

Shire Hall, Cambridge – Commercial Update

To: Assets & Procurement Committee

Meeting Date: 28 November 2023

From: Executive Director Finance & Resources

Electoral division(s): Castle

Key decision: Yes

Forward Plan ref: 2023/081

Outcome: Update the Committee on the redevelopment of Shire Hall and confirm next steps following non-completion of the redevelopment agreement by the agreed deadline.

Recommendation: The Committee is invited to:

- a) note the Commercial update and withdrawal of Brookgate prior to the deadline approved by the July Strategy & Resources Committee;
- b) approve the instruction of advisers and commence the marketing of the Shire Hall site at the earliest opportunity with defined deadlines for exchange and completion of contracts;
- c) bring an update report to the March Assets and Procurement Committee on market engagement and a preferred bidder for approval, or next steps to move to that stage of appointment at the following Committee.

Officer contact:

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1. Background

- 1.1 Following the Full Council decision to relocate the Council's headquarters from Shire Hall in May 2018, and approval of draft Heads of Terms in late 2019, negotiations on the detailed terms and contracts commenced with Brookgate. Subsequently a detailed review of the Shire Hall proposals and progress was presented to Strategy & Resources Committee in July 2021, with the Brookgate scheme re-confirmed.
- 1.2 Due to the significant economic impact of the COVID pandemic, in particular material and labour cost inflation and supply chain uncertainty, updated terms were approved by the Council's Strategy and Resources Committee in January 2022. In January 2023 a further update and amendment to terms was approved following the impact of the Government's emergency budget that drove a rapid rise in interest rates and gilt yields. 50 year gilt rates had risen from around 1.16% at the start of detailed negotiations (November 2019) to their current level (October 2023) of 4.56% (UKDMO data), impacting both finance costs and development values for the scheme. Similarly overall construction costs increased by 24% from Heads of Terms approval in November 2019 until September 2023 (ONS COPI data).
- 1.3 An update report was presented to the July 2023 Strategy and Resources Committee providing a comprehensive update on the then ongoing negotiations with Brookgate for the redevelopment of the Shire Hall site. Despite ongoing economic uncertainty slowing progress, legal negotiations were in their final stages with few significant outstanding points of contention. Committee approved a deadline for the completion of negotiations and signing of contracts.
- 1.4 Shortly before the deadline set by the Strategy and Resources Committee for signing (14th August 2023) Brookgate contacted the Council to advise that following detailed consideration of the deal by their Board, they were unable to proceed on the agreed terms. Legal papers were withdrawn shortly afterwards.
- 1.5 This report sets out the actions taken in response to the withdrawal of Brookgate and makes recommendations to ensure delivery of a successful redevelopment of the site and deliver the financial, environmental and other benefits of the scheme.

2. Main Issues

- 2.1 Following the withdrawal of Brookgate, Officers responded rapidly to work with the Council's retained advisers, BNP Paribas and Pinsent Mason, to take the redevelopment forward. A detailed review of all options for the site was initiated to consider all redevelopment options with detailed development appraisals to assess the current market conditions and due to the volatility and variability of recent times. With several reviews having taken place during the negotiation process, this earlier work provided a basis for a comprehensive update on options for the site. In parallel, all disposal options for the site were revisited, including a full freehold sale, long leases and other options, and market testing. Pinsent Mason was instructed to provide legal advice on various aspects of the redevelopment options including procurement matters.

- 2.2 These workstreams produced a comprehensive development overview of the site (with multiple development options and appraisals), detailed procurement advice, clear commercial and market intelligence and risk and funding options. These are set out below with the relevant factors assessed for the options.
- 2.3 The costs to the Council to date relating to the transaction comprise the costs of the Shire Hall campus site and professional fees. Whilst negotiations have been ongoing the Council's Property team have undertaken a major clearance exercise of Shire Hall and Octagon to remove the redundant and surplus furniture and items from the site. This continued for a significant period after the relocation to Shire Hall due to the volume of material. Careful management of this process has seen significant quantities of surplus furniture either sold or sent for reuse. The Property team has avoided large quantities of landfill, and generated a net income from selling and recycling these items rather than disposing of them. This provided both financial and environmental benefits, and facilitated the Strategic Asset team in mitigating the cost of Business Rates. It should also be noted that the Registrations Service remained on site at Shire Hall until September 2022, so there were some ongoing occupational costs.
- 2.4 In the table below the net costs of the Shire Hall site are set out by Financial Year (operating costs less income from the car parks). Property Services has also invested in improving signage and facilities in the car parks to increase usage and support the city centre. It has also invested in the heritage interpretation and amenity of the site, with brand new heritage information boards and increased litter bins and litter picking to improve visitor experience.

