



**Report to: Policy and Resources Committee, 26<sup>th</sup> July 2022**

**Report of: Corporate Director – Finance and Resources**

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**Subject: THE ARCHES – WORCESTER: VARIATION TO LEASE TO 54-56 FOREGATE STREET**

**1. Recommendation**

**That the Committee:**

- 1.1 approves a variation to the lease of 54, 55 and 56 Foregate Street on the terms set out in the private report in support of The Arches – Worcester project; and**
- 1.2 delegates authority to the Corporate Director - Finance and Resources and the Corporate Director – Planning and Governance in consultation with the Chair and Vice Chairs of the Committee to conclude negotiations and enter into all necessary legal agreements to complete the proposed variations and related works.**

**2. Background**

2.1 In February 2019 the Department of Culture Media and Sport awarded a grant of £3m from the Cultural Development Fund (CDF), administered through the Arts Council, towards the Arches project with a further £1.6m to be secured through local contributions. The Arches project aims to regenerate the railway arches from Foregate Street down to the river and create a cultural destination, enhancing the existing creative offer of the city and delivering new festivals and creative industries into the city. The physical regeneration aspects of the project, managed through the project's infrastructure workstream, have been divided into 3 phases:

- Phase 1 – Refurbishment of 5 arches which are subject to an existing lease to the University of Worcester at the rear of the Hive, to offer lettings spaces to creative industries and a performance space, together with associated public realm to open up a pedestrian and cycle route.
- Phase 2 – Refurbishment of 2 arches along Netherton Court to provide further accommodation with associated public realm to open up a pedestrian and cycle route.
- Phase 3 - Demolition of 56 Foregate Street and public realm improvements to open up the proposed pedestrian and cycle route from the City Centre to the River Severn.

- 2.2 The implementation of Phase 3 of the infrastructure works required the acquisition of the leasehold interests in 56 Foregate Street (shown edged in red on the attached plan) in order to demolish the building on the site and achieve the project objective of creating a pedestrian and cycle route into Foregate Street.
- 2.3 To facilitate this, at its meeting of 9 February 2021 the Committee approved the acquisition of the long leasehold interest in 54, 55 and 56 Foregate Street from Darvist Ltd. The acquisition of the lease with over 40 years to run was undertaken by the Council acting in its own capacity, not the Arches - Worcester partnership board, and was funded solely by Council resources. The income generated from letting of 54 and 55 Foregate street is forecast to be sufficient to cover the ongoing revenue costs of the acquisition, including the borrowing costs, based on current available information
- 2.4 The freehold interest of all three sites remains with Network Rail but these properties are part of the national portfolio of railway arches which are leased to The Arch Co. The Council consequently needs to obtain the consent of Network Rail and the Council's landlord The Arch Co. to any subsequent works including the proposed demolition of 56 Foregate Street.
- 2.5 Within the demise of the properties acquired by the Council are two arches which are currently obscured by 56 Foregate Street and are not usable because of the limited access (shown edged in black in the attached plan, covering Nos. 54 and 56 foregate street and the area to the rear of No. 56). The demolition works will uncover these two arches and enable them to be brought into use as potentially income-generating assets. It has therefore been proposed that these two arches will form phase 2 of the project, thus obviating the need to acquire and convert two further arches.

### **3. Cultural Development Fund considerations**

- 3.1 The City Council is the accountable body for the CDF grant and has entered into a legally binding funding agreement with the Arts Council which administers the funding on behalf of the Government Department. Under the terms of the CDF, all capital and revenue cost of the project must be incurred by 31 March 2023. The original funding agreement stipulated 31 March 2022 but this was extended by one year due to the disruption caused by the Covid-19 pandemic. The funding agreement gives the Arts Council a discretion (which they may or may not exercise) to withhold from the City Council scheduled payments, or clawback payments made, if outputs are not delivered against specified milestones.
- 3.2 To mitigate the funding risks to the City Council, the project has been structured in phases so that each element of the funding agreement is treated separately. Therefore, in the event that all funding is not defrayed by the end date, the funder's rights of clawback of any underspend can only apply to incomplete phases. Within the project budget, there is proposed capital spending of £623,570 for phases 2 and 3 and £350,000 revenue spending for the demolition works. The latter is treated as revenue because it does not give rise to an asset.
- 3.3 The match funding element represent 36% of the total costs of the project. Therefore, a total of £623,085 is subject to a risk of clawback by the Arts Council in the event that the work is not completed by the end of the funding period, 31 March 2023. It is estimated that the work will take 14 months from the date of agreement

to proceed, allowing for negotiation and completion of all legal documents, the development of plans for demolition and public realm works, agreements over party walls, procurement of a demolition contractor and completion of all works.

