

CABINET

19 March 2019

Title: Institutional Funding Proposal – ApartHotel Investment	
Report of the Cabinet Member for Finance, Performance and Core Services	
Open Report with Exempt Appendices (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972 as amended)	For Decision
Wards Affected: None	Key Decision: Yes
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Accountable Strategic Leadership Director: Claire Symonds, Chief Operating Officer	
Summary <p>This report sets out proposals for the Council to enter into an investment arrangement with an Institutional Investor and a specialist Aparthotel operator. The proposal would generate significant annual revenue for the Council but sums outlined in the proposed Heads of Terms are indicative only and will be finalised through the detailed due diligence and negotiation process.</p> <p>A site for the new Aparthotel as well as planning permission has been secured and construction is underway. The new ApartHotel has been designed to meet the short-stay hotel (ApartHotel) market primarily from business visitors to the City of London and surrounding fringe areas. The current owner, an overseas investment fund, will continue to take all construction and development risk until Practical Completion which is due in November 2019 at which point the Council and would enter into the investment and lease arrangements.</p> <p>The proposed transaction is a lease and leaseback arrangement between an Institutional Investor (long leaseholder), the Council (head lessee) and a specialist ApartHotel operator as tenant of the Council. This Council would retain a profit rent to reflect rental obligation required by the institutional investor and any index uplifts will be mirrored in the Aparthotel operators lease to ensure the profit rent margin increases at the same level. The Council will receive the freehold of the property at the end of the Headlease period which GVA have advised is currently valued at £94.6m</p> <p>No rent is payable between the parties until the new hotel is constructed and the Aparthotel operator have entered their lease. Under this arrangement the Council would pay a guaranteed and indexed head rent to the funder for the term. Simultaneously the Council would receive a matching guaranteed and indexed rent from the Aparthotel operator for the term of the agreement. The rent payable by the Aparthotel Operator to the Council is higher than the rent payable to the Institutional Investor, providing a profit rent to compensate the Council for providing the rental guarantee. The Aparthotel operator assumes full operating, maintenance, insurance and occupancy risk for the term of the Aparthotel Operator lease.</p>	

Recommendation(s)

The Cabinet is recommended to:

- (i) Agree the draft Heads of Terms between the Council and the Institutional Investor as detailed in Appendix 1 to the report;
- (ii) Agree that the Council enter an Agreement to Lease with the Institutional Investor and the Aparthotel Operator on state aid compliant market terms;
- (iii) Agree that the Council enter a 50-year Head Lease with the Institutional Investor on state aid compliant market terms;
- (iv) Agree that the Council grant a 25-year sub-lease with an option to renew to a specialist Aparthotel operator;
- (v) Delegate authority to the Chief Operating Officer, in consultation with Director of Law and Governance and the Cabinet Member for Finance, Performance and Core Services, to negotiate final heads of terms, final commercial and lease terms and agree the contract and ancillary legal documents to fully implement and effect the proposals set out in the report;
- (vi) Authorise the Director of Law and Governance, or an authorised delegate on her behalf, to execute all the legal agreements, contracts and other documents on behalf of the Council; and
- (vii) Delegate authority to the Chief Operating Officer, in consultation with Director of Law and Governance, to incorporate a special purpose vehicle (whether a company or Limited Liability Partnership) if considered necessary and appropriate, such incorporation to include such shareholders or members' agreement as may be required.

Reason(s)

The proposals in this report would help to deliver the objectives of the Investment and Acquisition Strategy community development and help to deliver regeneration in East London.

1. Introduction and Background

- 1.1 An opportunity has been presented to the Council under the Investment and Acquisition Strategy (IAS) to participate in an institutional funded Aparthotel investment. The proposals in this report would be held within the commercial property asset class of the IAS.
- 1.2 The development has been brought forward and financed by an overseas investment fund (the asset is held in a Special Purpose Vehicle) who are looking to sell the scheme to a long-term institutional investor once the building reaches Practical Completion in November 2019. The institutional investor would purchase the asset and would then enter into a HeadLease with the Council in return for

annual profit rent. The Council will then simultaneously enter into an operational underlease granted to the Aparthotel operator in return for a fixed rent.

