

# Report to Cabinet

**11 September 2024**

<b>Subject:</b>	Funding for Major Capital Projects
<b>Cabinet Member:</b>	Cabinet Member - Housing and Sustainable Development, Councillor Vicki Smith
<b>Director:</b>	Executive Director - Place, Alan Lunt
<b>Key Decision:</b>	Yes. Value of Funding Requirement
<b>Contact Officer:</b>	Assistant Director - Asset Management, Sarah Ager

## 1. Recommendations

It is recommended that:

- 1.1 Approval be granted for an additional budget allocation totalling £17.768m to complete the refurbishment of the following low and high blocks -
  - Alfred Gunn House - £6.904m
  - Darley House - £5.289m
  - The Lakes - £4.783m
  - Thorn Close - £0.792m
- 1.2 Cabinet endorse and recommend to Full Council that the 2024/25 Housing Revenue Account Capital Programme be varied and increased by £17.768m to reflect the reprofiling of the capital budget and the increased costs of delivery;
- 1.3 Authority be delegated to the Executive Director of Place, in consultation with the Executive Director of Finance and Transformation, to remodel the Housing Revenue Account (HRA) Capital Investment Programme to accommodate the increased costs set out at 1.1 above;
- 1.4 Authority be delegated to the Executive Director Place, in consultation with the Executive Director, Finance and Transformation and the Monitoring Officer/Assistant Director – Legal and Assurance, to appoint a suitably qualified and experienced construction professional to undertake

a detailed post completion review of the projects identified and to make such recommendations for improvement in the management of major capital contracts as they may see fit.

## **2. Reasons for Recommendations**

- 2.1 Following a robust review and analysis of the projects in question by the Place Directorate management team now responsible for delivery of the schemes, the requirement for additional resources to ensure completion and to enable the letting of all 349 affected dwellings involved, has been identified.
- 2.2 Having considered alternative courses of action, the option to continuing to invest in these assets still represents better value for money to the Council than alternative options as outlined in this report.

## **3. How does this deliver objectives of the Council Plan?**

Living in Sandwell	<p>The additional budget will allow for the completion of major capital projects, which in turn will result in high quality well insulated homes that will result in residents paying as little as possible to live in properties that are warm and healthy, allowing a greater percentage of income to be spent on other essentials.</p> <p>The additional budget will support Sandwell MBC in continuing to maintain, upgrade and invest in its housing stock and to continue to meet the 'Decent Homes' and other regulatory standards required by the Regulator for Social Housing (RSH).</p>
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## **4. Context and Key Issues**

- 4.1 A Cabinet decision of 18 October 2017 approved the Housing Revenue Account Investment Programme, which included the proposed refurbishment of 13 high rise blocks not already refurbished under the decent homes programme. This included proposed improvements to Alfred Gunn House and Darley House. Subsequent Cabinet decisions of 29 September 2022 and 23 March 2022 approved the refurbishments of The Lakes and Thorn Close respectively.
- 4.2 A review of scheme development, contractor procurement and project management in respect of these four projects has been undertaken and several areas of concern identified. These included inadequate project

management practices, avoidable delays, and the subsequent requirement to instruct contractors to undertake additional works, all of which have led to significant additional cost. This is despite the lowest tender submissions being selected for appointment in all four cases. Key issues are summarised below:

- 4.2.1 Historically, the council's approach to the approval of major capital projects has been based on budget estimates rather than contractor tender returns. This has resulted in budget approvals not reflecting the prevailing market conditions and realistic project costs.
- 4.2.2 In some cases, to ensure that projected scheme costs following tender returns were within budget approvals, contingencies and 'provisional sums' were removed. A construction contingency is a part of a project's budget put aside to cover any unforeseen costs, risks, events, or changes in scope that may affect the project's cost over the course of its life. Provisional sums are cost estimates provided at tender stage where detailed costings are not yet available. They refer generally to essential rather than discretionary items of expenditure. Excluding contingencies and provisional sums is a high-risk approach and is not recommended practice. In doing so, approved budgets were inadequate to complete the projects from an early stage in their development.
- 4.2.3 Cost estimates utilised for seeking budget approval did not include professional fees that are essential in the development and delivery of major capital projects. The addition of unavoidable professional fees also resulted in cost overruns.
- 4.2.4 The scope and specification of the works initially approved has proven to be insufficient to achieve the required Decent Homes Standard and additional variations have been issued to contractors throughout the development and construction stage which has led to costs increasing significantly.
- 4.2.5 Additionally for these projects, initial estimates were provided as long as six years ago and have been subject to construction related inflation, which has continued to run significantly higher than Consumer Price Index (CPI) inflation during the intervening period, with no commensurate approvals being sought because of the additional cost pressures.
- 4.2.6 Contract management during the project period has proven to be inadequate. As a result, in some cases, significant but avoidable

delays have occurred which have led to legitimate claims for extensions of time from contractors, resulting in additional costs which should have been avoided.

