

CABINET

20 March 2018

Title: Travelodge Dagenham – Investment Proposal	
Report of the Cabinet Member for Finance, Growth and Investment and Cabinet Member for Economic and Social Development	
Open Report with Exempt Appendix 2 (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972 as amended)	For Decision
Wards Affected: Eastbrook	Key Decision: Yes
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Accountable Strategic Director: Claire Symonds, Chief Operating Officer	
Summary <p>This report sets out proposals for the Council to enter into a Forward Funding Agreement with the developer of a new Travelodge development in Dagenham. The proposals would generate a good investment return for the Council and would also support the redevelopment of an important regeneration scheme in the borough.</p> <p>This development opportunity forms part of the former Sanofi site, which is identified within the Council's Barking and Dagenham Growth Strategy 2013 – 2023 as a 'key opportunity site'. As part of the Sanofi's exit strategy a mixed-use redevelopment approach was agreed by Sanofi with the Council. Part of this strategy included seeking planning permission for hotel use on part of the site. This resulted in the grant of the outline planning consent later granted for part of the former Sanofi site (i.e. the property which is the subject of this report) (the Property). Subsequently, Berkeley Square Developments Dagenham Limited purchased the Property from Sanofi and secured detailed planning approval for a 78 bed Travelodge with ground floor restaurant (A3) unit and associated parking.</p> <p>The principal regeneration objectives of the Council in entering into this transaction are to:</p> <ul style="list-style-type: none">• facilitate the wider regeneration of the former Sanofi site, bringing forward a key development site and implementing an extant planning permission for hotel use and A3 retail use• contributing to the Council priority of 'Growing the Borough' by the creation of jobs and amenities through the development. <p>Under the proposals, negotiated by Be First on behalf of the Council, the Council would enter into a Forward Funding Agreement with the current owner of the site as follows:</p> <ul style="list-style-type: none">• The Council would take ownership of the development site	

- The Council would simultaneously enter a development agreement whereby the current owner of the site, Berkeley Square Developments, would construct the hotel, restaurant and car parking space
- The Council would enter into an agreement for lease to grant a 25-year lease to Travelodge Hotels Limited
- All elements of the transaction would be entered into simultaneously ensuring that the Council's construction and investment position is protected

Recommendation(s)

The Cabinet is recommended to:

- (i) Agree to the acquisition of the freehold interest at Yewtree Avenue, Dagenham RM10 7XS (the Property, as shown in Appendix 1 to the report), subject to completion of further due diligence and to the principle of borrowing up to £940,000 plus stamp duty of £36,500 and fees of £110,500 within the General Fund from the Public Works Loan Board;
- (ii) Agree to the principle of borrowing up to £5,711,000 within the General Fund from the Public Works Loan Board to fund the development costs of the Travelodge development;
- (iii) Agree, subject to completion of further due diligence, to enter into a Development Agreement with Berkeley Square Developments to construct the development scheme on the Property;
- (iv) Note that the acquisition of the Property shall be subject to an extant agreement for lease, which upon acquisition the Council would be bound to grant and agree, subject to completion of due diligence, to grant a 25-year lease to Travelodge Hotels Limited on the terms set out in the report;
- (v) Agree to hold the Travelodge investment within a Special Purpose Vehicle (if legal advice indicated this would be appropriate);
- (vi) Agree that Be First, as agent for the Council, be authorised to lead the negotiations, including appointment and management of property, financial and legal advisors as required;
- (vii) Delegate authority to the Chief Operating Officer, in consultation with Director of Law and Governance and the Cabinet Members for Finance, Growth and Investment and Economic and Social Development, to scrutinise the due diligence reports, negotiate terms and agree the contract documents to fully implement and effect the proposals set out in the report (including a decision as to utilising a SPV); and
- (viii) Authorise the Director of Law and Governance, or an authorised delegate on her behalf, in consultation with the Chief Operating Officer, to execute all the legal agreements, contracts and other documents on behalf of the Council.