- 1.3 A key investment objective of the Institutional Investor in purchasing the asset is to create stable and low-risk long-term returns to pay future pension liabilities. Such investors commonly aim to reduce their income risk by seeking to insert an intermediary tenant (in this case the Council) to sit between themselves and the ultimate occupational tenant and who has a better credit rating than the occupational tenant. In return, the intermediary tenant receives a profit set at a level commensurate with the level of risk transferred.
- 1.4 The site sits in Aldgate and is very close to the City of London's financial district so is well placed to provide short and mid-term accommodation to support the banking/insurance industries. Overseas and out of London based Clients and Employees of the banks will be able to use the apartments at the weekends alongside holiday makers. Furthermore, the location provides for a very strong alternative use value in the form of offices, standard private rental sector residential and hotel use.
- 1.5 LaSalle Investments, one of the Largest Pensions Funds in the UK/US, have bought six ApartHotels in London in the last twelve months due to the diversification characteristics of this hotel segment. The proposed development has been built using standard construction methods to allow for future flexibility of conversion to alternative uses with minimal works e.g. other hotel formats, PRS, affordable housing, shared ownership/ private sale housing which provide options that could be pursued in the event of a default of the Aparthotel operator lease or at the expiry of the 25-year lease.
- 1.6 The key indicator used to determine the strength of the opportunity is the expected earnings of the hotel expressed by the expected operating EBITDA of the scheme (EBITDA stands for earnings before interest, taxes, depreciation and amortization). This is the key investment metric used by investors to assess a project as it provides a snapshot of short-term operational efficiency and in this case shows the Aparthotel operators ability to pay rent, debt costs and taxes. For this investment, the range of expected EBITDA is £4.70m to £6.87m, a spread of £2.17m.
- 1.7 JLL Hotels & Hospitality Group ("JLL") were commissioned by the overseas investor to market the opportunity and received strong interest from potential Aparthotel operators with eight Aparthotel operators bidding for this opportunity. All Aparthotel operators were offered a 25-year operational lease on a Full Repairing and Insuring basis and were required to provide full and detailed operating assumptions to support their offers.
- 1.8 The proposed Aparthotel operator was established in 2005 and has since grown into one of the most respected serviced apartment operators catering to both corporate and leisure guests. They only manage Aparthotel property and have a current average occupation rate of 95%. Their approach to guest experience has allowed them to beat the industry average length of stay by 110 days (4 months for PB vs. 10 nights for industry.) They manage assets across London, with over 400 units across 65 postcodes.

2. Proposal and Issues

- 2.1 Under the proposals the Council would pay a guaranteed and index linked rent (RPI) subject to a collar of 0% and a cap of 5% for a term of 50 years to the Institutional Investor. Simultaneously, the Aparthotel operator will enter into a 25-year lease with the Council which mirrors the rent review mechanism contained within the Headlease thus maintaining the profit rent received by LBBB. The Aparthotel operator would assume full operating, maintenance, insurance and room occupancy risk during their 25-year lease term.
- 2.2 If the Aparthotel operator does not renew their lease the Council has the option to either seek a new Aparthotel operator or to redevelop the site for residential and/or office use at the end of the 25-year term.

3.0 Investment Returns

- 3.1 The proposals contained in this report would help to deliver the Council's Investment and Acquisition strategy (IAS) objectives by increasing properties held within the commercial property asset class in the sub-regional area. There is no capital outlay required from the Council.
- 3.2 The detailed Red Book Valuation report provided by the Council's external financial advisors GVA on the proposed options is contained at Appendix 2 which is in the exempt section of the agenda as it contains 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.

