them. A difficulty was encountered when the Council decided to take out an insurance policy to cover the cost of any compensation above that which had been budgeted for. The decision to use the section 237 powers had already been taken by Cabinet, but the insurance company had different requirements about public notification of the use of the powers which did not sit easily with the Council's wish to be open and transparent. While these problems were successfully overcome, it is important for any future development using section 237 powers that the Council liaises with insurance providers at an early stage in order for any such difficulties to be avoided.

4.5 Legal services provided excellent support in securing agreement to the terms of the Council-Zurich agreement, in a very short and politically challenging timescale, which initially committed the Council to the role of developer. This continued through to unconditionality on the Council-Zurich agreement and the Agreements for Lease, with the support of external lawyers Brabners. External support was initially bought in at the pre-construction stage to negotiate the building contract, an area where the Council was then lacking in resources but Brabners were strong, and this was extended to the other contracts. This extension gave legal services some support and helped to spread the risk, but has led to some small gaps in the knowledge of legal services when trying to recall the details of negotiations. During the post-construction phase, legal services have again provided excellent support in making sure that all appointments and warranties were made available to all parties at the necessary times, but again picking up from Brabners led to some small knowledge gaps in how the detail of the final documentation was agreed.

4.6 The Council's internal governance procedures have worked particularly well – the weekly (then fortnightly) project meetings evolved to a core group of officers from regeneration, legal services and finance, and these disciplines (with the support of others when necessary such as communications) were critical to its success. The monthly Board meetings were chaired by the Executive Director Economy & Environment, and also worked well, giving the opportunity to make any strategic decisions whilst also maintaining an overview of programme, budget, risk assessment, etc. These procedures have enabled regular reports to the politicians through various forums.

4.7 Pick Everard's monthly cost reports were important in maintaining budgetary control and anticipating future project costs. These reports enabled financial services to monitor project spend and forecast future expenditure effectively. Also the use of the Sypro software by Pick Everard enabled an efficient approach to contract management and way of dealing with 130 compensation events which was used by the contractor and the client team.

4.8 The Council as client has made decisions during the construction process which are less "commercially minded" but are consistent with the expectations of a more ethical organisation spending public money. This approach was matched by Pick Everard, and has proved that such an ethos can still deliver a project on time and within budget.

4.9 The Council as client is able to bring other Council disciplines into play to assist the contractor, with an ease of access to colleagues in highways, planning, building control and other areas particularly helpful for the contractor.

4.10 If the Council were to undertake a similar project in the future, a similar approach to governance, risk and project management, with targeted support from external organisations to fulfil particular roles, would be recommended.

4.11 Even though the Council was the client, Morgan Sindall was reluctant to put too much emphasis on the use of local sub-contractors to deliver the project. In its opinion, using local sub-contractors would jeopardise its existing supply chain relationships and control over costs, especially if those sub-contractors had been involved in the tendering process. This is something which the Council needs to consider in the future when working with the larger contractors. Despite this, Morgan Sindall has advised that 76% of supply chain spend was placed within 30 miles of the site, and it should be noted that the contractor was supportive in providing work experience placements.

Lessons learned from the partners

4.12 Contractors want to make a profit, get the project completed quickly and take as little risk as possible. Morgan Sindall were consistent from initial negotiations that they would not take on the responsibility for existing structures – it was only the recommendation of our external lawyers Brabners that led to Morgan Sindall undertaking some survey work into the Co-op structure. Contractors will also seek to recover costs from the client at every opportunity, but due to the type of contract, Morgan Sindall's team in Walsall took a pragmatic and collaborative approach as expected through the NEC Option C contract.

4.13 Primark demanded certainty around timescale and progress, and had a detailed specification in the Agreement for Lease. Given their business model, they are very rigorous in their approach to new store openings. Primark were however willing to accept some changes to the specification on matters which had been agreed informally between their team and Zurich before the Council took on the project. This flexible approach led to a good working relationship between Primark, Morgan Sindall, Pick Everard and the Council.

4.14 The Co-op's approach has been different to that of Primark – very little contact during the construction process, a more limited specification and an acceptance that the building is a refurbishment. On critical matters such as the cathodic protection system and small delay in handover, the Co-op have been helpfully flexible.

4.15 On occasions, Zurich and their advisers have taken a strictly commercial approach and there have been some lengthy debates about interpreting exactly what should be undertaken by the Council in its role.

4.16 The utility provider WPD was uncompromising in reaching a conclusion on the legal agreements for the sub-stations, leading to a delay in the project. Whilst the lead in times should have been sufficient to resolve the issues, legal services advised of the potential difficulties in engaging with WPD and Zurich in tripartite arrangements and reaching a conclusion, and it is unlikely that this particular issue could have been dealt with in any other way.

