

## CABINET

16 April 2024

<b>Title:</b> Travelodge Hotel, Yew Tree Avenue, Dagenham - Development Agreement	
<b>Report of the Cabinet Member for Regeneration and Economic Development</b>	
<b>Open Report with Exempt Appendix 1 (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972 as amended)</b>	<b>For Decision</b>
<b>Wards Affected:</b> Eastbrook	<b>Key Decision:</b> Yes
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<b>Accountable Director:</b> David Harley - Interim Development Director, Be First	
<b>Accountable Executive Team Director:</b> Jo Moore, Strategic Director of Resources	
<b>Summary</b> <p>Cabinet in March 2018 approved the acquisition of land at Yew Tree Avenue, Dagenham and the funding of the development of a 78 bed Travelodge hotel with ground floor retail unit. The development was completed and the hotel has been trading successfully. However whilst a letting was made for the retail space, the tenant defaulted and never commenced trading.</p> <p>The report proposes to enter a Development Agreement with Travelodge (TL) for the conversion of the vacant ground floor retail into 15 additional hotel rooms. This would require a capital contribution from the Council for Travelodge’s development costs. In exchange Travelodge will enter an Agreement for Lease for the additional space, subsequently paying a rent on the same terms as the existing hotel. The proposal will generate an increased return for the Council over and above the loan cost, create a more marketable asset and deliver additional hotel rooms. Management of the asset with a single tenant will also be easier. The Council would have the option to sell the asset at a later date to realise the benefit of this uplift.</p> <p>Details of the proposed financials are set out in Appendix 1, which is in the exempt section of the agenda as it contains commercially confidential information (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.</p> <p>The construction risk will lie with the developer and the funds would be paid on a staged basis, so interest costs are minimised. The cost of the works will be capped at the point of commencement of the works. The draw down period will be relatively short, but the Council will have to fund the loan facility until completion at which point the rent will be paid by TL that will cover the loan. The proposal would require a change of use planning</p>	

application and the agreement requires LBBD to secure the necessary planning approvals and these costs are rolled up into the overall capital investment proposed.

### **Recommendations**

The Cabinet is recommended to:

- (i) Approve the entering into of a Development Agreement with Travelodge in respect of the conversion of the vacant ground floor retail space at the Dagenham East site into 15 additional hotel rooms (Option 1), in line with the terms set out in Appendix 1 to the report;
- (ii) Authorise the Strategic Director of Resources, in consultation with the Cabinet Member for Finance, Growth and Core Services and the Cabinet Member for Regeneration and Economic Development, to agree final terms for the Development Agreement (including the capital contribution), the agreement for lease and the new lease; and
- (iii) Delegate authority to the Head of Legal to execute all the legal agreements, contracts, and other documents on behalf of the Council in order to implement the arrangements.

### **Reason(s)**

The proposal will address a vacant retail unit by providing additional hotel bedrooms as well as providing additional rental income for the Council from the scheme.

## **1. Introduction and Background**

- 1.1 The site at Yew Tree Avenue was acquired by LBBD in March 2018. LBBD entered a development agreement with Berkeley Square Developments for the development of the site and provided funding for the scheme (Minute 114, 20 March 2018 refers).
- 1.2 The completed property comprises a modern 78 room hotel and a ground floor retail space of 4,500ft<sup>2</sup>. There are 28 customer car parking spaces. The hotel element is let on a fully repairing and insuring basis to Travelodge on a 25-year lease from 8th November 2019.

## **2. Proposals and Issues**

- 2.1 A tenant held a lease of the ground floor retail unit on a 15-year lease effective from 2nd December 2021. Despite signing the lease and carrying out minor fit out works the tenant did not open the premises for business and had fallen behind in rent. An agreement was made for the tenant to surrender the lease in exchange for the repayment of the outstanding rent.
- 2.2 The Council now has the option to seek to relet the unit for retail use however there is also an option proposed by Travelodge whereby the Council enter into a Development Agreement with Travelodge for the conversion of the vacant ground floor retail into 15 additional hotel rooms. The Council would provide the capital

contribution for Travelodge's development costs. The sum would be held on account with withdraws subject to certificates of value (of the work completed) provided by an independent surveyor.