4.0 Project Delivery Structure

- 4.1 The transaction structure is a lease and leaseback arrangement between an Institutional Investor (long leaseholder), the Council (head lessee) and a specialist Aparthotel operator as tenant of the Council.

5.0 Hotel Investment Assessment

- 5.1 The Council have instructed a third-party property consultant (GVA) to assess the investment proposal and to provide a recommendation as to whether to proceed or not. GVA have confirmed that the proposals within this report provide an acceptable investment for the Council and the full report which includes their assessment of value is contained at Appendix 2.

6.0 Project Timetable

- 6.1 The timing of the transaction and payment of the arrangement fee to the Council would be as follows:

Date	Milestone
19 March 2019	Cabinet approval of the investment proposal
27 March 2019	Final hotel operator Investment Panel approval

April 2019	Transaction documentation finalised and signed by The Institutional Investor and the Aparthotel Operator and LBBD
November 2019	Practical Completion – the Aparthotel operator takes possession after signing the building off as completed and enter their lease, LBBD enter their lease with the Institutional Investor and revenue commences. Payment of arrangement fee is expected in Q4 2019/20

7.0 Options Appraisal

7.1 The Council has been approached to participate in a new Aparthotel development in Aldgate. Construction of the new building is underway and Practical Completion is expected in November 2019. An Institutional Investor has been identified to purchase the asset at practical completion and will earn an indexed rental return for the duration lease term with the Council and a specialist ApartHotel operator has been selected following a market opportunity.

7.2 To reduce income risk, the Council has been approached to enter the lease structure between the Institutional Investor and the Aparthotel Operator. Commercially the Council would pay a guaranteed, indexed annual rent to the Institutional Investor and in return retain a profit rent to compensate the Council for providing a rental guarantee. The Council would not be required to provide any capital funding either during construction or during the lease term and would, subject to agreement of the final options, own the asset at the end of the Head Lease term.

7.3 Scenario 1 – Do Nothing

7.3.1 The Council has the option to not participate in the arrangement. In this case the Development Owner would seek another Local Authority partner in order to secure the sale to the Institutional Investor. The Council would lose the opportunity to earn an annual profit rent. No arrangement fee would be made to the Council.

7.4 Scenario 2 – provide a rental guarantee to the Institutional Investor in return for a long-term profit rent (preferred option)

7.4.1 The profit rent and arrangement fee payable to the Council would generate sustainable long-term returns to support the financial sustainability of the Council in line with the objectives set-out in the IAS.

7.4.2 In addition, the ability to redevelop the site for housing or alternative uses in the future provides a long-term asset that would support future housing delivery objectives of the Council through direct development or disposal to realise capital value for investment within the borough.

8.0 Consultation

8.1 The proposals in this report have been considered and endorsed by relevant Cabinet Members and the endorsement of the Council's Investment Panel will be sought prior to the finalisation of terms.

9.0 Investment Analysis

9.1 Investment and Acquisition Strategy (IAS)

- 9.1.1 The proposals in this report would help to deliver the investment objectives of the Investment & Acquisition Strategy. The new hotel would be held within the Commercial asset class of the IAS and would generate a profit rent to compensate the Council for agreeing to guarantee a head lease payment to an institutional investor.
- 9.1.2 Under the terms of the arrangement the Council will not provide any development funding or incur any future hotel operating costs (capital or revenue). All development risks will remain with the developer.

9.2 Risk

- 9.2.1 The Authority's payments under its lease will be fixed irrespective of whether the Aparthotel operator continue to meet their obligations under the terms of its own lease. The Authority has several options available should the Aparthotel operator default, which include contracting with other Aparthotel operators, or converting the use to residential and/or office accommodation. In addition, on execution of the headlease, the Institutional Investor will make a 'cushion' payment to LBBD to be held for 3 years. This will provide revenue security should the Aparthotel operator default during the first three-year period from lease commencement date.

