

AGENDA ITEM 9

**REPORT TO THE TEES VALLEY
COMBINED AUTHORITY CABINET**

5 FEBRUARY 2018

**REPORT OF THE
INVESTMENT DIRECTOR**

PORTFOLIO: INVESTMENT

FEETHAMS, DARLINGTON

SUMMARY

The purpose of this Report is:-

- to inform Cabinet of Darlington Borough Council's proposal to bring forward the development of new Grade A office accommodation at Feethams in Darlington Town Centre; and
- to seek approval for up to £3.23 million investment into the Feethams office project, to enable the project to be brought forward for development.

RECOMMENDATIONS

It is recommended that the Combined Authority Cabinet:-

- i. notes Darlington Borough Council's ("DBC") proposal to bring forward the speculative development of approximately 3,900 sq.m. with a gross internal floor area of 3,624 sq. m of new Grade A office accommodation at Feethams (the "Project");
- ii. subject to:-
 - the formal approval of DBC's funding for the Project (scheduled for its Cabinet meeting on 6th March 2018 and then full Council meeting on 22nd March 2018);
 - to the ERDF application submitted by DBC being successful (see paragraphs 5 and 15 below);
 - the Finance Director being satisfied that the case for prudential borrowing is made;
 - submission and assessment of an updated business case; and
 - the satisfactory completion of due diligence under our Assurance Framework,

- approves the allocation of up to £3.23 million of Combined Authority investment funding in respect of the development of this office accommodation;
- iii. approves the use of the Combined Authority's prudential borrowing powers, once they are in place, to fund the Project, with the repayments to be financed from rental income to be received as a result of the investment; and
 - iv. delegates the finalisation of the funding and associated contractual arrangements for the Project to the Combined Authority's Managing Director and Finance Director.
 - v. establishes a regular assessment of the office market across the Tees Valley, to enhance the evidence-base for future development of office space by the Combined Authority and its partners.

DETAIL

Project Description

1. The Project will deliver Grade A office accommodation in Darlington Town Centre, benefitting growing small and medium sized enterprises (SMEs) and other businesses in key Tees Valley sectors, including business and professional services, digital and creative. The site itself is already in the ownership of DBC and is cleared and ready for development - an indicative map of the site is at Annexe 1.
2. The Project will support the Business Growth and Places themes within the Tees Valley Strategic Economic Plan ("SEP"). The development is a priority for DBC as Darlington is an attractive location for businesses but has a distinct shortage of town centre Grade A property. Locating office jobs on this site and will enhance footfall and vibrancy in the town centre, along with increased spend during the day, in the early evening and in the night time economy.
3. It is proposed that the office building would be five storeys high with a total gross internal floor area of 3,624 sq. m. The offices would be flexible and open plan but capable of being sub-divided and occupied by two different tenants per floor. The offices could accommodate a total of approximately 350 office desks and up to 500 staff, depending on space ratios and desk sharing arrangements. There is scope for additional accommodation on the site that could be added at a later date.
4. It is important that a clear signal is sent to prospective tenants (both private and public sector) that this proposal has a realistic chance of proceeding and being completed in 2019. To mitigate against the risk that the office accommodation is built on a speculative basis but is not then fully occupied, DBC will continue to work to secure a number of pre-lets. DBC has already appointed agents to market the offices and help identify occupiers. Although there is interest from potential office tenants, DBC's agents have advised it is very difficult to secure formal pre-lets with SMEs in particular in these early stages and certainly before building work has commenced. However, DBC propose to target national and local tenants through a robust marketing strategy and liaise with potential occupiers over intended lease terms. If the building is not fully occupied in the early period, DBC may also consider locating some of its own activities in the new building as a fall-back position.

5. The current estimate of total project cost is £8.5 million. These project costs will be funded as follows:-
 - TVCA: £3.23 million;
 - DBC: £3.23 million;
 - ERDF: £2.04 million.
6. DBC and TVCA have also presented the Project to the Teesside Pension Fund (“TPF”), who are interested in investing if the Project can meet its investment requirements. These discussions with TPF are ongoing, but it is anticipated that without a significant level of pre-lets or a public sector supported head lease, TPF is unlikely to be able to support the Project. Discussions will continue as the scheme develops but, assuming the Project goes forward as a speculative build, it is not anticipated that TPF funding solution will be a significant part of the funding mix.
7. The contractual arrangements will be as follows:-
 - (a) The Combined Authority will enter into a funding agreement with DBC for the payment of the £3.23 million funding;
 - (b) DBC will enter into an agreement with the contractor (when procured) for the design and construction of the accommodation;
 - (c) The risk is shared but DBC will manage the building;
 - (d) DBC will set up its own arrangements for the marketing and management of the offices; and
 - (e) DBC and TVCA will enter into an agreement that reflects the risk including any risks associated with the ERDF funding.
8. DBC will consider the project at its Cabinet meeting scheduled for 6th March and then its full Council meeting on 22nd March.

