
Project:	Hastings Towns Fund Business Case Support		
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Subject:	Churchfield Business Centre - Economic Case Technical Note		

Mott MacDonald is supporting Hastings Borough Council (HBC) to develop the business cases for the projects identified in Hastings' Town Investment Plan (TIP). The TIP formed the basis for the offer from government in June 2021 of £24.3m. The grant funding support is subject to completion of a Full Business Case for each project/programme. For the Churchfield Business Centre project, Mott MacDonald has been commissioned to provide advisory support to Council officers. A small extension to the commission was made for Mott MacDonald to undertake the value for money economic appraisal of the business centre. This short Technical Note presents the results of the appraisal for HBC officers to integrate into the final business case draft.

This appraisal is based upon the proposed Churchfield Business Centre providing the following outputs presented in the business case:

- Total 9,558 sqft (887m²) comprising:
 - x5 322 sqft (30m² units).
 - x24 344 sqft (32m² units).
- General B Class use (offices, small industrial use and research).
- Likely 0 – 5 employees per unit (dependent on the nature of the business).
- Business units let on an 'easy in easy out' lease basis with one month's notice.

1 Economic Benefits

The quantitative Value for Money (VfM) assessment focuses on capturing several core benefits, linked directly to the project's Theory of Change. A proportionate approach to appraisal has been undertaken, relying on a benefits transfer approach and best practice government guidance including the HM Treasury Green Book and Ministry for Housing, Communities and Local Government (MHCLG) Appraisal Guide to assess the Benefit Cost Ratio (BCR) created by the scheme.

For the purposes of this appraisal, the Preferred Option is compared against a counter-factual Do Nothing scenario where the site is assumed to remain undeveloped as the Council has no statutory obligation to develop the site which has remained vacant since the 1990s.

The quantitative analysis covers three key metrics:

- Land value uplift (LVU) at the intervention site.
- The labour supply benefits from safeguarded and created employment.
- Amenity disbenefits resulting from lost greenspace.

These benefits have been selected for the quantitative VfM assessment as they capture the core impacts of the scheme and can be quantified at this stage.

The quantitative assessment has an appraisal period of 40-years and is presented in 2021 values for simplicity. For all benefits and costs, the standard HM Treasury Green Book social time preference discount rate of 3.5% is applied.

1.1 LVU

Guidance from MHCLG¹ sets out a detailed method for appraising the benefits of new development. LVU analysis quantifies the change in the value of the land from its current use to its future use as a result of an intervention. LVU is appraised by comparing the land value between the current use (greenfield) and the future use (office space) in the Preferred Option. The land value is calculated using the following equation:

$$\text{Land Value} = \text{Gross Development Value (GDV)} - (\text{Development costs} + \text{Fees} + \text{Profit})$$

The difference between the calculated current and future land value represents the uplift attributable to the scheme and is calculated by the following equation:

$$\text{Land Value Uplift (LVU)} = \text{Land Value (future)} - \text{Land Value (Current)}$$

In accordance with appraisal guidance, as a development appraisal has not been developed, Mott MacDonald has used Valuation Office Agency (VOA) benchmark data to provide indicative values of current and future land uses for all options. While benchmarking is the second best alternative, it is a common method where a development appraisal has not been produced as it is determined not to be required for the financial analysis.

The key inputs/assumptions for calculating LVU impacts and additional identified impacts are:

- 1.61 hectares of land to be developed.
- Current land use of greenfield. The South East England value of £25,000 (2019 values) is applied from VOA benchmark data.
- Future land use of office for the edge of the Central Business District. The South East England value of £2,470,000 (2019 values) is applied as the closest proxy within the VOA benchmark dataset.
- Assumed LVU realised in 2022/23 when the centre opens.

In calculating LVU, a 5% per annum real terms increase in land values has been assumed. This is in line with the MHCLG Appraisal Guide.

The present value benefit associated with LVU is £3.3m from the change to a more productive use.

1.2 Labour supply benefits

MHCLG guidance gives an approach for quantifying the fiscal benefits of moving locally unemployed workers into employment. The guidance utilises TAG A2.3 (Appraisal of Employment Affects) to calculate welfare impacts over and above user benefits to the Exchequer. These are the tax revenues resulting from labour supply impacts and can be estimated as 40% of the resultant change in GDP. This tax revenue impact reflects both the increase in tax revenue (income tax, national insurance contributions and corporation tax) and the reduction in out-of-work subsidies. The method is outlined below.

The Churchfield Business Centre is anticipated to support c.52 Full-Time Equivalent (FTE) jobs at the site. This is based on an estimated capacity by the HBC delivery team of 0-5 jobs per unit, 29 units at the business centre and an assumed occupancy of 90% (a cautious assumption based on the achieved occupancies of c.95% for similar units in the area).

