

Classification: Public
Key Decision: Yes

Gravesham Borough Council

Report to: Full Council
Date: 23 June 2020
Reporting officer: Stuart Bobby, Chief Executive
Subject: Greenwich Peninsular Development Investment Opportunity

Purpose and summary of report:

To seek Full Council approval for the progression of the proposals outlined within this report in relation to an investment opportunity on the Greenwich Peninsular.

Recommendations:

Following consideration of the information contained within this report, Full Council are recommended to:

1. Support the proposals for the Council to enter into the transaction set out at a headline level at paragraph 2.3 of this report, subject to the conditions outlined in Section 10.
2. Delegate authority to the Chief Executive in consultation with the Leader, the Director (Corporate Services) (in the role of S151 officer) and the Deputy Monitoring Officer to take all necessary practical, financial and legal actions required to determine viability of the transaction and take a final decision to proceed, including entering into the relevant formal legal agreements required.
3. Agree that the Treasury Management Strategy Statement is appropriately updated, including the extension of the existing Operational Borrowing Limit and Authorised Borrowing Limits as required to ensure there is sufficient capacity to support this investment.

1. Background

- 1.1 As Members will be aware, the council is currently working with the Reef Group regarding the redevelopment of the St. George's Centre and the proposed developments at the Charter and St George's phase II. Through this project, the council has developed a sound working relationship with Reef.
- 1.2 In late 2019, the council was approached by Reef Group with regards to a potential development opportunity on the Greenwich Peninsular.

2. Greenwich Peninsular Proposal

- 2.1 As part of the significant redevelopment of the Greenwich Peninsular area, which is being led by Knight's Dragon Development, a masterplanning exercise has been undertaken with a detailed redevelopment plan put in place.
- 2.2 The proposal that has been put before the council is for the development of a new Travelodge hotel (300 beds) at a key location on the Greenwich Peninsula, close to the O² Arena and Greenwich Station. Appendix two provides a location map for the site in question.
- 2.3 The proposal for the council, in headline terms, is as follows:
 - 2.3.1 The council will enter into a 50 year income strip lease (similar to that entered into on the St George's Centre) for the development with the ability for the Council to purchase the freehold for a nominal sum before the end of its lease.
 - 2.3.2 The initial rent payable by the Council under that lease will be subject to annualised RPI uplifts with a 4% cap and a 1% collar for the duration of the 50 year period.
 - 2.3.3 Travelodge will enter into a 35 year sublease which would be subject to compounded RPI uplifts every five years, bound by the same cap and collar arrangements as the Council's head-lease payment.
 - 2.3.4 There is the potential for surplus income for the council upon completion of the Hotel, based on the differential between the initial rent payable by the council and that due from Travelodge.
- 2.4 Officers have completed initial due diligence in order to ensure that the proposals put forward are not only in the best interests of the borough, but also of the council as a whole particularly in light of Covid-19. The council has been, and will continue to be, supported by a number of experts and professional advisors including Trowers and Hamlins LLP (law firm), Jones Lang LaSalle (property consultancy company), Grant Thornton (Auditors) and Link Asset Services (treasury management advisors) who have been engaged to ensure that the council has received an independent review and evaluation of the proposals put forward by The Reef Group. Further advice will be obtained as needed.
- 2.5 Commercial advice received to date from Jones Lang LaSalle has been considered and has indicated that assuming the operating income increases by 2.8% per annum (Jones Lang LaSalle's assumed RPI long term growth rate), GBC will achieve a profit rent throughout the 50-year term by entering into an Income Strip Lease.
- 2.6 It should be noted that the council will wish to undertake its own financial modelling as part of its ongoing due diligence up until the point any decision to proceed is taken.
- 2.7 The proposals outlined within this report, whilst not delivering a direct economic and social impact to the borough, are intended to deliver on-going financial benefits to the council, enabling specific projects within the borough to be delivered.
- 2.8 Given the current pandemic situation and the uncertainty this has caused around the immediate and longer term outlook of the national economy, it is not considered commercially sensible to seek a firm decision to proceed with the

project at this time, and therefore delegated authority is sought to proceed with the scheme subject to the conditions set out within Section 10 being met.