- 3.4 An options paper has been presented to the Arts Council on request setting out the proposal outlined above and requesting an extension of the deadline to April 2024 to allow for the works to be complete. Should this not be approved, there is a risk that project funding may be lost if the works cannot be completed in time.
- 3.5 The proposal to replace phase 2 of the project with the two 'revealed' arches was discussed with the Arts Council at a meeting of 9 June 2022. It was considered acceptable under the terms of the funding agreement but is subject to formal approval. In the event that it is not formally approved, the Project Board will still need to acquire two further arches from ArchCo. There is funding within the project of £180,000 for the acquisition and conversion of these additional two arches. This must, under existing terms, along with all other CDF funding be defrayed by 31 March 2023.

#### **4. Arch Co. Proposals**

- 4.1 Since acquiring the leasehold interest the Council has been in negotiations with The Arch Co. to agree the terms for demolition of 56 Foregate Street. The Arch Co. currently receives 50% of the rental income from the properties and is, therefore, entitled to receive compensation for the loss of income from 56 Foregate Street.
- 4.2 On 12 July a proposal was received which is provided in confidential **Appendix A**. The appendix is confidential as it contains business information relating to a third party. The proposal is subject to approval by The Arch Co.'s Board.
- 4.3 Accepting the terms of the proposal would require a variation of the lease such that the two 'uncovered' arches would, in effect, transfer from the Council's ownership to The Arch Co.'s, after five years. The Council would not be able to derive any ongoing income from the arches after this time but would continue to retain 54 and 55 Foregate Street as under existing arrangements. If the demolition works do not take place the Council would not be able to derive income from the arches in any event.
- 4.4 All other arches in the project are subject to this same condition that they are retained for the use of the project for five years after the end of the funding period. At that point they will transfer back to the ownership of the leaseholder who will be free to set terms and conditions of the lets in accordance with the headlease for each property.
- 4.5 The capital sum proposed in the Appendix could be met from the Arches – Worcester budget, which includes funding for demolition works of £350,000. However, this would reduce the funding available to meet the actual costs of the demolition. There will, therefore, potentially be an additional requirement for funding but estimated demolition costs have yet to be established.

## **5. Preferred Option**

- 5.1 The preferred option is for the Council to agree to the draft Heads of Terms and changes to the lease as set out in the appendix.

## **6. Alternative Options Considered**

- 6.1 Complete the public realm works only. The Public Realm for Phases 1 and 2 can be completed without the need to convert arches 6 & 7 or the demolition works. The budgeted costs for Phase 1 and 2 are £181,300. Removal of these budgets from unspent costs would reduce the potential risk of clawback to £459,500. However, the objective of creating a pathway from Foregate Street Station to the Riverside via the arches would not be achieved. The lease for 54-56 Foregate Street would be unchanged but there would be opportunity to generate income from No. 56. Substantial costs would be incurred, however, to bring this property back up to standard for retail use.
- 6.2 Continue with the original programme. The agreed capital programme requires the conversion of two arches (arches 6 & 7). No agreement has been reached with The Arch Co. regarding the availability or suitability of two other arches. There are four neighbouring arches, only one of which has utilities (water only). All four would require security to be obtained and detailed programmes of work to complete. Given the length of time taken to progress arches 1-5, it is not anticipated that the security can be obtained and the works designed, procured and completed within the project funding period. The substantive work on Arches 1-5 took 9 months to complete. If four months is allowed for preliminaries, an anticipated end date would therefore be 31 August 2023 as a minimum. Work on the demolition of 56 Foregate Street could be undertaken in parallel. This is estimated to take 14 months. The current estimated earliest completion date for all work would therefore be end September 2024.
- 6.3 Undertake a partial demolition of 56 Foregate Street. This option might de-risk aspects of the demolition works. One of the potential delay factors in the programme is securing agreement from Network Rail to close the railway line to Foregate Street Station for a weekend while demolition works are undertaken to reduce the height of the building below the viaduct parapet level. Rather than demolishing the whole building, it may be possible to create an archway through 56 Foregate street, leaving the upper floor intact. The costs of undertaking this option have yet to be established. However, it is anticipated that, due to the structural and underpinning works that will be needed, they are unlikely to be materially different to the costs of whole demolition and will not significantly reduce the estimated timeline for the demolition itself. Also, while the two additional arches may be uncovered by partial demolition, access would remain severely restricted and it is unclear whether they could be brought into effective use. The main value of this option is to reduce the need for agreement to close the railway which is an unknown factor in terms of time delay.

