CUSHMAN & WAKEFIELD

Station Approach, Hereford

Analysis of Operating Costs and Lifecycle Expenditure

10 June 2019

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1. Introduction and Background

Herefordshire Council is supportive of the expansion of Higher Education provision in Hereford and is considering a proposal to support a new development of purpose-built student accommodation on a site it owns on Station Road. The proposed scheme would extend to 178 bed spaces of which circa 75% would be for the well-established Herefordshire College of Art and the balance for the relatively nascent HEI, New Model in Technology & Engineering NMiTE, which has ambitious plans to establish and grow HE provision in the town.

There is presently no purpose-built student accommodation in Hereford and achieving viability for the proposed scheme on commercial terms is proving challenging. The Council is considering a proposal whereby it will support the delivery of the scheme by funding it using an 'income-strip' lease established for this purpose. The Council would provide its covenant to such a lease commitment.

The scheme has been worked up by Engie who are selected as a Development Partner to the Council following an earlier Development Competition. Engie has now tabled detailed development proposals for the Council's approval.

The Council now wishes to receive expert advice in relation to the expected operating costs and lifecycle maintenance costs for the proposed scheme and has provided a requirement for advice as follows:

Student Accommodation on Station Approach operational expenditure value for money assurance

There is a need to ensure that the operational expenditure proposed is at an appropriate level to allow the student accommodation to be maintained. And that the operational expenditure assumptions offer value for money. This assurance is required for the operational phase of the facility.

Value for money assessment of the operational phase

The value for money assessment of the operational phase will include:

- *Assessment of the reasonableness of the operational cost profiles and phasing compared to current similar student accommodation units.*
- *Assessment of the reasonableness of the proposed smoothing of the operational costs profiles.*
- *Assessment of the reasonableness of the operational costs assumptions.*
- *Assurance that the operational costs represent Value for Money.*
- *Confirmation of the credentials of the report author in commenting on the operational phase of this type of project.*

The information feeding into the assessment of value for money in the operational phase includes: contractual commitments relating to the maintenance of the facility and the proposed profiled operational expenditure commitment.

The operational phase assessment should address the following points:

- *Assurance of the effectiveness of the contractual commitments to maintain the facility to an appropriate standard throughout the life of the lease;*
- *Assurance that the contractual commitments will lead to the facility being returned to the council in an appropriate condition;*

- *Review of the maintenance spending profile to ensure that they will meet the contractual commitments, are based on reasonable assumptions (including lifecycle assumptions) and offer value for money.*

Cushman & Wakefield is pleased to provide this paper in response to this requirement.

NOTE that our advice is limited to commentary on expected operating and lifecycle costs for the proposed new development only and not on the wider elements informing a value for money appraisal of the scheme.

We are pleased to structure this paper as follows:

- **The property:** We comment on the scheme's location, the approach to design, the choices of materials specified and how these will affect expected costs.
- **Services:** We summarise our understanding of the services required. We comment on the expected level of service specification, how much these will be expected to cost and how this will affect the performance / attractiveness of the property.
- **Risk pricing:** The context within which FM services are provided will affect their pricing. In situations where suppliers take on the risks of future maintenance and services costs whilst needing to achieve a prescribed level of performance, they will typically charge a margin to cover risk, which if not used will be taken in profit.

2. The property and services

2.1. Location

We understand the proposed property will be located in Station Approach, Hereford close to the town's railway station in an area of mixed, principally commercial uses. The building will cover circa 50% of the site and externally the remaining area will be mostly hard landscaped with limited (estimated c.6 no.) car spaces, circulation / access and some planting, which will require maintaining over the life of the building.

The location is not an established purpose-built student accommodation location and there is no other purpose-built student accommodation in the town. The relatively isolated location of the scheme could lead to services costs being at the higher end of expectations. This said, as FM services are typically labour intensive, the impact might be offset by Hereford being a relatively low wage costs location compared to more established locations or the average for the UK. The Annual Survey of Hours and Earnings (ASHE) 2018 by the Office of National Statistics demonstrates this, where the median average wage in Herefordshire is £17,940 compared to £24,804 and £29,588 in Birmingham and UK-wide respectively.

