

MIDDLESBROUGH COUNCIL

AGENDA ITEM 3

OVERVIEW AND SCRUTINY BOARD

13 MARCH 2018

**CALL-IN – CENTRE SQUARE EAST
OFFICE DEVELOPMENT - COUNCIL
INVESTMENT AND ACCOMMODATION –
SUBMITTED TO EXECUTIVE – 20
FEBRUARY 2018**

PURPOSE OF THE REPORT

1. In accordance with Middlesbrough Council's Call In Procedure, to allow Members of the Overview and Scrutiny Board (OSB) the opportunity to review a decision made by the Executive.

RECOMMENDATION

That the Overview and Scrutiny Board considers the decision of the Executive and determines whether it should be referred back to the decision making body for reconsideration.

EXECUTIVE DECISION – 20 FEBRUARY 2018

2. A meeting of the Executive was held on 20 February 2018. At that meeting, consideration was given to a report of the Deputy Mayor and Executive Member for City Centre Strategy, the Executive Member for Finance and Governance, the Executive Director of Growth and Place and the Strategic Director for Finance, Governance and Support, in respect of a report that sought Executive approval for the investment in office space at land east of Centre Square for the purposes of (i) securing an efficient, cost-effective and sustainable solution for the long-term accommodation of Middlesbrough Council staff and (ii) investment in a second building in the development to achieve a commercial return for the Council.
3. A copy of the above report, is attached at **Appendix 1**.
4. Following consideration of the submitted report, the Executive agreed as follows:
 1. That the financial and economic benefits of enabling the first phase of the development, the strategic fit with the Council's future accommodation requirements and the advantages of providing essential investor

confidence/proof of concept in the local market for Grade A business accommodation, be acknowledged.

2. That the independent value for money advice (BNP Paribas) in terms of the parameters of the proposed lease arrangements and their relative advantages/disadvantages in terms of whole life cost financial modelling, be noted.
3. That the commitment to a 35 year lease for building one of the Centre Square development, in accordance with the parameters set out in part B of this report, for the purposes of accommodating Council staff and services as the principal Civic building for Middlesbrough, be approved.
4. That the commitment to a 35 year lease for building two of the Centre Square development, in accordance with the parameters set out in part B of this report, for the purposes of subletting the space to stimulate additional commercial activity within Middlesbrough City Centre and with the aim of generating an operational surplus in support of the Council's financial position, be approved.
5. That the indicative funding requirement (between £33 per sq.ft and £55 per sq.ft - up to £5m) for building fit-out to Council requirements and relocation of Council staff to the new facility, subject to a staff/member consultation exercise, upon practical completion of the development and fit-out period, be approved.
6. That the demolition of the existing Civic Centre building (estimated at C.£900k including all making-good works to the Town Hall and Middlesbrough House at their respective interfaces the existing Civic Centre and the potential temporary provision of parking) in accordance with all appropriate listed building consents, be approved.
7. That
 - a. an allocation of £250,000 for the costs associated with site preparation, due diligence, specialist advice and statutory licenses with respect to the future intention to develop proposals to dispose of / develop the vacated Civic Centre site, including temporary use as a car park (with associated surface and boundary treatments), with appropriate uses with respect to the character of the Grade 2* listed Town Hall and emerging character of adjacent commercial areas, be approved; and,
 - b.any changes to:
 - i. the substantive rental agreement (only where this has a positive net effect on the financial case) and is within the parameters of external advice;
 - ii. all operational decisions, site management obligations/arrangements and contractual arrangements associated with the management and administration of the principal and underlet lease agreements;
 - iii. the eligibility criteria for tenant businesses in the sub-let property;
 - iv. all contractual commitments for site marketing, maintenance and site management; and,
 - v. final approval of fit-out specification for the Council's accommodation; be delegated to the Executive Director for Growth and Place and Director of Finance, Governance and Support in consultation with the Executive

Member for Finance and Governance and the Deputy Mayor and Executive Member for City Centre Strategy, be approved.

The decisions were supported by the following reasons:

1. The provision of new accommodation in central Middlesbrough will bring additional employment opportunities to the area and make a significant step in pump-priming this private development. Middlesbrough Council's commitment and leadership will give the market additional confidence in the area, enabling private delivery of the remaining phases.
2. Building Two will provide additional commercial employment space for Middlesbrough, attracting new and sustainable employment to the commercial centre. This additional footfall will increase patronage for the City Centre's businesses and provide a welcome boost to the local economy.

CALL IN PROCEDURE

5. The power to call in a decision of a local authority executive body was introduced under the Local Government Act 2000. The process is intended to hold decision makers to account and ensure that executive powers are discharged properly. Call in ensures that a decision can be reviewed and reconsidered before it is implemented.
6. The procedure allows Members the opportunity to call in decisions for review by the Overview and Scrutiny Board as follows:
 - A decision made by The Executive;
 - A decision made by an individual Member of the Executive;
 - A decision made by a committee or sub-committee of the Executive;
 - A key decision made by an officer with delegated authority from the Executive; or
 - A decision made under joint arrangements.
7. The process is initiated by at least five Members of the Council requesting a decision to be reviewed within five working days following publication of the decision and submitting a form that outlines the reason(s) for the call in.
8. Following the meeting of the Executive on 20 February 2018, two call-in forms were received. The first call in form received on 26 February 2018, was signed by five Members supporting the request to call in the decision outlined above. The form was signed by Councillor Young (who initiated the call in) and Councillors C Hobson, J Hobson, Coupe and B Hubbard. Councillor Rathmell also indicated that he would like to support this request for Call-In.
9. The reason for the call in, as submitted to the Council's Monitoring Officer, is as follows:

Value for Money

A second call-in form was received on 26 February 2018 and this was also signed by five Members supporting the request to call in the decision outlined above. The form was signed by Councillor Rathmell (who initiated the call in)

and Councillors Hubbard, Mohan, Saunders and McCabe.

The reason for the call in, as submitted to the Council's Monitoring Officer, is as follows:

- (i) Process and Governance failings
 - (ii) Viability of Development
10. To assist the Overview and Scrutiny Board in the call in process, the Deputy Mayor and Executive Member for City Centre Strategy, the Executive Member for Finance and Governance, and appropriate Council officers will be present at the meeting. The Executive Members and officers will explain the reasons and rationale behind the report and the decision that was made. The Member who initiated the call in will also be present to explain their views and concerns in respect of the decision.
 11. A copy of the procedure to be followed at the meeting is attached at **Appendix 2**.
 12. The Chair of the Overview and Scrutiny Board has advised that she would like to conduct the meeting in two parts to consider each of the Call-ins separately.
 13. If any of the signatories to the Call-in requests intend to rely on any information contained in the confidential part of the Executive report, the Board will consider holding the meeting in private.
 14. Following the outcome of the Call-in request, the Overview and Scrutiny Board has two courses of action available:
 1. To refer the decision back to the Executive for reconsideration. In that case, OSB should set out in writing the nature of its concerns about the decisions.
 2. To determine that it is satisfied with the decision making process that was followed and the decision that was taken by the Executive. In that event, no further action would be necessary and the Executive decision could be implemented immediately.
 15. In the event that the decision is referred back to the Executive, a further meeting of the Executive would be arranged within ten further working days. The Executive would then make a final decision in the light of any recommendations made by OSB.
 16. Where the recommendations of OSB are not accepted in full by the relevant Executive body, the body should notify the OSB of this and give reasons for not accepting the recommendations.

BACKGROUND PAPERS

17. The following background papers were used in the preparation of this report:
 - Middlesbrough Council's Constitution/Call-In Procedure.
 - Report to Executive - 20 February 2018.

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PART A

MIDDLESBROUGH COUNCIL

EXECUTIVE REPORT

AGENDA ITEM 13

Centre Square East Office Development – Council Investment and Accommodation
Deputy Mayor / Executive Member for City Centre Strategy: Councillor Charles Rooney

Executive Member for Finance and Governance: Councillor Nicky Walker

Executive Director of Growth and Place: Kevin Parkes

Strategic Director, Finance, Governance and Support: James Bromiley

20th February 2018

PURPOSE OF THE REPORT

1. The report seeks Executive approval for the investment in office space at land east of Centre Square for the purposes of (i) securing an efficient, cost-effective and sustainable solution for the long-term accommodation of Middlesbrough Council staff and (ii) investment in a second building in the development to achieve a commercial return for the Council.

