

<b>Report title</b>	i9 Office Development – Investment Case	
<b>Decision designation</b>	RED	
<b>Cabinet member with lead responsibility</b>	Councillor John Reynolds City Economy	
<b>Corporate Plan priority</b>	Place - Stronger Economy	
<b>Key decision</b>	Yes	
<b>In forward plan</b>	Yes	
<b>Wards affected</b>	(All Wards)	
<b>Accountable Director</b>	Tim Johnson, Strategic Director, Place	
<b>Originating service</b>	City Development	
<b>Accountable employee</b>	Paul Lakin Tel Email	Head of City Development Tel: 01902 557978 Paul.Lakin@wolverhampton.gov.uk,
<b>Report has been considered by</b>	Place Leadership Team Strategic Executive Board	29 January 2018 06 February 2018

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**Recommendations for decision:**

That Cabinet recommends that Council:

1. Approve the Investment case for the i9 office development at Wolverhampton Interchange.
2. Authorise the allocation of up to £13 million capital investment by way of prudential borrowing to forward purchase the i9 office development.
3. Approve the proposal to declare the Council's land holdings at Railway Street car park as surplus to requirements to enable the office development.
4. Approve the Council granting a headlease to ION and the grant of an underlease from ION to the Council.
5. Approve delegation to the Cabinet Members for City Economy and Resources, in consultation with the Strategic Director for Place and Director of Finance for: -

- i. The appointment of ION (being the developer under the Master Development Agreement or their subsidiary) as developer to deliver the scheme;
  - ii. The entering into various legal agreements with ION including Funding/ Phase Agreements, collateral warranties, supplemental agreement to the Master Development Agreement for the Interchange, headlease, underlease, and any other ancillary documentation necessary in order to give effect to the recommendations in this report;
  - iii. Participating in the process for ION to procure and appoint a contractor to build i9;
  - iv. The approval of terms for lettings with occupiers;
  - v. The application for, and granting of, relevant licences to enable the construction of i9;
  - vi. Approval of the terms for the headlease to ION and the underlease to the Council subject to advice from Corporate Landlord;
  - vii. The Council establishing an investment company to hold the asset if this proves to be a preferential option.
6. Approve the use of the Council's powers under s.247 of the Town and Country Planning Act 1990 to stop up parts of the highway at Railway Street to enable development.
  7. Agree to receive a further report regarding the appropriation of the development site for planning purposes (if appropriation is required).

That Cabinet recommends that Council notes:

1. That an application has been submitted by ION Developments Ltd to the Black Country Local Enterprise Partnership (LEP) for capital support from the Land and Property Investment Fund (LPIF) by way of a grant.
2. The investment case is subject to/ conditional on LEP board approval for the full business case/ economic appraisal and award of the grant. The funding bid has not yet been formally determined.
3. That the maximum capital investment sum in the forward purchase of i9 is £13 million.
4. That discussions and negotiations with potential office occupiers will be intensified once the Council has committed to invest in the forward purchase of i9 and LEP board have approved the full business case.

## **1.0 Purpose**

- 1.1 To seek approval of the case for the Council investment in the purchasing of the i9 building as the next commercial phase of the Wolverhampton Interchange masterplan. This proposal is presented in the context of the Council's regeneration priorities in the City Centre. They are outlined in the City Centre Area Action Plan (AAP) and the emerging 'City Centre Investment Prospectus' where the Wolverhampton Interchange is identified as the city's key office growth quarter with potential to develop into a major sub-regional office centre.

## **2.0 Background**

- 2.1 A separate report is submitted in the private part of the agenda in respect of this item, as it contains details of financial information required to be kept private in accordance with Schedule 12A of the Local Government Act 1972. The grounds for privacy are that it contains information relating to the financial and business affairs of any particular person (including the authority holding that information). The public interest in maintaining the exemption under Schedule 12A outweighs the public interest in disclosing the information.
- 2.2 A report presenting a development and investment proposal for i9 was approved by Cabinet on 18 October 2017. This report is an update to that report having finalised the detailed design of the building, and development of a funding proposal.