Reason(s)

The initiative will contribute significantly to the Council Priority of 'Growing the Borough.' The project would have a major impact on changing perceptions of the Borough and ensuring Dagenham is focussed on new employment opportunities which raise aspirations of residents and help deliver the 'No-one left behind' objective of the Growth Commission and the vision of the Borough Manifesto.

1. Introduction and Background

- 1.1 The Travelodge site forms part of the former Sanofi estate, within which the Council already has significant landholdings. By Minute 74 (15 November 2016), the Cabinet approved the purchase of 9 acres of land from Sainsbury's on part of the former Sanofi site at Dagenham East with a view to bringing forward development of TV/film studios as part of a mixed used development and subsequently approved purchasing more land in January 2018. The wider Sanofi site is identified within the Council's 'Barking and Dagenham Growth Strategy 2013 – 2023' as a 'key opportunity site' for the creation of jobs and opportunities for residents and is an important regeneration priority.
- 1.2 The 1.3 acre site lies currently undeveloped behind the successful Marston's pub/restaurant (The Pipe Major) and is within 100m of Dagenham East tube station and is part of the gateway to the larger Londoneast-uk site. The development of a hotel in this location would act as an important amenity to support the emerging proposals for TV/film studios and enhance the attractiveness of the site to potential development partners for the wider site.
- 1.3 The site is 'Zone 9' of the Sanofi site, which received reserved matters planning consent (15/00810/REM) in November 2015 for development of a 78 bedroom hotel with separate restaurant on ground floor level together with associated car parking and Costa Drive Thru. The Costa Drive Thru does not form part of the development proposal and will be developed separately. Be First has engaged pro-actively with the developer, Berkeley Square Developments Dagenham Limited who owns the site and secured planning consent. Through these discussions an opportunity has arisen to act as a funder to put in place funding to develop the consented scheme. Local authorities are able to intervene and to use their powers to invest to support regeneration projects and simultaneously to increase their long-term income producing asset base. The site forms part of the former Sanofi site, and planning permission in respect of the Travelodge development contains environmental conditions relating to ground contamination. These matters will be covered in detail through the due diligence process.
- 1.4 The developer has already agreed an agreement for lease with Travelodge Hotels Limited, pursuant to which a 25-year lease will be granted to occupy the hotel (on practical completion of the works to construct the hotel). The developer has a contractor ready (The Barnes Group Limited) to commence works on site to build out the scheme over an anticipated 14 month build period, who were selected by way of a competitive tender. Upon completion, the Council will be the beneficiary of direct collateral warranties attaching to the constructed development. Once the scheme is completed the hotel area will be managed and maintained by Travelodge

under the terms of their lease (full repairing and insurance), with the Council as freeholder responsible for common areas (car park) for which costs will be re-charged through an uncapped service charge to Travelodge.

2. Proposal and Issues

Summary

- 2.1 Berkeley Square Developments Dagenham Limited, is seeking funding for the hotel and restaurant element of the planning consent. Under the proposal, Be First will act as development agent for the Council to bring forward the opportunity, with the Council purchasing the land and entering into a development and funding agreement to fund Berkeley Square Development as developer to build out the hotel and restaurant unit. The land will be transferred by the developer to the Council on completion of the sale contract and on practical completion the lease will be granted to Travelodge.
- 2.2 Upon completion of the sale transaction, the Council will take ownership of the freehold of the development site for £940,000 (exclusive of VAT). Based upon current Heads of Terms which are subject to final negotiation with the developer, the costs are as follows:

Development costs	
Land	£940,000
Developers Build costs	£5,710,584
SDLT and Fees	£147,000

- 2.3 The developer will hold all development risk during the construction phase of the project. Berkeley Square Developments Dagenham Limited will employ Ridge and Partners LLP to oversee the construction programme, whilst Be First will put in place a monitoring surveyor to ensure that draw down of funding is made against qualifying expenditure.

