

## **PROJECT DOCUMENTATION**

### **FULL BUSINESS CASE**

# *Student Accommodation on Station Approach*

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## Approvals

This document requires the following approval.

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## Table of Contents

1.	Purpose of document .....	5
2.	Project aims and objectives .....	5
3.	Background .....	5
3.1.	Project Drivers .....	7
3.2.	Current performance measures .....	8
4.	Scope.....	8
4.1.	Included in Scope.....	8
4.2.	Out of scope .....	9
5.	Stakeholders .....	9
6.	Constraints and dependencies.....	9
6.1.	Initiatives which depend on this project are: .....	9
6.2.	This project depends on: .....	9
7.	Options considered .....	9
8.	Budget provision .....	12
9.	Detailed costs and assumptions on final recommendation.....	12
10.	Benefits.....	12
10.1.	Cashable benefits.....	13
10.2.	Non-cashable benefits .....	13
10.3.	Dis-benefits.....	14
11.	Resources.....	15
12.	Project timeline .....	15
13.	Risks .....	15
13.1.	The key risks of not doing the project are: .....	15
13.2.	The key project risks are:.....	16
14.	Appendices .....	17

## 1. Purpose of document

There are three basic business options concerning any investment: do nothing; do the minimum; do something. "Do nothing" should always be the starting option to act as the basis for qualifying the other options – the difference between "do nothing" and the other options is the benefit that the investment will buy. The analysis of each option provides the project board and its stakeholders with sufficient information to judge which option presents the best value for the organisation. It provides the answer to the question "for this level of investment are the anticipated benefits more desirable, more viable and more achievable than the other options available?" The Business Case for the chosen option should be continuously assessed for desirability, viability and achievability as any new risks and/or changes may make one of the other options more justified

For the project to provide student accommodation at Station Approach the three options considered in this business case are:

**Do nothing:** Council identifies an alternative use for the development site.

**Do the minimum:** Develop a student accommodation facility at least cost providing minimum requirements for quality and maximising the use of space for accommodation.

**Do something:** Develop a student accommodation facility of a standard that meets the requirements of the site, being in a prominent location next to a listed building and forming an important gateway into the city.

## 2. Project aims and objectives

The high level objectives for the project are:

- Provide a capital receipt for the site reflecting its value as an asset of the council through receiving a premium from issuing a long term leasehold on the site for 125 years. The lease has a mutual break at 50 years.
- Increase economic activity due to support for Hereford College of Arts (HCA) growth strategy
- Increase economic activity due to support for first three New Model in Technology and Engineering (NMiTE) cohorts

The project will also support the creation of jobs in Herefordshire, both in the short term during construction and commissioning, and in the long term in running the facility and as a result of the increased economic activity supported through the growth in higher education.

## 3. Background

In 2016 Cabinet approved the commissioning of a developer to progress the development of suitable sites in its ownership including the capability to progress development funding. The Development Partnership is intended to support the delivery of the ambitious goals of the Invest Herefordshire economic vision and support the council's financial sustainability and will include a mix of house building and regeneration

projects that will be delivered over the next 10 to 20 years. The overarching agreement with Engie Regeneration Ltd, putting in place the Development Partnership, was signed in June 2018.

On 27 July 2017 Cabinet requested, as part of the One Public Estate (OPE) programme, an option appraisal for the development of the land at station approach and the country bus station. The uses identified for the sites were key worker/student accommodation and a multi storey car park. The option appraisal recommended:

- Student accommodation on the land at Station Approach
- Multi storey car park and other facilities on the land at Country bus station and car park

Cabinet resolved to commission a business case for the site at Station Approach as part of the development and regeneration programme, as soon as the Development Partnership was in place.

On 28 July 2018 the Cabinet member for contracts and assets decided to include the land at Station Approach in the development and regeneration programme and set the council's criteria for the project in line with the options appraisal. This is the first Development Partnership project on the urban village site.

The only long-term customer for the student accommodation is HCA, which currently has a proven demand for purpose built accommodation of the type proposed. The ability to offer potential students suitable accommodation is considered by HCA to be important for the successful delivery of its expansion plans. There is also a proposal that an allocation of rooms within the accommodation could be made available on a short term basis to students of the new higher education institute, NMiTE, thereby supporting its development.