### **Market demand**

- 2.3 The success of i10 as an office development has demonstrated a latent demand for high quality office floorspace close to Wolverhampton's transport interchange. The combination of competitive office rents and accessibility to the UK market means that Wolverhampton has an opportunity to capture new businesses and to provide options for existing occupiers looking to upgrade and expand. A lack of quality office space in the City Centre has constrained growth.
- 2.4 CBRE has prepared an office demand analysis to give commercial insight into the marketability of i9. Knight Frank has also contributed to the report as the letting agent for i10. The demand analysis concludes that the provision of a new speculative high-quality office building of up to 50,000 sq. ft. is supported by wider market conditions and historic take up patterns.
- 2.5 Whilst the building will face an element of competition from refurbished and second-hand stock (particularly in local Business Park locations and other provincial regional centres), when considering inward investment and consolidation opportunities the location, design and quality of the proposed i9 building offer suggests it will compete favourably in the market place. Inevitably market conditions can change however proposed rental tone and associated incentives are achievable when considered against existing evidence and proposed timing.

- 2.6 The above is supported by i10 evidence as well as the anticipated benefits associated with HS2 and prosperity across the wider Greater Birmingham location in the short term.
- 2.7 There is speculation that the government will create a raft of new agencies (as a result of Brexit) which would be placed outside the capital as part of the government's drive to open up the civil service. i9 may be primed to capitalise upon this decentralisation.
- 2.8 Many occupiers need space available in the short term and will not wait for space to become available when there are alternative options within the region. Conversely, developers are reluctant to commit to financing construction without the assurances of pre-let. The approach set out in this report involves the Council championing the speculative build approach and addressing a market failure. Due to this being a speculative development it opens up possibilities in respect of grant funding.

### **Benefits statement**

- 2.9 The i9 office scheme supports two key themes under the Council's Corporate Plan:
  - a. Supporting businesses, encouraging enterprise and attracting inward investment and;
  - b. Developing a vibrant city.
- 2.10 The incentive for the Council to directly intervene to enable new development is much stronger than for a private developer, as the Council not only gets the potential benefit of future revenue streams, but also has the secondary benefit through retained business rate.
- 2.11 A major new office block will increase the range and number of jobs and career opportunities within the city of Wolverhampton, this will make a significant boost to the city centre economy and provide further stimulus for office development in the location.
- 2.12 It is anticipated that on completion the development will create 330 FTE jobs. The additional business employees in this location will generate additional spending power into the local economy, and should have a strong benefit on the success of local food and drink outlets including those in i10 and i11.
- 2.13 The Black Country Consortium estimates that the building will generate Gross Value Added (GVA) of £79 million. GVA is a standard economic impact measure used by both the LEP and the WMCA and demonstrates the project will make a strong economic return.
- 2.14 The City Centre currently does not have any high-quality office stock available to attract investors to come to the city. Without available space Wolverhampton cannot compete for new office space requirements.
- 2.15 A new office block in this location would benefit from the very significant commitment the Council has made to the construction of the new railway station.

- 2.16 The building is being designed by Glen Howell architects to a very high internal and external standard and being in such a prominent location will be a long-term asset for the city. Furthermore, because of the high costs associated with building new office blocks very few are being constructed. This should help increase the level of demand and ultimately the financial value of a new build office.
- 2.17 The commitment to deliver a concrete frame building (as opposed to a steel frame) will also help secure much stronger long-term value in the building as better floorplates can be created and easily sub divided if need be.
- 2.18 Creating an environmentally high-performing building in a highly sustainable location, with relatively low long-term occupation costs, and access to public transport will increase the appeal of the offices to tenants. This will be particularly the case with those organisations, including Government agencies, who have made clear commitments to reduce their carbon footprint.

### 3.0 Progress

- 3.1 Since the report to Cabinet on 18 October 2017 work has been ongoing to develop the case presented in this report with particular attention being paid to understanding the case for Council investment in the scheme.
  - a. **Detailed design and planning** – The detailed design process is integral to defining the overall build costs for the project and the associated implications in respect of Council investment and the gap funding application. Glenn Howells Architects have been retained by ION to develop designs for the building. Whilst retaining the same architectural principles that saw Glenn Howells win the design competition for the building, the detailed design has evolved to address specific site constraints and opportunities. The building is now a total of 64,314 sq ft which includes 41,764 sq ft office floorspace over five floors with 5,285 sq ft of retail floorspace on the ground and lower ground floors. A full planning application for the scheme is due for submission in February 2018 following a positively received public consultation event.
  - b. **Grant application** – ION submitted an initial proposal for gap funding to the LEP which received positive initial feedback. At the time of writing this report a full application is being worked up and will be submitted in February 2018. This seeks grant funding, based upon 30% tangible costs (bid amount detailed in the exempt report) that addresses the gap between cost and value of delivering the building, including associated commercial risk.
  - c. **Heads of Terms** – detailed work has been ongoing to agree Heads of Terms between ION (as developer) and the Council (as vendor). These capture the principles of the development deal (outlined in section 6.0 of this report) and will form the basis of the legal agreements with ION.
  - d. **Appropriation**- The grant of a lease to ION (detailed in paragraph 9.3 of this report) will be conditional on the easements (including rights of light) and other restrictive