9.3 Lease Classification

- 9.3.1 The lease from the Institutional Investor to the Authority will be deemed a finance lease as substantially all the risks and rewards associated with the asset are passing to the Authority.
- 9.3.2 This will result in the asset being recognised on the balance sheet with an equivalent liability recognising the payments to be made to the Institutional Investor over the lease term. Each lease payment made will split between reducing the outstanding liability and servicing the interest costs implicit within the lease.
- 9.3.3 The Authority will recognise the asset as an Investment Property, as it will be held solely to earn rentals or for capital appreciation purposes or both.
- 9.3.4 The subsequent lease between the Authority and Aparthotel operator can be assessed using a number of classification tests to determine the appropriate lease classification. Reviewing the current proposals in association with these tests suggests that the lease can be classified as an operating lease, in which case all income will be deemed to be revenue.

10. Financial Implications

Implications completed by: Helen Seechurn (Finance Director)

- 10.1 The financial implications of the proposed investment are contained within the Heads of Terms in the exempt document at Appendix 1 (this appendix is in the

exempt section of the agenda as it contains 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). Members should note the key financial benefits of the scheme include an upfront arrangement fee anticipated to be received in October 2019 is dependent on Cabinet agreement and on completion of this agreement by 29 March 2019.

- 10.2 Any returns on this scheme are assumed to be revenue contributions which will assist delivery of savings as defined in the MTFs.
- 10.3 The arrangement with the Council acting as head lessor is not without risk. Further due diligence is required on financial modelling and this will be completed by the Council's independent advisers Link Asset Services and GVA. These reports will need to confirm the initial rental income the Council will receive from the Aparthotel operator and after payment of rent to the institutional investor and also confirm that the indexation for each lease are aligned. Initial calculations indicate that this will leave a profit rent of £0.60m, with future rental payments uplifted 5 yearly for inflation (RPI). It is essential that, prior to any agreement, the cashflows are confirmed and are reflected in any lease agreements.
- 10.4 Other risks that affect the financial position include the credit rating and security of the Aparthotel operator. The Council will retain step in rights to secure another operator in the event of operator failure. These are dealt with in the GVA property report at Appendix 2.
- 10.5 The arrangement is a lease and leaseback arrangement, with the Council acting as guarantor of an annual lease arrangement. The impact of the cap/collar has not yet been considered, and sensitivity analysis requires review. Key parts of this agreement are similar to the Travelodge scheme that was agreed by Cabinet in December 2018.
- 10.6 The arrangement is such that the Council will own the freehold to the land at the end of the lease term for a peppercorn and will in turn benefit from increased land value growth over this period. Over the lease term land values are expected to increase. Not considering land price inflation over the lease term (which is difficult to predict with any certainty) the Council will be able to buy the site for £1 at the end of the term because the Institutional investor will have fully amortised their debt over the lease term.
- 10.7 Set up costs and SDLT incurred by the Council up to an agreed amount will be funded by the institutional investor.
- 10.8 Beyond the agreed initial lease period of 25 years with the Aparthotel operator, the council will remain responsible for the asset with the head lease obligation remaining lease term. This currently presents future options to the council including renewal of arrangement or possibility of commercial or residential potential. The current financial appraisal assumes the renewal of hotel operations.
- 10.9 The IAS approved by Cabinet 16 October 2018 allows for investment: 'To establish a property portfolio to generate long-term revenue and capital growth, targeting an

initial revenue return of £5.2m by 2020/21 and indexed at CPI thereafter'. The proposal in this report would contribute to achieving this objective.