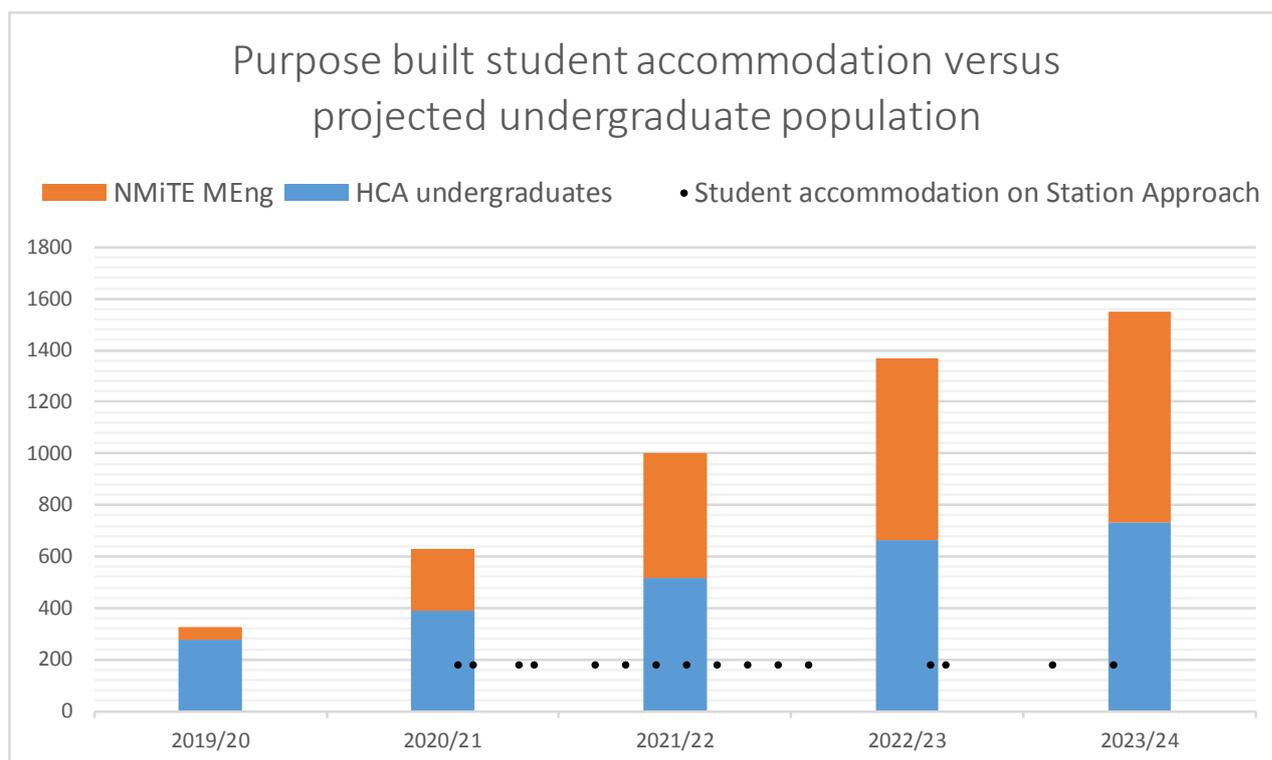
An option appraisal was commissioned<sup>1</sup> looking at options for the Station Approach and country bus station sites. The Station Approach site was considered to be the most suitable for student accommodation. This accommodation will support HCA strategy to grow its degree level student community to at least 680 full time students and support the early development of the proposed new university NMiTE. Letters of support have been received from HCA and NMiTE, and a nominations agreement has been established with HCA.

To enable the significant forecast growth in Higher Education a range of teaching and accommodation facilities will be required over the next 5 to 10 years. The following graph identifies the projected student growth numbers for both HCA and NMiTE (based on numbers provided by the respective organisations), against the level of accommodation that the station approach development will provide. Please also see appendix 9 an external report on student accommodation supply and demand undertaken by GVA to inform this project.

As the student numbers and demand grow it is anticipated that further phases of student accommodation will be required at other key locations such as the College Road Campus site the council acquired in early 2019.

