

01 July 2011

Dear Pat

RESPONSE TO ENGLISH HERITAGE LETTER DATED 21 JUNE 2011

Thank you for forwarding the letter from David Brock of English Heritage with regard to our proposals for the restoration of King Edward VII Hospital and as requested I am writing to set out our response to the contents of the letter.

HERITAGE SIGNIFICANCE & ENGLISH HERITAGE APPROVAL RECOMMENDATION

Firstly I am very pleased to note that English Heritage have endorsed our view as to the significance of the site stating that:

“The repair or restoration of these heritage assets would definitely be a public benefit, because of their individual quality and the quality of the ensemble.”

and have removed their objection on the grounds of viability stating:

“In view of the public benefit from the restoration of these superb buildings, we would be prepared in that case to recommend that approval could be given.”

PHASING OF REPAIRS & DEVELOPMENT

When speaking with you this week you stated that you read English Heritage's response to mean that they require all of the conversion and restoration works to be undertaken prior to the commencement of any new build. I have since spoken with David Brock of English Heritage and he has suggested that we should submit any supporting evidence if we believe further information needs to be assessed by English Heritage in light of his response. David did confirm that they are aware that obviously the conversion it would itself take a significant period of time due to the sheer scale of the buildings, as confirmed in his letter:

“If the repairs and conversion of the main assets (the main hospital block and the chapel) could be front-loaded so as to achieve that objective **at a relatively early stage of the project** the essential public benefit would be secured with a minimum of risk.”

I also confirmed at this stage that on a very crude calculation if *just* the repairs were to be undertaken and not the conversions, prior to the legal completion of any new build units, this would add in terms of funding and holding costs at least £1.5-2 million. EH go on to state that they believe that

“We understand that this option has been rejected by the developer, as increasing the costs, citing our Guidance which states that ‘with larger projects, an effective compromise *can* [my italics] be phasing’ (7.5.1).”

“The Guidance does not state that phasing is invariably appropriate. It is most appropriate where there is a series of discrete assets that can be tackled separately.

In this case, if an approach was to be adopted which repaired each wing in turn, for instance, a failure of the enterprise would leave the completed parts yoked to those which were at very best shells (since there will be a substantial element of removal, and many scars), and thus with significant loss of amenity and value. In our view, the increase in costs is merely speculative, while the benefit of reducing the public risk is paramount.”

“There is never any certainty in property development and development appraisals are not 100% accurate. However, with a robust Section 106 (drafted with specialist legal advice) we believe that this second application could possibly work. In view of the public benefit from the restoration of these superb buildings, we would be prepared in that case to recommend that approval could be given”

I am strongly of the opinion that either English Heritage have not had all the necessary the information to enable them to draw this conclusion or they have, in a desire to respond promptly, not understood the full implications of their advice. It is clear from their letter that they have based their advice on the premise that our claim that the conservation deficit will be substantially increased is **‘merely speculative’**. This is factually wrong and fatally flawed. This stance not only puts the SDNPA at danger of a cost award at appeal it also serves to make the possibility of saving this fine collection of heritage assets less likely.

Quite simply it is obvious that these heritage assets are of exceptional historic and cultural value but that it is also a very challenging site from which to unlock the potential to create a long term sustainable future. It is now abundantly clear that a sensible solution is paramount given the significance of the heritage assets involved. There are now NO objections from the major significant consultees and that, as is the norm, the very local objections from rational objectors (excluding those who would prefer to see it demolished) are based on a desire to minimise the amount of development.

The solitary reason for English Heritage’s initial objection was on the grounds of the . lack of certainty of delivery due to the size of the conservation deficit. City & Country has responded constructively; we have provided further substantiation to justify our confidence in delivering the scheme and we have added further development through the second application to minimise the deficit . We have also made a commitment to submit a third application that does not increase the amount of development but simply reduces the conservation deficit through the relocation and reduction of the assisted care usage while still ensuring that the highway generation is below those levels of the hospital when in operation.