Financial and Investment

- 2.4 An appraisal of the site (with the benefit of Travelodge) has been carried out by Be First and this supports the purchase price and the agreed price for the works. A formal independent external valuation has been commissioned to verify this appraisal; this will form part of the due diligence process that will be carried out before the proposals in this report are executed. A summary of the appraisal and indicative returns are set out within Appendix 2, which is in the exempt section of the agenda as it contains the commercially confidential information (relevant legislation - paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended)) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.
- 2.5 The developer and Travelodge have exchanged an agreement for lease and the form of lease which Travelodge will accept is for 25 years from completion on a full repairing basis. Rental terms are set out within Appendix 2. Travelodge has security of tenure under the Landlord and Tenant 1954 and has an option to take another 25-year lease after expiry of the initial 25-year term (and the renewal lease

will have tenant break clauses on not less than 6 months' notice at 5th, 10th, 15th and 20th anniversaries of the term).

- 2.6 At practical completion the Council will grant a lease of the hotel to Travelodge. A rent-free period will be granted to Travelodge and the calculation of its length depends on whether the date of practical completion of the hotel is prior to 14 December 2018 or after 12 January 2019. On the basis that the build period is approximately 14 months it is anticipated that the date of practical completion will occur after 12 January 2019.
- 2.7 The A3 unit is currently unlet and the developer will market for a tenant throughout the development period until practical completion, at which point responsibility will transfer to the Council if unlet. The Council will therefore benefit from the long-term revenue stream from the Travelodge and A3 use tenant.
- 2.8 All investment properties are valued to reflect the risk profile of the tenants (usually termed covenant strength). This investment valuation will change to reflect changing market conditions which will reflect market and project specific which will constantly affect the yield used to capitalisation the gross rent. Currently, the value it is based upon comparable current market evidence and is verified by an independent valuation. Yield rates are set out within Appendix 2.
- 2.9 The proposals contained in this report will help to deliver the Council's Investment and Acquisition strategy (IAS) by increasing properties held within the commercial property asset class. The project yields set-out above are below the target rates of return in the current version of the IAS; this reflects current market yields which are lower than when the IAS was written.

3. Options Appraisal

- 3.1 **Option 1 – Do Nothing.** The Council has the option to do nothing, and not intervene to invest in the Travelodge hotel and associated retail use and the opportunity may not get delivered in the current market left to the market to deliver.
- 3.2 **Option 2 – Develop and Sell.** Subject to market conditions, the Council would realise a profit at a margin that is consistent with trading at this level. Through this approach, the Council can control the delivery of the scheme, and in turn support the regeneration of the wider Sanofi site.
- 3.3 **Option 3 – Fund and Hold** - Through this approach, the Council can control the delivery of the scheme, and in turn support the regeneration of the wider Sanofi site. By investing in the scheme and holding the asset the Council has greater influence over its primary regeneration objectives for the wider Sanofi site and will also benefit from a long-term income stream from a tenant with a strong covenant over a 25-year lease period. At the end of the development period, the Council would have the option of disposing of the site if it considered prudent to do so. Under this option, the Council will make a net additional income per year and benefit from rent increases in line with RPI, subject to a cap, during the term of the lease every five years, with potential of selling and realising the profit as outlined in Option 2.
- 3.4 Options 2 and 3 will be reviewed at practical completion and regularly thereafter decision is made to retain the investment when the project is completed.

4. Consultation

- 4.1 Consultation on the development proposals were undertaken through the statutory consultation process which accompanies the planning process for the planning applications of Ref: 15/00959/OUT and Ref: 15/00810/REM (as varied on 27 April 2017 Ref: 17/066241/NMA) respectively.
- 4.2 The Council has powers for the acquisition of and investment in land to further the discharge of its functions, therefore, no additional consultation requirements arise in respect of the proposal

5. Financial Implications

- 5.1 The detailed financial information is included at Appendix 2, which is in the exempt section of the agenda as it contains the commercially confidential information (relevant legislation - paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended)) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

6. Legal Implications

Implications completed by: Suzan Yildiz, Deputy Head of Legal Services (Commercial) / Richard Beckinsale, Gowlings