4.17 The terms of collateral warranties and appointments are very important in the construction industry. All parties seek to minimise their own exposure, putting their risk onto other parties, to mitigate against future claims. The Council needs to be robust in ensuring that its position is not comprised in such negotiations.

Learning from particular decisions

4.18 The Council took the decision to remove the first floor above the Co-op, rather than moth-balling it, to reduce future maintenance requirements, business rate liabilities, etc. It is this decision which revealed the chlorine issue in the Co-op roof, which in the short-term has proved costly, but in the long-term should ensure the stability of the Co-op structure. However, some of these costs could have been reduced if a conclusion had been reached sooner by Morgan Sindall on chlorine survey work, and it is regrettable that more urgency was not put into this matter by the contractor because this ultimately led to delay costs. However once the issue was highlighted, Morgan Sindall and Pick Everard moved extremely quickly to bring a swift conclusion to this issue.

4.19 At pre-construction stage, Morgan Sindall was keen to switch from the NEC Option C contract to a fixed price contract. This was resisted for procurement reasons (the Council went to tender on the basis of Option C) and also on the advice of Pick Everard about anticipated final costs. Furthermore, Morgan Sindall's potential gain was renegotiated so that all parties had the opportunity to gain more form the mechanism. Without these negotiations, the Council would not have benefited from the pain-gain mechanism to the level achieved.

4.20 It has been noted above that there were particular challenges in working with WPD on the legal agreements, a situation foreseen by legal services at the beginning. Whilst tripartite legal agreements on 3 sub-stations is challenging, it is perhaps regrettable that more energy was not put into chasing other parties sooner because ultimately this led to a delay in completing the project. If the Council is faced with a similar position in the future, considerable pressure should be applied to the utilities companies to achieve agreement early in the construction process.

4.21 The Council was presented by Zurich with an opportunity to take on existing contractual arrangements with tenants which could not be renegotiated. Taking on other agreements without the ability to renegotiate has led to constraints and additional issues through the development process.

4.22 At the commencement of the construction phase, the issue arose concerning the detection of asbestos in the former Tesco building when a “clean air” certificate had been provided by Zurich’s team. This led to a delay in commencing the construction, and ultimately an additional cost. Legal advice was sort to consider if the Council was in a position to seek damages to meet these costs, but because it had no contractual arrangements with Zurich’s supply chain, it was advised that it would very difficult and costly to secure damages. The learning point is that reports provided by others should only be considered as a guide, and that the Council should commission its own due diligence reports when taking possession of buildings.

Summary of lessons learned

4.23 The “top ten” lessons learned can be summarised as follows:

- The Council can take on the role of developer and deliver a complex project on time and considerably within budget – it requires collaborative working to be successful.
- Pick Everard’s multi-disciplinary support, in particular the project manager’s role in budget management, was critical to the delivery of the project.
- Internal legal and financial support has been excellent and central to the success of the project, and the use of section 237 powers was innovative.
- Where external legal support is used, it is important that internal colleagues are kept fully informed to maintain detailed knowledge and understanding.
- The Council’s internal governance procedures for this project have worked well and should be replicated.
- National contractors will find it difficult to source local sub-contractors and suppliers.
- Contractors are risk averse, and will seek to minimise their exposure through the terms of building contracts, warranties and appointments of sub-contractors – the Council should be robust in such negotiations.
- Utilities companies are challenging, and every effort should be made to make sure all necessary agreements are put into place at the earliest opportunity.
- When taking possession of buildings, the Council should not rely on previous reports but should commission its own building surveys.
- Rather than taking on existing contractual arrangements, the Council would benefit from being able to undertake its own negotiations with tenants.

5. Resource and Legal Consideration

5.1 As well as the regeneration benefits of the project noted below, the project is financially viable. With the final cost of the project likely to be in the region of £7m, the income from the two tenants over the terms of their 25 year leases will be approximately £13.3m, with additional income for the Council from business rate uplift estimated at almost £1.3m over the same period. Further business rate uplift should be achieved by the delivery of the Norton & Proffitt and Old Square Phase 2 schemes.

5.2 To inform Cabinet’s decision making process in April 2013, valuation advice was commissioned to understand when the new asset’s value would be at its greatest, and this concluded that it was likely to be when Primark’s rent free period had lapsed. However, given the upturn in the market and renewed investment interest in Walsall town centre, new market advice will be commissioned on how the Council can make best financial use of the asset.

5.3 There has been an ongoing involvement in this project from legal services, with the support of external lawyers Brabners, in delivering a complex range of legal documentation, including land transactions, leases, building contracts and associated appointments, warranties, etc. This role is now close to concluding, with only one or two outstanding items likely to require any further input from legal services. Should the Council decide in the future to dispose of the asset, then further involvement will be required from legal services.