	2019/20	2020/21	2021/22	2022/23	2023/24 Forecast
Shire Hall Area	1,123,742.91	1,266,444.96	1,110,288.06	637,039.48	381,129.10
Shire Hall Car Park	-130,520.88	-37,923.69	-114,582.88	-212,371.55	-250,000.00
	993,222.03	1,228,521.27	995,705.18	424,667.93	131,129.10

- 2.5 The Shire Hall building and Octagon remained in Council use during FY2020/21 (including compliant occupation during COVID lockdowns) and into FY2021/22. However, the annual cost saving is over £850k per annum and reducing. The spend on professional advisers, BNP Paribas as property consultants and agents, and Pinsent Mason solicitors is £173,000. This spend has reached a point where the complex set of contracts was in a form that was effectively ready to sign. Details of the fees are set out in exempt Appendix 1. The professional services contracts were procured through appropriate procurement routes at the outset of the scheme, LGSS Law (now Pathfinder Legal Services) and Crown Commercial Services), and the contracts are being reviewed in accordance with Council procurement policies.
- 2.6 The Council obtained advice from our legal advisers, Pinsent Masons, on the available options for developing the site. For CCC to have maximum controls over the delivery of the scheme would require a full procurement process for the appointment of a developer (as it would constitute a public works contract). This would be expensive and take a significant amount of time. Instead advice remains that approaching the market to offer a land transaction, with the potential for CCC to take an income strip lease, is still the most beneficial option. The detailed advice in exempt Appendix 2 sets out the differences and

reports on risks in relation to each option. The following paragraphs though set out how each option ranks on these assessments, with a summary table set out below paragraph 2.19.

- 2.7 The first part of BNP's review involved detailed development appraisals of other potential uses of the site, in addition to the proposed office/hotel scheme. The appraisals were based on current figures for Income Strip transactions and within the parameters previously by Members for the Brookgate transaction previously. The schemes and the initial (residual) site value and initial CCC retained (i.e. profit rent under the Income Strip kept by CCC) rent are set out below in ranked order, with the most financially beneficial at the top:

Income Strip development appraisal outcomes		
Ranking by site value and retained rent	Shire Hall use	Octagon use
1 st	Hotel (management contract)	Offices
2 nd	Offices	Offices
3 rd	Hotel (leased)	Offices
4 th	Student Accommodation	Offices
5 th	Senior Living	Offices
6 th	Build to Rent Residential	Offices

- 2.8 This analysis confirms that development of the site involving offices and hotel uses remain the most valuable options for developers. Whilst any marketing of the site will see developers undertake their own appraisals and assessments it provides the Council with a clear guide as to options and likely outcomes. The following points are to note when considering options:
1. Operating a hotel through a management contract (under an international brand such as Hilton or Accor) in option 1 is the most lucrative on a gross basis, however this carries a high degree of management cost and commercial risk as the council is taking on the room vacancy risk for the hotel – the income assumes suitable levels of occupancy in the hotel. If this declines then the Council's income will decline and could go into loss in extreme events (e.g. 9/11, COVID etc). This is a similar operation to that operated by CCC at Brunswick House, noting that student letting are longer term and less fluid and seasonal than hotel bookings. The Council will need to ensure that it has suitable management and professional expertise to oversee and manage the hotel operator and ensure overall hotel performance.
 2. Refurbishing both Shire Hall and the Octagon as high-quality offices is the next best option, but significantly exposes the council as a landlord in the Cambridge office market. If office rents slow this puts the income at risk, particularly in an Income Strip situation. Some parties have expressed interest in creating hi/mid tech lab space.
 3. The original scheme of a leased hotel and offices remains financially attractive and provides some diversity of risk across two property sectors (hotel and office).