4.2.7 Continued elevated levels of construction inflation and identification of additional unforeseen remedial requirements, in some cases in the absence of budget contingencies, has placed further cost pressures on projects. While some delays were unforeseeable and unavoidable (for example, delays created due to the Covid 'lockdown' during March 2020), others should have been anticipated and have resulted in significant additional cost.

4.2.8 There remains, in some cases, outstanding compensation claims by contractors that will need to be determined prior to final account. Whether the claims can be justified or not remains to be assessed following submission of relevant evidence by contractors. As a result, there remains a significant range of potential final costs that cannot yet be determined. As a result, requests for additional budget have been based on the worst-case scenario.

4.3 Officers will ensure that all future expenditure is rigorously managed and that claims submitted by contractors are thoroughly assessed to ensure that only justifiable claims are approved. On this basis, the table below identifies the current budget approval on the projects in question and the final costs based on contractors' estimates of final accounts. A 15% contingency has also been provided to allow for unforeseen occurrences and post contract works to be undertaken by Housing Asset Management.

	Alfred Gunn House	Darley House	The Lakes	Thorn Close
Approved Budget	£25,250,049	£20,531,853	£11,554,999	£3,735,007
Maximum projected total cost	£32.106m	£25.733m	£16.338m	£4.527m
Additional Budget Requirement	£6.904m	£5.289m	£4.783m	£792,363

4.4 This level of expenditure cannot be met by the current approved capital investment programme, which was agreed at Cabinet in February 2024 at £30m per annum. There is a requirement to approve the increase of the capital programme by £17.768m in 2024/25, which can be funded by 2023/24 carry over.

- 4.5 If the capital programme is not increased to allow for these overspends, there will be a significant impact on delivering on other priority commitments, such as the social housing decarbonisation fund and aids and adaptations, as well as other decency improvements that will have a knock-on impact on the revenue budgets.
- 4.6 The sections below outline the key issues that have affected each specific block.

### **Alfred Gunn House**

- 4.7 The following issues created delays and associated costs.
- An unavoidable delay of 7 weeks from March 2020 because of the Covid 19 Pandemic.
  - No allowance was made in the original budget for design and consultancy fees, which have now been added.
  - Several variations to the contract have been required, associated with additional works identified as the project has progressed, some of which were not foreseeable resulting in additional delays and associated claims.
  - The need to move telecommunications equipment from the roof of the block. The moving of the equipment was delayed by 15 months from its expected initial completion date. During this time, the contractor could not gain access for works to the roof. Delay costs based upon preliminaries and additional inflation costs for 15 months is currently estimated at £3.26m.
  - Design change for a new sprinkler system to meet current statutory requirements (original design for a misting system did not meet required standards) affected the internal refurbishment of the flats including, additional ceilings, electrical work.
  - An allowance was made for refurbishment of kitchens and bathrooms (including re-use of existing units); however, it was decided that was it more cost effective and beneficial to the residents to enhance the internal refurbishment of the flats with new bathrooms, fire doors and kitchens at this stage. This has added £3.31m to the costs.

- Due to the condition of the concrete in certain areas additional structure support work to the existing roof and balcony areas were required. The additional budget pressure is estimated at £1.198m.

## **Darley House**

4.8 The following issues created delays and associated costs.

- All provisional sums and contingencies amounting to £1,419,500 were omitted from the contract at its outset, to bring the contract value within the sum agreed.
- No allowance was made in the original budget for design and consultancy fees, which have now been added.
- Several variations have been incurred to date, the most significant of which is £1,500,000 for delays in providing the contractor with possession of the site, because of construction cost inflation during the intervening period.
- The balance of the remainder of the added cost is accounted for by a small number of additional items, many of which could not be foreseen until the building was opened. The largest cost is associated with omissions from the original tender as well the installation of fire safety measures identified as part of fire safety investigations.

## **The Lakes**

4.9 The following issues created delays and associated costs.

- All provisional sums and contingencies amounting to £592,000 were omitted from the outset and added to the contract value as a fixed price increase, designed to account for construction industry price inflation between the tender period and commencement of the works to bring the contract value within the Cabinet approved value.
- No allowance was made in the original budget for design and consultancy fees, which have now been added.
- Architects Instructions of £595,500 have since been incurred for additional work not foreseeable at the time. The works specified broadly comprise of additional structural steelwork to the lift shaft, details to the windows, additional ventilation to flats and additional rainwater goods.

