
Decision maker:	Cabinet member: corporate strategy and finance
Decision date:	9 August 2017
Title of report:	Shell Store incubation centre
Report by:	Economic Development manager

Classification

Open

Key decision

This is a key decision because it is likely to result in the council incurring expenditure which is, or the making of savings which are, significant having regard to the council's budget for the service or function to which the decision relates.

Notice has been served in accordance with Part 3, Section 9 (Publicity in Connection with Key Decisions) of the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012

Wards affected

Dinedor Hill

Purpose

To seek approval for the refurbishment of the "Shell Store" building, within the Hereford enterprise zone, to enable the construction of new incubation and research space facilitating business investment and job creation.

Recommendation(s)

THAT:

- (a) the refurbishment and conversion of the redundant "Shell Store" building into 2,137 sqm of commercial and research floor space on the "Skylon North" site within the Hereford enterprise zone as identified in appendix 1, and at a cost of no more than £6.498m be approved; and**
- (b) the programme director growth be authorised to take all operational decisions necessary to implement the above recommendation including planning and funding applications, procurement and contractual steps within the approved budget.**

Alternative options

1 Not proceeding with the development

Advantages

This option would mean that the council would not have to utilise its approved self-financing borrowing capability; the council would not be exposed to the risks associated with this project.

Disadvantages

This option would result in a continuing lack of start-up space available to rent within the Hereford enterprise zone (EZ), and wider Hereford city, and an identified need and demand not being met.

Should the council not proceed with the development but market the site for sale as commercial land it is unlikely to receive a positive value given the considerable demolition and reinstatement costs associated with the clearance of the building. This is considerably less than the end value of the proposed scheme.

The full potential of the EZ would not be realised in terms of built floor space and jobs created.

2 A partnership approach procuring a development partner to provide finance and expertise

Advantages

This would involve the private sector taking an element of financial risk in the project with a corresponding reduction in the council's financial risk.

An experienced development partner brings with them commercial imperative and requisite expertise.

Disadvantages

We have tested the market and there is no interest amongst private sector developers to become involved in the redevelopment of a historical building, particularly given the relatively small floorspace and intention to let on short term flexible leases, which would be limited to certain specific sectors targeted by the EZ. In addition a private sector investor would require a profit margin and that would increase total project costs.

Reasons for recommendations

3 The principal reason for support is the impact on productivity, job creation and hence economic value. There is a proven demand for high quality start up or grow on business space to rent on the EZ which is not being met by the private development market. The EZ is unlikely to meet its full jobs targets, or maximise business uptake (and hence business rates returns) unless it accommodates the full range of business development opportunities.

Key considerations

- 4 This project will provide employment space for approximately 25 businesses when the centre is fully occupied. By 2023 it is anticipated that 28 businesses will either be located in the incubator or have graduated from the centre.
- 5 These 28 businesses are expected to have generated circa 128 new jobs by 2023 and circa 466 new jobs by 2031. Due to the sectoral focus of the centre and the anticipated collaboration with higher education establishments 112 of these 128 jobs will require an NVQ (or equivalent) level 4 or higher. These jobs would contribute an additional £7.6m a year of gross value added (GVA) to the Herefordshire economy.
- 6 The Department for Business, Environment and Industrial Strategy released a report in mid-April 2017 titled – “Business Incubators and Accelerators: The national picture.” This research identified that four LEPs: Cumbria, Gloucestershire, Tees Valley and The Marches – do not have business incubation or acceleration centres which reflects poorly on our wider innovation and business support.
- 7 Conversely the report identifies that there are five incubators in Worcestershire and that Worcestershire is in the top three LEP’s in terms of highest proportion of incubators per 1000 new businesses formed each year.
- 8 The report goes on to state that UK businesses are prepared to relocate an average of 35 miles to participate in an incubator. There is therefore a prospect of Herefordshire losing good quality start-ups to incubation centres within Worcestershire.
- 9 Of the 205 incubator programmes in the reports data base, 111 of them have been created since the beginning of 2012 which demonstrates that incubators are a growing concept and Herefordshire is in danger of being left behind in terms of this business support provision.
- 10 The intention for the Shell Store project is that the facility consists of two linked components jointly referred to as the incubation centre or Shell Store:
 - a. An incubation centre providing high quality accommodation, incubation and support services to new or young enterprises.
 - b. A development and access centre managed by a Higher Education establishment which would provide a central, shared clean laboratory, research facilities and training/conferencing space that would foster and develop higher education and technology business collaborations as well as being a source of higher education and graduate enterprise in its own right.
- 11 There is no similar facility existing within the county. Limited incubation facilities exist within the Wolverhampton University Business Solutions Centre but cater primarily for individuals looking for desk space, there is no facility to accommodate company employee growth.
- 12 The Shell Store building is currently a derelict First World War construction located within the Skylon North plot on the EZ. The building has local architectural and historical value but is not listed. The refurbishment proposals would retain and refurbish the building structure to a point where new incubation and research facilities could be contained within the existing building footprint. Landscaping and car parking facilities would also be provided.