SUMMARY OF RECOMMENDATIONS

2. It is recommended that the Executive:
 - a. acknowledges the financial and economic benefits of enabling the first phase of the development, the strategic fit with the Council's future accommodation requirements and the advantages of providing essential investor confidence / proof of concept in the local market for Grade A business accommodation;
 - b. notes the independent value for money advice (BNP Paribas) in terms of the parameters of the proposed lease arrangements and their relative advantages / disadvantages in terms of whole life cost financial modelling;
 - c. approves the commitment to a 35 year lease for building one of the Centre Square development, in accordance with the parameters set out in part B of this report, for the purposes of accommodating Council staff and services as the principal Civic building for Middlesbrough;
 - d. approves the commitment to a 35 year lease for building two of the Centre Square development, in accordance with the parameters set out in part B of this report, for the purposes of subletting the space to stimulate additional commercial activity within Middlesbrough City Centre and with the aim of generating an operational surplus in support of the Council's financial position;
 - e. approves the indicative funding requirement (between £33 per sqft and £55 per sqft – up to £5m) for building fit-out to Council requirements and relocation of Council staff to the new facility, subject to a staff / member consultation exercise, upon practical completion of the development and fit-out period;
 - f. approves the demolition of the existing Civic Centre building (estimated at C.£900k including all making-good works to the Town Hall and Middlesbrough House at their respective interfaces the existing Civic Centre and the potential temporary provision of parking) in accordance with all appropriate listed building consents;
 - g. approves an allocation of £250,000 for the costs associated with site preparation, due diligence, specialist advice and statutory licenses with respect to the future intention to develop proposals to dispose of / develop the vacated Civic Centre site, including temporary use as a car park (with associated surface and boundary treatments), with appropriate uses with respect to the character of the Grade 2* listed Town Hall and emerging character of adjacent commercial areas; and,
 - h. approves that any changes to:

- i. the substantive rental agreement (only where this has a positive net effect on the financial case) and is within the parameters of external advice;
 - ii. all operational decisions, site management obligations / arrangements and contractual arrangements associated with the management and administration of the principal and underlet lease agreements;
 - iii. the eligibility criteria for tenant businesses in the sub-let property;
 - iv. all contractual commitments for site marketing, maintenance and site management; and,
 - v. final approval of fit-out specification for the Council's accommodation;
- be delegated to the Executive Director for Growth and Place, and Director of Finance, Governance and Support in consultation with the Executive Member for Finance and Governance and the Deputy Mayor / Executive Member for City Centre Strategy.

IF THIS IS A KEY DECISION WHICH KEY DECISION TEST APPLIES?

3. It is over the financial threshold (£150,000)
- It has a significant impact on 2 or more wards
- Non Key

DECISION IMPLEMENTATION DEADLINE

4. For the purposes of the scrutiny call in procedure this report is
- Non-urgent
- Urgent report

EXECUTIVE SUMMARY

5. This report informs Executive of the opportunity to invest in part of the Centre Square East development of Grade A office space, with a view to providing an affordable solution to the Council's long term accommodation requirements; generate operational savings; a commercial return in support of Council finances; and, pump-priming market confidence in the development of major commercial employment space.
6. The business case for the Council relocating to a new office was approved by Executive on 19th December 2017. This report considers the merits and risks of enabling the initial phases of a strategic office development, in support of local economic objectives including local employment opportunities, supporting the retail core, addressing market failure in accommodation markets and rebalancing the local economy in terms of its retail and commercial mix.
7. The report recommends Council commitment to a (up to) 35 year headlease of the first two buildings (forming part of the wider masterplan of up to seven new buildings) at the Centre Square East development. Building one is considered ideal to service the Council's own accommodation requirements and Building two offers the opportunity to underlet the property to private tenants; and, in doing so, an opportunity to generate a commercial return in support of Middlesbrough Council's financial position. Similarly, there is no available local accommodation available to meet the Council's requirements, especially at the comparative price and quality offered by this proposal.
8. The proposal tabled by the Ashall Projects (MB) Ltd offers an inclusive package of accommodation, estate management regime, service regime; including marketing and lettings support. This market specialism, protects the qualitative integrity of the wider development estate and helps to mitigate risks associated with ensuring that early tenancies can be secured on the site; to a specification which is expected by likely tenants.
9. With the prudent utilisation of the Council's weighty financial covenant, it is possible to enable strategic development in a way which meets its own accommodation requirements and generates income. In doing so, the Council is supporting a cost-effective funding model by showing leadership in the local investment markets in a way which creates 'the most bang for our buck' and positively stimulates local commercial markets.
10. The headline objectives of the Centre Square East development are :
 - a. creating c.200.000 sqft of Grade A office space to compete at a national level;
 - b. creating a localised professional services cluster and high value employment in Middlesbrough City Centre;
 - c. addressing market failure in commercial accommodation markets;
 - d. hosting up to 2,000 new jobs to support the local economy and city centre retailers;
 - e. attract new investment into central Middlesbrough; and,
 - f. maximising opportunities to create an operational surplus to invest in Council services.

Background and External Consultation

11. From the *'Disposal of Land at Centre Square for the purposes of Commercial Development'* Executive report of 6 September 2016, and subsequent presentations, members will be aware of the ambition for premium office space at the Land East of Centre Square and that Ashall Projects (MB) Ltd has secured the land interest and worked up exciting plans for the development.
12. The Executive report of 6 September 2016, *'Disposal of Land at Centre Square for the purposes of Commercial Development'*, secured the appropriate approval for the disposal of the land, in accordance with the asset disposal policy of that time. The approval to dispose of the land, and associated legal agreement, was made in accordance with the Management of the Council's Land and Property Assets report, agreed by Executive on 17 March 2015. This predates the current Asset Disposal Policy, as approved by Executive Sub Committee for Property on 7 December 2016.
13. Market analysis completed by KPMG in February 2016 found that, over the last thirty years, Middlesbrough's economy has suffered as a result of a lack of investment in its office space. Consequently, Middlesbrough has seen the outward migration of major professional employers and experienced a number of 'near misses' in terms of being unable to convert enquiries into tenancies, accommodating new business within the local area. Essentially, Middlesbrough has a chronic under-supply of suitable, readily-available, office accommodation of a quality and scale that is appealing to prospective inward investors / employers.
14. Indicative enquiries and demand from potential occupants is positive. This is reflective of anecdotal local demand and is further validated by the detailed financial analysis conducted by KPMG in 2016. However, regardless of interest / demand levels, it has not been possible to secure pre-let lease agreements of sufficient duration, or covenant strength, to fund the development in a wholly commercial way. This issue has been further highlighted by the Centre for Cities analysis of the local economy and the independent due diligence exercise carried out with respect to this proposal.
15. Whilst significant demand has been demonstrated, the historical lack of activity in the commercial accommodation markets in the Tees Valley means that the local market is somewhat of an unknown quantity in terms of institutional finance. This uncertainty, coupled with the relatively low rents achieved in ageing stock, effectively discounts the availability of institutional investment for speculative development. To unlock institutional capital flows, the public sector has a role in enabling early stages of development, providing a proof-of-concept which allows institutional capital to follow.
16. The Centre Square East development is an example of frustrated demand. Prospective tenants do not have the strength of financial covenant, or security of lease duration, which would allow capital markets to unilaterally fund this development. As validated by external agencies such as KPMG and Centre for Cities, it is increasingly common practice for the public sector to intervene in such matters to pump-prime development and partially de-risk commercial developments in a way which comforts and encourages capital markets.