¹ MHCLG (2016) Appraisal Guide - https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/576427/161129_Appraisal_Guidance.pdf

The Institute for Public Policy Research (IPPR) undertook a review of the value of open workspaces for small businesses and entrepreneurs². The review found that open workspaces support their tenants in a number of ways including by offering a space that suits the needs of small and growing organisations through flexible terms that reduce risk and lower costs due to space efficiencies. Open workspaces further benefit start-ups by offering business support services like training opportunities, mentoring, events and linking users with funders and by facilitating peer-to-peer interactions. The IPPR review found that open shared workspaces support economic growth by:

- Supporting increased revenue turnover from business cohorts.
- Creating jobs as businesses using them expand.
- Helping young businesses to start operating and survive the early years.
- Facilitating greater collaboration on projects, ideas and knowledge exchange due to facilitation of peer-to-peer interaction.
- Allowing co-location with their peers for wellbeing and productivity.
- Helping attract funding and clients by facilitating meetings with investors, providing crucial networks that many start-ups would not have.

While the IPPR found significant evidence of open and shared workspaces supporting economic growth in the above ways, the authors note that measuring the exact size of the net additional impact is challenging.

A rapid review of the literature has identified a large number of other studies suggesting that coworking space can support businesses to grow faster and have improved survival rates compared to businesses not working within a facilitative environment³. Further benefits identified include keeping innovative, entrepreneurial talent in the local community and placemaking benefits from bringing entrepreneurs into previously under-utilised space. Coworking spaces can develop a population that is invested in the surrounding neighbourhood and, in turn, more likely to remain in the area and continue stimulating economic development locally, helping to level-up previously left behind communities.

Two types of labour supply benefit have been appraised:

1. **Business growth supported by the facilities** (physical and wrap-around services) meaning that businesses are able to grow their workforce faster.
2. **Employment safeguarded** due to an improved survival rate of businesses at the site compared to businesses elsewhere in Hastings.

This welfare gain is estimated through the following steps.

Table 1.1: Method steps for quantifying labour supply benefits

Stage	Business growth	Jobs safeguarded
1.	<p>a) Business growth - Business units have capacity to support between 0-5 FTE jobs, and so it is assumed that upon entering, businesses have 2 FTEs per unit taken up. It has been assumed that employment will increase at the site at a rate of 0.5 FTE jobs per business unit every five years above the Do Nothing. Over 5 years, this will lead to a total of 14.5 new FTE jobs. After 5 years, it is assumed that another business cohort will fill the space, allowing the process to repeat itself. After 10 years have passed, the total new jobs would have reached 29 new FTE jobs created by businesses in the space that would not have happened without the site.</p> <p>b) Jobs safeguarded - It is assumed that on the site, businesses will be better supported, and so deliver higher survival rates than in Hastings at large. Assuming each business unit supports 2 FTE jobs in businesses entering the space, gives an initial capacity of 58 FTE jobs supported. Without the intervention, it is assumed business deaths are at the ONS latest 2014-2018 survival of newly born enterprises rate for Hastings. For simplicity, a survival rate of 5 percentage points per year above the current Hastings survival rate has been applied.</p>	

² Start Me Up: The Value of Workspaces For Small Businesses, Entrepreneurs and Artists in London <https://www.london.gov.uk/sites/default/files/valueofworkspace-ippr2016.pdf>

³ See for example Fuzi (2015) Co-working spaces for promoting entrepreneurship in sparse regions: the case of South Wales <https://www.tandfonline.com/doi/pdf/10.1080/21681376.2015.1072053>; Chuah (2016) Beyond the Core: The Role of Co-working Spaces in Local Economic Development <https://academiccommons.columbia.edu/doi/10.7916/D8JQ114T>; and Davis (2019) The economic benefits of co-working <https://www.coworkingresources.org/blog/the-economic-benefits-of-coworking>