Ambition and Potential Benefits

9. This proposal is aligned with Tees Valley’s growth needs and will contribute towards the strategic ambitions set out in the Business Growth and Place themes within the SEP, which contains a target of net 7,000 new jobs in professional/office services, to which this Project can contribute.
10. The aim is to create new accommodation to support and encourage employment opportunities and boost economic growth through the provision of new high quality accommodation.
11. From DBC’s perspective, this Project will aid the delivery of the Feethams Planning and Development Brief and effectively complete DBC’s Feethams Plan.
12. Potential benefits arising from this development will also include:-
 - (a) the retention of local SME businesses that might otherwise leave Tees Valley to seek better growth opportunities elsewhere;

- (b) increased economic outputs;
- (c) a catalytic effect on the speculative office development market, increasing the potential for further market investment in the wider area; and
- (d) increased footfall from the offices would help support retailers in the town centre and particularly the coffee shops and restaurants opposite the site in the new Feethams cinema/leisure development.

Evidence of Need and Demand

13. The demand for the project has been examined by independent consultants Cushman & Wakefield. The work identified that there is currently a shortage of Grade A accommodation within the region as well as a shortage in accommodation above 10,000 sq. ft. The research identified that the majority of accommodation in Darlington Town Centre is dated and that there would be nowhere to satisfy any demand for Grade A office accommodation in the Town Centre at the current time. The view was that it is unlikely that the scale of Grade A office accommodation proposed for Darlington Town Centre will negatively impact on other Tees Valley locations, with occupiers likely to be new to the area, or expanding businesses already situated within or close to Darlington looking to satisfy their growth or to occupy better quality accommodation. The accommodation will be marketed at a market rent with the intention of maximising income, and there is no intention to undercut rental levels elsewhere in the Tees Valley.
14. The proposed scheme will also be marketed nationwide, to attract businesses by providing high quality accommodation. The quality of the scheme, coupled with its location on the Tees Valley rail and road network, is therefore key to attracting occupiers.
15. While this assessment provides assurance there will be limited displacement from this project, it raises a wider need for the Combined Authority to enhance our market intelligence about the office market across the Tees Valley. In anticipation of future projects, by the Combined Authority or its partners, we propose to initiate a regular process of market assessment, commissioning a local firm to report regularly on the state of office market across the Tees Valley.

Funding

16. We would expect to borrow to fund the Project, as it is a commercial investment, and repayment of our loan would come from the net rentals received. As the Project is a speculative build, it is impossible to have certainty over the likely returns that the Project will deliver, and as such, there is a level of risk that there will be insufficient income to fully repay borrowing with interest.
17. The latest financial projections are considered to be prudent. DBC is currently undergoing a further stage of value engineering to ensure that costs are minimised to the extent possible and to work to establish a prudential borrowing case. This work will continue through the due diligence phase.

18. We recommend that Cabinet approves proposition on the basis of borrowing, subject to the Combined Authority's Finance Director being satisfied that the case for prudential borrowing is made based on agreed base case assumptions.

FINANCIAL IMPLICATIONS

19. To commit £3.23 million to the Feethams project to be funded via prudential borrowing, subject to the case for prudential borrowing being satisfied.

LEGAL IMPLICATIONS

20. Any legal issues in respect of the Project will be dealt with in the funding agreement to be entered into between the Combined Authority and DBC in due course. The Combined Authority will use its standard funding agreement for capital projects to govern the terms of its investment. The funding agreement will be tailored so as to minimise the risks identified in the risk section below as far as possible.

RISK ASSESSMENT

21. The key risks in relation to the Combined Authority's investment in the Project are as follows:-
- (a) potential time and cost overruns leading to the development being delayed - this will be managed through the Combined Authority's funding agreement with DBC (including monitoring and reporting arrangements) and through DBC incentivising the timely completion of the construction works through its contractual arrangements with its contractor;
 - (b) that the accommodation is built but cannot then be let fully - DBC has undertaken early marketing activity to try and secure lettings and minimise the risk of the building not being fully occupied once constructed. In terms of its own investment, as owner of the building DBC will carry the direct risk of not being able to let the premises and will recover its own investment through rental and business rate income; and
 - (c) DBC sells the accommodation at a future date – this will be addressed in the funding agreement with DBC.
22. Conversely, the risk of not delivering the accommodation is a lack of quality office accommodation in Darlington to accommodate growing SME companies who want to locate in the town.