17. There are many recent instances where the public sector have taken an active role in investment projects where development activity has been pump-primed and this has provided increased market confidence; as well as a commercial return for the public body involved. The Stephenson Quarter at Newcastle and the recent development to service Durham City Council's own accommodation requirements, are such examples. Similarly, the Council's recent commitment to invest in Tees Advanced Manufacturing Park (TAMP) is partly predicated on market intervention for a commercial return.
18. The recent Corporate Peer Review process applauded the Council's approach to enabling investment and cited the enabling loan at the Holiday Inn Express as a positive approach. Indeed, the Council is making, and continues to make, a significant commercial return on this investment, in addition to the obvious strategic benefits. The findings of the Peer Review encouraged the Council to consider similar investment opportunities as a way to generate income and support the overall revenue position of the Authority. Whilst the recommendations were not limited exclusively to local benefits, it is clear that by prioritising local enabling investment, the Council can also benefit from wider social benefits and a multiplier effect for the local economy.
19. Middlesbrough Council commissioned KPMG to conduct a Market Analysis exercise of the office market in Middlesbrough (February 2016). In summary, the report finds that:
 - a. Middlesbrough has suffered from a lack of investment in its office space market since the 1980's, resulting in the outward migration of major professional employment opportunities lost to both Middlesbrough and, increasingly, the wider Tees Valley;
 - b. occupants demand quality. Whilst the quantum of available office space is significant (and relatively cheap), businesses are willing to pay a premium in favour of comfortable, modern, efficient and prestige accommodation;
 - c. as Middlesbrough businesses expand (those in the Boho Zone being notable examples) their accommodation options are severely-limited in terms of available scale and quality. Increasingly, these businesses are forced to look farther afield to meet their needs and these critical skills are lost to the Middlesbrough economy;
 - d. Middlesbrough's local economy is out of equilibrium. Broadly, retail accounts for two-thirds of town centre activity and commercial activity represents a third. For a City Centre to be balanced and thrive, this relationship should be reversed in favour of Commercial activity; and,
 - e. new office development can act as a catalyst for further investment across Middlesbrough. Professional employment brings higher rates of disposable income and this additional consumption helps to sustain City Centre businesses.
20. Crucially, the KPMG findings are wholly in accord with the Centre for Cities report. Centre for Cities is an independent think-tank and acknowledged authority in assessing the economic impact of cities and major urban areas. Their report was commissioned to explore the importance of having a recognised City Centre identity within the Tees Valley and the positive impact that this can have for both Middlesbrough and the wider Tees Valley. This report highlights the increasing importance of business clustering and interactions; particularly in professional services and skilled roles.

'More knowledge-focussed types of economic activity tend to value the benefits that proximity and face-to-face interaction brings, and analysis shows that these types of jobs have increasingly been clustering in city centres..... Private sector Knowledge Intensive Business Services (KIBS) jobs, which include jobs in law, architecture and finance. Middlesbrough has the largest share of these jobs in the Tees Valley but the rate still lags behind national trends'

Centre for Cities Report 2016

21. Knowledge Intensive Businesses (KIBs) generally reflect skilled and professional services such as accountancy, solicitors, architects, financial services etc. Whilst not exhaustive, these roles create a higher than average contribution to Gross Value Added (GVA) and have a propensity to pay their employees higher than average wages.
22. Centre for Cities also finds that the quality of office environment is considered as key. For example, whilst the costs of office space in an area like Leeds are three times more expensive than Middlesbrough, the agglomeration of professional services, coupled with the high quality office stock, mean that business accommodation costs, whilst important, are a lesser consideration in terms of the qualitative benefits.

'All aspects of the local economy can also thrive with a strong base of KIBS employment. The increased footfall that high-skilled jobs create increases the size of the market that retail and leisure businesses can sell to, which is likely to have a positive knock-on impact on the performance of the high-street. Emerging evidence suggests that the presence of high-skilled, 'tradable' jobs has a multiplying effect on those service jobs that sell to local markets. The result is that a strongly performing city centre economy is likely to create jobs for a range of skill levels.'

Centre for Cities Report 2016

23. In the longer term, the ability of city centres to attract and retain more knowledge-focused jobs will become increasingly important in determining economic performance in centres, and their surroundings, as well as underpinning the sustainability of any future growth.

Summary Conclusion

24. Analysis of the existing market conditions and various sources of specialist advice have concluded that:
 - a) market failure exists in commercial property markets across the Tees Valley, particularly in terms of capital flows for enabling investment;
 - b) significant demand exists for new commercial accommodation and the corollary lack of speculative supply is a source of frustrated demand in the market;
 - c) public sector investment and leadership is one of the few credible mechanisms for which such enabling investment funding is available; and,
 - d) an increasing commercial presence within Middlesbrough is an essential requirement in rebalancing the city-centre economy, sustaining the retail core and addressing market failure in the markets for institutional capital investment.

Proposal

25. To achieve the dual aims of unlocking the economic potential of the Centre Square development and delivering a fit-for-purpose, cost-effective and efficient accommodation solution for Middlesbrough Council, Council officers have considered the merits of a proposal based on taking a headlease of the first two buildings of the Centre Square East development. The outline of the proposal is:

- a. In response to Middlesbrough Council's recently established accommodation requirement, Middlesbrough Council would rent and occupy Building One 60,044 sqft Net Internal Area (NIA) of the development (former Register Office site). See Appendices A and B. This building is of a scale which can efficiently meet Middlesbrough Council's accommodation requirements and provide an element of lettable ancillary space for meetings and restaurant / A3 retail. An Executive report of 19 December 2017, '*Council Future Accommodation Requirements*', it was agreed that the Council should seek options for new accommodation, relocating staff and services into new facilities; thereby vacating the existing Civic Centre.
 - b. Notwithstanding the demonstrable market demand and significant accommodation queries to date, the Council would also seek to take the headlease of Building Two, in advance of having secured tenants; albeit work would commence on marketing the site at the earliest opportunity. This represents 33,852 sqft (Net Internal Area) of the development with a view to underletting this building to private tenants, for a rent premium above what the Council would pay in rent. As such, the Council has the opportunity to make a commercial return on the underlet. Similarly, the Council would be liable for the base rent, and associated costs, in the event of any period of vacancy.
 - c. Both buildings would be subject to an additional charge to contribute to a comprehensive estate management programme.
 - d. There is also an option to include an inclusive rate for the shared / common spaces within Building Two, which would cover the provision of associated utility bills, site security and routine maintenance. The Council is assumed to resolve its own utility bills and maintenance programme within Building One.
 - e. Both leases would be for a period of 35 years, at which point the Council would retain the option to purchase the land and buildings for £1.
 - f. The leases would be granted on a full repair and maintain (FRI) basis, meaning that each tenant would be responsible to insure and provide for the upkeep of the lettable space.
 - g. The offer also includes the Council receiving a contingency sum, to cover any circumstances when the property lies empty or to cover rent free / incentive periods for new tenants.
26. The above proposal utilises the Council's strength of covenant to secure institutional investment for the first two buildings of the development. By providing a proof-of-concept in the local market, the aim is to demonstrate a compelling case whereby institutional investment can be secured for the remaining units in the development masterplan.
27. Of course, within the parameters of a framework of external validation advice to ensure value for money, the headline proposal is subject to further refinement and negotiation to meet the Council's headline objectives and bespoke requirements.