## **7. Implications**

- 7.1 Financial and Budgetary Implications

The compensation payment requested by The Arch CO. will be funded by Future High Streets Fund grant. However, as this cost is not separately funded, there will be a knock on impact on the demolition budgets. Altogether there is approximately £970,000 available within the project budgets for completion of phases 2 and 3. The actual demolition costs are yet to be estimated. However, there should be a reduction in the costs of conversion of the two arches as these would not need to be to the same standard as arches 1 to 5. The average costs of conversion work to date, including connections for utilities, has been approximately £230,000 per arch.

## 7.2 Legal and Governance Implications

The Council has powers under s120 Local Government Act 1972 to acquire land for the purpose of any of its functions or for the benefit, improvement or development of its area. In addition, the Council has a power of general competence under s1-4 Localism Act 2011 to do anything an individual can do, subject to any statutory prohibitions which may be in place. The Council must nevertheless act reasonably in the exercise of these powers, having regard to its overall fiduciary duty.

The Council intends to fund these proposals from the Cultural Development Fund. The Council must ensure that the terms of these funding agreements are complied with, including that grant outputs are delivered, or else there is a risk that grant funding could be clawed back.

HM Treasury has recently updated its rules on the use of Public Works Loan Board funding for the purpose of income generation, property investment and potential development. If PWLB funding is required to support the completion of the project, then the Council must have regard to the Treasury rules. Any decisions to increase borrowing and make investments must be compatible with the Council's general fiduciary duties in respect of the stewardship of public funds, and specifically the Council must have regard to the Prudential Code and Treasury Management Limits, issued periodically by CIPFA.

In respect of the proposed changes in lease terms, full legal due diligence will be undertaken prior to the completion so that the rights and liabilities relating to each property are understood.

## 7.3 Risk Implications

There are a number of risks inherent in all property redevelopment. Until detailed survey information is available and end uses identified, potential costs of redevelopment cannot be relied on. The Council would seek to mitigate these risks by working with experienced developer partners.

Detailed proposals for the demolition and public realms works will be subject to further approval by Members through the Council's governance processes.

There is a risk that the project costs will fall to the Council in the event that the works are not completed on time in accordance with the terms of the CDF. Agreement is being sought with the Arts Council to extend the project funding period.

The clawback risks are explained in the main part of the report. The City Council cannot predict whether the Arts Council will or will not exercise its legal rights in this

regard; hence the ongoing dialogue with the Arts Council to try to secure an agreed variation position which the City Council can rely on, before it commits significant expenditure on this phase of the project.

#### 7.4 Corporate/Policy Implications

The Arches – Worcester project supports key regeneration priorities for the Council as outlined in the City Plan, City Centre Masterplan and the draft Arts and Culture Strategy which is currently in consultation.

#### 7.5 Equality Implications

No significant implications have been identified in this report

#### 7.6 Human Resources Implications

No significant implications have been identified in this report

#### 7.7 Health and Safety Implications

No significant implications have been identified in this report. Any capital works undertaken as a result of this proposal will be subject to detailed health and safety assessment.

#### 7.8 Social, Environmental and Economic Implications

The recommendations in this report will support the Council's regeneration aims for this part of the city centre.