- 2.9 It is therefore proposed that delegated authority be given as set out in the recommendations in this report to continue the necessary practical, financial and legal actions required to determine viability of the project and take a final decision to proceed. In doing this, the council will also need to approve the necessary changes to its Treasury Management Strategy Statement and Capital Programme.

3. Legal Considerations

3.1 Council powers to enter into the proposed arrangements

- 3.1.1 Expert legal advice has been sought from Trowers and Hamlins to ensure that all potential legal implications have been fully considered and to also ensure that the council's best interests are represented in the complex legal discussions that have taken place. The following paragraphs are based on advice from Trowers and Hamlins.

Entering into the Lease

- 3.1.2 Section 120 of the Local Government Act 1972 (Section 120) gives the Council the power to acquire land (including a leasehold interest) for either:
- the benefit, improvement or development of its area; or
 - for a purpose relating to any of its powers or pursuant to duties under any enactment (other purposes).
- 3.1.3 The Council in exercising Section 120 may acquire land within or outside its area. Given its location, the acquisition will be under the second bullet point i.e. for a purpose relating to any of its powers or pursuant to duties under any enactment (other purposes).
- 3.1.4 Further powers that could be exercised by the Council to acquire the leasehold interest are:
- 3.1.4.1 Section 12 of the Local Government Act 2003 (Power to invest) provides the Council with the power to invest for:
- any purpose relevant to its functions under any enactment, or
 - the purpose of the prudent management of its financial affairs
- 3.1.4.2 Chapter 1 of the Localism Act 2011 (General Power of Competence) permits the Council to do anything which an individual may do.
- 3.1.5 The Council views this transaction as an investment decision and therefore Section 12 of the Local Government Act 2003 applies.

The Council leasing the space to Travelodge

- 3.1.6 The Council would be required to satisfy itself that the terms of the lease (and rent agreed) was in compliance with section 123 of the Local Government Act 1972 ('not less than the best consideration which could reasonably be obtained'). This would be the same requirement as the council making a grant of a long lease of any other property (accounted for in the general fund).
- 3.1.7 To fulfil this requirement, a valuation conducted by an external qualified surveyor will be obtained by the Council to support both section 123 compliance and state aid compliance set out in section 3.2 of this report.

3.2 State Aid

- 3.2.1 The acquisition of an interest in land and the grant of a sub-lease to Travelodge by the Council could give rise to state aid in the event that there is any overpayment by the Council in relation to its lease with the Fund or an underpayment of rent to the Council by the Travelodge.
- 3.2.2 The Council will need to demonstrate that the overall transaction is in compliance with market conditions by reference to comparable transactions. As per paragraph 3.1.7 above, the Council will engage an external qualified surveyor to fulfil this requirement.

3.3 Procurement

- 3.3.1 The Public Contracts Regulations 2015 (the PCR) require the Council to carry out an EU procurement procedure for any works, services or supplies that it procures which are over the EU thresholds or are not subject to an available exemption.
- 3.3.2 The Hotel proposal is considered by the Council as an investment opportunity. The transaction does not provide the Council with the ability to determine who the anchor tenant is nor provide the Council to put in place a legally enforceable obligation with The Reef Group or the Fund to deliver the works to construct the Hotel on the land. This is therefore not considered to form a Public Works Contract and the arrangement is therefore exempt from the PCR.
- 3.3.3 Once a formal decision on the proposals is made by the Council, it will be necessary to publish 30-day Voluntary ex ante transparency (VEAT) notices to publicise the council's decision to enter into the agreements with The Reef Group. Should there be no objections received during the period, a Contract Award Notice will be issued with a 14-day standstill period and after this stage, the development processes can commence.

3.4 Constitutional Requirements

- 3.4.1 The decision to enter into this transaction is reserved to Full Council, as are the required changes necessary to the council's Treasury Management Strategy Statement. Therefore this report sets out the recommendations for Full Council.

