

**AGENDA ITEM**

**REPORT TO COUNCIL**

**28 JUNE 2016**

**REPORT OF SENIOR  
MANAGEMENT TEAM**

**COUNCIL DECISION**

**NORTH SHORE HOTEL**

**SUMMARY**

The Tees Valley economy continues to grow, with positive signs across a number of areas and an increase in employment opportunities in many key sectors forecast. This positive economic growth underpins work carried out in recent months to assess the demand and feasibility of a limited service branded hotel in Stockton showed a significant undersupply of hotel rooms across the Tees Valley highlighting a clear, unmet market demand,. This report builds on a report to Cabinet on 19<sup>th</sup> May 2016 and describes the opportunity for investment in, and ownership of, by the Local Authority, a 125 bed hotel on the North Shore Gateway Site (NSGS). The report details work undertaken in respect of feasibility and demand for a hotel within the Borough, along with the principles of operation and management, detail of the relevant terms of operation, necessary legal agreements and the financial and economic benefits of investment to the local authority, community and wider local economy.

**RECOMMENDATIONS**

1. Council approve the use of prudential borrowing up to £17million to meet all development costs, fees and capital expenditure, to be finalised in a future report back to Cabinet and Council the final capital cost is confirmed.
2. Council approve the establishment of a Local Authority Trading Company and note the reasoning for the establishment of a Local Authority Trading Company as set out at paragraph 22-30.
3. Council note that the Place Committee at their meeting on 13<sup>th</sup> June 2016 were presented with details of the feasibility work undertaken along with rationale and selection criteria adopted in the procurement process.

**DETAIL**

**Background**

1. A detailed report on the opportunity for investment in, and ownership of a 125 bed hotel by the local authority was presented to Cabinet at their meeting on 19<sup>th</sup> May 2016. The report contained detail of the feasibility, analysis and procurement process undertaken to determine the rationale for investment, operational model and management arrangements which are reflected in the below recommendations which were approved at Cabinet on 19<sup>th</sup> May 2016.
  1. Cabinet approve the principle of investment in the development and ownership of a hotel.

2. Cabinet recommend to Council agreement to the use of prudential borrowing up to £17million to meet all development costs, fees and capital expenditure, to be finalised in a future report back to Cabinet and Council the final capital cost is confirmed.
  3. Cabinet give delegated authority to the Director of Finance and Business Services and the Director of Economic Growth and Development in consultation with the Leader of the Council and Cabinet Member for Regeneration and Transport to negotiate and agree the terms of all necessary agreements and leases to enable the construction, funding, operation and use of the proposed hotel.
  4. Cabinet approve the selection of Interstate United Kingdom Management Ltd as the preferred management company, along with the brand franchise Hampton by Hilton and authorise the work to agree appropriate management and franchise agreements to enable the operation and use of the hotel in accordance with the agreed, submitted heads of terms.
  5. Cabinet delegate responsibility for agreement of final scheme design to the Director of Economic Growth and Development in consultation with the Cabinet Member for Regeneration and Transport.
  6. Cabinet authorise the establishment of a Local Authority Trading Company wholly owned by the Council so as to allow the Council to exercise in respect of the hotel development the power to trade contained in the Local Government Act 2003 and the Localism Act 2011.
  7. Cabinet recommend to Council the approval of the case for the establishment of a Local Authority Trading Company as set out at paragraph 21-32.
  8. Cabinet approve the appointment of the Chief Executive, Director of Finance and Business Services, Director of Economic Growth and Development and Director of HR, Legal and Communications as directors of the Trading Company.
  9. Cabinet note that the Place Committee at their meeting on 13<sup>th</sup> June 2016 will be presented with the rationale and selection criteria adopted for comment prior to consideration of recommendations 2 and 8 above to full Council.
2. The recommendations for Council set out in this report reflect the recommendations made to Cabinet on 19<sup>th</sup> May 2016 and the subsequent Cabinet approvals. A copy of the relevant minute extract is attached as **Appendix D**.
  3. Details of the proposed scheme were presented to the Place Select Committee on 13<sup>th</sup> June 2016. The report of the Place Select Committee is attached at **Appendix E**.