2.2. Design

It is understood that the property will be developed in modern cluster flats, purpose built for student accommodation use. The cluster flats will comprise 4 to 7 en-suite bedrooms plus a shared kitchen/living room. In addition, there are 6 no. studio flats providing larger self-contained units. Average floor areas are as follows:

Floor areas, proposed scheme at Station Approach

Room type	Number of rooms	Total area	Average room size
Standard ensuite in flat	168	2,294	13.65
Accessible rooms in cluster flat	4	80	20.02
Studio flats	3	84	27.95
Accessible studio flats	3	113	37.55
Total	**178**	**2,571**	**14.44**

The common parts will provide circulation / access, reception with a management office / storage, a reasonably sized common room, laundrette and cycle store. Overall the building extends to a gross internal area (GIA) of 5,289m2 working out 29.7m2 per bedspace.

The cost of maintaining and operating the facility will be a direct function of the building area. The spatial allowances in this instance are broadly in line with norms for modern student accommodation

schemes, typically averaging 28.5- 30.5 m2 (GIA) per bedspace. Accordingly, no adjustment to standard costs should be necessary based on spatial design.

2.3. Materials and cyclical replacement

Cushman & Wakefield has not been able to analyse the building specification to the level of individual finishes or choice of materials / suppliers for key components such as bathrooms, kitchens and bedroom furniture. We would comment as follows:

A typical ***design life*** for a student accommodation scheme will be similar to that employed for most new commercial and residential development i.e. 40-50 years. Major building components will be selected to support this lifespan including foundations, structure / frame and roof.

Further key building elements can have lesser design life expectancy with planned lifecycle replacement needed to extend asset life to 50 years. Provision should be made to either re-provide these or include contingency budgets to manage risks. Typical replacement cycles assumed are as shown in the table at Appendix 1. Some major elements such as building services/electricals, porcelains, fenestration will typically have 25-30 years life expectancy.

Funding strategies will usually expect to see financing entirely or substantially paid down on an asset prior to the 25-30 year timeframe, as often this is the time planning horizon for a property to be substantially refurbished or even re-purposed.

Where the funding / delivery model goes beyond this term, it is appropriate to ensure that provision is incorporated into the structure to allow for comprehensive refurbishment addressing these significant elements – this might be approached on a phased basis in the 25-30 year period.

Kitchens need to be simple and extremely robust to withstand a student cluster-flat-share environment. Experienced student accommodation operators will tend to use one or two industry leading suppliers whose kitchen materials / build they have found to be durable in this environment. These tend to be relatively expensive to install initially but will have a lifecycle replacement target of circa 15 years. A standard domestic kitchen might survive only half this time and create issues for the operator within weeks (with doors coming off, damage to drawers, surfaces burnt etc). Generally, operators will prefer to invest up-front to install highly-durable kitchen facilities at the outset to avoid the costs and hassle of dealing with issues downstream, which can be disproportionately expensive. It is also difficult to replace kitchens or undertake any significant works in an operational student accommodation scheme, with works involving risks / challenges and usually undertaken in closed periods.

White goods including cookers, refrigerators, microwave ovens, kettles and toasters will tend to last for a much shorter period in a student accommodation kitchen than in standard domestic usage. For the purposes of budgeting FM services costs, typical replacement cycles assumed are as shown in the table at Appendix 1.

Further ***Furniture, Fittings and Equipment (FFE)*** including all bedroom furniture, fittings and equipment, floor coverings and wall finishes to the flat areas and common parts will receive heavy wear in a student accommodation environment, similarly to kitchens. Detailed consideration will need to be given to their specification to ensure their durability in this environment and their efficiency in terms of services costs (e.g. different floor coverings – different cleaning regime and cost).

The above has implications for the type of construction agreement employed to deliver a student accommodation. Robust specification of performance requirements for these items will normally be desirable where the provider is not subsequently liable for operating / maintenance costs. Design and

Build contracts where decisions on such things are left to the contractor will generally not be appropriate if value engineering will allow the contractor to deliver to the lowest common denominator.

2.4. Services

Student (end-user) expectations of the nature and quality of service they should expect from their accommodation provider has shifted markedly over a generation. Students very much consider themselves as consumers with purchasing power, making buying decisions with an expectation of service. An institutional approach to service delivery will no longer meet expectations and successful operators will follow 'hotel' industry service models.

