

SLOUGH BOROUGH COUNCIL

REPORT TO: Cabinet **DATE:** 20th March 2017

CONTACT OFFICER: Joe Carter, Assistant Director Assets, Infrastructure & Regeneration
Neil Wilcox, Assistant Director Finance & Audit (s151 Officer)
Stephen Gibson; Head of Asset Management

01753 - 875653
01753 - 875385
01753 - 875852

WARD(S): Central Ward

PORTFOLIO: Housing & Urban Renewal - Cllr Ajaib
Leader of Council - Cllr Munawar

PART I **KEY DECISION**

REDEVELOPMENT OF OLD LIBRARY SITE

1 Purpose of Report

- 1.1 In June 2016 Cabinet approved recommendations for the Council to develop two hotels and a restaurant on the Old Library Site (“OLS”) and agreed that Slough Borough Council (“SBC” or “the Council”) should enter into an Agreement to Lease with a hotel operator. In September 2016 it was subsequently agreed that the mixed-use scheme should include 60 residential apartments. It was resolved that the entire development will be undertaken by Slough Urban Renewal (“SUR”), which has an option on the site and noted that both elements of the project (hotels and residential/restaurants), albeit separate, require to be built concurrently.
- 1.2 The purpose of this report is to update Cabinet on progress made since September 2016, reaffirm the financial business case and seek delegated authority to enter into contract with SUR and the hotel operator. At the same time, this report recommends the disposal of the residential/ restaurant site in accordance with the existing Option Agreement and Partnership Agreement arrangements with SUR.

2 Recommendation(s)/Proposed Action

The Cabinet is requested to resolve:

Hotel Element

- (a) That the updated financial report contained in Appendix One, which updates Cabinet members on costs, income and payback be approved.
- (b) That delegated authority be given to the Interim Chief Executive or nominated deputy, acting following consultation with the s151 Officer and the Leader and Commissioner for Housing and Urban Renewal, to:

- i. Agree and enter into an Agreement for Lease with landlord's works obligations and subsequent Lease of part of the Old Library Site for a 25-year lease term with a hotel operator for the two hotels, noting that this term could be extended to 40 years to match the offer from the hotel operator;
- ii. Agree and, where the Council is a party, enter into the additional legal agreements set out in sections 5.15 and 5.16 of this report and any other ancillary agreements required to give effect to the redevelopment proposals for the site;
- iii. Consider whether to appropriate to planning purposes the Council-owned land required for the development which is currently held by the Council for other purposes and, if he considers it appropriate to do so, to effect the appropriation of such land to planning purposes subject to complying with the statutory procedures for such appropriation;
- iv. Take any other necessary actions, acting in the best interests of the Council, in order to enable the redevelopment of this element of the site for hotel use as set out in this report.

Residential Element

- (c) That the disposal of part of the OLS to SUR to develop the residential/ restaurant element of the overall project be authorised for a valuation sum that represents no less than the best consideration reasonably obtainable.
- (d) That delegated authority be given to the Assistant Director, Assets Infrastructure & Regeneration or nominated deputy following consultation with the Leader and the Council's section 151 officer to:
 - i. Agree the final valuation sum.
 - ii. Consider whether to appropriate to planning purposes the Council-owned land required for the development which is currently held by the Council for other purposes and, if he considers it appropriate to do so, to effect the appropriation of such land to planning purposes subject to complying with the statutory procedures for such appropriation;
- (e) That delegated authority be given to the Assistant Director Assets, Infrastructure and Regeneration following consultation with the Cabinet Member for Housing & Urban Renewal to:
 - i. Approve all non-financial terms for disposal.
 - ii. Agree and, where the Council is a party, enter into the additional legal agreements referred to in sections 5.15 and 5.16 of this report and any other ancillary agreements, required to give effect to the redevelopment proposals for this element of the site and take all necessary any other necessary actions, acting in the best interests of the council, to give effect to the proposals.

Partnership Business Plan

- (f) That the Site Development Plan for the redevelopment of the Old Library Site prepared by SUR and contained in Appendix Three (to follow) be approved.