- A loss and expense claim has been submitted by the Contractor but has not yet been accepted by the council. Both the legitimacy and commercial value of this claim is being challenged. This may result in an additional pressure to the project budget which must be considered when determining the additional budget requirement.

### **Thorn Close**

- No allowance was made in the original budget for design and consultancy fees, which have now been added.

### **Proposed Post Completion Review**

- 4.10 The review undertaken by the current Place Management team has identified a range of issues which have resulted in additional costs and significant delays. New procedures have been implemented to ensure that in the case of future major capital projects, a more rigorous approach is taken including a detailed financial appraisal to ensure that investment is the best option, more robust budget setting, clarity on the establishment of contract scope and specification and better 'in flight' project management. A new reporting mechanism has been implemented to ensure full clarity on budget setting and requests for additional resources in the event of unforeseen and unavoidable additional cost.
- 4.11 It is intended to seek to appoint a suitably qualified and experienced construction expert to conduct a detailed post completion evaluation of the projects and to make recommendations as to how future major capital projects should be managed. This will ensure that new processes and procedures reflect the lessons learnt and that effective measures for project inception, approval and management are in place in future.

### **Ensuring Effective Future Project Management**

- 4.12 Significant efforts have already made to ensure that the issues that have arisen in relation to these capital projects could not re-occur. New structures and processes have been implemented to ensure effective decision making is in place at all stages of project development. This includes the following.
- A Major Capital Projects Board (MCPB) has been established, chaired by the Assistant Director, Asset Management and attended by the Assistant Director Property and Assets. The Board contains representation from Housing and Urban Design Building Services

(UDBS), finance and legal and is responsible for overseeing all aspects of project development, from initiation, through to approval, procurement implementation and completion.

- A detailed Standard Operating Process has been developed which details officers' roles and responsibilities alongside their relevant governance requirements. All stages of each project will have a clearly defined, 'responsible officer' who will be accountable for their role in the project.
- Before each new scheme is agreed to be included in the investment programme, there will be a detailed options appraisal carried out, inclusive of cost benefit analysis and recommendations for best value over a 30-year period.
- The options appraisal will be scrutinised by the MCPB and confirmed prior to seeking formal approval from Cabinet to progress.
- Following the Tender process, the MCPB will confirm the preferred tender and value and at that stage review project specification and budget to confirm that the project remains within affordable parameters.
- During the project, the Lead Client Officer from Housing will attend monthly contract meetings with contractors and report progress through to MCPB. Any additional works arising from any unforeseen issues during the life of the project will be approved by the MCPB before contractors are instructed.
- UDBS act as the principal designer and carry out the day-to-day contract management functions, ensuring contractual obligations are fulfilled.
- On Project Completion, final total costs will be assessed, and the project signed off prior to the payment of any retention to the contractor.

## **5. Alternative Options**

### **Option 1 - Make no further investment and allocate the resources to other capital projects.**

- 5.1 In the case of Alfred Gunn House, approximately 30% of the scheme would be uninhabitable because flats have been stripped back to bare shells and have not yet been refurbished. In addition, security costs would be incurred for incomplete parts of the building, and the building left in an incomplete state would present a significant risk to resident's safety. The loss of income would equate to £204,179 pa. If the site were to be decanted and sold on the open market, it would attract a nominal



value only due to the cost of refurbishing or demolishing the existing block.

- 5.2 In the case of Darley House, external wall insulation works have not been completed yet. This would mean the external structure would in places not have the level of thermal insulation required to support residents to sustain their tenancies. One lift is yet to be installed and whilst the centralised heat centre has been completed, no in-flat installations have taken place. If the site were to be decanted and sold on the open market, it would attract a nominal value only due to the cost of refurbishing or demolishing the existing block.
- 5.3 In the case of The Lakes, approximately 35% of the scheme would be uninhabitable because flats have been stripped back to bare shells and have not yet been refurbished. The loss of income would equate to £136,640 pa. If the site were to be decanted and sold on the open market, it would attract a nominal value only due to the cost of refurbishing or demolishing the existing block.
- 5.4 In the case of Thorn Close, if the site were to be decanted and sold on the open market, it would attract a nominal value only due to the cost of refurbishing or demolishing the existing block.
- 5.5 Option 1 is considered not to represent best value on the basis that the projects would be left incomplete. This option is therefore dismissed.