- 10.10 This strategy also, subject to regular review, allows up to 10% of the investment asset portfolio structure (currently £100m allocation) being 0.64% net yield (after debt). Whilst this decision will not score against the £100m target because it will not be financed through prudential borrowing, the expected yield (based on capital costs for comparison purposed) to be achieved from the scheme is expected to be above the target net yield (after finance costs) for this asset class.
- 10.11 It should be noted that although there is no additional borrowing required to enter this deal that the Council will be assuming obligations under the head lease with the Institutional Investor and the risks associated with this lease (principally the Obligation to pay an indexed rent for the lease term) will need to be taken into account when making future investment decisions.
- 10.12 The pre-development and development costs will be met by the Developer. Consequently, the council will not be responsible for development cost overruns. The development is currently part constructed and will be scheduled to be completed and operational by October 2019.
- 10.13 In making this decision members should also refer to the legal implications as detailed in that section. It should be noted that although not located in this borough this project will increase business rates in the London Business Rates Pool of the Council is a constituent member.

11. Legal Implications

Implications completed by: Suzan Yildiz, Deputy Head of Legal Services (Trowers and Hamlin are also advising the Council on the transaction)

11.1 Council's powers to enter into the proposed arrangements

- 11.1.1 The Council has a variety of powers to enable it to enter into the proposed transaction. These are subject to the Council also complying with its fiduciary duties to its taxpayers/residents.
- 11.1.2 The actual powers which the Council relies on is to an extent governed by its purpose/intention in entering into the arrangements and whether any of the limitations or restrictions of those powers conflict with the proposals made by the fund.
- 11.1.3 We have separated the proposed transaction into relevant stages.

11.2 Entering the Lease with the Institutional Investor

- 11.2.1 Section 120 of the Local Government Act 1972 (section 120) gives the Council the power to acquire land (including a leasehold interest) for a purpose relating to any of its powers or pursuant to duties under any enactment (other purpose).
- 11.2.2 The Council in exercising section 120 may acquire land within or outside its area.

11.2.3 This means that the Council is required to identify another function (power or duty) which it seeks to exercise/rely on. Two powers which may be available include the general power and its investment power under Section 12 of the Local Government Act 2003.

11.3 The general power

11.3.1 The general power is set out in chapter 1 of the Localism Act 2011 and permits the Council to do anything which an individual may do. The general power is subject to several limitations which include that it cannot be used to circumvent any prohibition or restriction which exists in legislation which precedes the general power. We are not aware of any contravening legislation which would apply to the proposed transaction.

11.3.2 The general power is also subject to the limitation under section 4 of the Localism Act 2011, namely that if it is used for a commercial purpose then the Council must do that thing through a company or society registered or deemed to be registered.

11.3.3 Should the Council rely on the general power to directly enter the lease (rather than using a Council-owned company to do so) the Council would have to satisfy itself that it was not acting predominantly for a commercial purpose. In doing so it would have to analyse whether the letting of an Aparthotel (in terms of the arrangements) was 'trading'.

11.4 Section 12 – the Local Government Act 2003 (LGA 2003) (Power to invest)

11.4.1 The Council's power to invest (Section 12, LGA 2003) may be exercised for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs. In exercising this power, the Council would rely on the second limb, namely that the proposals aid prudent financial management and should have regard to relevant statutory guidance. The financial implications consider how the proposals assist the prudent management of the Council finances.

11.4.2 The Ministry of Housing Communities and Local Government (MHCLG) issued new statutory guidance (attached to the email) under section 15 of the Local Government Act 2003 on local authority investments on 1 April 2018 (MHCLG Guidance). In approving the proposals both officers and decision makers should have regard to relevant aspects of the MHCLG Guidance.

11.4.3 Local Authorities are required to adopt an updated investment strategy as is required in that guidance. The Council's Investment Strategy contains provision for commercial investments in hotel and leisure facilities. The report and accompanying financial reports (which are confidential and exempt) address how the proposals are aligned with the investment parameters for the commercial asset class.

11.4.4 The Guidance references 'non-financial assets' which includes certain property portfolios: 'non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property'.

11.4.5 There are specific requirements for non-financial investments, and property portfolios, set out in paragraphs 37 to 40 of the Guidance. The Guidance requires

local authorities to consider whether the asset retains enough value to provide security of investment using the fair value model in International Accounting Standard 40: Investment Property as adapted by proper practices.