While in an ideal world it would be perfect if we could have a guarantee for absolutely everything so that there were no risks but this is just totally unrealistic, especially in this difficult and complex situation. The very local objectors wish to keep the amount of development to a minimum, English Heritage’s own guidance dictates that the development is kept to a minimum, City & Country has proposed a solution that whilst being in deficit has been verified by the SDNPA’s own financial expert as ‘not unrealistic’ and hence deliverable. It is absolutely clear, as we are sure it will be to an inspector on appeal, that to a normal, rationale, reasonable and sensible person in possession of all the relevant facts that City & Country has, through many months of hard work and fine tuning of the proposals found what would be an excellent solution. The proposals very carefully and fairly balance the competing demands and considerations surrounding this most challenging project while ensuring that the amount of enabling development is kept to an absolute minimum.

I have asked my team to calculate what the effect would be to the conservation deficit, if it was necessary to deliver the entire repairs and conversion scheme to the Chapel and Sanatorium without any new build phasing, on the present day basis that English Heritage prefer to use. This calculation demonstrates that conservatively the conservation deficit increases from approx £18 million to just under £38 million. The effect of which would be to substantially increase the amount of development required and to significantly increase the likelihood that the project and the solution will fail. Both of these outcomes are not what I believe SDNPA or English Heritage want. They are certainly not in the interest of the local community or the heritage assets themselves. Thus we would strongly advise you to seek further clarification from English Heritage with regard to their advice and to seek further advice from your own financial expert.

The phasing strategy, which we have already submitted within the draft S106 was based on ensuring that the principle buildings were enhanced and repaired on a phase by phase basis ahead of the new build completions in a sensible, practical and deliverable manner. This was in order to find the balance between minimising the conservation deficit and the amount of enabling development required and bringing forward the benefits of the restoration and conversion works at an early stage. The DVS has considered the programme, the phasing and the deliverability of the proposals and confirmed that commercially our solution is 'not unrealistic'.

I will now take you through the following:

- the basic logic of our programme and hence the phasing
- what this programme means in terms of risk to the listed buildings
- the assumptions made that have lead to the significant increase in the conservation deficit
- a summary our response

DEVELOPMENT PROGRAMME LOGIC

The overall programme is driven by a desire to make best use of all resources and to minimise costs through a practical scheme that sensibly allows early sales thereby reducing finance and other costs, in order to reduce the conservation deficit and minimise the need for further enabling development.

From experience, once the time for the historic repairs has been factored into the calculations the limiting determinant is the predicted rate of sales. This is because too much completed unsold property will increase finance costs, increase holding costs and drag down capital values. On schemes of this nature, based on our own experience, we would predict an average sales rate of 5 units per month over the scheme's lifetime. This is split into 2 per month for the assisted care and 3 per month for the private residential. This is an increase on the 2006 scheme due to the improved range of units and so a wider range of purchasers.

The Construction Team and phasing is then designed as near as possible to deliver completed units to suit the optimum realistic sales scenario and thus improve the cashflow and reduce the conservation deficit. There are also a number of other practical and value based considerations that affect the construction phasing such as:

- a sufficient amount of development complete especially with regard to external repairs to give confidence to purchasers that they will have a good outlook and not be disturbed unduly with protracted construction activity;
- adequate facilities for residents when they move in including parking and completed areas of landscaping etc. to maximise values;
- minimise the cross-over of construction activities with new and existing residents for health and safety reasons;
- an efficient and realistic rate of construction based upon services and skills required;
- the physical constraints and needs of the listed building itself;
- the conversion works and new build works need to run in parallel, as it is the new build works that in effect funds the conversion works, and the S106 will require the timing of the conversion works be tied to the new build.

Each phase is designed to balance all these criteria in the most cost effective way to ensure units are ready to be handed over and occupied to meet the realistic sales programme. This strategy for phasing is exactly the model we are using on our other sites, such as Balls Park and The Galleries because it is the most viable option.