**Option 2 - Termination of contracts with the current contractors and re-tendering the remaining works is also an option.**

- 5.6 It is important to note that the additional works identified as the projects have progressed are necessary to achieving the Decent Homes Standard. Also, there has been no breach of contract by the contractor that would warrant contract termination. This option is ruled out on the basis that:
  - 5.6.1 Additional costs have already been incurred and there has been no breach of contract by the contractor.
  - 5.6.2 Any change in contractor would delay the projects and would be highly likely to result in a challenge from the incumbent contractor, at major cost to the council.
  - 5.6.3 The schemes would still need to be completed, with no guarantee that costs would be less.
  - 5.6.4 Any change in contractor would result in a significant delay due to demobilisation, procurement, and contract mobilisation, and would itself incur additional costs.

- 5.6.5 The schemes would be uninhabitable, incurring void rent loss on 279 units.
  - 5.6.6 The council's ability to reduce the housing waiting list would be reduced until such time as the projects is completed.
  - 5.6.7 The approach would place the council at significant reputational risk.
- 5.7 The implications of not completing the works will be that the projects are left unfinished, and it will be both challenging and expensive in procuring the services of a contractor to complete the project. The accommodation will also not be lettable, resulting in void rent loss. Option 2 is therefore dismissed.

### **Option 3 – Making Further Investment and Completing Refurbishment**

- 5.8 The implications of not completing the works will be that the projects are left unfinished, and it will be both challenging and expensive in procuring the services of a contractor to complete the project. The accommodation will also not be lettable, resulting in significant void rent loss. There is also a continuing cost of decanting, with affected tenants being entitled to home loss and disturbance payments reflecting the disruption caused. The council does not currently have sufficient vacant units to re-house decanted tenants into permanent accommodation. Given current rates of turnover in the general needs housing stock, it would take a considerable period of time to re-house permanently all temporarily displaced tenants if refurbishment were not completed. Completing refurbishment works and letting all units would negate these issues.
- 5.9 More than £55million has already been spent on refurbishment, the cost of which would be irrecoverable if schemes were not completed. Completing the refurbishment on the other hand will result in 349 fully refurbished, high-quality units being available for letting, for which there is significant demand, providing good quality safe and well-maintained accommodation.
- 5.10 On this basis, Option 3 is considered to represent best value and should be selected.

## **6. Procurement**

- 6.1 The contracts were let in accordance with the Councils contract procedure rules. The contracts with existing contractors allows amendments and additions in accordance with Clause 14.2 A of the

permitted circumstances, where variations are permitted to existing contracts within the Councils procurement rules.

- 6.3 All contractual variations required to facilitate the necessary works to complete each project will be undertaken in accordance with the Council's contract procedure rules.

## 7. Implications

<b>Resources:</b>	The report is requesting approval of an additional capital funding totalling £17.768m for the completion of 4 major projects. This additional funding requirement will result in a reduction in available capital for other council housing stock projects, which will require re-profiling into future years.
<b>Legal and Governance:</b>	<p>Legal Services has no objection regarding approval of the report recommendations. However, since a significant additional amount is involved, it is recommended that Legal Services is consulted at every stage on case-by-case basis so that further conduct of the contracts or amended contracts remain compliant with the applicable laws and any associated risks are appropriately managed.</p> <p>All contractual variations required to facilitate the necessary works to each asset will be undertaken in accordance with the Council's Contract Procedure Rules.</p>
<b>Risk:</b>	<p>Risks of not completing the projects are:</p> <ol style="list-style-type: none"> <li>1. Reputational</li> <li>2. Schemes being incomplete and unlettable, resulting in a loss of rental income.</li> <li>3. Deterioration of the schemes because of non-occupancy, resulting in additional investment being required.</li> </ol>
<b>Equality:</b>	Failure to complete the works will result in reduced affordable housing within the borough which would negatively impact upon those on low incomes unable to access housing for sale or at market rents.
<b>Health and Wellbeing:</b>	The health and wellbeing of those requiring affordable rented housing will be negatively affected if the additional investment is not secured rendering the properties incapable of being relet.

<b>Social Value:</b>	No direct implications arising from recommendations.
<b>Climate Change:</b>	The homes in the block will be more energy efficient, reducing fuel consumption and tenants' energy costs.
<b>Corporate Parenting:</b>	No direct implications arising from recommendations.

## 8. Appendices

None

## 9. Background Papers

1. Executive Decision taken under Cabinet Authority report – 'Refurbishment Low-Rise blocks of Flats – The Lakes, Lion Farm, June 1, 2023
2. Report to Cabinet Asset Management Investment Programme for Housing 2023-24
3. Report to Cabinet Asset Management and Maintenance Investment Programme 2022/23