4. Student accommodation is also viable and demand remains stable in Cambridge, however the Council already has significant commercial exposure to this sector through its operation of Brunswick House and the lease to Collegiate at Castle Court, Cambridge. Such a scheme is also likely to require direct agreements with institutions in order to gain planning consent. The student accommodation market outside of Cambridge is currently in a state of flux due to course quality issues and compliance cost of new regulations. Soft market testing indicates that there is more of an appetite to procure and develop the site rather than an income strip deal. The value of that disposal being significantly less than the income strip proposals as discussed in paragraph 2.12 to 2.13 below.
5. Senior Living does not achieve the minimum Residual Site Value of £6m considered necessary for any scheme to be considered viable for the Council. It is also a highly specialised market, and various factors such as the site being located at the top of a long hill above the main shopping area may limit interest in this use. Senior Living has been excluded from further consideration for these reasons.
6. Rented residential accommodation makes a £2.67m loss on the site value and may create Buy to Let issues so has also been discounted. To make this scheme viable it is based upon zero affordable housing, which is unlikely to be acceptable for planning and other reasons.

Further financial details of the appraisals are set out in exempt Appendix 3.

- 2.9 BNP's analysis provides a guide to viable redevelopment options for the site and informs the marketing and disposal options. Following the development appraisals BNP conducted a confidential 'soft market test' of site and scheme with a select group of developers that had the expertise and financial scale to undertake a redevelopment of the site. This process asked the developers to consider the existing scheme and also put forward alternative proposals if they considered these more viable and/or lucrative for the Council.
- 2.10 In parallel to this BNP evaluated the options to dispose of the site via a freehold sale and a long leasehold transaction. As a recap, the Income Strip means that CCC retain the freehold ownership of the site in the long term, with a developer obtaining planning consent and redeveloping the site with funding from an external funder. Upon completion the Council pays rent to the funder for the agreed lease term (50 years is proposed), whilst the Council is paid rent by the tenants of the site e.g. office occupiers, hotel operator etc. This generates a net profit (the Retained Rent in table 1).
- 2.11 The other options for the disposal or redevelopment of the Shire Hall site area a freehold sale, long leasehold disposal, CCC undertaking planning only, CCC undertaking the development itself of the site or self-managed hotel:

- 2.12 A freehold sale is the outright sale of the site to a third party for them to develop or use the site as they deem appropriate. This would produce a capital receipt, likely to be in the range of £10m to £15m, but will end the Council's involvement in the site. Due to the high-profile nature of the site a buyer may pay a premium above the quoted price range, in part depending upon perceived market conditions. It is the quickest and simplest method of disposal.
- 2.13 A long leasehold disposal in this scenario the site would be sold for an initial capital receipt and a long-term rental income. The capital receipt and rental income will be significantly lower than the figures for an Income Strip. The lease term would be for a term of between 99 and 999 years, with different financial outcomes according to lease length. Under a long lease the Council will have very little control over the site. This option would see a high proportion of the redevelopment profits and long-term income pass the lessee/developer. This option has been evaluated on a 150 year lease and under every development scenario it results in a negative site value and long term income significantly below the income strip. The negative site value would in effect require the Council to pay the developer/long lessee the capital sum at the start to commence the scheme.
- 2.14 The Council obtaining planning consent for the site itself would then provide a consented development to bring to the market and to offer to developers. Whilst having consent in place will make the site attractive, there are several problems with this. Firstly CCC will need to make the commercial developer decisions on the details of the development, forecasting the best options several years ahead. If the scheme has a hotel within it, this will have to be designed to a particular hotel operator's requirements. CCC would need to enter into an agreement with the hotel operator in order to undertake detailed design of the hotel. This would require a formal procurement exercise to select a hotel operator, delaying the preparation and submission of the planning applications by many months. These are core skills of property developers and the Council would be closely engaged in significant commercial decisions outside its scope of expertise. If the planning consent obtained is then not aligned to market conditions at the time then this will further delay any scheme and reduce financial returns.
- 2.15 Self-development is another mechanism for the Council to retain ownership of the site and profit from the redevelopment is to carry out some or all of the redevelopment work itself. This means that CCC takes the profits that would otherwise pass to a developer, but also takes on the developer's commercial risk. If there were problems such as significant cost overruns or construction delays the costs would fall directly on the Council to fund. This level of risk is not considered appropriate for the Council, and it would require a dedicated and specialist team to manage the redevelopment.
- 2.16 The self-development route would also require the Council to find around £100m of development funding, something that would be challenging and impose risks on wider council finances. We do not consider it would be straightforward to include such a scheme in the County Council's capital programme and remain in compliance with the PWLB loan stipulations which prohibit capital investment in assets primarily for yield. Challenges with construction costs or delays beyond contingencies could see the Council facing multi-million cost overruns and this is an area that has directly impacted some other councils who have engaged in direct development activity. Whilst this method of delivery has the potential for the high returns it also carries the highest commercial and financial risk, and