Market / Operational Fit of Proposal

28. In order to assess the viability of the proposal it is important to consider the use profile of the buildings and to firmly establish that they are suitable for the Council's requirements. This has been confirmed and verified through consideration of the following points.
29. Building One is proposed to accommodate Council staff currently in the central buildings, with the retention of Middlesbrough House, and the Town Hall, in line with established Agile working principles. With consideration of required office, meeting, storage and ancillary space the building is considered proportionate with the Council's requirement. Building One has the capacity to accommodate Council staff without unnecessary redundant space and provides capacity for up to 5,241 sqft of prime restaurant / A3 retail space on the ground floor.
30. Analysis by Ryder Architecture has outlined the Council's own current occupational requirement as C.57,737 sqft. The building proposed has available space of C.54,803 sqft (net of A3 commercial space) and, therefore, a marginal deficit of C.2,934 sqft. By way of comparison, this is a similar floorplate to that of the refurbished courtroom in the Town Hall. The Council currently aims to operate an agile staffing ratio of seven desks, per 10 staff. A very small marginal reduction in this level would comfortably accommodate Council staff whilst remaining flexible for future use requirements. Accommodation requirements have many variables but the building is inherently large enough to meet the Council's needs.
31. In the event that staffing changes and agile working practices were to leave any of the space underutilised, the modest amount of surplus space has many potential uses. Any surplus space could be easily partitioned from the principal office space, subdivided and used for public / corporate meeting space; and subject to an appropriate charge.
32. As with any business, the building would require a fit-out which is reflective of the specific business operations. As highlighted in the '*Council Future Accommodation Requirements Executive report of 19 December 2017*', the cost of such measures is estimated between £33 per sqft and £55 per sqft (up to £5m), depending on specification and inclusive of all preparatory design work.
33. Should this proposal be progressed, work would be undertaken to engage, and consult with Council services, staff and Elected Members to ensure that maximum opportunity is taken to shape the future workspace to the bespoke advantage, and requirements, of Council services. When this work is complete, a future report would seek Executive approval for the fit out options and final cost profile(s).
34. Building Two is proposed solely as a letting opportunity to stimulate / meet market demand. It has been designed to conform with current industry specifications and to be as adaptable as possible to modern business requirements. The space would be marketed at the earliest opportunity to maximise the opportunity of an early and stable letting.
35. An encouraging number of inward investment enquires regarding leasing commercial space within the Grade A Office Development, as shown in the table below. This has been achieved in advance of marketing the site or agreement of a construction start date.

Sector	Requirement	Timescale for occupation
Financial services	150,000 sq ft.	Q3/Q4 2019/2020
Financial services	50,000 sq ft.	Q1 2020
Systems design and implementation	25,000 sq ft.	Q3/Q4 2019/2020
Digital Media	15,000-20,000 sq ft.	Q3/Q4 2019/2020
IT and Internet service provider	5,000 sq ft.	Q3/Q4 2019/2020
Number of smaller legal and professional services firms	TBC	TBC

36. The Executive report of 19th December 2017 '*Centre Square Office Development Delivery Update*' outlines C.250,000 sqft of commercial office investment enquiries, specifically in relation to this scheme; all before the product has been formally marketed or advertised.
37. The detailed financial viability of the investment in commercial office space for Buildings One and Two, is considered in detail in Part B of this report.
38. The architectural and operational specifications of the buildings are set apart from anything else currently available in the Tees Valley. The buildings are environmentally efficient and are seeking BREAAAM Excellent accreditation. The available office space, at the market rent targeted within the business case will make the facilities competitively priced and highly appealing to potential occupiers.
39. A key consideration for the Council is the key benefit of hosting its staff close to the retail and service centre of Middlesbrough. Staff play a key role in animating Middlesbrough and supporting the City Centre economy through their personal spending and car park income. The location of the buildings supports this policy and helps to yield these strategic benefits.
40. It is also critical to note that there is no readily-available local land holding, existing office space or nearby development opportunity which could satisfy the strategic and operational requirements of Middlesbrough Council, as set out in the '*Council Future Accommodation Requirements*' Executive report of 19 December 2017.
41. The buildings are considered fit-for-purpose, a strong fit with the Council's own requirements, as well as being of universal appeal to prospective tenants. The buildings will yield efficiency gains in terms of their like-for-like running costs (up to 50% cheaper to run than current arrangements) and as being part of an accommodation solutions for a rationalised, consolidated and Agile workforce.

42. The 'Council Future Accommodation Requirements' Executive report of 19 December 2017, cites the Councils accommodation objectives as:

Accommodation Objective	How this proposal meets this objective?
Avoid future expenditure by reducing the whole life cost of Civic Centre	The Civic Centre is anticipated to cost C.£14m to bring up to specification and retain a life cycle of up to 35 years. This approach realises no immediate economic benefits and is limited in scope due to the existing configuration of the building. The proposal tabled effectively eliminates this requirement.
Support the increase in Agile workers by providing a contemporary, flexible workspace	Grade A office space has the efficiency, scale and flexibility to accommodate Council staff in a fit-for-purpose environment for a consolidated workforce. It is configured to be adaptable to evolving needs and flexible workspace.
Produce revenue savings through reducing running costs and expenditure on staff relocations	Grade A office space is anticipated to use a third less energy than the current civic centre. This will generate immediate revenue savings (of up to 50% on a like-for-like basis) whilst providing workspace which can be heated and cooled much more efficiently. The new space also allows for future-proofing, as it would be much easier to integrate with emerging technologies such as district heating systems.
Contribute to the City Centre economy and add value to the economic wellbeing of Middlesbrough	Building One would be able to accommodate more staff, in an efficient floorspace. The accommodation is equidistant from the main restaurant and shopping areas within Middlesbrough and staff can continue to support the retail economy.
Improve staff productivity through improved retention and reduced absenteeism.	A brighter, better-ventilated and open workspace will reflect well on the authority as an 'employer of choice'. Investment in staff has proven correlations with productivity and retention. Given the recent history of nationally-imposed austerity the Council is keen to show leadership by investing in its talent and the economic success of the area.
Improved customer satisfaction by increasing accessibility and facilitating improved response times.	By having a consolidated workforce, with some services reintroduced to the Civic Campus, there will be improved / closer dialogue between services and less time taken to travel between meetings.

Value for Money Analysis

43. Of course, the critical consideration is that the rental proposal is competitive, represents value for money and mitigates the Council's financial exposure, as much as is possible.
44. As a complex commercial undertaking, due diligence has been conducted with independent sector specialists, to assess the value for money credentials of this proposal and whether the finished product the Council will take on, is proportionate with the costs identified.

45. Faithful and Gould are specialists in Cost Management, Engineering and Construction and have validated that the lease proposals are proportionate with typical development costs. BNP Paribas are world-leaders in commercial property / economic specialists and have validated the financial model. Together, they have been engaged to ensure that the proposal represents value for money in terms of issues including:
- i. the price per square foot of the lease is a competitive rate and within normal parameters for the market;
 - ii. the terms of periodic rent reviews / increases are typical;
 - iii. the duration of the lease is proportionate with the funding model;
 - iv. the rental rate at which Middlesbrough Council hopes to achieve from the underlet is achievable in the market;
 - v. the service support specifications and management regime being appropriate;
 - vi. the service support specifications and management regime charges are within market norms;
 - vii. appropriate benchmarks and parameters for offering lessee incentives and rent free periods; and,
 - viii. the relative merits and risks associated with the proposed funding structure, against alternatives.
46. The disclosure of commercially sensitive financial information in this report would undermine Middlesbrough Council's negotiating position with both the prospective landlord and prospective tenants. This information is explored and analysed in detail in Part B of this report.
47. In summary, due diligence conducted by BNP Paribas and Faithful and Gould has concluded that the lease proposal, as presented, reflects:
- a) a proportionate cost for the development, in terms of the outlined cost appraisal and with respect to the relative value of Middlesbrough Council's covenant;
 - b) a reasonable risk and return profile for Middlesbrough Council, particularly when building in the market enablement and associated economic benefits;
 - c) that the proposed rent rate which the Council aims to achieve is reflective of the local market and the prices which tenants are willing to pay; and,
 - d) that the assumptions on quality of the development, price-point of the market rents and demand for the proposed units, are sufficient to allow for a reasonable expectation that the units would be leased by the market within a reasonable timeframe.

Strategic Drivers

48. In recent years Middlesbrough has made great strides in protecting and growing its City Centre offer; particularly in the retail and leisure sectors. This hard-won progress is relatively fragile and it is increasingly important that Middlesbrough's local economy is sufficiently balanced and robust as to sustain recent successes.
49. In the longer term, the ability of city centres to attract and retain more knowledge-focused jobs will become increasingly important in determining economic performance and underpinning the sustainability of future growth. New economic activity builds supply chains and supports ancillary businesses such as retail and

leisure. The business sectors targeted for this accommodation pay higher than average wages and generate higher disposable incomes for their staff. This spend cycles through the economy and generates a significant impact through direct and indirect multiplier effects.