6.1 Power for the Council to enter into the transaction

- 6.1.1 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 its functions, whether or not involving expenditure, borrowing or lending money, or the acquisition or disposal of any rights or property. Further, in accordance with the Local Government Act 1972, Section 120, the Council is empowered to acquire by agreement any land situated inside or outside its area for: -
- (i) the purposes of any of its functions stipulated by the 1972 Act or other statutory provisions, or
 - (ii) for the benefit, improvement or development of its area, and notwithstanding that the land is not immediately required for that purpose. Until the land is required for the purpose acquired, it may also be used for any purposes associated with of any of the Council's functions.
- 6.1.2 The Council has the power to fund the development in the manner proposed under Option 2 in reliance upon section 12 of the Local Government Act 2003 where the proposed investment is consistent with its functions or the prudent management of its financial affairs.
- 6.1.3 To the extent that the investment proceeds under Option 2 (ie. it is not a long-term investment (meaning the investment is repaid within 12 months because the property is sold)), the Council can rely on the general power of competence ("GPOC") under section 1 Localism Act 2011. Section 4 of that Act requires the

Council to establish a company where it does those things for a "commercial purpose".

6.1.4 Council officers have confirmed that the primary purpose of the transaction is to secure the successful regeneration of this property in the context of the wider regeneration of the Sanofi site and that the return on the investment is incidental to that purpose. External solicitors have advised that the fact an activity may generate a return and have a commercial element to it does not in itself mean that a company must be established and has provided detailed advice referencing the relevant case law from the Supreme Court and the Court of Appeal as well as the more recent February 2018 High Court decision in the case of *Peters v London Borough of Haringey*. This element of the transaction will be kept under review through the due diligence, hence, authority is delegated to officers to decide if a special purpose vehicle company should be utilised.

6.2 Procurement implications

6.2.1 The Council is procuring the developer to carry out the development (via the building contractor). The approximate value of the building works plus developers' is above the current threshold for works contracts.

6.2.2 The developer has also appointed a building contractor and the Council is funding, by more than 50%, the underlying construction contract. The building contractor has not been appointed by way of an OJEU process.

6.2.3 At two levels therefore (appointment of the developer and appointment of the contractor), the Council has not been able to ensure that a procurement process is undertaken in accordance with the Public Contract Regulations 2015 ("Regulations") because it intends to participate in a transaction where the appointment of Berkeley Square Developments Dagenham Limited (as the developer) and The Barnes Group Limited (as the contractor) are conditions of the transaction going ahead.

6.2.4 The Council has been advised that Regulation 32 (2)(b)(iii) of the Regulations permits the procurement of works without a competition in cases involving the protection of "exclusive rights". In this case, exclusivity arises due to the developer's land ownership position such that the Council is unable to insist on a procurement exercise. This approach is most commonly seen in the case of registered providers that fund the delivery of homes under section 106 agreements without the ability to insist on the relevant developer conducting a full OJEU process. Whilst there is no guarantee that a procurement challenge would not arise, the Council is advised that it would be able to robustly defend its position on this basis.

6.3 State Aid implications

6.3.1 In this transaction, state aid could arise if the Council were to:

- Acquire the land for a price higher than its market value
- Dispose of the land for less than its market value
- Pay for the development of the Travelodge at a price higher than that which would ordinarily be paid on the open market

- Provide finance on terms which are more favourable than those available on the open market

6.3.2 In relation to the first three bullet points, the Council's agent, Be First has undertaken its own valuations by reference to the relevant property and construction markets and confirms that no state aid has arisen as the agreed financial transaction is reflective of market conditions and does not create a commercial advantage for the developer or Travelodge beyond that ordinarily obtainable in the market. The final bullet point is not relevant in this situation because were a finance charge to be applied to the advanced monies, it would simply have the effect of increasing the Council's overall cost of delivery by the equivalent amount. Hence, the developer is not in receipt of a benefit that it could not otherwise attract on the open market.

6.4 **Best consideration**

6.4.1 The Council's power to grant the lease to Travelodge under section S123 of the Local Government Act 1972, providing that the lease terms represent the best consideration reasonably obtainable in the open market. The Council will need to secure best consideration on the grant of the lease to Travelodge. The property cannot be disposed of for less than the best consideration reasonably obtainable. Although the Council was not involved in securing Travelodge as a tenant of the completed building, Be First is satisfied that the terms of such disposal represent the best consideration reasonably obtainable. An independent external valuation has been commissioned. Any onward sale of the Council's assets would be subject to a tender process in due course and consent of the Council to that disposal would be sought at the relevant time. An onward sale is not included in the recommendations of this report.