### **Background - North Shore**

4. The North Shore masterplan was agreed in 2011. Since then, progress has been made in the form of 125 residential units on the Vivo housing development, completion of Thirteen headquarters and Fusion Hive Innovation Centre. A further 80 homes are planned as part of phase three of Vivo and Fusion Hive continues to exceed expectations with almost 50% occupancy some nine months after opening.
5. A key component of the masterplan is the development of the prominent gateway site, marked A1 on the attached plan. The masterplan identifies the site for a hotel and leisure use, providing a high quality gateway to both the town centre and North Shore and strengthening linkages between the Northshore site and town centre via Church Road.

6. In order to maintain the positive momentum gained by the developments referenced above, work has been underway for a number of months to assess the feasibility and demand for a hotel on the North Shore Gateway Site (NSGS).

### **Feasibility, Demand Analysis and Operational Models**

7. A hotel market and financial feasibility study has been undertaken to establish the current level of provision, market opportunity and potential means of delivery and operation of a hotel on the NSGS.
8. The findings of the feasibility study showed that there is currently an undersupplied hotel market in the Tees Valley, with internationally branded hotel supply particularly limited. The undersupply is evidenced by midweek occupancies across the Tees Valley peaking above 95% alongside evidence of growing corporate demand.
9. This level of demand is also evidenced by recent expansions of existing Premier Inn Hotels across the borough, the opening of a Holiday Inn Express in Middlesbrough in 2015 and further confirmed hotel developments by Premier Inn in Darlington and Middlesbrough.
10. Having established that there is a significant under supply of internationally branded hotel provision in the Tees Valley, the feasibility study went on to explore potential operating structures for a hotel along with the optimum number of bedrooms and detailed financial projections.
11. The main detail in this respect is that there are effectively four established operating structures for hotels in the UK which are; owner occupied hotels, management contract, lease agreement and a brand franchise agreement with a third party operator and that internationally branded hotel operators would look require a hotel of between 125-150 rooms. This approach was reinforced by advice received during the feasibility process which showed a low level of market interest in a leasehold arrangement or direct investment from a major hotel chain.
12. A third party management company operating a brand franchise on behalf of a hotel owner is now the most common approach to hotel operation in the UK, with a number of local authorities adopting the position of owning hotels, operated on this basis. Detailed advice received, as part of the feasibility and demand analysis suggests that in order to secure an international hotel brand franchise, the recommended operational and delivery structure for Stockton, is capital investment by the local authority, who would secure a franchise agreement with a suitable hotel brand and seek a third party management contract for the day to day management of the entire hotel operation.
13. Examples of this delivery model can be found elsewhere in the UK, namely Stockport and Aberdeen and they are based on the premise that once a hotel operation has stabilised (usually over a period of 3-5 years) owners can bring the hotel to the investor market where it can be sold on the strength of an established level of demand/occupancy or continue to operate the hotel and bring forward for disposal depending on market cycles/economic climate at any given time.

### **Management Company and Brand Franchise Procurement**

14. Following conclusion of the demand analysis along with identification of the most feasible and deliverable operational model, agents acting on behalf of the Council undertook a thorough procurement exercise to establish a level of brand and management company interest.
15. Initial expressions of interest were assessed, with management companies Redefine BDL and Interstate United Kingdom Management Ltd (Interstate) along with brand franchise Holiday Inn Express and Hampton by Hilton invited to submit detailed proposals including

financial forecasts based on occupancy and average room rate payable along with draft Heads of Terms (HoTs) for operation.