3. The Slough Joint Wellbeing Strategy, the JSNA and the Five Year Plan

The development of the site will make a significant contribution to the Regeneration and Environment element of Slough's Joint Wellbeing Strategy:

- A hotel development in the town centre will improve the image of the town, providing good quality hotel accommodation, which is currently in short supply.
- Constructing the new developments will improve local temporary employment opportunities through SUR's commitment to promoting employment and skills as well as increasing apprenticeship opportunities enabling local people to improve their learning and skill base.
- Operation of the hotel and restaurant will improve permanent local employment opportunities in the hospitality and catering sector.
- The hotels and restaurant will contribute to business rates receipts.

3b Five Year Plan Outcomes

The developments will help deliver the following of the Five Year Plan outcomes:

- **OUTCOME 3:** Introducing a new hotel offering in the town centre will contribute to Slough being the premier location in the south east for businesses of all sizes to locate, start, grow, and stay. The existing period of exclusivity between the operator and the franchisor will soon expire. By committing at this juncture the Council will prevent another operator within the same brand from coming forward with a proposal within the franchisors area of operation, which could be outside Slough.
- **OUTCOME 4:** Incorporating new residential properties will contribute to realising the objective of increasing the supply of good quality housing and compliment the Housing Strategy.
- **OUTCOME 5:** Providing centrally based hotel accommodation and a restaurant will increase demand, footfall and activity in the town centre, thus contributing to the centre of Slough being vibrant, providing business, living, and cultural opportunities.

4 Other Implications

(a) Financial

A detailed financial summary for the hotels is included in Appendix One (which contains exempt information and is included in Part II of the agenda). In summary, the Council will receive a guaranteed base rent and a performance turnover rent (based on an agreed percentage of Total Revenue). The Council would be lending into the scheme at the prevailing Public Works Loan Board ("PWLB") rate of 2.95% and compares favourably to the higher prevailing private sector borrowing rate over 40 years of around 4%. The overall annual income the Council will receive is substantially above the borrowing costs from the PWLB.

Appendix Two (which contains exempt information and is included in Part II of the agenda) makes a comparison between the various elements of the financial business case between June 2016 and March 2017 and provides a snapshot of where costs have varied and why.

It is important to consider the risks identified below and the likelihood of these occurring. The largest area of risk on an ongoing basis is if trading conditions deteriorate. The proposed scheme is backed by one of the largest worldwide hotel brands and in accordance with the agreed heads of terms for the redevelopment of the OLS, they will seamlessly step in to the operation of the hotel if the proposed operator ceases to trade. This provides assurance that there will continue to be a hotel offer on this site. If there was an event which was so catastrophic which resulted in a fundamental and irreparable breach of the lease, the Council, as owner of this building, would then seek to terminate the lease and then convert the site into another housing related use. However, this scenario is deemed highly unlikely.

(b) Risk Management

Risk	Mitigating action	Opportunities
Legal – State Aid	Borrowing costs have been tested against the market rates for 40 year borrowing to ensure that the over income that the Council receives passes the EU State Aid test i.e. that the Council is not receiving an income which is below a market rent on this scheme.	The combination of the base rent and performance rent could greatly increase the overall profitability of the hotels development.
Finance – SBC exposure to a cyclical business sector.	Constant and appropriate asset management and control where occupancy, average room rates and costs are monitored against agreed levels/industry norms. A guarantee is in place to protect the Council’s interest should there be a sustained period of underperformance from the hotel operator. This is backed by the largest worldwide hotel operator with a very strong reputation and covenant.	Increase in business rates. The introduction of Crossrail and proximity to Heathrow will provide protection against economic downturn.
Finance – the hotel operator fails to perform and fails to pay the base/turnover rent.	A rent guarantee is in place from both the proposed hotel operator and an international branded hotel group.	The covenant risk is covered by a guarantee from a worldwide hotel operator with a desire to protect their brand integrity.