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<sup>1</sup> Herefordshire Council, Development & Regeneration Programme; Station Approach and Country Bus Station Site Options Appraisal to Support Stage 0, 16th March 2018



### 3.1. Project Drivers

The project is intended to support the growth strategy of the HCA and the early cohorts of the proposed higher education institute, NMI TE. Herefordshire is currently seen as lacking opportunities for higher education. The project will support the aim of the council’s Economic Development Strategy: to become a great place to learn<sup>2</sup>: at the heart of this is the recognition that in order to attract inward economic investment particularly in new growth sectors, Herefordshire needs to develop skills in the county, available to those businesses.

The existing provision is limited to the relatively small HCA, and through Further Education (FE) Colleges, in a limited number of subjects. This has inevitably contributed to an out-migration of young, educated graduates and challenges for local businesses to collaborate on innovation initiatives with higher education (HE) establishments which will make it difficult for Herefordshire businesses to improve productivity. The county is considered to be a HE ‘Cold Spot’<sup>3</sup> by the Higher Education Funding Council for England.

The council has declared its support for the development of higher education through, amongst other things, its commitment to provide: council sites for NMI TE to acquire (Council support for the New Model in Technology and Engineering (NMI TE) higher education institute – sites; July 2016); support for the

<sup>2</sup> Invest Herefordshire; Herefordshire’s Economic Vision

<sup>3</sup> HEFCE ‘Cold Spot’ Analysis, <http://www.hefce.ac.uk/data/>

development of the business case for the new university (Revenue support for New University green book business case development; June 2016); and support for the development of student accommodation for HCA (DRP student accommodation on station approach; June 2018).

### 3.2. Current performance measures

There are no specific performance measures to act as a baseline.

## 4. Scope

### 4.1. Included in Scope

The project will result in a capital receipt. The facility will be financed externally and run by a special purpose vehicles. The council will retain the freehold of the site and there is a mutual break at 50 years which means that the facility can be returned to the council for £1.

One of the advantages of utilising external finance is that a number risks are transferred to the financier, such as;

- **Construction Phase:** The construction phase risks are passed to City Heart Partnerships Ltd, such as managing any related delays in completing the construction, and additional costs through the construction phase.
- **Rent setting:** The external funding model requires at the outset that the SPV increases rents by RPI (within the cap and collar) for the life of the agreement.
- **Operating costs:** One of the features of the external funding model is that the risks associated with operating costs are passed to the SPV. This means that the SPVs are effectively taking the risk for the full 50 years on bad debts, energy, utilities, insurances, WiFi (c.£100 per bed per annum on its own), security, planned proactive maintenance, reactive maintenance, staffing, cleaning, grounds maintenance, health & safety and all the other services required under the Nominations Agreement.
- **Inflation:** a tracking error between assumed interest and actual interest could cause financial stress.

Although the option to fund the project externally is preferred, the possibility of the council directly funding has been considered. If this approach was taken then the council will retain ownership of the asset and would need to commission a third party company, or special purpose vehicle (SPV), to run the facility on its behalf. In this scenario, there would be no capital receipt, the council would inherit the significant risks outlined above, but the council would have the benefit of any profit from the SPV.

This business case assumes that external funding is used to fund the project (the council's preferred approach). The analysis of project finance has considered both options and shows a positive net present value for the project if it uses Public Works Loan Board (PWLB) so the business case will remain positive. However, while the capital is available, the project will take a significant proportion of the Development Partnership capital budget. The council will also then own a number of the risks that would otherwise transfer to the finance provider such as the risks outlined above.

The project will follow the new project approval process described in the overarching agreement of its development and regeneration programme to design the facility.

## 4.2. Out of scope

The car park is not considered in scope as it is only a temporary car park and was not intended to be in operation in the long term, a holding use until the student accommodation development could be considered. The council's car parks are managed as an integrated service and it is anticipated that the needs of the current users of the Station Approach car park will be met by the significant capacity in the local area. Appendix 1 below provides a further details of car parking provision in the wider area.