would require significant internal Council management and professional input over a protracted period of time. For these reasons this option has been discounted.

- 2.17 The final option is a variation of the Income Strip, where a developer undertakes and funds the scheme, but instead of renting Shire Hall to a hotel operator the Council operates the hotel as its own business. The day-to-day operations of the hotel would be managed by an established contractor under a well-known hotel brand (e.g. Hilton, Accor), but CCC takes the commercial profits and risk. This is similar to how CCC operates its student accommodation at Brunswick House.
- 2.18 The self-manage options has the highest returns under the appraisals, however it also has a significant degree of risk, particularly for the long-term income. Tourism has seen significant downturns after major events such as 9/11 and COVID, and the Council would be fully exposed to this risk. As hotel operations is a specialist sector the Council would also need specialist in-house resource to oversee and manage the management contract, the costs of this eroding returns. In the hotel rental option the hotel operator takes these commercial risks and the Council is only required to operate as a normal landlord, which is already able to do.

2.19 Overview of disposal options

	Freehold	Long Leasehold	Income Strip	CCC planning	Self-develop site	Self-manage hotel
Time to transaction completion	3-6 months	3-6 months	3-6 months	18-24 months	5 years+	5 years+
Capital Receipt	Moderate to High	Moderate	High	High	N/A	High
Long term income	Nil	Very low	High	High	High	High
Financial Risk	Very low	Low	Medium then low once signed	Medium	Very high	Medium then Very High post-completion
Commercial Risk	Very low	Low	Low-Medium	High	High	Medium
CCC funding requirements	None	None	3 rd party funded	£1m	£100m+	3 rd party funded
Long term income	Nil	Very low	High	High	High	High
CCC control over site	None	Very limited	Full control over site excluding buildings	Control until developer appointed post-planning	Full control until building leases completed	Control of site and oversight of hotel operation
Ownership after completion	None	CCC retains freehold and reversion in c.150 years	CCC retains freehold and reversion in c.50 years	CCC retains freehold and reversion in c.50 years	CCC retains freehold and reversions	CCC retains freehold and is occupier/user of the hotel.
Deliverability	High	High	Medium-High	Medium	Low	High
NPV 50 years	£19.0m	£6.3m	£58.5m	£57.2m	£95.8m	£46.1m

2.20 With high returns and a lower risk profile, the Income Strip option remains likely to be the most suitable providing substantial returns and limiting risk. The freehold and long lease options mean losing control of the site effectively on a permanent basis, and do not provide as substantive overall returns as other options. The freehold would simply provide a one-off capital receipt and mean no further CCC involvement in the site.

- 2.21 There has been extensive work and discussion around the heritage and environmental aspects of the Shire Hall scheme. These will remain unchanged in any future scheme and are summarised below:

Scheduled Ancient Monuments & Listed building (Old Police Station): all proposals for the site will require full planning, Listed Building and Scheduled Ancient Monument consents, and ensure protection of the assets on site.

Town Green: the necessary applications have been submitted for the nomination of the lawn between the front of Shire Hall and the Mound to be given the legal protection as a 'Town Green'. This process is under way and will take a number of months to complete time due to statutory processes and timescales.