<p>Finance – the hotel operator ceases to trade due to adverse trading conditions / administration.</p>	<p>The Franchisor will step into the operation of the hotel and ensure that it continues to operate</p> <p>There is an agreed level of guarantee from the hotel franchisor to protect the Council against any shortfalls in lease contributions. However, this is a one off sum and will not be topped-up.</p>	
<p>Demand risk – there is an oversupply of rooms.</p>	<p>A report from an independent hotel market expert has confirmed that the proposal matches current and future market opportunities within Slough.</p> <p>Anecdotal evidence confirms high occupancy rates in Slough.</p> <p>Existing hotels in Slough are budget level or ageing.</p>	<p>Creates a new supply for Slough with modern, innovative and defined accommodation offering.</p> <p>Development of a landmark site with a highly visible and attractive project.</p>
<p>Property/ Development Control – the construction and design process will need to be precise to avoid over runs, over specification and/or additional costs.</p>	<p>Construction costs will be market tested via SUR and verified through a jointly appointed Quantity Surveyor to ensure costs are appropriate.</p> <p>The Council will seek a fixed-price construction cost as far as possible to avoid unforeseen expenditure and secure protection from build cost inflation.</p>	<p>A faster procurement route and a VfM tested route.</p>
<p>Planning – SUR fails to obtain planning permission and/or risks associated with proposals</p>	<p>Pre-Planning meetings have been undertaken with feedback from SBC Planners and Transport & Highways. Take out any necessary insurances.</p>	
<p>Timescales - failure of SBC to operate within commercial timescales</p>	<p>Cabinet approves delegated authority to approve suite of legal agreements. External legal support.</p>	
<p>Human Rights</p>	<p>No risks identified</p>	
<p>Health and Safety</p>	<p>No risks identified</p>	
<p>Employment Issues</p>	<p>No risks identified</p>	<p>The introduction of the hotel and restaurant will create new short and long term employment opportunities for local people.</p>

Equalities Issues	No risks identified	
Community Support	No risks identified	
Communications	No risks identified	
Community Safety	No risks identified	
Timetable for delivery	No risks identified	
Project Capacity	Whilst project managed on behalf of the Council by SUR, this and other key strategic projects will place increased pressure on business as usual for Asset Management, Legal Services and Planning. Resources will be made available.	The developer will be sympathetic to the use of a Planning Performance Agreement whereby an additional Planning Officer post is funded directly.
Other	No risks identified	

(c) Human Rights Act and Other Legal Implications

It is not considered that there are any Human Rights Act implications arising from the proposals.

The Council has a range of powers to enter the agreements envisaged by this report, including the general power of competence under Section 1 of the Localism Act 2011 to do anything that individuals can do subject to any specific restrictions contained in legislation. The Council also has the power to acquire, appropriate and dispose of land in accordance with Sections 120-123 of the Local Government Act 1972 subject to obtaining all appropriate consents and approvals and ensuring that any disposals are for a consideration that is the best that can reasonably be obtained.

Where land has been appropriated for planning purposes, section 203 of the Housing and Planning Act 2016 will operate to override any private rights or covenants that might otherwise impede the implementation of a development for which planning permission has been obtained. Compensation may become payable to those whose rights are so overridden. In order to appropriate the land to planning purposes and to enable s 203 to take effect the Council will need to be satisfied that the Council could have compulsorily acquired the land under section 226 of the Town and Country Planning Act 1990 and therefore that appropriating the land for planning purposes will contribute to the achievement of the environmental, social and economic well-being of its area. Any disposal of land appropriated for such purposes is effected in reliance on Section 233 Town and Country Planning Act 1990, which is also subject to a duty to obtain best consideration.

(d) Equalities Impact Assessment

There are no identified needs for an EIA at this juncture.

(e) Property

See Section 5 below.

5 **Supporting Information**

Background

- 5.1 The OLS is owned by SBC and is subject to an option in favour of SUR. The site was identified for hotel use within the Heart of Slough Strategy and was granted outline consent for a 120 bed hotel along with 91 residential units and retail/leisure use in 2009, therefore the proposed mixed-use development reflects the long-term aspirations of the Council.
- 5.2 As reported in June 2016, the site was selected as a preferred location by the proposed hotel operator as a consequence of its proximity to the town centre, major road transport routes, car parking and the railway station.

Demolition & Construction Programme

- 5.3 Whilst later than anticipated, it is expected that the existing building will be demolished by the end of April 2017 (previously expected to be December 2016). Since the demolition timescale is not on the critical path the delay will have no effect on the programme. The original scope of the demolition contract was to demolish down to slab level, however this may be changed by negotiation. An explanation is contained in Appendix Two.
- 5.4 Based on the updated accelerated programme, it is anticipated that SUR will submit a planning application for the entire site by July 2017. Subject to approval, it is anticipated that SUR will achieve Contract Close on 18/12/17 to enable the relevant project documents to become unconditional so that SUR can then commence construction by April 2018, with completion by February 2020.