## 5. Stakeholders

Herefordshire Council – own the site and will: benefit from a capital receipt; have a role in underwriting the project; will have nomination rights for half the rooms for the first 3 years; may profit from gain share arrangements from the accommodation and any commercial facilities developed on the site

Engie Regeneration Limited – will construct the facility

Cityheart Partnerships Limited – manage the design and build;

A specifically created SPV – will have a lease of the facility and will operate the facility

External Funder – will provide long term funding and have a long lease of the land at Station Approach

HCA – are the an intended customer for the facility via a hard nominations agreement

NMiTE – will have access to the facility for the first three years via the council's nomination rights

## 6. Constraints and dependencies

### 6.1. Initiatives which depend on this project are:

HCA growth strategy (please see appendix 10 of the decision report)

### 6.2. This project depends on:

The project will be delivered via the council's Development partnership.

## 7. Options considered

The main long-term customer for the student accommodation is HCA, which has a proven demand for purpose built accommodation of the type proposed. The ability to offer potential students suitable accommodation is considered by HCA as important for the successful delivery of its expansion plans. There is also a proposal that an allocation of rooms within the accommodation could be made available on a short term basis to students of the proposed new university, NMiTE, thereby supporting its development.

The Station Approach site was considered to be the most suitable site to support HCA strategy to grow its degree level student community to at least 680 full time students and to support the early development of the proposed new university NMiTE. This development will complement the anticipated development

of the recently acquired College Road campus (please see section 3 above). It will provide a city centre facility that will offer capacity for NMiTE’s first cohort and the early stages of HCA’s growth plans while the College Road campus will support the future growth of both colleges. Letters of support have been received from HCA and NMiTE.

Three options have been considered:

**Do nothing:** An options appraisal was undertaken for the station approach and country bus station sites considering a range of uses such as a multi storey car park and student accommodation. Physical constraints of the site did not end themselves to a multi storey car park. Options appraisal supported use as a key strategic site for student accommodation.

**Do the minimum:** Develop a student accommodation facility at least cost providing minimum requirements for quality and maximising the use of space for accommodation.

**Do something:** Develop a student accommodation facility of a standard that meets the requirements of the site, being in a prominent location next to a listed building and forming an important gateway into the city.

Option	Analysis
Do nothing	<p>Council identifies an alternative use for the development site.</p> <p>Benefits</p> <ul style="list-style-type: none"> <li>- The council would retain the option to use the development site for some other purpose.</li> </ul> <p>Costs</p> <ul style="list-style-type: none"> <li>- The economic value expected to be delivered by developing student accommodation on the site will not be delivered. As identified in section 3 a significant increase in accommodation will be required over the next few years. Should the proposed project not progress no other development could support the currently planned growth in undergraduate numbers at the HCA and the currently anticipated first cohort of NMiTE students (planned for Sep 2020).</li> <li>- HCA have included the potential accommodation on Station Approach in their latest prospectus. Their strategy for growth is likely to be undermined without the accommodation.</li> <li>- NMiTE first cohort is likely to be reduced in size with a negative impact on the proposed NMiTE business plan.</li> <li>- There is currently no alternative use identified.</li> </ul>

Option	Analysis
Do the minimum	<p>Develop a student accommodation facility at least cost providing minimum requirements for quality and maximising the use of space for accommodation.</p> <p>Benefits</p> <ul style="list-style-type: none"> <li>- Developing a minimum specification, maximum bed facility would, most likely, improve the return from the site for the council. However, such an option would not have been considered appropriate by the planning consultees or approved by the planning committee. The specification of the proposed development (which was already above minimum) was enhanced during the planning process in response to objections from, for example, Historic England.</li> </ul> <p>Costs</p> <ul style="list-style-type: none"> <li>- The originally proposed plans for the accommodation were above the minimum requirements for such facilities. These plans were not considered to be of sufficient quality for the location and would not have been approved by the planning committee. A scheme designed around minimum standards would, therefore, not have been a practical solution.</li> </ul>
Do something	<p>Develop a student accommodation facility of a standard that meets the requirements of the site, being in a prominent location next to a listed building and forming an important gateway into the city.</p> <p>Benefits</p> <ul style="list-style-type: none"> <li>- The building will reflect the council's ambitions for the city and the rich history of the HCA. It will provide an excellent and attractive accommodation option for students, of both HCA and NMiTE, which will improve the attractiveness of higher education in the county.</li> <li>- HCA's growth strategy will be enhanced by the proposed high quality scheme.</li> <li>- NMiTE's first full cohort will be provided with approximately 90 units of accommodation.</li> <li>- Student accommodation offers a commercially viable way of delivering a high quality development for the Station Approach site.</li> </ul> <p>Costs</p> <ul style="list-style-type: none"> <li>- Opportunity cost of allocating the site as student accommodation.</li> </ul>

## 8. Budget provision

As it is expected that the project will be externally financed the bulk of the spending on the project will happen after the site has been leased and the council has obtained a capital receipt. Until that point, the design phase of the project has been carried out in line with the new project approval process of the overarching agreement of the council's Development and Regeneration programme.