6.5 **Constitutional Considerations**

6.5.1 The Council's Constitution, Part 4, Chapter 4 sets out the Land Acquisition and Disposal Rules. In accordance with paragraph 2.1, all strategic decisions about the use, acquisition and disposal of land and property assets are within the remit of the Cabinet. Formulation of strategic decisions is overseen by the Property Advisory Group (PAG) and the Cabinet. Investment decisions may proceed upon the recommendations of Investment Panel or Chief Operating Officer who has investment powers.

6.5.2 The recommendations and an estimated acquisition at the current price detailed in the report renders this a key decision, requires the acquisition decision to be taken by Cabinet in accordance with the Land Acquisition and Disposal Rules. Approval of any due diligence reports, agreeing final terms and entering into any agreements is delegated to the Chief Operating Officer and Director of Law, in consultation with the relevant Cabinet members in order to facilitate further due diligence and the mechanics of completion.

6.5.3 Approval is being sought for acquisition plus Stamp Duty Land Tax and professional fees. It should be noted that an independent valuation should be commissioned before a formal binding offer is made and/or final terms negotiated for the acquisition and associated lease. An independent valuation has been commissioned in order to satisfy these requirements, in particular that the lease

terms represent best consideration under Section 123 of the Local Government Act 1972.

7. Other Implications

7.1 Risk Management

- **Construction Risk** - Berkeley Square Developments Dagenham Limited will hold construction risk during the construction programme, therefore limiting the Council's exposure. Security arrangements for the performance of the Developer and in turn the contractor are set out within Appendix 2.
- **Market Risk** – The Travelodge lease is a 25 year lease (with a right to renew) with no tenant break clauses for the initial 25 years. The vacant A3 unit will be marketed in order to secure a tenant at the earliest opportunity, and a variation to the planning consent may be sought to expand its use to A1 and A2 uses if necessary. Equally, once constructed, the hotel would have a use for either an alternative operator or as an alternative use (for example hostel provision) in the event of default by Travelodge.
- **Funding risk** - The Council takes ownership of the land at the point of entering in to the development and funding agreement and appropriate safeguards are built into the development and funding agreement. Security arrangements for the performance of the Developer are set out within Appendix 2.
- **Ground contamination** – whilst the entire Sanofi site had a ground contamination risk, conditions related to ground remediation have been discharged for the Travelodge development site. The contractor has included contingency allowance within their construction price.

7.2 **Contractual Issues** – Contractual implications are as described and covered within the Legal Implications section of this report.

7.3 **Staffing Issues** – The project will be managed on behalf of the Council by Be First Regeneration, with the main element of resource being required to get the scheme in to contract. External monitoring surveyors will be appointed to monitor expenditure during the construction phase of the project.

7.4 **Corporate Policy and Customer Impact** - No issues relating to the specific recommendations.

7.5 **Safeguarding Children** – The proposals should have no impact on safeguarding children. Hotel accommodation increases the provision of good quality nightly accommodation in the borough, which may be required in emergency situations.

7.6 **Health Issues** – No issues relating to the specific recommendations.

7.7 **Crime and Disorder Issues** – The development makes use of a currently vacant brownfield site, which is currently at risk of illegal occupation or fly tipping. The development proposals will therefore have a positive impact on the local community.

7.8 **Property / Asset Issues** – A 25-year lease will exist with Travelodge and bring an income stream in to the Council. There are provisions for rent increases every five years within the lease as set out within Appendix 2. The retail unit which will form

part of the development is not currently subject to an agreement with a tenant and is being marketed to prospective tenants.

- 7.9 The Council will be transferred the land upon which the hotel is to be developed upon completion of the purchase contract, and therefore will have the ability to review options for the site should it so wish at the end of the lease term. The proposal would be a significant addition to the Council's asset register and as such forms a key element of the main body of the report.

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

List of appendices:

Appendix 1: Site Plan

Appendix 2: Financial Summary and Financial Implications (exempt document)