11.4.6 In taking forward the proposals finance and legal officers should discuss the impact of MHCLG's Guidance and whether the arrangements qualify as 'non-financial assets' under it. Consideration of the financial implications should include the extent to which the proposals amount to fair value and any proposed mitigation of risks.

11.5 Power to grant a lease to the Aparthotel operator

11.5.1 The Council has a power to grant a leasehold interest in the property to the Aparthotel operator under section 123 of the Local Government Act 1972. In doing so it should ensure that it receives the best consideration which reasonably could be obtained. A valuation report confirming this should be obtained.

11.6 The Council's Fiduciary Duties

11.6.1 The Council's fiduciary duties could be briefly summarised as it is acting as a trustee of tax and public sector income on behalf of its residents' rate and tax payers. The Council in effect holds money but does not own it; it spends money on behalf of its residents' business rate and council tax payers.

11.6.2 The Cabinet in agreeing the recommendations should consider the risks and rewards of approving them and the proposed arrangements. In practice the Cabinet should consider whether the proposals are on market normative terms which a prudent investor on the open market would enter into, whether the Council will achieve an appropriate return for the risk it is taking and whether the risk and potential cost to it of entering into the arrangements can be appropriately mitigated. Those the Cabinet delegate to should also consider the Council's Fiduciary Duties in finalising and agreeing the documentation.

11.7 Procurement structuring

11.7.1 The primary purpose of the transaction appears to be one of landlord and tenant and as such there is a strong legal argument that it falls outside of the Public Contracts Regulations 2015.

11.7.2 In finalising the documentation and structure advice should be obtained to ensure that any risk of procurement challenge is mitigated and minimised. Advice should be obtained at an early stage of negotiations about this.

11.8 State aid compliance

11.8.1 Under the proposals the Council will be entering into the arrangements mainly for mainly financial purposes. The leasing and letting of Aparthotel accommodation are market activity and in agreeing final terms for both the Institutional Investor and Aparthotel operator leases, the Council should be satisfied they are state aid compliant. To do this the Council should ensure it acts as a market operator would, meaning the terms it agrees should be such that an operator or investor in the private sector would agree to those terms in the same or similar circumstances). The Council should seek evidence from a commercial adviser whether in their

opinion market/private sector parties in the same circumstances would be likely to do agree to the same or broadly comparable terms which constitute the market norm. Such a report (confirming that private/market sector parties will do so) will evidence state aid compliance.

11.9 Risk Management

11.9.1 Investment transactions of this nature carry a range of risks which are effectively detailed below. A number of risk factors, including planning, title investigations, commercial terms and construction, warrant early due diligence, with the aim of determining whether any of those risk factors have adverse implications on the transaction, including impact on future capital value and income yields. For example, if planning permissions regulating the development in terms of scale, nature/use class and restrictions do not materially align with the proposal pitched or valuation assumptions, the associated risks may impact on usage of the completed development and consequently income. As the Council carries the risk of paying guaranteed rent under a headlease, it is imperative to carry out due diligence to appraise the risks.

Trowers have been commissioned to report on preliminary due diligence, which should be considered fully by the Chief Operating Officer, as a delegate, before proceeding with the transaction. As the transaction progresses, Trowers would report more fully on due diligence. It is recommended that as heads of terms for the Council's headlease are distilled and transaction documents (such as an agreement for lease) progress that the valuers should have the opportunity to comment on the terms, and that the legal and valuation considerations are closely integrated.

12. Other Implications

12.1 Risk Management

12.1.1 **Planning Risk** – It is of critical importance to establish planning risk and impact on value/income for uses of this nature which are an emerging asset class and arguably straddle different use classes (residential, hotels or sui generis). C1 Class hotel use is imperative to ensure that the permissible use aligns with the business model for apart hotels and to check the various conditions or restrictions that may apply. These issues are important and can go to value, both in terms of capital growth and risk to income. Planning can add or remove value. A use class of C3 or sui generis would be restrictive. Title, property, construction and other asset management risks will need to be considered in the detailed due diligence stage.