4. Financial Implications, Risk and Due Diligence

4.1 Funding Principles of the Scheme

- 4.1.1 The scheme would be funded through an income strip structure. This is effectively a forward-funding structure whereby the investor (typically a pension fund) would work in conjunction with the developer (The Reef Group), to deliver the Hotel development. The council would be required to make a commitment to the development by agreeing to take a non-assignable operational lease for 50 years on the site, which provides an inflation-linked annual return to the investor in return for their initial capital investment. The council would service this annual head-lease payment to the investor using the income generated from use of the site (and in this case, the 35-year pre-let sub-lease to Travelodge). Importantly, the annual rental income from Travelodge under than sublease is forecast to exceed the annual head-lease payment that would need to be made to the investor.
- 4.1.2 The council is in the process of undertaking detailed financial modelling of the proposal. In doing this, the council will be undertaking its own research and seeking independent commercial advice from professional experts (Jones Lang LaSalle) to formulate the assumptions used in the modelling.

4.2 Treasury Management

Investment Guidance

- 4.2.1 The Ministry of Housing Communities and Local Government (MHCLG) issued new statutory guidance under section 15 of the Local Government Act 2003 on local authority investments on 1 April 2018 (the MHCLG guidance). This is supported by further guidance issued by CIPFA in November 2019 on prudential property investment.
- 4.2.2 Prior to entering into any formal arrangements the Council will need to 'test' the transaction against this guidance and document its conclusions. The council will also need to consider whether the potential outcomes of the current PWLB Consultation and the Public Accounts Committee inquiry into local authority commercial investment may have an impact on this transaction and the funding of future projects for the council.

Treasury Management Strategy Statement and Capital Strategy Implications

- 4.2.3 The lease interest is expected to be classified as a finance lease and will therefore increase the Capital Financing Requirement of the Council. There will, however, be no additional Minimum Revenue Provision (the statutory amount normally set aside each year to meet debt repayments) required in respect of this as any liability is taken account by virtue of the principal repayment of the lease rental payments each year.
- 4.2.4 There will be a need for the council to extend its existing Operational Borrowing Limit and Authorised Borrowing Limit to ensure there is sufficient capacity to support this transaction.

- 4.2.5 The Capital Strategy outlines the principles followed by Gravesham Borough Council in its approach to capital investment over the long-term implications. This transaction fulfils the capital investment priorities of the council through it generating a beneficial financial return to the council that can be directed to support services and maintain its ongoing financial sustainability over the longer term.

Impact on future borrowing plans of the council

- 4.2.6 In making a decision to offer debt funding, market lenders will assess the council's credit position and risk of default based on its existing borrowing, credit arrangements, future planned borrowing and financial commitments.
- 4.2.7 Advice received from Link has indicated that where the council is funding projects outside of Borough purely for commercial yield, this may be viewed by a market lender as a higher risk potentially and may draw further scrutiny when looking to access borrowing from market lenders. The lender will want to be comfortable that any borrowing they provide will be used for a purpose that they are comfortable with, such as supporting local area economic growth, employment and housing.
- 4.2.8 The proposed income strip for Greenwich may therefore have an impact on the council's credit assessment and impact on ability to source borrowing from market lenders if this route is chosen to fund any future projects.

4.3 **Accounting Requirements & Due Diligence**

- 4.3.1 The lease liability will be held as long-term borrowing within the balance sheet and any accrued interest will be included within creditors.
- 4.3.2 In order to ensure that there are no conflicts in terms of company inter-relations between any of the parties involved and also to undertake due diligence, a number of checks will be made:
- 4.3.2.1 A review of information held on Companies House undertaken in order to determine if there are any links between officers involved in The Reef Group, Travelodge and the investor.
- 4.3.2.2 GBC officers will also undertake a standard financial analysis of the Parties involved in the transaction.

4.4 **Taxation Considerations**

- 4.4.1 Advice will be sought to ensure any tax considerations of the transaction are fully understood.

5. **Property Considerations**

- 5.1 **Current economic conditions** - any investment is not without risks, which are heightened in times of uncertainty. The current COVID-19 pandemic situation is unprecedented and at the time of writing this report, it is too early to be certain what the likely ramifications will be particularly for the leisure and hotel industries which may well be one of the last to re-open even in part. External commercial advice on the investment has therefore been sought from Jones Lang LaSalle (a

specialist company in this area), continues to demonstrate that this investment, whilst not without risk, is anticipated to provide an ongoing net revenue stream to the council after taking into account the covenant of Travelodge, and current forecasts for the London Hotel market.