**Ward(s): Cathedral**

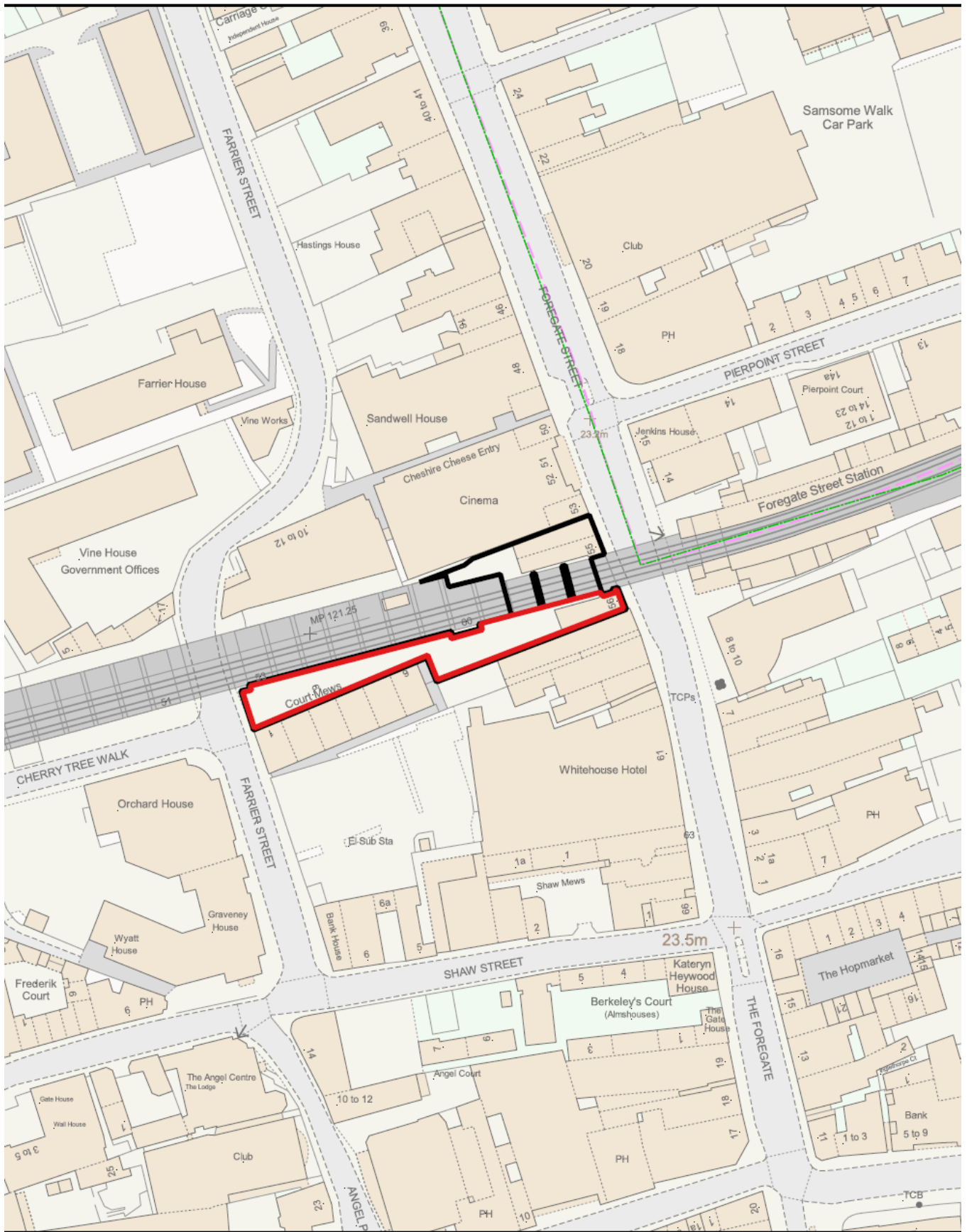
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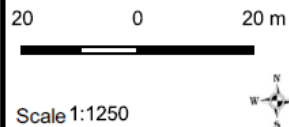
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**Background Papers: None**

Nos 54,55 and 56 Foregate Street Worcester Shown for identification purposes only



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