Hotel Proposal

- 5.5 The hotel proposals remain unchanged. The Council will develop a 144 room short-stay and 92 room long-stay hotel, operated under a single lease arrangement. As previously reported, the proposal is for a single building containing the two hotels with horizontal separation. The ground floor to 5th floor will be the short -stay hotel, with the long-stay hotel on floors 6-10. In both cases there will be fewer facilities than in a full service hotel and sharing of back of house functions will lead to greater economies of scale.
- 5.6 The original proposal assumed that service access to the hotels and restaurants would be via the existing access road between OLS and Cornwall House and would be shared with residential tenants. For practical reasons and having liaised with the operator, the preferred option is to take a new private access road off High Street. This proposal, which is subject to Planning, has no impact on the hotel or the residential units but effectively splits the ground floor restaurant area into two distinct units.

Restaurant & Residential Element - Proposal and land Disposal

- 5.7 The restaurants, which will have a High Street frontage, will be located immediately below the residential apartments, which will create animation on the ground floor of the building in line with planning requirements. This is a prime A3 trading location in the town opposite Pizza Express and Wetherspoons. The centre of Slough currently has a limited supply of quality restaurant facilities; therefore it is reasonable to

anticipate demand rising sharply in the town centre following the substantial residential and office developments contained within the Heart of Slough proposals. The restaurants are likely to be developed speculatively and let following completion of construction although pre-lets may be achievable. As a consequence of the new location of the access road (described above), there will be a loss of circa 950 sq. ft. of restaurant space, however the unit sizes remain commercially viable.

- 5.8 The proposed residential scheme includes 60 apartments, which are a mix of 1 and 2 bedroom properties half of which face south over High Street. The residential development is structurally and legally independent from the hotels, allowing for separate ownership. Since the existing scheme is designed as a commercial project (assuming properties for sale), it could be refined to reflect a PRS scheme should Herschel Homes enter into a pre-purchase agreement with SUR.
- 5.9 The Council established Herschel Homes Limited (a wholly owned housing subsidiary company) in December 2016. In doing so, Cabinet approved a 5 year business plan that included the potential for Herschel Homes to acquire this Private Rented Sector-led development. At the same meeting the Council introduced Slough Asset Management Limited, which will acquire investment assets. The expectation is that both companies will negotiate the acquisition of the completed properties from SUR.
- 5.10 Section 123 (2) of the Local Government Act 1972 prevents the Council from disposing of land for less than the “best that can reasonably be obtained” without the consent of the Secretary of State. In the case of the residential/restaurant element of the OLS, this will be subject to a Red Book Valuation on the special assumption that the site has the benefit of planning permission and the land value has been calculated on what is termed a residual land value basis. In other words the land value is the Gross Development Value of the completed development less the costs required to carry out the development (excluding land but including profit).

The costs of undertaking the residential/restaurant element of the overall development will be subject to both a market testing exercise and also in the case of the construction costs, an open book tender exercise overseen by an independent Quantity Surveyor appointed by SUR. This exercise will arrive at the market value.

Currently SUR is assuming that funding for the residential and restaurant element of the proposal will come from a commercial third party lender. The Council may however wish to offer funding to SUR subject to the Council receiving appropriate professional and legal advice to ensure that any such loan from the Council to SUR for this purpose would be on market terms so that the Council is in compliance with any State Aid requirements.

Car Parking

- 5.11 Car parking for the hotel residents will be provided at the Burlington Road Car Park, 100m south west of the site. The hotel operator requires a minimum of 80 spaces, 120 spaces optimum. This is achievable on the current 166 space surface car park, 40 of which are subject to an existing lease.

External Advice – Hotel Market

- 5.12 Based on independent advice to the Council, which made an assessment of the market conditions and product proposal:

- The preferred brands are appropriate to the market opportunity in Slough, which has established long-stay demand.
- It is envisaged that a new, modern attractive hotel will attract demand from other market sectors, and
- The base case projections (room rates and occupancy levels) are a realistic assessment of potential future trading.

Taking account of the above, the advice in September 2016 concluded that it was unlikely that the guarantee would be called upon.

5.13 In order to test the robustness of this advice the advisor was requested to review the projections taking into account updated costs and timescales. The feedback remains positive. The Council is advised that the Slough hotel market remains strong and recent additions to the market (noted in their original work) are in the process of being absorbed. Since the operator has not altered its estimates of average room rate and room occupancy, the external consultant remains confident that the dual branded project affords the opportunity to position the site and the development as the key hotels in Slough. Finally, the Council is advised that the projections of revenue and Gross Operating Profit remain valid.

