Appendix D

MINUTE EXTRACT

Cabinet Meeting – 19th May 2016

1. Title of Item/Report

North Shore Hotel

2. Record of the Decision

Consideration was given to a report that provided details about the proposals for a North Shore Hotel.

The Tees Valley economy continued 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 underpinned work carried out in recent months to assess the demand and feasibility of a limited service branded hotel in Stockton. The report described 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 detailed 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.

The North Shore masterplan was agreed in 2011. Since then, progress had 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 were planned as part of phase three of Vivo and Fusion Hive continued to exceed expectations with over 40% occupancy some 8 months after opening.

A key component of the masterplan was the development of the prominent gateway site, marked A1 on the plan provided. The masterplan identified 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.

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

A hotel market and financial feasibility study had been undertaken to establish the current level of provision, market opportunity and potential means of delivery and operation of a hotel on the NSGS.

The findings of the feasibility study showed that there was an undersupplied hotel market in the Tees Valley, with internationally branded hotel supply particularly limited. The undersupply was evidenced by midweek occupancies across the Tees Valley peaking above 95% alongside evidence of growing corporate demand.

This level of demand was 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.

Having established that there was 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.

The main detail in this respect was that there were effectively four established operating structures for hotels in the UK which were; 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 to 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.

A third party management company operating a brand franchise on behalf of a hotel owner was 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 suggested that in order to secure an international hotel brand franchise, the recommended operational and delivery structure for Stockton, was 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.

Examples of this delivery model could be found elsewhere in the UK, namely Stockport and Aberdeen and they were based on the premise that once a hotel operation had stabilised (usually over a period of 3-5 years) owners can bring the hotel to the investor market where it could 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.

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.

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.

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.

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.

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.

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. Following the appraisal process described, Interstate emerged as the preferred management company with Hampton by Hilton identified as the most suitable brand franchise to enter into operation with.

Subject to approval by both Cabinet and Council, the negotiated HoTs would form the basis of operating and franchise legal agreements going forward.

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.

Part of that process required 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 form the business.

As a result of the Council wholly owning the LATCo all risks associated with the operation of the company and therefore the hotel would lie with the Council. A detailed financial appraisal which had been subject to independent due diligence had considered all possible financial and operating risks.

The business objectives for this scheme were 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 would also deliver much wider socio-economic benefits to residents, town centre businesses and local suppliers.

An Economic Impact Assessment (EIA) of a 125 bed hotel on the NSGS had been undertaken to assess the socio-economic benefits of the scheme. The headline findings were summarised below

- £6.7million p.a. Gross Value Added (GVA) to local economy
- Circa 100 direct and related jobs created

It was anticipated that circa 30 jobs would be created within the hotel itself. The majority of jobs created within the hotel would provide new opportunities for local people and it was 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 were always maximised.

A hotel of this size operating at the projected occupancy levels would 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 was estimated to exceed £1.6million per annum.

Similarly the forecast benefits through suppliers and expenditure from the hotel and hotel employees suggests circa 40 jobs would be created in local businesses.

Furthermore, a hotel of this size would bring about an increased income to local authority budgets through NNDR payments estimated to be in excess of £150,000 p.a.

The anticipated total cost for delivery of a 125 bed hotel on the NSGS was estimated at circa £17million. This figure included all construction costs, associated works and fees. At this stage the figure of £17million was an estimate based on existing market construction rates as well as tendered sums for design.

In order to meet the required capital investment, the use of prudential borrowing of up to £17million would be required.

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 was more than sufficient to cover the annual cost of prudential borrowing repayments on the anticipated capital cost of the project

Use of forecasts showing five years of trading was 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 (exempt) contained a breakdown of forecast profit and loss at year five of operation. The table also built in deductions for a maintenance and repair reserve as well as taxes and other costs.

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 was sufficient to cover borrowing and all other costs based on forecasts undertake.

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

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

Subject to approval of all recommendations within the report, appointment of a design team would be undertaken along with drafting of all relevant legal agreements to enable development.

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.

Under paragraph 3 of Schedule 12A Local Government Act 1972 members of the press and public left the meeting while Members considered the exempt information.

Members of the press and public were invited back into the meeting.

RESOLVED that:-

1. The principle of investment in the development and ownership of a hotel be approved.

RECOMMENDED to Council that:-

2. 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 when the final capital cost is confirmed.

RESOLVED that:-

3. 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. The selection of Interstate United Kingdom Management Ltd be approved as the preferred management company, along with the brand franchise Hampton by Hilton and the work be authorised 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. Delegated responsibility for agreement of final scheme design be given to the Director of Economic Growth and Development in consultation with the Cabinet Member for Regeneration and Transport.

6. The establishment of a Local Authority Trading Company wholly owned by the Council be authorised 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.

RECOMMENDED to Council that:-

7. The approval of the case for the establishment of a Local Authority Trading Company as set out at paragraph 21-32.

RESOLVED that:-

8. The Chief Executive, Director of Finance and Business Services, Director of Economic Growth and Development and Director of HR, Legal and Communications be appointed as directors of the Trading Company.

9. The Place Committee at their meeting on 13th June 2016 be presented with the rationale and selection criteria adopted for comment prior to consideration of recommendations 2 and 7 above to full Council.