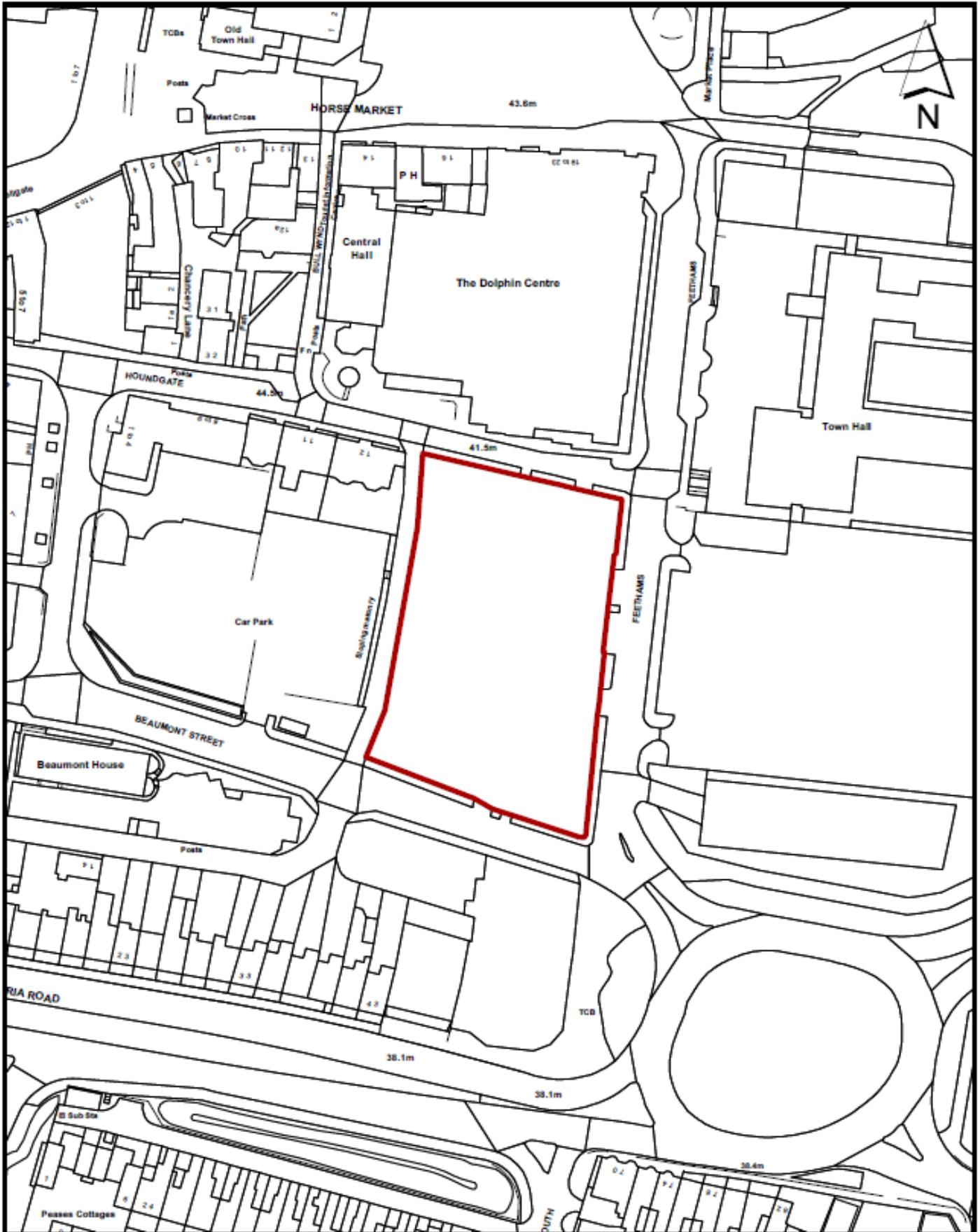
CONSULTATION

23. DBC will be undertaking consultation on the development of the site through its normal consultation and planning processes.

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ANNEXE A – Site Plan





DARLINGTON BOROUGH COUNCIL
 ECONOMIC GROWTH GROUP
 CORPORATE LANDLORD TEAM
 ESTATES & PROPERTY, TOWN HALL
 FEETHAMS, DARLINGTON
 Co. DURHAM, DL1 5GT

Project Title: **DBC OWNED LAND**
 Drawing Title: **FEETHAMS PLOT 1**

Scale: 1 : 1250	Sheet: AT A4
Date: 13/04/16	Area: 1.14 Acres
Drawn: RMH	

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