6. Citizen Impact

6.1 This project was pursued for regeneration purposes, to drive footfall in the town centre by making Walsall town centre a more attractive place to visit, and to create jobs. Evidence suggests that footfall has increased in the town centre, for example by 15-20% in the Old Square shopping centre since Primark opened, increasing by 25% on Sundays. Anecdotally, the town centre “feels busier”, particularly in Digbeth, and this is particularly important with the current disruption to Park Street caused by the rail electrification works.

6.2 It was originally estimated that 150-160 direct jobs would be created through the project, but Primark alone is heading for 170 jobs, which may increase to 200 by Christmas. The Co-op is expected to create about 30 jobs when open. The Council and other partners assisted Primark in its initial recruitment process, and of the figures made available by Primark for its first tranche of recruitment of 86 employees, 60 are known to have been residents of the Borough, of which 29 had previously been on out of work benefits. The Council’s Employment & Skills Team assisted 249 residents with applications for these jobs, with 8 ultimately being offered employment. Whilst this may appear a relatively low conversion rate, 88 residents received assistance with their CVs, 36 were referred to a pre-employment training course, 27 attended information sessions and 30 attended application sessions arranged by the Employment & Skills Team, and 18 residents received assistance with their interview techniques. As such, it is understood that a further 13 residents have since entered into apprenticeships or employment.

6.3 The project was also pursued to send out the right message to the private sector (developers, investors and existing/future tenants). This objective can be considered a success, with 4 nearby retail units investing in their shops, and more energy having been put into the Norton & Proffitt and Old Square Phase 2 schemes (both have planning consent and Norton & Proffitt expected to start on site in the coming months). Institutional investment in the town centre is also increasing, with REI having recently acquired prime retail space in 59-75 Park Street (BHS, Waterstones, Superdrug, etc), and the Waterfront cinema/leisure scheme to be acquired by a pension fund.

7. Performance and Risk Management issues

7.1 Through the construction project, the Council’s project management team worked collaboratively with the contractor’s team to manage in excess of 150 items on the project risk register. From a corporate perspective, the high level project risks that were presented to Audit Committee in July 2013 were effectively managed through the Project Board, which met formally from March 2014 to July 2015, chaired by the Executive Director Economy & Environment. A graphical overview of how the risks have been managed is attached at appendix 1.

8. Equality Implications

8.1 The jobs created through the delivery of the project have been open to all of the Borough’s residents, and as noted above some will have welcomed and benefited from the delivery of the project. The project has improved the environment of the town centre, bringing into use what was a high profile and vacant site, delivering another development in the core of the town centre.

9. Consultation

9.1 Officers involved in the weekly (then fortnightly) project steering group meetings, were consulted on the lessons learned from the project before they were presented to the final Project Board meeting. A lessons learned report has also been presented to the Leadership and CMT.

Author
Richard Chadwick
Team Leader – Town Centre Development
☎ 654747
✉ richard.chadwick@walsall.gov.uk

Simon Neilson
Executive Director

Audit Committee – 9th November 2015

Old Square Redevelopment Project – Lessons Learned Report
Appendix 1: Risk Management Analysis

The graphs below depict the high level project risk scores, as initially reported to Audit Committee in July 2013, and then assessed and managed by the Project Board through to July 2015. Please note, risks 5 and 6 were added post Audit Committee.