Under this agreement the council approves and underwrites the Programme Development Fee that includes the cost of design for the development. The fee is then included in the overall cost of the scheme and will be included with the construction costs. It will, therefore, be paid for by the external finance provider.

The council will incur costs in the period before final project approval including: external legal support; financial due diligence; staff costs; site preparation to enable the reuse of the council assets e.g. parking meters and CCTV camera. These costs will be included in specific decision reports.

## 9. Detailed costs and assumptions on final recommendation

The council is proposing to provide a long lease on the site to the external funder who in turn will provide a shorter lease to a SPV. The construction of the development is to be provided by a third party. The council will, therefore:

- Retain the freehold of the site, with the development reverting to the council at the end of the lease;
- Receive a capital receipt of £677K
- Establish the critical first stage student accommodation required to support Higher Education growth in Hereford, supporting the economic development of the county as a whole.

As identified in section 4 above, the external finance provider and City Hearts Partnership Ltd are responsible for the construction and operational costs of the development, rent setting and all associated risks.

## 10. Benefits

Expected Benefit	Initial analysis	References/Comparisons
Capital receipt	£677K estimate in the preliminary appraisal	Cityheart DRP stage 2 detailed development appraisal
Construction employment	The construction programme for Station Approach indicates a peak level of 65 operatives per day.	

Expected Benefit	Initial analysis	References/Comparisons
Employment due to management of the facility	There will be a requirement for the SPV to manage the facility	
Increase in economic activity due to support for HCA growth strategy	Reduce the overall level of out-migration of young people from Herefordshire	HCA Strategy
Increase in economic activity due to support for first three NMiTE cohorts	Research by the LSE demonstrates that there is a strong correlation between opening universities and increased economic growth <sup>4</sup>	NMiTE business case

**10.1. Cashable benefits**

Expected Benefit	Initial analysis	References/Comparisons
£677k Capital receipt	£454k estimate in the preliminary appraisal	Council site valuation

**10.2. Non-cashable benefits**

Expected Benefit	Initial analysis	References/Comparisons
Construction employment	The construction programme for Station Approach indicates a peak level of 65 operatives per day.	
Employment due to management of the facility	There will be a requirement for the SPV to manage the facility. This will be 2 ftes: an accommodation manager and a caretaker. There will also be a requirement for cleaning and maintenance staff.	
No reduction in car parking revenue	Alternative car parking provision in the wider area will ensure that the overall income	Estimates provided by Technical Services

<sup>4</sup> The Economic Impact of Universities: Evidence from Across the Globe; Anna Valeroa and John Van Reenenb; April 2016

Expected Benefit	Initial analysis	References/Comparisons
	of car parking revenue to the council should not be affected.	
Increase in economic activity due to support for HCA growth strategy	Reduce the overall level of out-migration of young people from Herefordshire	HCA Strategy
Increase in economic activity due to support for first three NMiTE cohorts	Research by the LSE demonstrates that there is a strong correlation between opening universities and increased economic growth <sup>5</sup>	NMiTE business case

### 10.3. Dis-benefits

Expected Dis-Benefit	Initial analysis
(£50k) estimated external legal support	Funded from the Development Partnership capital budget
(£35k) re-design to match Welsh Water requirements relating to the sewer	Funded from the Development Partnership capital budget
(£8k) financial due diligence	Enabling the procurement of the project financial model
(£100k) client support and due diligence	Potential further due diligence and staff costs to support the project

## 11. Resources

Pre-development costs of

- £415,740 were underwritten in the stage 1 proposal;

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<sup>5</sup> The Economic Impact of Universities: Evidence from Across the Globe; Anna Valeroa and John Van Reenenb; April 2016