50. As cited by KPMG in 2016, Middlesbrough's private sector economy shows signs of fragility due to no marketable Grade A office space and insufficient representation of professional services companies. There has been a reduction in office space across the city as previously empty offices have been reoccupied and renovated for alternative uses e.g. residential and commercial conversions. The quality and quantity of the remaining office space falls below the specification expected by Knowledge Intensive Business (KIB) investors.
51. The growing propensity for self-sustaining development cluster offers opportunities not only to attract inward investment, but to meet the growth demands of local businesses, ultimately reducing out-migration and retaining local skills-sets, talent and employment opportunities.
52. Grade A office space increases the potential to attract professional jobs into the City Centre. When complete, the development masterplan put forward by Ashall Projects (MB) Ltd. has the potential to host up to 2,000 professional employees, who subsequently bring higher rates of disposable income. Additional employment can be generated should the vacated Civic Centre site be brought forward for a similar purpose.
53. Whilst Building One will accommodate existing Council employees, as a consequence it allows for the demolition of the Civic Centre and its redevelopment as an additional site for office development; as was agreed by Executive on 19th December. Thus maintaining the ambitions for adding up to 2,000 jobs into the City Centre.
54. The enablement of this scheme also makes a significant contribution to the strategic objects of the sub regional Strategic Economic Plan (SEP) and the delivery objectives of Tees Valley Combined Authority (TVCA). There is an aspiration to create additional employment of 25,000 jobs within the Tees Valley economy by 2025; 7,000 of which are in professional services. As such, the success of this scheme will have a disproportionately high impact on the achievement of this goal. TVCA is fully aware of this development and is supportive of its aims and strategic fit.
55. KPMG confirm that, a strong KIB base is known to strengthen and sustain local economies. Coupled with the rise in population and earning potential there will be increased footfall and spending within the City Centre, sustaining and strengthening the retail and leisure sector, and developing the strength of the local pound. The scheme will be fundamental to enhancing Middlesbrough's retail and leisure functionality.
56. The proposed development would also help to balance the City's commercial / retail equilibrium, which at present is underrepresented by office premises.
57. Despite assertions to the contrary, there is not a substantial amount of empty office space in Middlesbrough. However, over the last few years there has been little or no appetite from developers to return empty offices back to their original use. These

buildings do not provide the type of accommodation in terms of floor plates, design, energy efficiency, air conditioning, amenity etc that modern professional service companies require; and their conversion is either technically difficult or cost prohibitive. As a result, a number of vacant offices have been redeveloped for an alternative use, due to the available stock not meeting the requirements of businesses / investors. Consequently, there remains an essential need for premium quality office accommodation within Middlesbrough.

Anticipated Benefits

58. By playing an enabling role in the initial phase of the Centre Square East development, the Council is taking a strategic leadership role, showing confidence in the area, to demonstrate market viability which aims to unlock long term institutional capital flows for development across the Tees Valley. Whilst there are direct financial benefits from accommodating the Council staff in modern and efficient workspace (explored in Council Future Accommodation Requirements Executive report of 19 December 2017'); as well as the anticipated financial return on the underlease of Building Two, there are numerous strategic benefits which add to the argument to invest in this development.
59. The inclusive nature of this investment proposal does not expose the Council to specialisms, skills or administrative activities for which it does not have expertise. The bulk of the delivery, maintenance and marketing responsibilities, which relate to such a development, have been included in a comprehensive package which also supports the integrity of the wider estate and future phases. This protects the standards, ethos and economic value of the assets in the long term; maximising the economic benefits and impact of the assets, for the long-term.
60. Middlesbrough has the highest employment density of Knowledge Intensive Business (KIB) jobs in the region, therefore it is best placed to attract and retain more knowledge focussed jobs if it takes the appropriate enabling steps.
61. Critically, when complete, the proposed development would generate an annual uplift on receipts of business rates. This is fundamental to the Council's Medium Term Financial Plan (MTFP); particularly in the light of the removal of revenue funding by national government and Council's having to become increasingly self-reliant when generating income streams to protect services. A C.200k sq. ft Grade A office development, as proposed, can represent additional business rates receipts once complete and fully occupied. Other benefits such as increased parking fee income are also likely to result.
62. Critically, the proposal creates an opportunity to generate an operational surplus from the lease premium generated on Building Two. It is estimated that Building two will become cost neutral at an occupancy rate of C.82% and any revenue surpluses beyond this point, would support the Council's financial position. This estimate does not include secondary income opportunities such as additional business rates, additional car parking income and additional patronage of public transport networks; which would support the viability of additional routes / an enhanced network.
63. There are opportunities to direct any surplus income to various Council priorities. As a first priority, it would be prudent to use some of the surplus to make provision for future upkeep and refresh of the accommodation, this would best protect the longevity of the asset as an appealing, marketable product. Beyond this the Council

would be free to utilise any surplus to support the Council's revenue position and sustain service provision.

64. Furthermore, the completed development will contribute towards:
- i. the provision of Grade A office space able to host approximately up to 2,000 professional jobs;
 - ii. revitalising Middlesbrough's economy, attracting employers who will provide knowledge intensive jobs;
 - iii. developing of the circular economy i.e. the additional employment will allow other businesses to prosper;
 - iv. the creation of an iconic business destination in the heart of the Tees Valley;
 - v. refreshed public amenities and the completion of the aspiration for Centre Square to be at the commercial heart of Middlesbrough;
 - vi. additional business rates yields;
 - vii. rebalancing Middlesbrough's commercial / retail mix;
 - viii. drawing in new companies, not currently in the Tees Valley and inward investment;
 - ix. the creation of a major employment destination with sustainable accessibility options, including public transport;
 - x. complementing existing and planned developments;
 - xi. progressing the commercial ambitions of the investment prospectus; and,
 - xii. building on the Mayor's vision for a fairer, safer, stronger Middlesbrough. Particularly, in terms of *strengthening and diversifying our local economy*; and, *strengthening our town through bold and innovative regeneration*.

Additional Considerations

65. **Vacating the Civic Centre** – as per the '*Council Future Accommodation Requirements*' Executive approval of 19 December 2017, when the Civic Centre is vacated, given its age and condition, it is not anticipated that the building would represent a realistic case for onward disposal. Similarly, its architecture and condition would be at odds with the neighbouring, modern facilities. When empty the Civic Centre would represent a continued financial burden in terms of continued business rates liabilities, security and mothballing costs.
66. To offset these residual costs, it is recommended that the Civic Centre is demolished as soon as is practical, following vacation. The demolition, including 'making good' of the access links with Middlesbrough House and the Town Hall are estimated to cost £900k. This work will be undertaken to the appropriate heritage specifications and with full consideration of the heritage importance of the Town Hall. The remaining site, in a prime location, could then be developed to the further advantage of Central Middlesbrough. The Executive report of 19 December 2017, '*Council Future Accommodation Requirements*' established approval to incorporate the vacated Civic Centre site as an additional development opportunity, in line with how the Centre Square East office development is progressing. As an interim measure, it would be appropriate to utilise the vacant plot as ancillary / temporary parking, with appropriate surface and boundary treatments in fitting with the evolving character of the area.