Funding

5.14 The Council would fund the cost of the capital investment for the hotels through internal investment balances, whilst ensuring appropriate Minimum Revenue Provision was set aside in accordance with the capital financing framework, or through external borrowing. It would be more advantageous for the Council financially to use internal balances, but this depends upon the level of investment balances at that point in time and the overall cost of the capital programme funded through Council funding.

The development has been financially modelled assuming the Council will borrow the funding from the Public Works Loan Board (“PWLB”) and not only includes the interest on that loan but repayment of the principal sum over 40 years. The loan is fixed for 40 years and fully amortised.

Legal Agreements

5.15 Since the project includes several parties, the legal structure is complex and involves all parties to sign up to a suite of agreements. Failure to reach agreement within defined timescales will introduce a significant commercial risk, since there is potential competition from other sites both in Slough and also in neighbouring areas. The operator has effectively made ‘first to market’ advantage a condition of their involvement.

The suite of agreements currently envisaged and parties involved is set out in the table below:

Agreement	Parties
Development Agreement	SBC and SUR
Agreement for Lease	SBC, SUR and Tenant
Lease	SBC and Tenant

Rental Guarantee	SBC and Tenant's Parent / Affiliate Company
Owner's Step-in Agreement	SBC, Tenant and Franchisor
Parent Rental Guarantee	SBC and Franchisor
Franchise Agreement	Tenant and Franchisor
Technical Services Agreement	SUR and Tenant
Building Contract	SUR and Contractor
Various Professional Consultant Appointments	SUR and members of its Professional Team
Various Sub-Contracts	Contractor and its various sub-contractors
Various Collateral Warranties	In favour of SBC
Car Parking Licence	SBC and Tenant
Retention Bond	SBC and SUR
Variation to Option Agreement	SBC and SUR

- 5.16 In order for SBC to meet commercial timescales, this report recommends that the Interim Chief Executive or nominated deputy, in consultation with the Leader and Commissioner for Housing & Urban Renewal, is delegated authority to approve and, where the council is a party, to enter into the above mentioned suite of documents and any other necessary agreements required to give effect to the proposals.

Slough Urban Renewal – Site Development Plan

- 5.17 Running in parallel with reports to Cabinet on the OLS, the Board of SUR (which consists of three representatives from the Council) has considered reports known as a Site Development Plan (“SDP”), which are essentially site specific business plans. The last report, which was a draft indicative SDP, was approved by the Board in November 2016.
- 5.18 The most recent version of the SDP is enclosed as Commercial Appendix Three. This report provides details information on costs, timescales, project development matters and risk mitigation. The financial information in the SDP is consistent with the Council's cash flows as set out in Confidential Appendix One. It is anticipated that this report will be approved by the Board of SUR in advance of the Cabinet meeting scheduled for 20 March 2017. This report recommends approval of the SDP.

6 Comments of Other Committees

- 6.1 There are no comments from other committees.

7 Conclusion

- 7.1 The purpose of this report is to provide an update to Cabinet and allow the Council to enter into contract with the hotel operator and SUR for the development of the OLS. Based on expert independent advice, the report confirms that the financial forecasts presented by the operator are robust and the hotel market in Slough remains strong.
- 7.2 From a financial perspective, the Council will have a solid long-term revenue stream that covers the cost of borrowing and additional overheads through the administration and creation of the scheme. The Council will also retain and enhance the capital value of a key asset in the centre of town.

- 7.3 The creation of new and high standard hotels in the centre of town will provide new services to residents and businesses in the area. The creation of long-stay accommodation will enable a variety of different customers to use the hotels, serve a wide range of business and leisure need in the local area and add to the overall attractiveness of Slough as a place for businesses to invest and grow. The hotels will also have the facility for live music and other events, which will compliment activities, organised from the Curve and positively contribute to the aspiration to stimulate the evening economy in the town.
- 7.4 The introduction of a group of wholly owned companies has provided the opportunity and potential for the Council to receive a long-term income stream from these assets through dividend payments.

8 **Appendices Attached**

The following appendices contain exempt information and are included in Part II of the agenda:

Appendix One - Financial summary – Hotels

Appendix Two – Financial Comparison

Appendix Three - SUR Site Development Plan – **To follow**

9 **Background Papers**

- 9.1 None