Environmental standards: the current plans for the redevelopment of Shire Hall and the Octagon have been designed to achieve BREEAM 'Excellent' standard. This will be taken forward into any new scheme. Further, in relation to Staycity's specification for the hotel, they set out demanding requirements to achieve their corporate climate/Net Zero targets. It is anticipated that any other operators will be seeking to achieve similar standards as part of the corporate approach to ESG matters.

Telecoms: the two initial approaches made by telecoms operators for the site had been withdrawn following responses from the Council's advisers, but subsequently a further approach was received to erect a mast in the former staff car park. This is being resisted as previously.

- 2.22 The income strip approach remains attractive as a means of attracting external investment into the redevelopment of the campus whilst retaining and enhancing the valuable underlying freehold asset, with this reverting to public ownership. The Council does not currently have sufficient headroom in its own capital programme (given competing requirements) to fund the development itself and would likely face regulatory barriers to accessing PWLB lending were it to pursue this route (whether it was funded by borrowing or otherwise). Additionally, although there is a potential reward in retaining all future revenues, there are cautionary considerations as to whether the additional delivery and construction risks should be taken on by the Council, even if financing was available.
- 2.23 The income strip approach should see an ongoing revenue income stream retained by the Council, which is beneficial given the nature of the ongoing services the Council provides. The income strip will also bind the Council into paying the institutional investor a set proportion of the rent each year, with this rising in line with inflation and the Council exposed to risk should income levels decline (or fall below the level due to the investor). The Council has set out in its capital strategy how its overall exposure to commercial property risk is proportionate to the Council's overall spending (< 4%) and that the property portfolio is diversified, with no other exposure to income strips or hotels. External sector specialist advice received to date has identified the shortage of supply of hotel capacity in Cambridge and further due diligence will be undertaken on long-term leaseholders (particularly the hotel leaseholder) through which the Council would seek to manage its risk exposure.

- 2.24 The financing rate / yield for this project required by an institutional investor is a crucial determinant of the schemes' profitability. In re-appraising the project, the advisor has taken the opportunity to build additional headroom into yield rates compared to those parameters previously presented to Committee. Advice received both from those familiar with income strip transactions, and broader comparators/competitor regular income investment opportunities (drawing on economic forecasts) is that yields (alongside interest rates) are expected to fall by the point that financing is confirmed (post planning). This has the potential to improve the expected returns, but as has been seen to date is also a risk. Until the proposed marketing exercise is undertaken, and ultimately a funding rate agreed for a permitted scheme thereafter, this will remain an uncertainty.

Next Steps

- 2.25 Having completed a comprehensive review of the site and its marketing potential, with significant market interest being shown, it is proposed that the Council instructs its advisers to prepare a marketing campaign for the Shire Hall site to launch early in the New Year with a clear timetable for the process through to legal completion. A deadline for legal completion would be expected to be set for the Summer of 2024.
- 2.26 The marketing process will offer the site on an 'open' basis for developers and bidders, noting the Council's requirement to seek Best Consideration and the ability of a successful developer or bidder to complete legally binding contracts and the development. Whilst the Council will not impose specific requirements on developers or bidders, there will be a preference for retaining ownership and a long-term income. The Council already has detailed knowledge of the site, the legal issues and a suite draft legal contracts for an income strip transaction to help expedite the process. In addition, there is a hotel operator with considerable knowledge of the site.
- 2.27 The evaluation of bids and selection of a preferred developer or bidder is anticipated to take place in March or April 2024, with conditional exchange the following month, subject to Member approval.

3. Alignment with ambitions

- 3.1 Net zero carbon emissions for Cambridgeshire by 2045, and our communities and natural environment are supported to adapt and thrive as the climate changes

The redevelopment will result in more energy efficient buildings on the Shire Hall site

- 3.2 Travel across the county is safer and more environmentally sustainable

There are no significant implications for this ambition.

- 3.3 Health inequalities are reduced

There are no significant implications for this ambition.

- 3.4 People enjoy healthy, safe, and independent lives through timely support that is most suited to their needs

There are no significant implications for this ambition.

- 3.5 Helping people out of poverty and income inequality

There are no significant implications for this ambition.

- 3.6 Places and communities prosper because they have a resilient and inclusive economy, access to good quality public services and social justice is prioritised

The redevelopment will provide a mix of employment, tourism and other benefits to the local economy and the financial returns will help fund Council services.