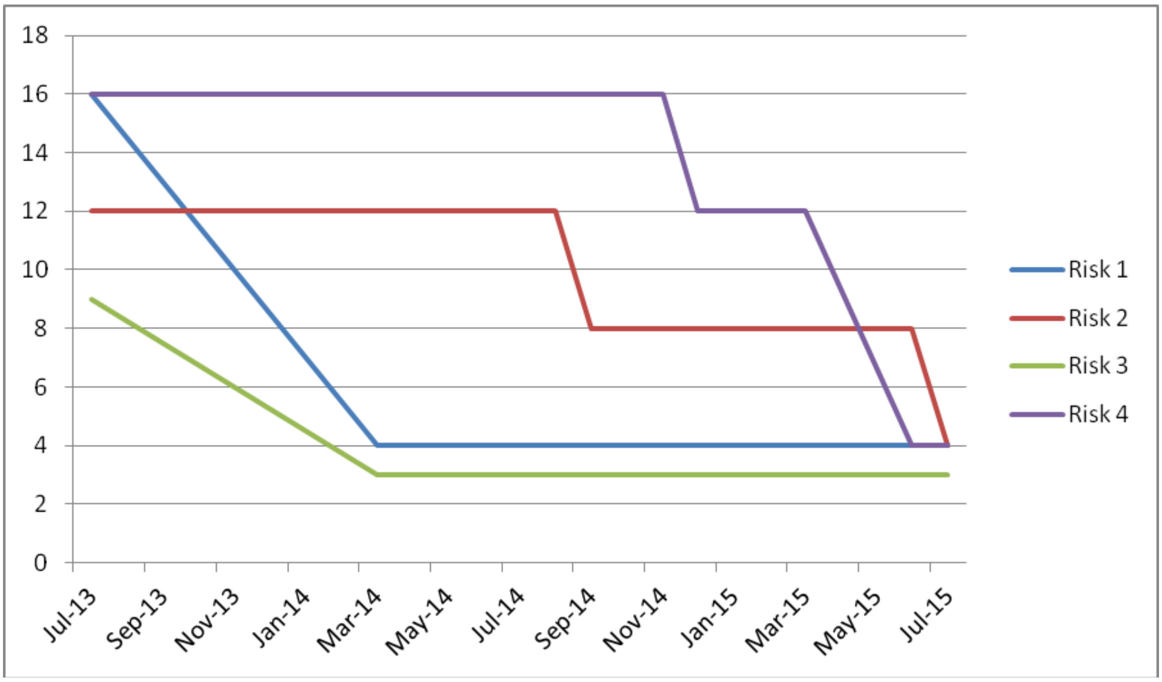
Graph 1: Risks 1-4

Risk 1: Failure to arrive at the unconditional agreement of tenant leases by the 30th Sept and conclusion of the land sale agreement and other pre-construction contractual agreements by this long stop date.

Risk 2: Parties affected by the use of the Section 237 powers could seek compensation for the loss of these rights, or seek to hold up the development through a judicial review of the process. Set aside a budget of £340k to cover the potential cost of claims for 6 years.

Risk 3: Affected parties challenging the amendments to the Traffic Regulation Order.

Risk 4: Failure to define and address 120 items on the contractors risk register.



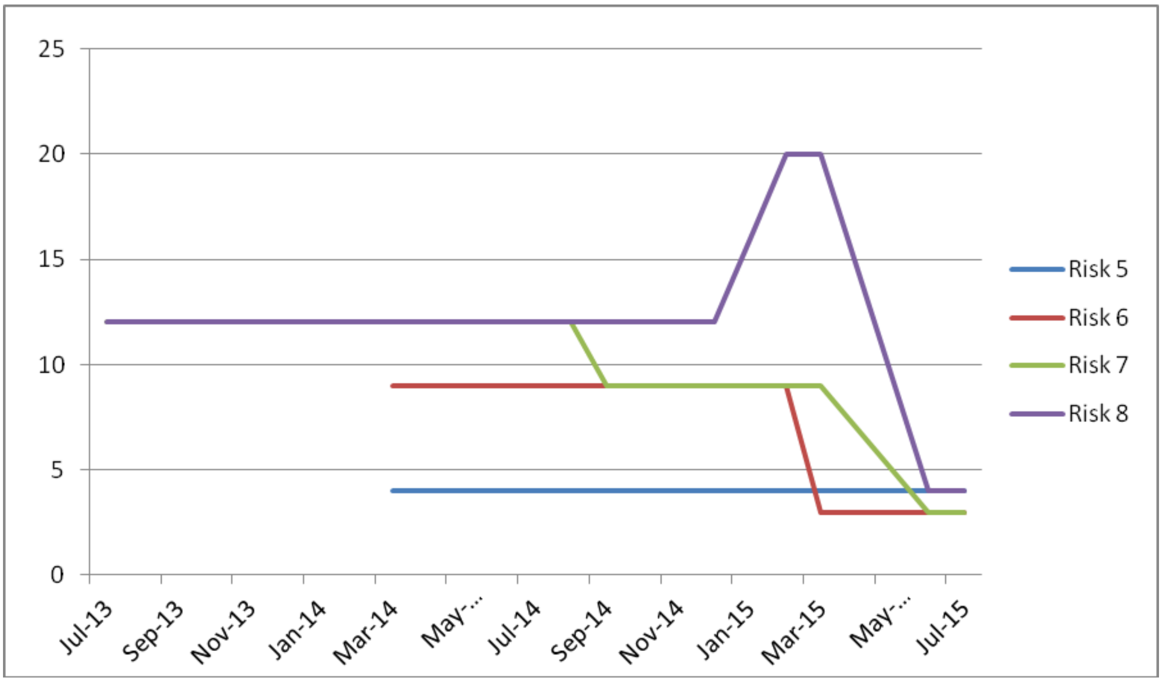
Graph 2: Risks 5-8

Risk 5: Failure to agree and complete the building contract with the contractor before development commences on site.

Risk 6: Management of the Town Centre during the construction period.

Risk 7: Overall project costs exceed the budget approved by Cabinet and as amended in the Capital Programme.

Risk 8: Failure to meet key programme milestones.



Graph 3: Risks 9-11

Risk 9: One or both tenants ceasing to trade during the 25 year lease period.

Risk 10: Failure to have robust project management at each stage of the development.

Risk 11: Reduced or no member support for the project.