12.1.2 **Construction Risk** – All development and construction risks, including ground contamination, are borne by the developer.

12.1.3 **Hotel Market Risk** –The Council's external property advisors have produced a detailed report on the investment proposals including a formal valuation. This report is contained at Appendix 2, the basis of which is summarised within this report. It is considered that this investment proposal is a market facing Aparthotel investment opportunity that would be acceptable to other private and institutional investors.

12.1.4 **Operator default** – Unlike other real estate investments where rents cease completely in the event of an Aparthotel operator default, for Hotels and Aparthotels

the asset could continue to operate as a standalone business meaning it could continue to generate revenue. However, the most likely scenario in the event of an Aparthotel operator default would be that the Council would look to secure another Aparthotel operator to take over the lease.

- 12.1.5 The covenant strength of the Aparthotel operator has been considered by the Council's external property advisors who consider that the covenant strength of the Aparthotel operator combined with the strength of interest in the proposal from the eight Aparthotel operators that bid for the opportunity, as well as the terms of the full FRI lease outlined within the Heads of Terms represents a strong investment opportunity.
- 12.1.6 On execution of the headlease, in addition to the arrangement fee, the Institutional Investor will make a 'cushion' payment to LBBB to be held for 3 years should the Aparthotel operator default during that period. This will provide additional security to LBBB as outlined in the Heads of Terms.
- 12.1.7 **Funding risk** - The Council has no direct funding obligation in the proposed lease structure during construction or during the term of the Aparthotel operator lease. The Council will only enter the lease structure on Practical Completion and commencement of hotel operations.
- 12.1.8 **Redevelopment risk** - if the Aparthotel operator lease was determined the Council would have a number of options it could pursue which are;
- to find another Aparthotel operator - given the strength of the London Docklands Aparthotel market as outlined by the market interest in the current opportunity, it is considered that a new hotel operator could be appointed. A new hotel operator could be granted a new lease on the same or similar terms to the existing Aparthotel operator lease, but they would require a rent-free period to rebrand and refurbish the building - typical such rent free period are two years (c £6m). The Council would receive no during this period.
 - redevelop/ convert the building for another use – this could be negotiated with the institutional investor and could provide residential/regeneration outcomes but would require new planning permissions and capital funding. A capital sum will be required for any conversion which along with the revenue loss during the conversion phase would need to be funded by the Council
 - Alternatively, the Council could either directly manage the asset itself or seek to appoint a hotel operator under a direct management contract to manage the hotel on behalf of the Council. In this case the Council would assume operations risk but could earn a significantly higher income from hotel operations than the expected profit rent.

To mitigate the impact of these risks the Council should ensure it retains a significant proportion of the arrangement fee in a reserve. As such, if approved the next iteration of the IAS will detail the arrangements for the proposed reserve as well as how and when these could be accessed.

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

- 12.3 **Staffing Issues** – There are no staffing issues associated with this report.
- 12.4 **Corporate Policy and Customer Impact** – The proposal in this report would help to deliver the objectives of the Council’s Investment and Acquisition Strategy and would help to provide revenue to support Council expenditure.
- 12.5 **Property / Asset Issues** – A 25-year renewable lease would exist with the Aparthotel operator. This would generate an indexed profit rent for the Council. There are provisions for rent increases every five years within the lease at 1% collar and 5% cap, based upon the Retail Price Index. These provisions are mirrored in the Head Lease between the Council and Institutional Investor. The Aparthotel would be a full repairing and insuring lease. In the longer-term the Council could seek to sell or redevelop the site for residential or mixed use to help deliver the Council’s Housing Strategy at that time.

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

List of appendices:

- Appendix 1: Draft Heads of Terms (exempt document)
Appendix 2: Draft GVA Valuation Report (exempt document)