The original programme we supplied with the first application has been adjusted to take account of the additional 22 units within the second application and a copy is attached. In order bring further clarity and understanding I have asked for some of the programme bars to be expanded and I also attach a better scale repair and phasing plan.

Based on our proposed phasing programme the completion of the development is 9 years, with the restoration and conversion works to the main sanatorium building taking just under seven years to align with the sales rate in order to minimise holding costs and achieve good sales values. However you will see from this programme and the phasing plan that critically **all the repairs to the external envelope of the chapel and the most problematic parts of the sanatorium** are proposed to be completed within the first **18 months** from a substantial start on site. This is the most critical work and it would be done at a very early in the process along with all the demolition work to the unsightly buildings adjacent these buildings. As is clear from the programme this work would occur **before any new units** are built and sold. The remainder of the sanatorium would be repaired externally within 4 years from this start on site. The internal conversion will follow behind and be aligned to the sales rates of the conversions. All the site infrastructure, structural landscaping and ecological improvements all occur within these early years. Thus you can clearly see that the project is substantially de-risked at an extremely early stage in a nine year development programme and that this strategy while not only being practical, substantially front-loads the heritage benefits in a manner that fully accords with the wants and wishes of all concerned.

On a further practical note you will be aware that the underground car parks which are required for the conversion schemes are located under the adjacent new build apartment buildings which will need to be built in order to make the conversion saleable and functional. It would be completely commercially unviable to build these blocks and to not be able to sell the units until ALL the conversions to the sanatorium and chapel were complete.

THE FINANCIAL & PRACTICAL IMPLICATIONS OF SANATORIUM & CHAPEL REPAIRS & CONVERSION BEFORE ANY NEW BUILD SALES

However if we are to consider the alternative being suggested by you to complete all the repair and conversion works before any new build sales, this would have the following effects

- Even though we would seek to reduce the period for the completion of the Sanatorium and Chapel works including its associated landscaped setting and car parking from 7 years down to 4 years in order to minimise the delay before profitable new build sales could be achieved, the overall programme would be extended by 19 months. This will significantly increase interest and other funding costs.
- The additional conversion stock created would not lead to an increased rate of sale because there is only a limited market for this specialist product at any one moment in time. This would mean that there would be substantial empty stock which would significantly increase such costs as management and maintenance costs, heating and other service costs, security costs, insurance costs, service charge void costs and redecoration costs associated with the three year lag in sales to build on the conversion units.
- This surplus stock would lead to a lack of strength of the sales team in negotiations with purchasers who would see that there are significant empty units, this will knock their confidence with regard to the attractiveness of the product and lead to an average 10% price reduction at least on values that could otherwise be achieved if the stock availability matched the market demand.
- To front end the significant costs associated with this strategy will substantially increase the funding requirements and even if this funding were to be available any lender would seek to not only charge additional margins but also seek an increased profit margin from 25% to 30% to guard against the increased development risks inherent in this strategy.
- Council tax on build complete unsold units over 6 months old
- Management and actual costs for landscape maintenance until handed over to the management company
- Insurance of build complete unsold units
- Running and maintenance costs of The Chapel, as not viable without business generated from the new build
- Increased management costs re the facilities provided in the Sanatorium (swimming pool, minibus etc) as new build not funding
- Increased prelims for increased programme
- Sales costs would be increased to take account of the increased programme

The following financial impacts result:

- increase in interest by £4,356,563
- increase in holding costs by £555,599
- increase in statutory and other charges by £60,427 due to GDV linked finance costs
- increase in sales and marketing costs by £442,135
- increase in service charge voids by £324,346
- increase in developers profit by £9,174,188 to reflect increased margin required by lenders to provide the necessary level of funding.
- decrease in sales revenue of £4,445,500 to reflect stock levels

The end result of this proposal is therefore to increase the present day values conservation deficit on the current applications from £18,443,306 to £37,802,024. This would equate to a least an additional 250+ units, just to get back to the proposed status quo. We believe this to be both irresponsible and inappropriate and against the wishes of all concerned.