Whoever is ultimately taking responsibility for the demand risk must recognise the role that services play in the perceived quality and experienced quality of the supply and design the service accordingly.

The division of responsibilities will vary from scheme to scheme so we consider these under a number of heads as follows:

2.5. Marketing, Letting & Admin, Bad Debt and Voids Risk

Where a College/HEI takes serviced accommodation from an operator, then they may either take a common law interest in the property/flats/rooms and use their own letting agreement or simply operate a Nomination Agreement where the operator's assured shorthold tenancy (AST) agreement is used.

If the College / HEI guarantees the rent then they will typically want to deal with Marketing, Letting & Admin, Bad Debt and Void risks. They may also wish to provide the primary interface with the student and deal with their pastoral care.

Typically, Colleges/HEIs will wish to take a 'top slice' of the rents charged to students to cover these costs which will amount to 3-10%, depending on the level of rent, responsibility for bad debt / void risk and levels of pastoral care is included.

In this instance, we would expect the following assumptions to be appropriate:

Item (description)	**Cost total**	**Cost per bed space per annum**
Marketing, letting & admin, bad debt *	£39,160 (£35,600 - £42,720)	£220.00 (£200-£240)
Pastoral care, welcome event, chattels insurance	£18,245 (£14,246 - £21,360)	£102.50 (£80-£120)

*Void risk would need to be considered separately.

In terms of pastoral care, there are numerous approaches to delivering a suitable service but costs can work out similar. The above includes for costs as follows:

Item	Description
Welcome event	£20 per student to cover a welcome event, which might be organised by the student body itself.
Student wardens	Either 1:70 ratio, therefore 4 No. student wardens offered £3,000 in rental discount (£12,000 per annum = £67.50 per bed space) or say 0.4FTE student welfare officer.
Chattels insurance	Group chattels insurance policy to arrange a base level of cover for student's possessions c. £15 per student.

2.6. Facilities management

The approach to operating the facilities in this instance is unclear and there are several routes which might be chosen. The size of the scheme means that it is below a minimum efficient scale needed to support an on-site, staffed reception/management presence efficiently. Such amenity might still be desired and provided but would be likely to impact on the average costs per bed space per annum versus industry norms.

Generally speaking, operators will seek to achieve 250-600 bed spaces to support a full local service efficiently with permanent staff on site between core operating hours. Alternative solutions would involve a contracted service with 24-hour helpdesk supported by web-enabled technology solutions. Most operators would consider a combination of the two, meeting the specific requirements of the scheme.

Costings outlined below assume that the facility is operated as one of a number of centres by an established student accommodation operator with established capability. As a freestanding FM entity, this would present an exceptional burden on a small operation to ensure compliance with industry regulation and standards and present challenges in terms ensuring quality of service and continuity of service.

The proposed facility is of an awkward size in a relatively isolated location. Ideally, in order to be confident that value for money is achieved the Council would agree an appropriate specification and have tendered this competitively between operators. In doing this, the Council would need to consider how a contract can ensure continuing quality of the supply with performance management machinery attached to service pricing and risk transfer which impacts on costs.

These issues are critical to value in the commercial sector where proportionately 1% more of the gross rent spent on servicing means at least 1% less to the net rent (slightly geared by void assumption) and ultimately circa 1% off the value that is achieved for the investment created. Thus, at a yield of 6.5%, £10,000 per annum in additional cost will translate into £150,000 reduction in the capital value. In an instance where income strip funding is used, the implied funding yield may be closer to 3% implying a capital impact of £330,000. Accordingly, increasingly robust due diligence is being applied to these aspects.

2.7. Lifecycle or Long Term Planned Maintenance

Major refurbishment including works to replace life spent building elements will need to be planned both for practical issues of access but also to ensure sufficient financial reserves are in place to meet costs. As the proposed property will be new, it is understood that the transaction structure will unlock provision for an annual smoothed budget amount to be allocated to a Maintenance Reserve Account, which will be drawn up when required over the term of the contract.