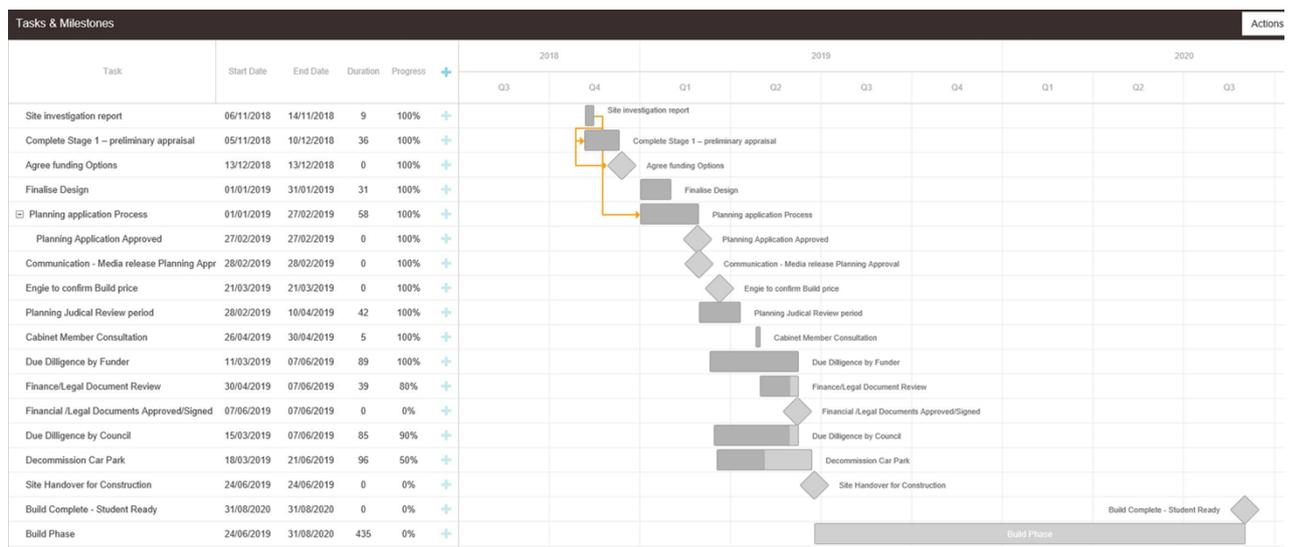
- a further underwritten value of £752,648 was approved for the delivery of stage 2 of the project;
- the council are therefore underwriting a total value of £1,168,388;
- a £151k contingency was included in the stage 2 costs but has not yet been required.

If the project is not taken forward these would be the costs liable to the council to fund from revenue reserves in the event of an improper rejection of the project by the council.

It is estimated that the council will incur capital spend of £50k for legal fees and so far have funded £35k which was as a result of the issues with the sewer. These items will be funded from the Development Partnership capital budget.

If, as expected, the project goes ahead with an external funder all the underwritten development costs will be covered within the overall project funding.

## 12. Project timeline



## 13. Risks

### 13.1. The key risks of not doing the project are:

RISK: the economic value – support for the HCA growth plan and support for the early cohorts of NMiTE will not be achieved

RISK: the approved Programme Development Fee of £1.1m which has been underwritten by the council will be payable to the developer

RISK: there is a risk to the council’s reputation of not carrying out the project, not supporting HCA and not supporting NMiTE

RISK: there is a risk that the relationship between the council and its developer partners will be severely damaged if the project does not go ahead

**13.2. As set out in section 3 above, an advantage of the proposed model is that construction, operational cost, and rent setting risks are transferred to the external financier and City Heart Partnerships Ltd. The key project risks are:**

RISK: **project rejection** – there is a risk that the project is not a priority for the new administration and the council decides to not go ahead with the project; RESPONSE: the project has been widely consulted on during its development and is considered to have broad support. However, if required, the council will use the mechanisms in the Overarching Agreement to manage the rejection of the project.

RISK: **Rental Guarantee risk** – the risk that income from students isn't enough to cover the payments to the funder. Any adverse changes to the level of occupation or tenancies would result in the council having to make a financial payment to the funder; RESPONSE: the agreed contractual terms balance the risks and benefits of the project; mechanisms will be put in place to manage the risk over the life of the project. These mechanisms include a nominations agreement with the HCA (and the council in the first three years) in which they guarantee a level of occupancy and a 'non-compete' agreement in which the HCA affirms its commitment to supporting the facility. If there is a risk that the rooms will remain unallocated there are provisions for the council to allocate rooms to other occupiers such as student nurses.