16. A period of assessment which included detailed appraisal of the HoTs, analysis of financial forecasts, numerous discussions with operators and brands as well as site visits was undertaken throughout late 2015 and early 2016.
17. A key element of the procurement process was an assessment of the HoTs and negotiation on a number of elements within the document to ensure the most favourable terms for the Council going forward. During this process, advice was received from hotel consultants, CBRE to ensure negotiated terms reflected wider hotel market trends and provided the right balance between financial value and operational relationship between owner and operator.
18. The HoTs set out a series of fees and conditions of operation, the length of term for the management and franchise agreement and the owners' rights in respect of performance management and potential termination of contracts.
19. Appraisal and negotiation of HoTs took place alongside formal interviews held throughout late March and early April which enabled officers to identify a preferred operator and brand franchise with which to move forward into formal agreement pending approval by Cabinet and Council.
20. Following the appraisal process described above, Interstate emerged as the preferred management company with Hampton by Hilton identified as the most suitable brand franchise to enter into operation with.
21. Subject to Council approval of the recommendations within this report, the negotiated HoTs will form the basis of operating and franchise legal agreements going forward.

### **Operational Structure and Local Authority Trading Company**

22. In order for the Council to have the power to trade, in the form of a hotel, a Local Authority Trading Company (LATCo) wholly owned by the Council would need to be established in line with requirements of the Local Government Act 2003 and the Localism Act 2011.
23. Part of that process requires the production of a comprehensive statement as to the objectives of the business, the required investment to meet those objectives, identification and analysis of risks as well as financial results and expected outcomes from the business.
24. As a result of the Council wholly owning the LATCo, all risks associated with the operation of the company and therefore the hotel will lie with the Council. A detailed financial appraisal which has been subject to independent due diligence did consider all possible financial and operating risks.

### **Socio-Economic Benefits of Investment**

25. The business objectives for this scheme are to continue the positive momentum of development on the wider North Shore site, build on and support recent investment in the redevelopment of Stockton High Street and contribute towards positive economic growth and changing perceptions in the Borough as well as improve the appearance and function of a prominent gateway to the town centre. The development will also deliver much wider socio-economic benefits to residents, town centre businesses and local suppliers.
26. An Economic Impact Assessment (EIA) of a 125 bed hotel on the NSGS has been undertaken to assess the socio-economic benefits of the scheme. The headline findings are summarised below
  - £6.7million p.a. Gross Value Added (GVA) to local economy
  - Circa 100 direct and related jobs created

27. It is anticipated that circa 30 jobs will be created within the hotel itself. The majority of jobs created within the hotel will provide new opportunities for local people and it is therefore anticipated that the vast majority of jobs created would be taken up by residents of the Borough. Similarly through construction phases the Council's procurement procedures seek to ensure that opportunities for local employment and the supply chain are always maximised.
28. A hotel of this size operating at the projected occupancy levels will see a significant increase in the number of visitors to the town centre, making visitor-oriented (restaurants, cafes, bars, entertainment and arts) services increasingly viable, thus increasing the vibrancy of the town centre offer, particularly the evening and leisure economy, creating circa 30 employment opportunities as a result of visitor spend which is estimated to exceed £1.6million per annum.
29. Similarly the forecast benefits through suppliers and expenditure from the hotel and hotel employees suggests circa 40 jobs will be created in local businesses.
30. Furthermore, a hotel of this size will bring about an increased income to local authority budgets through NNDR payments estimated to be in excess of £150,000 p.a.

### **Funding Requirements**

31. The anticipated total cost for delivery of a 125 bed hotel on the NSGS is estimated at circa £17million. This figure includes all construction costs, associated works and fees. At this stage the figure of £17million is an estimate based on existing market construction rates as well as tendered sums for design.
32. In order to meet the required capital investment, the use of prudential borrowing of up to £17million would be required.

### **Financial Forecasts**

33. As part of the assessment of management companies and brand franchises, detailed financial forecasts were requested from all parties as well as being sought through two independent specialist agents in the hotel field. All estimates received, including independent advice, forecast that the level of income after all expenses, fees and taxes is more than sufficient to cover the annual cost of prudential borrowing repayments on the anticipated capital cost of the project
34. Use of forecasts showing five years of trading is standard within the hotel market to assess a hotels performance at stabilisation. Use of projections at stabilisation gives a more realistic picture of future trading and a basis upon which to more accurately judge performance. **Appendix B** contains a breakdown of forecast profit and loss at year five of operation. The table also builds in deductions for a maintenance and repair reserve as well as taxes and other costs
35. Assuming a prudential borrowing figure of £17m over a 35 year period, annual repayments would be circa £830,000. As can be seen from the table in **Appendix B**, the net forecast income is sufficient to cover borrowing and all other costs based on forecasts undertaken.