Stage	Business growth	Jobs safeguarded
	<p>The difference in FTE jobs between these two survival rates is used in this analysis as the jobs "safeguarded". This results in c.2.5 jobs safeguarded per annum by year 5. After the first 5 years, it is assumed that the second cohort to fill the space in Churchfield will experience a similar impact of jobs safeguarded. Therefore, by year 10, the number of jobs safeguarded is expected to double to c.5 FTE jobs.</p>	
	<p>Employment is only claimed as a benefit for the Churchfield Business Centre for 10 years after each job is created/safeguarded.</p>	
2.	<p>A composite multiplier of 1.29 has been applied, in accordance with Homes and Communities Agency's Additionality Guide, 2014⁴. This incorporates the likely multiplier effects within the economy from:</p> <ul style="list-style-type: none"> • Supply linkages due to purchases made because of the intervention and further purchases associated with linked firms along the supply chain (indirect effects). • Income or induced effects associated with local expenditure from those who derive incomes from the direct and supply linkage impacts of the intervention. <p>The multiplier models the indirect and induced economic impacts.</p>	
3.	<p>Additionality is calculated based on:</p> <p>a. A leakage factor of 28% - Leakage is the proportion of the project outputs that benefit those outside of the intervention's target area/population i.e., the residents of Hastings. It is appropriate to apply a leakage factor as the labour supply benefit is a local, place-based benefit. Based on travel to work flows in the Hastings area (Census 2011), approximately 28% of Hastings jobs are filled by non-Hastings residents.</p> <p>b. A displacement factor of 10% - Displacement is the proportion of intervention outputs accounted for by reduced outputs elsewhere in the target area. Displacement is anticipated to be low for this intervention as demand for coworking space is high as demonstrated by the c.95% occupancy rates achieved elsewhere in Hastings (see Strategic Case). As such, a very low displacement rate is applied as per Table 4.8 in the HCA Additionality Guide.</p> <p>c. A deadweight factor of 0% - There is no deadweight due to the use of a Do Nothing scenario in this appraisal. For jobs growth, the 0.5 FTE growth per business unit over 5 years is assumed to be over and above the growth rate achieved without access to the business centre. For safeguarded jobs, deadweight is captured by comparing against the current Hastings business survival rate.</p> <p>d. Substitution factor of 0% - Substitution arises when a firm substitutes one activity for a similar one as a result of the intervention. This is not identified as an issue for this scheme.</p> <p>Additionality is calculated as follows: $\text{Additionality} = (1 - \text{Displacement}) \times (1 - \text{Deadweight}) \times (1 - \text{Leakage}) \times (1 - \text{Substitution})$. The additionality estimate is 65%, which is then applied to gross FTE jobs safeguarded/created.</p>	
4.	<p>Estimate GVA per worker for businesses in the business centre using ONS estimates for GVA per filled job for the Hastings in the year 2019 £41,438. Applying the Spring 2021 Office for Budget Responsibility (OBR) GDP deflator of 1.05 to convert this in 2021 prices gives a 2021 GVA per worker estimate of £43,340. This is a cautious estimate as manufacturing sector GVA per worker in the manufacturing sector is typically higher than the economy average, yet sectoral GVA per worker figures are not available at the district level.</p>	
5.	<p>This GVA per worker estimate is applied to the figure for FTEs across the appraisal period of 40 years to give a net additional GVA figure of £37.2m for employment created and £7.01m for safeguarded employment.</p>	
6.	<p>Apply a 25% long term unemployment factor to net additional GVA. The fiscal welfare impacts of this intervention can only be considered for individuals moving from unemployment to employment, as no welfare benefit is registered from individuals moving between jobs. This long term unemployment factor is a high level estimate, based on high levels of unemployment in Hastings, which reached 7.6% among the working age population in 2020, higher than for East Sussex (6.2%) and England (4.8%) in the same period⁵. The extent to which long term unemployed could take up the employment opportunities is however capped as many of the jobs supported at the business centre would likely have a medium/high skill requirement.</p>	
7.	<p>Apply the DfT's TAG welfare impact factor of labour market entrants/re-entrants of 40% of the change in economic output to account for the fiscal welfare saving⁶ (as explained above).</p>	
8.	<p>This leads to a total fiscal welfare benefit (tax gain/welfare cost) of £3.7m over 40 years for jobs created and £0.7m for jobs safeguarded.</p>	
9.	<p>Discount the benefits to present values in 2021/22 prices using the HM Treasury Green Book social discount rate of 3.5%.</p>	

Source: Mott MacDonald and various listed in table

⁴ HCA (2014) Additionality Guide Fourth Edition https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/378177/additionality_guide_2014_full.pdf

⁵ ONS (2020) Annual Population Survey

⁶ DfT (2018) TAG UNIT A2.3, Appraisal of Employment Effects

The present value of labour supply benefits is £2.2m in 2021 values.

1.3 Amenity disbenefits

The conversion of the greenfield site to the business centre results in a net loss of greenspace. The disbenefit of this loss to the local community has been monetised through the use of amenity values identified within the MHCLG Appraisal Guide. The amenity value of urban fringe (greenbelt) is applied of £1,797 per hectare per year (2016 values). On this basis, it is estimated that the development of Churchfield would result in an amenity loss of approximately £72,000 over a 40-year appraisal period (in Present Value terms). This estimate is cautious as it does not account for works at the site that are planned, such as the installation of trees and a pond at the site, which will offset the amenity disbenefit of the changing land use.

1.4 Present value costs

Costs for Churchfield were developed by the HBC project development team. See the Financial Case for a more detailed breakdown of the cost estimation.