RISK: **inflation risk** – there is a risk that the impact of inflation has a different impact on the income and costs associated with the project; RESPONSE: Although the SPV's operational costs and the finance costs will be affected by inflation, the rent levels and, therefore, the overall revenue for the facility will also be linked to inflation in order to ensure that the facility remains economically viable. The SPV also has some protection over inflation through the cap and collar that will be in place over the inflation applied to the payment to the funder.

RISK: **loan default risk** – there is a risk that the SPV defaults on the loan and the Council has to step-in. The Council will have to make the outstanding financial payment due to the funder; RESPONSE: The council will monitor the progress of the SPV to minimise the likelihood and impact of any SPV default.

RISK: **valuation risk** – the risk the asset is worth less at the end of the loan period. The transaction assumes that the student accommodation passes to the Council for £1 at the end of the loan period. If the SPV can service, its financing costs over the 50-year period and the Council can take ownership of the asset with a value at the end of the term then this would be a benefit to the Council. The risks outlined above could result in the Council stepping into the payment of the debt at some point during the loan term and taking ownership of an asset with a lower value in the future; RESPONSE: The council will receive a receipt of £677k leasehold receipt (please see valuation included in appendix 8. The value of the asset when it is returned to the council at the end of the lease has not been included in the evaluation.

RISK: **Accounting** – the Council may have to account for this as a financial guarantee contract which may have a material impact on the Councils accounts; RESPONSE: The financial guarantee will be accounted for by the council in line with advice received from its specialist accounting advisors.

## 14. Appendices

### Appendix 1 – Assessment of effects of closure of current temporary car park

**Appendix 1 Assessment of effects of closure of current temporary car park**

The station approach site was purchased in order to support the construction of the new city link road, which included the displacement cost of a business which occupied the whole of the site. Part of the site was required for the link road. The balance of the site has been used as a temporary car park since 2013. The car park was always intended to be temporary as the intention was to develop the site which was included in a list of sites suitable for inclusion in the One Public Estate programme.

There is currently strong demand for car parking in the vicinity of Hereford Railway Station. This demand is likely to remain strong and potentially increase as development continues along the city link road. The restrictions in place for the management of on street parking in the area means that demand for off-street car parking is likely to continue and may increase over time as development takes place in the area.

The council has responded to this issue and assessed that there is currently sufficient car parking capacity within the vicinity. Spare capacity is currently available in a number of existing car parks in the area, most of which are council owned. This varies by time, day and season. However, nearby car parks include at the country bus station, Merton Meadow North, Merton Meadow South, and the adjacent Network Rail car park. In response to the closure of the temporary car park on Station Approach, the council has improved the signage between the railway station and Merton Meadow North and South where capacity is most likely to exist. This car park is between 5 and 10 minutes' walk from the station and provides an alternative facility for rail commuters and others who currently use the temporary car park at the site.

The improvements to signage around the station is part of a wider capital improvement programme which has been carried out on the council car parks. The portfolio of council car parks is managed as an integrated service and the improvements have been designed to provide an improved service to the public while maintaining, or improving revenues for the council.

This integrated approach to managing and developing the car parking service will be maintained. The portfolio of car parks, including capacity and type of facility offered, will be matched to demand as developments take place on the link road and around the city.

While the council currently benefits from car parking revenues of approximately £125k per year from the station approach site. Which is used by an estimated 112 vehicles each weekday. Given the demand for parking, it is likely that users of the current temporary car park at this site will make use of other council controlled car parks in the vicinity. The integrated and coordinated management of car parks means that this service will continue to be provided across the car parks in the vicinity of the link road. The car parking service does not have targets for individual car parks and the overall budget for car parking revenue will continue to be met through the overall management of car park facilities.

In the medium term the council's approach to car parking in the area will address both the convenience provided by car parks to the north of the city and the desire to reduce the number of vehicles entering the city. As surface car parking is identified for potential developments consideration is being given to the provision of high quality multi-storey facilities to accommodate demand in future.