- 5.2 **Rent** - Whilst the occupation of the hotel by Travelodge and the requirement for them and the Council to pay rent would not commence until the hotel was ready for occupation there is no guarantee that the economy will have recovered from the adverse effects of Covid-19 by then. As such this could impact on Travelodge's business model and their ability to pay rent or even trade. When the agreements for lease are signed the Council becomes responsible for its rental payments once the hotel is built regardless of whether it receives any income. In the worst case scenario the Council would therefore be responsible for the payment of rent, and other outgoings, such as rates, utilities, repairs and maintenance etc., without any income to offset that outlay.
- 5.3 **Lease lengths** – The arrangement provides for the Council to take a 50 year lease as opposed to the 35 year lease agreed with Travelodge. Notwithstanding the comments above there is a 15 year period for which the Council would need to find an occupier / use in order to cover its rental and other liabilities under its lease.
- 5.4 **Alternative use** - whilst it may be possible to obtain planning permission for an alternative use e.g. conversion to residential, in the event that a hotel was no longer viable in this location this is not guaranteed. High-level advice from Jones Lang LaSalle has indicated that this would be viable even allowing for the costs of the conversion which would need to be financed for as well as the payment of rent and other outgoings mentioned above.
- 5.5 **Hotel categorisation** – Travelodge classify their hotels into A, B and C bandings with A being the best. In 2009 and again in the current pandemic situation, Travelodge have sought to obtain rent reductions in respect of their B and C banded hotels. Travelodge have indicated that this hotel will be a flagship, Travelodge Plus hotel and therefore is likely to fall within their A banding. Presumably, this assessment could change over time as further hotels are built and this hotel becomes 'old'. In addition there is now a propensity for occupiers to enter into CVAs etc. without warning and this is often used as a way of disposing of some properties and renegotiating rent on others – again this risk cannot be discounted.
- 5.6 **Brexit** - The transition period is due to end on 31st December 2020 and it is not currently known what arrangements will be in place for trade between the EU and the UK after that date. However if the UK leaves without a deal, for example, this could have implications for the hotel and leisure industries.

6. Planning Considerations

- 6.1 The planning application for the site was given conditional approval by the Planning Committee of the Royal Borough of Greenwich on 17 March 2020. Full details of the decision can be found at appendix four.

7. Environmental Considerations

- 7.1 Noise and air quality arising from traffic and, to a lesser extent, industry are the primary environmental health issues at the site that could affect future conversion to residential.
- 7.2 The proposed design and construction of the hotel development include sufficient noise insulation measures to achieve acceptable internal noise levels for residential properties. Provided these are properly implemented and maintained, it is considered that the high levels of traffic and industrial noise in the location can be mitigated to provide a suitable acoustic environment for residential properties.
- 7.3 It was reported that road-traffic emissions do not represent a development constraint or require embedded mitigation into the hotel scheme design, and that the overall effect on air quality as result of the site-suitability assessment is considered 'not significant' when considered against relevant air quality objective levels, which are positive indications. It is additionally possible that vehicular pollution will reduce in future due to changes in infrastructure and emissions arising from the increased use of alternative fuels.

8. Risk Analysis and Mitigation

8.1 Risk Analysis

- 8.1.1 A detailed risk and opportunity analysis has been undertaken which is attached to the report at appendix three.
- 8.1.2 As with any investment decision, the proposals in this report do come with an element of risk. To mitigate these risks as far as is possible the council:
 - Has sought assurances from Travelodge to assess their commitment to the project, which have determined that they categorise the proposed Hotel as a Category A asset – i.e. one which carries strong strategic importance to their current business plan.
 - Will continue to follow development closely in this regard, and are liaising with other local authority representatives with investments involving Travelodge to gain confidence that a Greenwich Peninsula development would attract a Category A rating by Travelodge. Jones Lang LaSalle have been asked for their view on this, and consider that the prime location of the Hotel, adjacent to the O2 and North Greenwich Station mean that this site is likely to attract significant interest from any operator, and command high land values for the foreseeable future.
 - Has required further due diligence work to be undertaken by Jones Lang LaSalle to ascertain potential other uses of the site should Travelodge choose not to extend their lease at the end of the 35- year period. In summary, this shows that uses such as an alternative hotel operator, or residential conversion, would generate similar, if not higher, net yields for the council.
 - Has undertaken a site visit with officers from a number of different disciplines (including planning and environmental health) to review the

current site and proposed build design and concluded that, based on the current legislative framework, those alternative uses considered by Jones Lang LaSalle would be permissible.