- 3.7 Children and young people have opportunities to thrive

There are no significant implications for this ambition.

4. Significant Implications

4.1 Resource Implications

The report above sets out details of significant implications throughout. Third party advice has been provided in support of the Council's considerations. Attention is drawn in particular to sections 2.22 – 2.24 in particular which summarises principal risks and features of the income strip and financing approach that is recommended. The exempt Appendix 3 includes a summary of the financial outputs of the various options considered.

The financial decisions at this stage are not binding and can be further considered after the open exercise has completed.

4.2 Procurement/Contractual/Council Contract Procedure Rules Implications

Detailed procurement advice has been obtained from the Council's legal advisors and is set out in Appendix 2.

4.3 Statutory, Legal and Risk Implications

The report above sets out details of significant implications throughout. Third party advice has been provided in support of the Council's considerations.

4.4 Equality and Diversity Implications

There are no significant implications within this category. An Equality Impact Assessment has been completed.

4.5 Engagement and Communications Implications

There are no significant implications within this category.

4.6 Localism and Local Member Involvement

The Local Member is a member of this committee and there has been extensive involvement of local residents, councillors and others during the Shire Hall redevelopment process.

4.7 Public Health Implications

There are no significant implications within this category.

4.8 Climate Change and Environment Implications on Priority Areas

4.8.1 Implication 1: Energy efficient, low carbon buildings.

Positive

Explanation: The redevelopment will provide new, energy efficient buildings on the site, replacing very energy inefficient existing structures.

4.8.2 Implication 2: Low carbon transport.

Positive

Explanation: The redevelopment will be subject to the relevant planning and transport policies for the City of Cambridge.

4.8.3 Implication 3: Green spaces, peatland, afforestation, habitats and land management.

Positive

Explanation: Steps have already been taken to protect the green space and heritage on the site, with the Town Green nomination and improvements to heritage interpretation and management of the spaces.

4.8.4 Implication 4: Waste Management and Tackling Plastic Pollution.

Positive

Explanation: Future occupiers will have to comply with the latest waste management requirements under planning and other regulations.

4.8.5 Implication 5: Water use, availability and management:

Positive

Explanation: The new buildings will meet the latest standards for water consumption and waste water handling.

4.8.6 Implication 6: Air Pollution.

Neutral

Explanation: N/A

4.8.7 Implication 7: Resilience of our services and infrastructure, and supporting vulnerable people to cope with climate change.

Neutral

Explanation: N/A

Report Clearance

Have the resource implications been cleared by Finance? Yes

Name of Financial Officer: Tom Kelly, Service Director Finance & Procurement

Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the Head of Procurement and Commercial? Yes

Name of Officer: Clare Ellis, Head of Procurement

Has the impact on statutory, legal and risk implications been cleared by the Council's Monitoring Officer or Pathfinder Legal? Yes

Name of Legal Officer: Procurement advice cleared by Rebecca Rowley, Legal Director, Pinsents Masons

Have the equality and diversity implications been cleared by your EqIA Super User?

Yes Name of Officer: Chris Ramsbottom, Service Director Property

Have any engagement and communication implications been cleared by Communications?

Comms are fully engaged with the report Name of Officer: Christine Birchall, Head of Communications

Have any localism and Local Member involvement issues been cleared by your Service Contact? Yes Name of Officer: John Macmillan, Group Asset Manager

Have any Public Health implications been cleared by Public Health?

Yes Name of Officer: Kate Parker

If a Key decision, have any Climate Change and Environment implications been cleared by the Climate Change Officer? Yes Name of Officer: Emily Bolton

5. Source documents

5.1 Source documents

Gilt Yields – 50 year/Ultra Long prices by month date table downloaded from United Kingdom Debt Management Office (DMO) website 15 November 2023

<https://www.dmo.gov.uk/data/ExportReport?reportCode=D4H>

Construction Output Price Indices, Office for National Statistics (ONS)
Dataset release date 10 November 2023.

Available online at:

<https://www.ons.gov.uk/businessindustryandtrade/constructionindustry/datasets/interimconstructionoutputpriceindices>