KEY EXPERTISE, RISK & A SECURE FUTURE

As English Heritage quite rightly state “[There is never any certainty in property development](#)” and we believe that a lack of confidence created because of the repeated failures that have occurred on this site in the past are resulting in a level of comfort today that actually kills a credible solution. The English Heritage guidance states:

“**5.15.3** Equally, it may be necessary to accept compromises if costs and the extent of enabling development are to be kept within acceptable limits”

While English Heritage has initially responded that they ideally wish to see all of the conversion and restoration completed prior to the enabling development this is contrary to their own guidance which is more usually used on larger scale development and to ignore it here is totally unrealistic.

I list below the various guidance notes that demonstrate (with my highlighting in bold) the fundamentals that need to be considered in reaching a conclusion:

“**5.2.1** In order to carry out a property development, the majority of developers require external funding from a bank or institution. Before agreeing to finance a property development, a bank will wish to see the developer’s accounts and **track record**. They will be required to provide substantiated development appraisals, setting out clearly how they intend to carry out the development, the level and term of borrowing needed, a schedule for repayment, for drawing down the loan and for making interest payments to the bank. **Phasing of larger schemes is most important, for it determines the maximum exposure of, and total interest payable to, the bank.**”

“**5.9.4 Interest charges** A developer will pay interest on monies borrowed, which vary from month to month depending upon the level of borrowing. In order to calculate accurately the total amount of possible interest payable on a site development, a cash-flow exercise is usually required which will calculate the borrowing requirement, and thus the interest due, on a monthly basis. Allowance must be made for interest payable during any void period at the end of the construction period. **The amount of interest payable may be affected by the phasing of the scheme and some larger residential schemes can, with careful phasing, become self-financing.**”

“**7.5.1 All development involves risk.** Costs can rise, the market can fall, and even the most prudent and experienced developers can fail as a result. **Ideally** the place should be repaired before the enabling development commences, or the funds necessary to do so deposited with a trust, or a performance bond or guarantee obtained. **However, these options can add to the developer’s financing costs, and so increase the amount of enabling development required. With larger projects, an effective compromise can be phasing, so that once a defined block of work has been done or payment made, the first phase of enabling development may proceed, with subsequent development phases scheduled to**

follow the delivery of subsequent benefits. It is essential that the benefits are a step ahead of the detriment, not a step behind.”

“7.5.2 An agreement requiring **phased repair of the place** linked to stages in the realisation of the enabling development, rather than on its completion, **mitigates the risks** but can still result in financial difficulties. Such agreements should ensure that the phases of works to the place are undertaken in a **logical** sequence, **beginning with repairs to the structure and external envelope, so that clear benefit is achieved even if the development is aborted**. The degree of risk needs to be carefully assessed in each case, but the objective of enabling development should always be secured as early as possible, and certainly not later than the use or occupation of the new development.”

City & Country has a very strong track record of delivering complex and sensitive listed building schemes that has been acknowledged by English Heritage. Throughout a variety of market downturns and with over 49 years in business we have continued to have the support and confidence of the banks. We understand that everyone is nervous of making the wrong decision and being faced with a half finished scheme that may eventually require more development however, with respect we *are* the experts on the viability and **deliverability** of this type of development. However, even if you wish to disregard this expertise, you should refer to the advice of your own and the government’s own financial expert, the DVS.

In any event, I would remind you of the following quotes from the EH guidance

“4.4.2 The **key expertise** of the commercial sector lies in judging the market and **taking on the risks** inherent in that judgement. **This ability and expertise is, and will remain, crucial to securing the future of most historic buildings that have become functionally redundant.”**

CONCLUSION

If a strategy was required to deliver all of the repair and conversion works to the Sanatorium and the Chapel before any of the new build sales this will increase the build programme by 19 months. Even if the conversion works were fast tracked and reduced by 3 years there would be an associated increase in the conservation deficit of approximately £20M. This in turn would substantially increase the risks associated with the project and result in the scheme becoming unviable and undeliverable.