There are multiple sources of public sector grant funding the project – LGF, CHART (ERDF), and Towns Fund which combined sum to £1,553,000 in nominal prices. The project also relies upon a Public Works Loan Board (PWLB) loan of £2,950,000. As the loan is repaid after 40 years from the revenue gain to the Council, and as the loan represents a capital charge, it is excluded from the calculation of net economic cost. For simplicity, it is also assumed that 100% of future net revenue surpluses (revenue minus operating and renewal costs) is used to repay the loans, though this may be a cautious assumption. There are no private sector funding/financing sources for this project.

The financial case assumes inflation of 2% per annum. Cost estimates are adjusted for real price growth by adjusting the inflation rate for underlying GDP growth using the latest OBR GDP Deflator.

An allowance for contingency of c.20% was included on the cost estimates based on the HBC cost estimation team's appraisal of appropriate risk allocations. This is removed and replaced by a higher optimism bias figure of 24%. This represents the upper bound optimism bias for standard building projects within the HMT Green Book supplementary guidance on optimism bias⁷. Optimism bias is a value applied only to the costs in the economic case to allow for the consistent and observed phenomena of over-optimistic cost estimation.

After optimism bias has been applied, the costs have been discounted to estimate the net economic costs. The table below details the net economic costs of the project.

Table 1.2: Net economic costs, discounted 2021/22 values, including Optimism Bias

Funding profile	2021/22	2022/23	2023/24	Total
Towns Fund grant funding	£461,280	£357,393	£0	£818,673
Public sector co-funding	£620,000	£286,482	£0	£906,482
Private sector contribution	£0	£0	£0	£0
Total cost	£1,081,280	£643,874	£0	£1,725,154

Source: Mott MacDonald

1.5 Value for money

There are two key metrics set out in the MHCLG appraisal guidance that can be used to assess VfM: the calculation of BCRs, which simply show the ratio of benefits to costs; and the Net Present Social Value (NPSV), which represents the present value of benefits less the present value of costs. Both metrics have been used to assess the VfM of the Preferred Option in comparison to the Do Nothing option.

⁷ HM Treasury (2002) Supplementary Green Book Guidance, Optimism Bias, Table 1.

The BCR of each intervention option is calculated on the following basis:

$$BCR(\text{intervention option}) = \frac{\text{Benefit}(\text{intervention option}) - \text{Benefit}(\text{do nothing})}{\text{Cost}(\text{intervention option}) - \text{Cost}(\text{do nothing})}$$

The NPSV involves determining the difference between the net marginal benefit and net marginal cost of each intervention option:

$$NPSV(\text{intervention option}) = \text{Net Benefit}(\text{intervention option}) - \text{Net Cost}(\text{intervention option})$$

Where:

$$\begin{aligned} \text{Net Benefit}(\text{intervention option}) &= \text{Benefit}(\text{intervention option}) - \text{Benefit}(\text{do nothing}) \\ \text{Net Cost}(\text{intervention option}) &= \text{Cost}(\text{intervention option}) - \text{Cost}(\text{do nothing}) \end{aligned}$$

The VfM assessment for this project is based on a 40-year appraisal period, in line with the payback period for the PWLB loan, therefore the minimum period the asset must be kept operational. In line with HM Treasury Green Book 2020 guidance, the benefits have been discounted at a rate of 3.5% per annum. The price base year is 2021. The results of appraisal are presented in the table below.

Table 1.3: VfM summary

Economic Case - VfM analysis	Project BCR
Total net additional benefits (£)	Preferred Option (NPV, 2021-22 prices)
Benefits for the BCR	
Welfare impact (fiscal - tax loss/welfare cost)	£2,188,714
LVU	£3,315,584
Amenity disbenefit	-£72,270
Total benefits for the BCR (A)	£5,432,028
Costs	
Towns Fund (B)	£906,482
Co-funding local authority cost (including borrowing) (C)	£818,673
Total cost (LUF + Co-funding) (D)	£1,725,154
Private sector cost (E)	£0
BCR calculation formula (A - E) / D	3.1
NPSV	£3,706,874

Source: Mott MacDonald

HM Treasury considers a BCR of >2.0 to be high VfM meaning this scheme can be considered very high VfM.

1.6 Summary

The economic appraisal of the Preferred Option has been carried out in line with the HM Treasury Green Book (2020) and the MHCLG Appraisal Guide (2016). In accordance with this guidance, the Economic Case focuses on public value from the perspective of society and appraises, in a proportionate manner, social, economic and environmental costs and benefits.

The appraisal has considered the costs and income of the project to estimate the net economic cost of the scheme. The VfM assessment estimates that the Preferred Option demonstrates very high VfM, with a BCR of 3.1 and NPSV of more than £3.7m.