covenants being extinguished so as to allow the development to proceed without risk of challenge. The Council is currently seeking professional valuation advice as to the potential costs/compensation that may need to be allocated and paid to beneficiaries of those rights or covenants. When this advice has been received the business case and viability will be reviewed in light of the potential costs associated with this course of action. A further report would be necessary if the Council is to use its powers of appropriation pursuant to section 122 of the Local Government Act 1972 and the power provided by section 203 of the Housing and Planning Act 2016. Section 203 of the Housing and Planning Act 2016 provides the power to override restrictive covenants and interests where land has been appropriated for planning purposes. Once the power has been exercised the beneficiaries of those rights and covenants have a right to claim compensation from the Council.

#### **4.0 Evaluation of alternative options**

4.1 A full options appraisal was presented in the 18 October 2017 Cabinet report.

4.2 The options analysis has regard to the fact that ION have an existing development agreement with the Council at Wolverhampton Interchange. Options that were discounted include;

- a. **The Council undertake development** – This would require the Council taking the lead role in designing, building and securing lettings. The Council is not a property developer and this approach would not only be resource intensive but would require the Council possibly having to fund 100% of the development costs and procure contractors with the relevant expertise.
- b. **The Council underwrites the lease** – To encourage speculative development the Council instead of financing the project could investigate underwriting the lease. Whilst this approach would significantly de-risk the construction and enable ION to seek private finance it would require a long-term revenue commitment from the Council. Furthermore, the Council would never own the building and would have to negotiate a lease arrangement which gives opportunities to sub-let the floor space at a profit rent. Whilst other Local Authorities have commonly used this approach to secure development it has normally been as a last resort when all other options have been dismissed.

#### **5.0 Reasons for decision**

5.1 The preferred delivery route, approved by Cabinet on 18 October 2017, was for the Council to purchase a completed new building in line with its open market value and for ION to access grant funding to mitigate the development risk. As a Small and Medium sized Enterprise (SME), ION is eligible to access grant funding of up to 30% against tangible costs.

- 5.2 Under this arrangement, the Council will ultimately own the building but will use ION to work up the scheme, manage the construction of the building (to an agreed specification) and secure the initial lettings. ION are industry specialists at utilising public funding to close viability gaps and have the in-house expertise to progress a gap funding application to the LEP.
- 5.3 The preferred delivery route also includes a rental guarantee from ION lasting up to three years post practical completion. The rental guarantee mitigates the commercial risk, to the Council, associated with this speculative development. Details of the rental guarantee are noted in paragraphs 8.7 - 8.14 of the exempt report.

## **6.0 Deal Structure**

- 6.1 The headlines of the deal structure are set out below and build upon the tried and trusted structure that successfully delivered the i10 scheme.
- a. The Council will purchase, from ION, the i9 building to a total value that is equal to the open market value.
  - b. The Council will grant ION a long lease for the land.
  - c. To protect the Council's position, ION will then grant an underlease of a similar length back to the Council.
  - d. Through the construction phase ION will manage the construction and marketing of the building. The Council will release payments at agreed milestones.
  - e. At practical completion (PC), the building will be handed over to the Council who will assume responsibility for the management of the building. If the building is not fully let at PC, ION will continue to market the building and secure lettings for a maximum of three years.
- 6.2 The potential for the Council to hold the asset via an arms-length company will be explored further. This type of asset would sit well within a broader portfolio of income generating properties. It may be possible to offset trading surpluses from established assets, such as i10, to support any possible deficits from other assets. A wider piece of work understanding the implications of a Council owned property investment company is ongoing, it is possible that i9 could be included in this portfolio. This will follow the principles set out in the Treasury Management Strategy (also on the agenda for Cabinet on 20 February 2018).