These cost increases are not as English Heritage suggest **‘merely speculative’** and they can be verified by the DVS, as I attach a full appraisal for their use. This information will however need to be redacted if it is to be published, as it is commercially sensitive.

There is a robust draft s106 in place that sees the repairs and conversion works carried out substantially ahead of the new build sales on a phased basis. This is a realistic and acceptable solution given the facts of the case.

As a **further compromise** in order to give some further comfort to English Heritage we would be prepared to alter the phasing thus and to accord with the more detailed phasing plan attached:

Current s106 Repair works	Current s106 phasing	Proposed s106 Repair works	Proposed s106 phasing
To carry out all demolition works and works to make the Chapel and Sanatorium wind proof and water tight	Prior to Completion of the 10th Private Dwelling	To carry out all demolition works and works to make the Chapel and Sanatorium wind proof and water tight	Prior to the sales completion of any new build units
To carry out the external repairs of the Chapel as specified in the Restoration Scheme	Prior to Completion of the 25th Private Dwelling	To carry out the external repairs of the Chapel as specified in the Restoration Scheme	Prior to the sales completion of any new build units
To carry out the repairs to the South West Wing of the Sanatorium as specified in the Restoration Scheme	Prior to Completion of the 50th Private Dwelling	To carry out the repairs to the phase 1 section 1 & 2 external repairs as detailed with the Restoration Scheme and shown on the accompanying phasing plan	Prior to the sales completion of the 50 th new build Private Dwelling
To carry out the repairs to the North West Wing of the Sanatorium as specified in the Restoration Scheme	Prior to Completion of the 100th Private Dwelling	To carry out the repairs to the phase 1 section 3 external repairs as detailed with the Restoration Scheme and the internal conversion of the Sanatorium phase 1a and shown on the accompanying phasing plan	Prior to the sales completion of the 100 th new build Private Dwelling
To carry out all of the external repairs to the Sanatorium as specified in the Restoration Scheme	Prior to Completion of the 150th Private Dwelling	To carry out the repairs to the phase 1 section 4 external repairs as detailed with the Restoration Scheme and the internal conversion of the Sanatorium phase 1b and shown on the accompanying phasing plan	Prior to Completion of the 150th new build Private Dwelling
To carry out the repairs to the Central and North East Wing of the Sanatorium as specified in the Restoration Scheme	Prior to Completion of the 175th Private Dwelling	The internal conversion of the Sanatorium phase 1c as shown on the accompanying phasing plan	Prior to Completion of the 200th new build Private Dwelling

To carry out the repairs to the South East Wing of the Sanatorium as specified in the Restoration Scheme

Prior to Completion of the 200th Private Dwelling

To carry out the repairs of the Engine House, Motor House and Lodge as specified in the Restoration Scheme

Prior to Completion of the 230th Private Dwelling

To carry out the repairs of the Engine House, Motor House and Lodge as specified in the Restoration Scheme

Prior to Completion of the 230th Private Dwelling

This new proposal does not add to the conservation deficit and make the proposals less viable in the same way that is suggested by bringing forward all of the restoration and conversion works before the new build. It better clarifies the work to be carried out, it is logical and deliverable and means that within the first two years of a meaningful start on site the SDNPA will see the project substantially de-risked because the most treasured and most at risk assets will be repaired and brought back into beneficial use with their setting dramatically enhanced and the first Jekyll courtyard garden restored.

I respectfully and strongly suggest that you refer our comments and proposals to English Heritage for their view on the matter, as we genuinely believe that they should provide the comfort that is required to address the concerns about deliverability of the restoration that will breathe new life into these significant heritage assets. If however you wish to discuss any other proposed solutions please feel free to contact me to discuss the matter.

Yours sincerely

Helen Moore

Residential Managing Director

City & Country Group

.