- 2.3 The Council would enter an agreement for lease with Travelodge for the additional space at an agreed rent. As the full scope of works have not been costed Be First will need authority to negotiate a reasonable variation to the capital contribution and if necessary, an overage clause to increase the rent in equal measure. Although there is an impact on rent margin due to the additional borrowing at a higher rate than that secured at the time the original hotel was constructed, the long-term income increases.
- 2.4 Appendix 1 sets out the financial implications of the proposal and the key alternative option.

### 3. Options Appraisal

#### 3.1 Option 1: Enter into a Development Agreement with Travelodge for the conversion of ground floor retail space into additional hotel rooms.

Letting Agent's Strettons has brokered a deal for Travelodge to take the retail space and convert it into 15 additional hotel rooms based on the terms in Appendix 1.

A development agreement would be entered whereby Travelodge appoint the architects and contractors and carry out the works. The Council would provide the capital contribution for Travelodge's development costs. The agreed sum will be held in an escrow account and withdrawable subject to certificates of value (of the work carried out) from an independent surveyor.

The development agreement will be combined with an Agreement for Lease (AFL) between the Council and Travelodge for the new hotel rooms. The level of capital contribution and the agreed rent will be subject to change as it will be dependent on the quoted works from the appointed architects and contractors. A condition precedent to the AFL is that Be First secures planning permission for the change of use which is expected to take up to 6 months.

Based on the quoted figures, this option will see the market rent of the property significantly increase. Additionally, the market value could also increase by having the entire site leased to Travelodge Plc as a single entity rather than different occupiers and lease lengths (known in valuing terms as compressing the yield).

Further valuations would need to be carried out but considering Travelodge's RPI rent review in November 2024, the increased rent and a compressed yield, the asset value could increase.

Associated fees for Option 1 are included in Appendix 1. The main risks associated with Option 1 are:

Overage on Capital Contribution	As the negotiations are in early stages the scope of works has not been costed and so the final capital contribution figure may vary. This risk of variation will be mitigated by agreeing an overage
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	clause between the parties. Be First will require authority to negotiate a reasonable capital contribution and overage clause.
Lease to single occupier:	Having a lease to a single entity can present risk to income if the tenant falls into liquidation or administration. However, having a lease to a secure covenant compresses the yield compared to a multi-let scheme where the quality of covenant varies. A single let FRI (Full repairing and insuring) property also reduces landlord liability and administrative expenses.
Travelodge & Hotel occupiers	During COVID -19 Travelodge entered a CVA (Company Voluntary Arrangement) with the subject property being designated a 'Category 2' site. A payment plan was implemented during this period and Travelodge are now paying rent in accordance with their lease. Although the quality of covenant is considered strong this demonstrated the risks and weaknesses of the TL covenant. However, Travelodge's can still be considered a reasonable covenant when compared with potential retail occupiers such as the current retail occupier who accumulated significant arrears.

### 3.2 Option 2: Re-let the ground floor retail space

Re-let the retail unit in the open market. Additional incentives would be required to secure the letting. The market norm would be to apply a six months' rent free period.

The main risks associated with Option 2 are:

Lease to multiple occupiers	This option will not increase the passing rent or capital value and the opportunity to maximise income will be missed.
Retail covenant strength	It is expected the retail space will be re-let to an occupier of similar covenant strength as the previous leaseholder. The current situation of arrears and void costs evidences the risks of this strategy.