## **7.0 Risk and Risk Management**

- 7.1 A full risk register will be put in place and monitored during the design and development process. However, at this stage it is envisaged the key risks which will need to be managed are as follows;

- a. **LEP grant is not secured** – The funding model is predicated upon grant funding being secured by ION. Positive discussions with the funders, demonstrates that this risk is largely mitigated but in the event grant funding is not secured the building phase will not proceed pending exploration of alternative funding routes. However, there will be abortive costs associated with this in relation to the costs that have been occurred at the outset in exploring the proposed scheme.
- b. **Previous Growth Deal funding** –  
This paragraph is PRIVATE – exempt from publication under Schedule 12A of the Local Government Act 1972 (as amended), Part 1, Paragraph 3. See exempt report.
- c. **Ability of ION to deliver** – ION have an excellent track record of delivering City Centre office schemes using gap funding and know the site and the market, having previously delivered i10 for the council. In anticipation of being invited to make an application for LEP funding, ION have commenced working up the scheme at their own costs and risk, although the costs incurred to date will be recoverable from the Council under the Master Development Agreement as they form parts of ION's cost in working up a proposed scheme for i9.
- d. **Cost overrun** – any construction cost over runs will be at ION's risk. ION have built a contingency into the costs and will employ experienced contractors through a tender process. It should be noted that the accountable body for the grant will undertake a full cost appraisal as part of the risk assessment of the viability gap. The Council will retain an independent Quantity Surveyor to ensure the building is delivered to specification and is on budget.
- e. **Increase in build costs / inaccurate build cost estimates** – we will ensure that any terms agreed with the developer should include provisions for the Council to actively monitor the construction programme and sign-off any changes to specifications as a result of value engineering.

## 8.0 Financial implications

- 8.1 This section is PRIVATE – exempt from publication under Schedule 12A of the Local Government Act 1972 (as amended), Part 1, Paragraph 3.

## 9.0 Legal implications

- 9.1 This section is PRIVATE – exempt from publication under Schedule 12A of the Local Government Act 1972 (as amended), Part 1, Paragraph 3.

## 10.0 Equalities implications

- 10.1 The work outlined in this report is designed to improve the environment for all. Individual schemes of work will be subject to an Equality Analysis in accordance with Council Policy

under the Equalities Act. Reasonable adjustments will be made for the needs of people with disabilities and ensure that the building is DDA compliant.

- 10.2 Economic and community considerations for the City Centre will need to be included as part of evaluating the outcomes of completed projects with an Equality Analysis.

### **11.0 Environmental implications**

- 11.1 The development of i9 will significantly improve the visual amenity of this area of the city centre. The purpose of the design competition was to invite architectural practices to demonstrate how a modern office block in this location could complement and enhance the neighbouring heritage assets.

- 11.2 The building will be delivered to BREEAM Excellent standard.

### **12.0 Human Resources implications**

- 12.1 The Human Resources implications in respect of the management of the building are noted in section 13.0 of this report.

### **13.0 Corporate Landlord implications**

- 13.1 Corporate Landlord is involved in the early stage design process ensuring future Facilities Management activities are taken into account (e.g. future maintenance, bin storage, solar gain, ventilation, façade, signage, lighting). The service has been actively engaged in design workshops with the architects Glen Howells.
- 13.2 Whilst the design and specification of the building is now largely fixed, detailed costs are reliant upon tender returns. It is important that any changes to specification as a result of value engineering are agreed with Corporate Landlord as this may have an impact on future maintenance regimes and cost.
- 13.3 Through the emerging heads of terms, ION has committed to engaging Corporate Landlord for approval for all lettings. Should the office accommodation be let on a multi-let basis there will be property management implications (e.g. shared concierge), this will be reflected in the service charges.
- 13.4 Closure of Railway Street car park will result in the loss of 40 car parking spaces within the City Centre, it is considered the overall impact on revenue income will be negligible as parking demand from this site is likely to transfer to Council owned Broad Street or other City Centre car park sites.
- 13.5 i9 will be added to the Council's commercial property portfolio and the Council will have management responsibilities for the common parts, the cost of which can be recouped through insurance recharges, rent and service charges.

**14.0 Schedule of background papers**

14.1 18/10/17, i9 Office Scheme - Development and Investment Proposal, Cabinet

CBRE Supporting document- Office Demand, i9 Wolverhampton Interchange, June 2017