Typical budget assumptions will require a budget of £350-£450 per annum (at 2019 values). Risk pricing

3. Pricing Overall

Based on our experience operating competitions for the delivery of student accommodation within 50-year DBFO partnerships, we believe that an appropriate smoothed annual budget to cover letting and admin, operating costs and lifecycle will be £2,200 per bed space per annum or £391,600 per annum overall for the facility (at 2019/20 prices).

This is based on the assumption of average letting periods of 42 weeks per annum. (The cost of rooms let over the summer can be priced on a marginal basis).

4. Conclusions

C&W has not received detailed specifications for the property, nor the services specification, overall contractual relationship, nor can we comment on the specific implication on costs resulting from the relatively isolated location. On the understanding that the assumption used for operating costs and lifecycle total £2,155 per annum (at 2019) we would comment that these are broadly in line with our own analysis (prepared separately) of what we would expect for such a facility.

In relation to the lifecycle provision in particular, the budget is at the lower end of expectations and the lifespan assumptions attached to building elements are stretched to the fuller extent of typical market assumptions and so not conservative. To be sustainable, this would require that detailed attention has been given to the specification of building elements to ensure their optimal lifecycle and/or routine maintenance will be undertaken thoroughly; and / or items such as redecoration will be undertaken at the operational level.

This analysis is provided on the basis that the new development will perform satisfactorily and the service required will continue unchanged for the length of the contract. C&W's instruction does not extend to reviewing the capacity of the financial structure involved to cope with risk.

We are not able to comment further on the detailed analysis of operating costs and lifecycle without thorough understanding of the contractual arrangements.

We are unable to give any assurances that the cost budget or contractual structure will lead to the asset being retained in appropriate condition.

The structure incorporates significant jeopardy from the perspective of the SPV unless the income is guaranteed. The SPV is relatively lightly capitalised and will have little capacity to cope with 'headwinds' in relation to poor revenues (the model assumes 98% occupancy throughout) or costs being higher than expected.

This entity offers little covenant so it might be concluded that the contractual arrangements only work well when everything is going well. If things turn sour or any 'headwinds' are encountered the impact could either feed back to the Council (or other stakeholders) with the need to subsidise costs/increase rents or the Council could end with the whole asset back in hand.

In terms of the commercial dynamic there is little commercial protection to any headwinds.

Appendix 1

Expected lifecycle and renewal frequency of key components

Item	Standard replacement cycle (years)	Maximum replacement cycle (years)
External		
Roof covering	30	35
Gutters	25	35
Door frames	30	35
Window frames	30	35
Glazing	30	35
Movement joint sealant	15	20
External signage	10	15
Car park surfaces	15	20
Internal		
Carpets to bedrooms	7	9
Vinyl finishes to kitchens	12	15
Carpet finishes to flat corridors	7	9
Vinyl floor finishes to bathrooms	12	15
Carpet floor finishes to entrance areas	4	6
Carpet finishes to stairs and landing	5	7
Exposed joinery	20	25
Doors	20	25
Ironmongery throughout	20	25
Signs	10	15
Reception counter	15	20
Security gates and barriers	20	25
Building control plant and systems	20	25
Heating system	15	20
Ventilation plant	20	25
Ventilation systems	20	25
Shower control	10	15
Water systems	30	35
Other water plant	20	25
Fire protection systems	20	25
Fire protection plant	20	25
Voice and data plant	15	20
Voice and data systems	15	20
Security systems	15	20
Security plant	20	25
Electrical plant	20	25
Electrical systems	25	25
Lighting plant	20	25
Lighting systems	25	30

Item	Standard replacement cycle (years)	Maximum replacement cycle (years)
FFE + M&E		
Kitchen appliances		
Microwave oven	6	8
Oven & hob	8	10
Fridge / freezer	8	8
Kitchen units and other fittings	12	15
Vinyl	10	12
Bedroom furniture & fittings		
Desk	12	15
Chair	8	10
Bookcase	15	25
Wardrobe	20	25
Chest of drawers	12	15
Mattress	6	8
Bed base	12	15
Bedside cabinet	10	12
Living area furniture		
Dining table	8	10
Dining chairs	8	10
Lounge chairs / sofa	8	10
Other		
Curtains	8	10
Waste bins	8	10
Sundries toilet roll holders etc.	5	10