- Will continue to seek expert advice on the drafting of legal documents, including commercial points, to ensure these offer the appropriate protections to the council;
- Will require the pre-letting agreement with Travelodge to be in place before formally signing any legal documents.
- Will be negotiating with the Reef Group for the provision of a further contingency fund to be held by the council, against which the council would be able to draw down from to sustain and provide some certainty around income levels during the 50 year period.

9. Additional information for Members

- 9.1 In order to ensure all Members are fully briefed on the project, and as a result of the need for social distancing in light of the COVID-19 virus, a video presentation was produced by The Reef Group and was made available to all members prior to the papers being discussed and presented to Cabinet.

10. Next Steps

- 10.1 Following discussion with the Cabinet at their meeting on 01 June 2020, approval is being sought from Full Council to progress with this project with delegated authority being granted Council to enable all necessary practical, financial and legal actions required to determine viability of the transaction and take a final decision to proceed, including entering into the relevant formal legal agreements required. It is proposed that any prior to any final decision to proceed, the following conditions are met:

- Appropriate commercial, legal and financial advice obtained supports the viability of the transaction.
- An up to date financial appraisal is prepared demonstrating that the scheme continues to be financially viable.
- A valuation conducted by an external qualified surveyor is obtained to support compliance with the requirements of both Section 123 of The Local Government Act 1972 and State Aid.
- That there are no objections received to the 30-day Voluntary ex ante transparency (VEAT) notice to publicise the council's decision to enter into the agreements with The Reef Group.
- The Council is satisfied that the transaction is within the spirit of the investment guidance issued by MHCLG and CIPFA, and that it has due regard to the current consultation on the PWLB and Public Accounts Committee inquiry on local authority commercial investment.
- The Council is satisfied that the transaction will not have a significant negative impact on the council's credit assessment and its ability to source borrowing from market lenders for future projects.
- Due diligence checks conducted on the Parties involved in the transaction raise no issues for concern.

11. Background Papers

- 11.1 Background papers pertaining to this report are held by the Director (Corporate Services). Anyone wishing to inspect background papers should, in the first place, be directed to Committee & Electoral Services who will make the necessary arrangements.

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IMPLICATIONS	APPENDIX 1
Legal	The legal implications are set out in section three of the report.
Finance and Value for Money	The financial implications are set out in section four of the report.
Risk Assessment	A detailed risk assessment has been undertaken and is appended to the report at appendix three.
Data Protection Impact Assessment	<p data-bbox="416 510 1469 613"><i>A data protection impact assessment (DPIA) should be carried out at the start of any major project involving the use of personal data or if you are making a significant change to an existing process.</i></p> <p data-bbox="416 651 1485 763">a. Does the project/change being recommended through this paper involve the processing of personal data or special category data or criminal offence data? No</p> <p data-bbox="416 801 1469 913">b. If yes to question a, have you completed and attached a DPIA including Data Protection Officer advice? N/A</p> <p data-bbox="416 965 1485 1077">c. If no to question b, please seek advice from your nominated DPIA assessor or the Information Governance Team at gdpr@medway.gov.uk. N/A</p>
Equality Impact Assessment	<p data-bbox="416 1137 1501 1279">a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community? If yes, please explain answer. No</p> <p data-bbox="416 1339 1437 1451">b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality? If yes, please explain answer. No</p> <p data-bbox="416 1503 1501 1592"><i>In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above</i></p>
Corporate Plan	The proposals set out within this report contribute to the following council objective: <i>#3 Progress: an entrepreneurial authority; commercial in outlook and committed to continuous service improvement, underpinned by a skilled workforce and strong governance environment.</i>
Crime and Disorder	The information contained within this report has no specific crime and disorder implications.
Digital and website implications	The information contained within this report has no specific digital and website implications

IMPLICATIONS	APPENDIX 1
Safeguarding children and vulnerable adults	The information contained within this report has no specific safeguarding children and vulnerable adult implications.