- 3.3 It is recommended that the Council proceed with Option 1. The increase in capital value will be a benefit to the Council if it chooses to dispose of the asset at a later date.
- 3.4 If the proposal is agreed it will result in a reduction of retail space in the Dagenham East area – there are already grocery stores and cafes on Rainham Road South and the 'Front plot' of the film studios is likely to have an active frontage. The hotel is a useful resource supporting the local economy. Overall the deal presents a positive for the Council. Primarily there is a clear financial benefit to the Council for agreeing this proposal, but the change of use application will need to highlight the positives and demonstrate it will not have a detrimental impact on the area. The argument is that the increase in hotel rooms increases the number of potential visitors to the area which has a knock-on effect for the neighbouring businesses. Also, although planning was originally granted for use as a retail space the incoming tenant did not commence trading so there is no effective loss. This will have to be agreed as part of the change of use planning consultation.
- 3.5 The implications of the additional borrowing and increase in rent have been applied in Appendix 1.

#### **4. Consultation**

- 4.1 The proposal was considered and endorsed by the Investment Panel on 20 December 2023.
- 4.2 The change of use would require planning approval which would involve public consultation.

#### **5. Commissioning Implications**

Implications completed by: Rebecca Ellsmore, Strategic Head of Place and Development

- 5.1 Inclusive Growth has considered the proposal and in particular the impact that the proposed change of use required by option one will have on the surrounding area. Given the availability of retail floorspace in close proximity, Inclusive Growth is supportive of the recommended option. It should be noted that securing change of use consent is expected to be a condition precedent of the development agreement and the fees to secure planning consent will therefore be committed at LBBB's risk.

#### **6. Financial Implications**

Implications completed by: David Dickinson, Investment Fund Manager

- 6.1 The financial implications are set out in Appendix 1, which is in the exempt section of the agenda as it contains commercially confidential information (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

#### **7. Legal Implications**

Implications completed by: Dr Paul Feild Principal Governance and Standards Solicitor

- 7.1 Section 1 of the Localism Act 2011 provides a general power of competence enabling the Council to do anything individuals generally may do, therefore allowing the Council to undertake a wide range of activities. Furthermore Section 111 of the Local Government Act 1972 enables the Council to do anything which is calculated to facilitate, or is conducive to or incidental to, the discharge of any of its functions, whether or not involving expenditure, borrowing or lending money, or the acquisition or disposal of any rights or property. The aforementioned powers enable the Council to enter into the proposed arrangement with Travelodge and make the capital contribution to cover the cost of the works of conversion and other transactional expense.
- 7.2 Under section 123 of the Local Government Act 1972 the Council has the power to dispose of land it owns which includes the surrender of the existing lease and re-grant of a revised lease. One constraint is that the disposal must be for the best consideration reasonably obtainable. The proposal is to expand the hotel letting capacity which is expected to be a more effective and efficient use of the property, particularly in terms of the assessment of the current economic return of the ground

floor retail unit. The proposal outcome being that there will be a new lease to Travelodge for the ground floor once converted to 15 more hotel rooms.

## **8. Other Implications**

- 8.1 **Risk Management** – To reduce any risks, Gowlings solicitors and Strettons surveyors will be instructed to oversee the negotiation and advise throughout. Building surveyors will also be employed to monitor expenditure.

There is a risk the change of use application may be unsuccessful. This is deemed low risk if the case for the change is fully set out. If the change of use is rejected, the Council can proceed with Option 2 which still presents a decent return. This is viewed as a low risk and Be First will bear the cost of the fees.

- 8.2 **Contractual Issues** - Gowlings solicitor will be instructed to draft the development agreement and agreement for lease. Gowlings will also carry out necessary due diligence on potential contractual issues before any agreements are entered. Any further contractual issues will be negotiated through the solicitors.

- 8.3 **Corporate Policy and Equality Impact** – An Equality Impact Assessment has been carried out for the proposal identifying neutral or positive impacts on different groups within the community.

**Public Background Papers Used in the Preparation of the Report:** None

**List of appendices:**

**Appendix 1:** Financial Implications (exempt document)