67. **Fit-Out and Internal Layout** – As with any new tenancy the Council will need to make preparations to design and fit-out the internal areas of Building One. As highlighted in the '*Council Future Accommodation Requirements Executive report of 19 December 2017*', the cost of such measures is estimated between £33 per sqft and £55 per sqft, depending on specification and inclusive of all preparatory design work. This work would need to progress as a matter of priority and, should this proposal be agreed, a future report would seek Executive approval for the fit out options and final cost profile(s).
68. **Marketing and Lettings** – as a lease inclusive of a comprehensive service offer, the business case has made an allowance to fund the marketing costs associated with securing a tenancy for Building Two and the A3 commercial space in Building One. If Middlesbrough Council is minded to invest in the proposed development, it will be critical to commence marketing at the earliest opportunity. The buildings form part of a wider estate, being comprehensively developed by one developer. As such, the site would benefit from the commercial credibility offered by a sector-specialist marketing presence, with a wide commercial reach. It is proposed that the principles of how the process of agreeing leases is governed is delegated to the Executive Director for Growth and Place and Director of Finance, Governance and Support.
69. **Site Management** -To ensure qualitative standards on the site, marketing appeal and to protect the Council's interest, the lease offer is inclusive of a comprehensive management regime, established for the benefit of the finished facility. Whilst the Council will be responsible to insure and maintain the internal elements of Building One the proposal includes a standard estate service charge to provide a consistent maintenance programme across the wider estate. The charge associated with Building Two will remain with the Council until such time as it is passed to the underlet tenants. These measures will serve to ensure that the wider estate is managed in a cohesive way and adds value in the long term.
70. For Building Two, it would be possible to incorporate an all-inclusive service charge to provide for the utility expenses, security provision, scheduled maintenance and general maintenance. This would be an expense for the underlet tenant and, as the costs are proportionate with occupancy, the cost would be much reduced in the event that the building remained empty for any period of time.

Policy Framework

71. Central Middlesbrough is the heart of the Tees Valley economy. The centre provides an interdependent mix of business, retail, leisure and cultural features with City Centre living. This project adds significant value to, and is entirely in accordance with, the objects of Middlesbrough's Investment Prospectus.
72. The proposed development will make a significant contribution to sustaining and enhancing this City Centre offer. Additionally, the proposals for the Centre Square Development are of a quality and scale that will be important to providing an outstanding site for inward investment for professional and service sector companies, not currently represented in the Tees Valley, thus contributing to the strategic objectives of the Tees Valley Combined Authority.
73. The scheme presents the means to make a significant contribution to the ambitions of the Tees Valley Strategic Economic Plan, as it complements the commitment to

strengthen the local economy by 2025. Grade A offices will be developed to appeal to high-value employers with a propensity to enhance the local economy with higher than average Gross Value Added (GVA); new employment opportunities in skilled trades; paying higher than average weekly incomes; and, in such density as to significantly contribute to the target of an additional 25,000 Tees Valley jobs by 2025 (see below). A concentration of skilled employment can underpin the City Centre economy, as disposable incomes multiply throughout supply chains and ancillary services. It also has the potential to create additional employment in the local labour market as local skills are matched with new employment opportunities, contributing to the eventual reversal of the outward migration of local talent.

74. The Tees Valley Strategic Economic Plan (SEP) proposes the need for 25,000 (net) new jobs for the Tees Valley over the next decade. This is required to meet the needs of the population and provides opportunity for economic growth that allows for increased prosperity in the area. The additional jobs are broken down by sector based on economic analysis of the areas prospects, as such:

Net Job Creation 2016-2026	Target
Low Carbon / Process, chemical and energy	+2,000
Advanced Manufacturing	+1,500
Other Manufacturing	-4,000
Construction	+3,000
Professional and Business Services	+7,000
Logistics	+3,000
Digital	+3,000
Higher Education	+1,000
Health and Social Care	+3,500
Services	+2,000
Culture and leisure	+3,000
Total	25,000

75. It is clear that, if this aspiration is to be met, a large proportion of employment increase will depend upon the growth and retention of professional services, and the ability to accommodate them in new, modern, efficient office space. To optimise the contribution this investment would make to the economy, it would be advantageous if this were located in the area's commercial centre i.e. Middlesbrough.
76. Investment in the site is a long term commitment and forms part of the Centre Square East allocation in the statutorily-adopted Middlesbrough Local Plan (policy REG25 of the 2009 Regeneration DPD). It is identified in the Plan for a high quality contemporary development that will not only support economic growth and the aspirations for the Town, but also achieve a design that reflects and complements the high standards set by mima and Centre Square. Acceptable uses are identified as including hotel, office, leisure and retail, the current proposals not only reflect these uses but also the ambitions in terms of quality being sought through the planning process.

77. The allocation, as part of the Plan, underwent extensive public consultation and was the subject of a public examination before an independent Planning Inspector appointed by the Secretary of State, who found the Plan sound. Members adopted the Plan, including the allocation of Centre Square for development, at a meeting of the full Council in November 2009. The site is therefore supported as a development site opportunity in the Local Plan, the development of which has already been considered and approved in principle by Members.
78. Comprehensive pedestrian and transport infrastructure surrounds the site. The A66 and Middlesbrough Railway Station sit to the North and Middlesbrough Bus Station to the West, whilst the cycle network feeds directly into the Centre Square East area, making the site an accessible destination. There are a wide range of amenities in the immediate vicinity including retail, hotels, restaurants, public parking and cultural venues. Such accessibility and facilities make the site ideal for attracting end occupiers. The site, therefore, has very good sustainability credentials as future workers and visitors will enjoy excellent public transport opportunities to access the proposed development.
79. It is important to note that the development secured planning approval in June 2017 and is in a position to finalise construction arrangements and funding, subject to contract.

Next Steps and Indicative Programme

80. Assuming approval is granted, the heads of terms for the lease agreement can be further refined and progressed to contractual arrangements for lease. With contractual arrangements in place the development aims to commence construction in early summer 2018.
81. Although all planning and construction risk lies with the developer, the Council would retain a 'watching brief' over its likely investment. The management, governance and monitoring of the project will rank highly in the Council's Corporate Governance Framework, with key milestones monitored along the critical path for programme timescales. The milestones are informed estimates / indicative based on the most up to date information at the time of this report and are potentially subject to marginal change. Whilst the majority of them lie outside the direct and sole control of the Council, the Council will need to ensure that appropriate governance is utilised to bring forward delivery. They include:

Administrative Milestones

- | | |
|------------------------------------|------------|
| a) Lease Agreement Completed | March 2018 |
| b) Marketing Strategy Determined | March 2018 |
| c) Site Management Strategy Agreed | March 2018 |

Construction Milestones

- | | |
|--|--------------|
| a) Commence Construction | June 2018 |
| b) Internal Design and Fit-out Plans to Executive (Building One) | January 2019 |
| c) Building One complete | July 2019 |
| d) Building Two complete | October 2019 |
| e) Building One Fit-Out Complete / Occupied | April 2020 |

IMPACT ASSESSMENT (IA)

82. This proposal is not judged to present any equality and diversity issues to any of the groups with protected characteristics.

OPTION APPRAISAL/RISK ASSESSMENT

83. Whilst the offer tabled is based on a lease agreement only. Due diligence processes have considered the relative merits of several intervention options of enabling development at Centre Square East and the Council having a financial interest in the development. They include:

Figure 1

Direct Development		
Description	Pro's	Cons
The Council develops the property utilising its own resources (capital reserves or Prudential borrowing). The building, when let, is either sold to recover capital or retained for the income generation.	<ul style="list-style-type: none"> • Potential for lower overall costs as land value and profit level will be reduced. • Direct control and ownership. 	<ul style="list-style-type: none"> • All occupational and redevelopment risk. • Capital and resource intensive. • Limited internal specialist skill and capacity. • Assumes an appropriate land holding to accommodate the development. • Cost over-runs and development delays are at the direct liability of the Council.
Gap Funding		
Description	Pro's	Cons
The Council engages a delivery partner and provides direct financial support to ensure commercial returns.	<ul style="list-style-type: none"> • No ongoing liability. • Fixed obligation. • Risk transfer to private sector. 	<ul style="list-style-type: none"> • Limited incentive to drive VFM. • State aid issues. • Monitoring intensive. • No income potential for the Council.
Guarantee Arrangements		
Description	Pro's	Cons
Typically done through the Council agreeing an overriding lease on the new building to attract funding and using the security offered to leverage capital value greater than open market values.	<ul style="list-style-type: none"> • Enables private sector funding. • Transfers development risk. • Flexible arrangements to generate surplus or profit rent. • Specialist knowledge and experience from developer / contractor. • Private delivery can increase the speed of delivery and generate significant savings – minimising overall cost. • Provides a test case for private sector investment to follow. • Increases market confidence and credibility in the local market. 	<ul style="list-style-type: none"> • Council retains occupational risk. • Potential rental shortfalls over life of lease. • RPI index risk v market rental growth. • Mid-term re-letting risks.