### **LATCo Key Risks**

36. A legislative, contractual, financial and operational risk assessment has been undertaken and monitored to ensure that all risks and uncertainties affecting the Council's and the LATCo position are identified. The current identified risks in respect of the LATCo are set out at **Appendix A**.

## **Site Assembly**

37. Negotiations, in the shadow of a Compulsory Purchase Order for the acquisition of the former Kwik Fit building are progressing and initial discussions with the Homes and Community Agency, as land owner over, a long lease on the site have begun with detailed negotiation and agreement of terms to be finalised subject to approval for the scheme from Cabinet and Council.

## **Next Steps**

38. Subject to approval of all recommendations within this report, appointment of a design team will be undertaken along with drafting of all relevant legal agreements to enable development.
39. At this stage, the indicative programme for delivery would see design complete in early 2017, followed by procurement of a construction company, beginning work on site in mid-2017 with an estimated completion date of summer 2018.

## **COMMUNITY IMPACT IMPLICATIONS**

40. The proposed project does not seek approval for a new policy, strategy or change to service delivery. The socio economic benefits and impacts of the proposed project are set out in paragraphs 26-30.

## **FINANCIAL IMPLICATIONS**

41. Detailed work undertaken so far indicates there will be sufficient income annually to cover the cost of borrowing. Further detailed design work along with procurement of the construction contract to confirm capital cost will be undertaken and at this point a revised borrowing requirement will be assessed and reported back to Cabinet and Council.
42. As part of the detailed financial assessment the Council procured Hotel Valuation Services, a company that specialises in due diligence of hotel investments and the conclusion to this work validated the market based assessments carried out through the feasibility phases.

## **LEGAL IMPLICATIONS**

43. As Members will be aware, due to the effects of the economic climate, and the inability of the private sector to secure funding for investments such as the proposed hotel scheme, the recommendation is for the Council to fund and develop the hotel through prudential borrowing (Section 1 of the Local Government Act 2003). In doing so, the Council relies on its powers to undertake building works on land for the benefit and improvement of the area under section 2 of the Local Authorities (Land) Act 1963 and the power to trade provided by the "General Power of Competence" in Part 1 of the Localism Act 2011 and Section 111(1) Local Government Act 1972 along with its powers to acquire and dispose of land in sections 120 and 123 of the Local Government Act 1972.
44. Members will note that there are limits placed on the general power when doing things for a commercial purpose. Specifically Section 4 of the Localism Act 2011 requires the power to be exercised through a company within the meaning of section 1(1) of the Companies Act 2006, which therefore require the Council to establish a trading company in this instance.

## **RISK ASSESSMENT**

45. The North Shore Hotel is categorised medium risk. Existing management systems and daily routine activities are sufficient to control and reduce risk.
46. Project specific risks relating to establishing a LATCo and trading operations are set out at **Appendix A**.

## COUNCIL PLAN POLICY PRINCIPLES AND PRIORITIES

### Policy Principles:

- **Protecting the vulnerable through targeted intervention** – this project has no direct impact on this policy principle
- **Promoting equality of opportunity through targeted intervention** – direct employment opportunities for residents will be generated through delivery of the project and through ongoing visits to the hotel.
- **Developing strong and healthy communities** – both the hotel management company and brand franchise have expressed a desire to, and demonstrated a track record of supporting community groups and charities and have acted as hub for community events. This was taken into account as part of the procurement process
- **Creating economic prosperity** – as detailed in paragraphs 22-26, the project will deliver significant employment and socio economic benefits as well as increase visitor numbers and improve perceptions of the Borough

## CORPORATE PARENTING IMPLICATIONS

There are no corporate parenting implications

## CONSULTATION INCLUDING WARD/COUNCILLORS

Leader and Deputy Leader of the Council, Cabinet Member for Regeneration and Transport

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Background Papers

Ward(s) and Ward Councillors:

Cllr Paul Kirton & Cllr Di Hewitt

Property

Implications for SBC assets and capital programme covered in body of the report.