a. Middlesbrough Council does not support the development

84. A significant risk in not delivering the development is a lack of quality accommodation to attract new inward investment or accommodate growing domestic companies. The risk here is that, in the absence of this development, growth and inward investment opportunities will be lost to the Tees Valley, as businesses look farther afield to meet their accommodation requirements.
85. As confirmed by independent advice of KPMG and BNP Paribas, there is no speculative market for the development of Grade A Office accommodation, such as is being proposed, outside of the South East of England. In the absence of public sector support, the probability of such a development being brought to the market is severely restricted. By way of comparison, Newcastle Stephenson Quarter involved direct intervention by the Council to deliver a mixed use hotel, office and car park project, utilising over riding lease structures and risk sharing agreements.
86. Notwithstanding the recent successes witnessed in Middlesbrough's centre, the Council has a strategic role in sustaining and nurturing the City Centre economy. With the rise of online shopping and out-of-town retailing, it is necessary to enable measures which protects fragile growth and gives the retail core the best possible chance of success. Evidence from Economists ERS shows that the average daily spend of a worker in the centre is c.£20. With the aim of 2,000 additional jobs this can inject an additional £10m into the local economy per year.

b. Middlesbrough Council take a headlease on the two buildings (recommendation)

87. By purchasing the properties outright, this would mean that the proposed buildings would lie outwith the proposed, consolidated estate and associated management regime. This would add an unnecessary administrative burden to the Council and could undermine the unified standards envisaged for the estate. Over time, the estate could diverge in terms of ownership and management standards and this has the potential to erode the quality of the offer. Further consideration of the relative merits of lease versus purchase is considered in Part B of this report.
88. This proposal is predicated on affordability and cashflow considerations and so represents an income strip / headlease model. This would limit the Council's short term capital requirement by effectively standing in as head lessee and guaranteeing the lease income of the site for a C.35 year period. The strength of the Council's covenant would allow the market to support the development and minimise borrowing costs for the development. Essentially this is like mortgaging a home, as compared with being a cash buyer. It allows an element of financial flexibility which is affordable and represents a mixed investment portfolio of capital-intensive investment and short term outlay.
89. Varying lease durations have been assessed but any duration less than 35 years is considered a different product by the funding markets and may not necessarily result in the option to reacquire the freehold of the property for £1 at the end of the lease term.
90. In this model, the Council would minimise its short term outlay, and seek to make a financial return on the lease premium. Given the Council's current capital commitment across a range of projects in Middlesbrough, this option offers a

credible solution in terms of minimising short term outlay and having a mix of products in its investment portfolio. Whilst it may sometimes be more cost-effective, in absolute cash terms, for a Council to purchase an entire development in its entirety, the aim of this development is to pass on the majority of costs to the underlet property and make a financial return on Building Two. Similarly, the development aims to stimulate the following of institutional capital flows to support the future phases of this development and provide a clear demonstration of the demand and funding appetite in the area.

91. As a lease option, all construction risk is held with the developer and the Council bears no responsibility for cost over-runs. In addition, the structure of the funding arrangement is such that the Council will have the option to purchase the buildings and land holdings for £1 at the end of the lease period.
92. Over the period, the difference in the net present value of purchasing the development over leasing development is C.£500,000 (in favour of purchasing/direct development). This does not include the trade-off for officer time and the diversion of costs / resources to work up and deliver such a proposal. Given the comprehensive and inclusive nature of the offer, the minimised administrative burden to the Council, the reduced construction risk exposure and the minimised requirement for upfront capital funding; this is considered a proportionate trade-off.

c. Middlesbrough Council purchases the two buildings outright

93. A commitment to purchase the two buildings development on completion is capital intensive and relies on a multimillion pound capital commitment from the outset. Whilst this involves the Council raising significant short term capital, it does have the potential to increase the amount of profit which the Council can make when underletting the property.
94. In this model, the Council would remain liable for all development and leasing costs including all risk in terms of empty units / space, cost over-runs during construction.
95. The outright purchase is a credible delivery model but has been discounted in terms of the trade-off between a large short term capital requirements versus minimising annual outlay.

d. Middlesbrough Council grants gap funding to enable the development

96. Gap funding a development of this nature would support delivery of the development but this would have potential state aid implications and, in this instance, would not yield a direct financial 'upside' for Middlesbrough Council to recognise its financial commitment.

FINANCIAL, LEGAL AND WARD IMPLICATIONS

Financial

97. The headlease of Buildings One and Two amounts to an annual financial commitment for 35 years. A significant proportion of the financial commitment aims to be recovered through the underlet to the future tenants of Building Two, with an operational surplus targeted for Middlesbrough Council. In order not to prejudice the Council's negotiating position / business case with prospective tenants, the

information is considered commercially confidential and is included in Part B of this report.

98. In addition to the annual lease commitment, estimates have been prepared for associated expenses in relation to the proposed relocation of Council staff. They include:
- a. £900,000 to demolish the Civic Centre and make good of the Town Hall / Middlesbrough House interfaces (including temporary parking provision and boundary treatments of the vacated plot);
 - b. an allocation of £250,000 for the costs associated with site preparation, due diligence, specialist advice and statutory licenses with respect to the future intention to develop proposals to dispose of / develop the vacated Civic Centre site;
 - c. preliminary work in relation to the design and configuration of the internal fit out arrangements £350,000 (inclusive in the fit out range below);
 - d. estimates for substantive works in relation to the internal fit out of the new accommodation between £33 per sqft and £55 per sqft (up to £5m). A separate report will return to Executive to confirm costed options and recommendations;
 - e. there is an option to make a rental saving by the Council paying its own Stamp Duty Land Tax (SDLT), estimated at C. £257,286; and,
 - f. a £2.2m contingent reserve to be held to offset voids and incentives.
99. Indicative Break-even / profitability analysis has been assessed at 82% occupancy of Building Two.
100. Further financial details are available at Part B of the report.

Financial Structure

101. A detailed analysis of the financial structure of the proposed development contains commercially confidential information and can be found in Part B of this report.

Risk

102. In taking the headlease of two buildings which equate to c.94,000 sqft NIA, the council is taking the occupational risk on the development and is liable for the rent and service charges in the event that no tenant occupier is forthcoming for Building Two. The risk for Building One is partially offset by the fact that it is proposed to accommodate Council staff, although there is some space available to underlet to a restaurant / A3 tenant. The risk reward balance is achieved where the Council can secure a commercial return for its risk exposure. It should be noted that early indications on demand for the property is positive, even in advance of formal marketing.
103. The progress in this development investment will be closely monitored as a project under the corporate Governance and Project Management Framework. This will include the maintenance of key project documents such as budget monitoring, risk logs, issue log and project plan. Progress will be reported regularly and any emergent issues would be escalated as appropriate. An independent monitoring surveyor is included in the development to ensure that the highest standards are met for both the headlease tenant (Council) and the investors (funders).

104. There is an inherent risk with any funding to enable development, and thus there is risk to the Council in terms of financial exposure. Whilst the bulk of the risk is displaced by the fact the Council would be a sitting tenant in one of the buildings, the risk remains in the event that it were difficult to let the accommodation at the assumed rental levels. In that circumstance, the Council would remain liable for the base rent of the second unit, any associated estate service charges, costs associated with interim maintenance and the associated business rates liability for the property.
105. **Development Risk** – Even with comprehensive investigations and due-diligence developments are always exposed to a level of risk in terms of unforeseen circumstances. As the client, Middlesbrough Council has no exposure to the risks associated with construction and development, with any cost over-runs, penalties and delays being solely borne by the developer. The Council is only exposed to the agreed rental rates and service charge, as such this transfers all development risk to the developer.
106. **Long Term Voids** – In the event that the underlet building remaining empty for any significant period of time, there are three main mitigation mechanisms to offset long term voids. They include:
- i. market analysis indicates positive demand for the accommodation, as specified. To increase the chances of early lettings a comprehensive marketing campaign will be undertaken to attract interest in the facility. This would commence at the earliest opportunity with a view to securing a tenancy agreement during the construction phase. This would minimise the time between receiving the new accommodation on practical completion and the commencement of the paying tenancy.
 - ii. in the event that the underlet property struggles to secure appropriate tenancy interest in a reasonable timescale, there is sufficient flexibility between the base rent (paid by MBC) and the market rate (paid by the tenant) so that the Council could choose to discount the rental rate of the property, to stimulate demand. The financial model is considered to have sufficient 'headroom' to ensure that the Council is not liable for a rent in excess of its underlet rental income. The rental rate anticipated is considered appropriate for the current market conditions and competitive in terms of alternative / existing provision.
 - iii. a contingency fund has been factored into the business case which covers the Council in the event of voids and to offset rental liabilities for tenant incentives (rent free periods etc). It is entirely typical of the market to offer rent free periods in proportion with the lease duration and strength of the financial covenant of the tenant. Whilst this allowance (rent and voids 'pot') was initially factored into a higher rental rate, it is considered more efficient for the Council to cover this contingency, via holding a contingent liability account for the underlet building. This would mean that the Council would fund any void / incentive in the short term and recover this outlay from the account, as balanced over the duration of the lease.
107. **Maintaining Tenancies and Asset Values** – The assets will need an appropriate specification of management regime and the ability to offer a quality service and quality accommodation for the long term. As such, a full-life-costing model is being used to ensure that the asset enjoys continual maintenance and investment to make it commercially relevant, competitive and appealing in the longer term.

Largely covered by an estate management fee and service charge, this is an additional expense to the tenant of each building which ensures that the buildings are appropriately serviced and site maintained to a high standard. In addition each tenant will be subject to a full repair and insure (FRI) lease. This means that, at the end of the lease, the tenant is liable to return the accommodation to the condition / standard at which it was let.

108. **Capital Cashflow** – The proposed model is a financial trade-off between Capital Cashflow and short term financial exposure. By taking a lease, rather than purchasing the development, or direct delivery, the Council can utilise the strength of its financial covenant to allow the market to secure competitive financial borrowing rates for the development, whilst minimising its short term outlay. This reduces the impact on the Council's Capital programme, whilst enabling development and financing the delivery of both new accommodation for Council business and an income generation opportunity via the premium on the underlet of Building Two. This type of investment also accords with the principles of enabling investment as set out in the recent findings of the Local Government Peer Review. This process applauded the Council's approach and encouraged the Council to consider similar such investments as a way to generate income and support the overall revenue position of the Authority.

Ward Implications

109. The Grade A Office development is situated in Central ward, however, the proposed development is anticipated to have a positive impact in terms of employment opportunities and economic growth, for the whole of Middlesbrough.

Legal - Procurement / State Aid

110. Legally-privileged information is set out in Part B of this report.

RECOMMENDATIONS

111. It is recommended that the Executive:
- a. acknowledges the financial and economic benefits of enabling the first phase of the development, the strategic fit with the Council's future accommodation requirements and the advantages of providing essential investor confidence / proof of concept in the local market for Grade A business accommodation;
 - b. notes the independent value for money advice (BNP Paribas) in terms of the parameters of the proposed lease arrangements and their relative advantages / disadvantages in terms of whole life cost financial modelling;
 - c. approves the commitment to a 35 year lease for building one of the Centre Square development, in accordance with the parameters set out in part B of this report, for the purposes of accommodating Council staff and services as the principal Civic building for Middlesbrough;
 - d. approves the commitment to a 35 year lease for building two of the Centre Square development, in accordance with the parameters set out in part B of this report, for the purposes of subletting the space to stimulate additional commercial activity within Middlesbrough City Centre and with the aim of generating an operational surplus in support of the Council's financial position;
 - e. approves the indicative funding requirement (between £33 per sqft and £55 per sqft – up to £5m) for building fit-out to Council requirements and

relocation of Council staff to the new facility, subject to a staff / member consultation exercise, upon practical completion of the development and fit-out period;

- f. approves the demolition of the existing Civic Centre building (estimated at C.£900k including all making-good works to the Town Hall and Middlesbrough House at their respective interfaces the existing Civic Centre and the potential temporary provision of parking) in accordance with all appropriate listed building consents;
- g. approves an allocation of £250,000 for the costs associated with site preparation, due diligence, specialist advice and statutory licenses with respect to the future intention to develop proposals to dispose of / develop the vacated Civic Centre site, including temporary use as a car park (with associated surface and boundary treatments), with appropriate uses with respect to the character of the Grade 2* listed Town Hall and emerging character of adjacent commercial areas; and,
- h. approves that any changes to:
 - i. the substantive rental agreement (only where this has a positive net effect on the financial case) and is within the parameters of external advice;
 - ii. all operational decisions, site management obligations / arrangements and contractual arrangements associated with the management and administration of the principal and underlet lease agreements;
 - iii. the eligibility criteria for tenant businesses in the sub-let property;
 - iv. all contractual commitments for site marketing, maintenance and site management; and,
 - v. final approval of fit-out specification for the Council's accommodation;

be delegated to the Executive Director for Growth and Place, and Director of Finance, Governance and Support in consultation with the Executive Member for Finance and Governance and the Deputy Mayor / Executive Member for City Centre Strategy.

REASONS

- 112. The provision of new accommodation in central Middlesbrough will bring additional employment opportunities to the area and make a significant step in pump-priming this private development. Middlesbrough Council's commitment and leadership will give the market additional confidence in the area, enabling private delivery of the remaining phases.
- 113. Building Two will provide additional commercial employment space for Middlesbrough, attracting new and sustainable employment to the commercial centre. This additional footfall will increase patronage for the City Centre's businesses and provide a welcome boost to the local economy.

BACKGROUND PAPERS

Appendices

- Appendix A – Site Masterplan
- Appendix B - Building Designs One and Two.

Background papers

Body	Report title	Date
Executive	Council Future Accommodation Requirements	19 th December 2017
Executive	Centre Square Office Development Delivery Update	19 th December 2017
Executive Sub Committee for Property Report	<i>Disposal of Land at Centre Square for the purposes of Commercial Development'</i>	6 th September 2016

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Centre Square East Office Development – Council Investment and Accommodation
Appendix A – Building Elevations

Building One – Civic Accommodation



Building Two – Underlet Accommodation



OVERVIEW AND SCRUTINY BOARD

CALL IN PROCEDURE

BACKGROUND

1. The power to call in a decision of a local authority executive body was introduced under the Local Government Act 2000. The process is intended to hold decision makers to account and ensure that executive powers are discharged properly. The process ensures that a decision can be reviewed and reconsidered before it is implemented.
2. It is essential that the scrutiny process retains full credibility in the way in which it deals with the call in. It is important that the outcome of the meeting is arrived at in an objective manner and not as a result of lobbying in advance of the meeting.

PROCEDURE

3. In order to ensure that all parties have a fair opportunity to present their case to the Overview and Scrutiny Board, the meeting will be conducted as follows:
 - a) The Chair will outline the procedure.
 - b) The relevant service department and Executive Member will explain the background to the decision(s) (Maximum 15 minutes).
 - c) The Member who called in the decision(s) will have the opportunity to ask factual questions (Maximum 5 minutes).
 - d) The Member who called in the decision(s) will present the case against the decision(s) (Maximum 15 minutes).
 - e) The service department and Executive Member will have the opportunity to ask factual questions of the Member who called in the decision(s) (Maximum 5 minutes).
 - f) Members of the Overview and Scrutiny Board (OSB) will have the opportunity to question all parties.
 - g) Following questioning, both parties may make closing submissions (5 minutes each), commencing with the service area/Executive Member, then the Member submitting the call in.
 - h) OSB will discuss the submitted information and reach a decision in respect of the call in.

- i) The Chair will confirm the OSB's decision.
- j) A written report, detailing OSB's decision and the reasons for it, will be prepared and made available to all Council Members by e mail.
- k) Where OSB refers a decision back to the decision maker, it shall be reconsidered by the decision maker within 10 working days.