- 13 The redevelopment would create approximately 2,137 sqm of employment space split between Incubation space, development and access space, reception, facilities and servicing space.
- 14 The intention for the incubator is that businesses graduate through the centre taking larger and larger units within the centre as their business and employment requirements grow. Eventually businesses will be of a size where they are required to move out of the centre thereby creating a ready source of demand for employment units within the EZ. It is envisaged that a typical period from start-up to graduation from the incubator would be three to five years but this will vary from business to business.
- 15 The council has secured a £2m contribution towards the project from the Marches European Structural and Investment Funds (ESIF) allocation, a European Union grant fund. The council has also secured a loan from the Marches LEP "Marches Investment Fund" of £2.498m towards the project costs. The LEP and council are in the process of agreeing the terms of this loan. The council will be required to fund the remaining £2m project costs through its own borrowing. The revenue costs of borrowing, will be repaid through the rental income generated by the project.
- 16 Once built and operational the council will contract with a management body to manage the letting and marketing of the incubation facility, this will be on market terms, follow a compliant procurement process, and will be funded through the rental income generated by the leasing of units within the building.
- 17 The NMiTE Higher Education project have been in discussion with the council over several months with a view to them occupying the development and access centre element of the building. This occupation will be via a lease agreement on commercial terms and NMiTE will be paying the market rate for the space.
- 18 In order to comply with ERDF regulations the council will retain the freehold of the building for at least a fifteen year period post completion.

Community impact

- 24 The site is allocated for employment use and is located within the EZ. The development will be covered by the local development order for the EZ which permits development of premises under B1, B2 and B8 use classes, subject to compliance with specified conditions including the Skylon Park design guide. The project provides space for new and growing businesses to occupy, generating new job opportunities for the local community.
- 25 Failure to proceed with the development will mean the loss of employment space and new job opportunities.
- 26 Refurbishment and renovation into the proposed use will provide an economically viable purpose consequently protecting a building which is subject to a degree of local historical interest.

Equality duty

- 27 Under section 149 of the Equality Act 2010, the 'general duty' on public authorities is set out as follows:

A public authority must, in the exercise of its functions, have due regard to the need

Further information on the subject of this report is available from
Nick Webster, economic development manager on Tel (01432) 260601

to -

- eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act;
- advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
- foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

28 The public sector equality duty (specific duty) requires us to consider how we can positively contribute to the advancement of equality and good relations, and demonstrate that we are paying 'due regard' in our decision making in the design of policies and in the delivery of services. Our providers will be made aware of their contractual requirements in regards to equality legislation.

Financial implications

29 The financial package can be summarised as follows:

Item:	£'000
Construction, sales and finance costs including project management (during build period):	
2017/18	463
2018/19	5,233
2019/20	300
2020/21	502
Total Capital Expenditure	6,498
Source of funding:	
European Regional Development Fund (ERDF)	2,000
Marches LEP loan (0%)	2,498
Herefordshire Council prudential borrowing	2,000
Total Funding	6,498

Capital programme approvals (December 2016):	
Specific Shell Store Budget	6,200
Enterprise Zone capital interventions budget	298

30 A contribution of £2m from the Marches ERDF programme has been secured. Evidence that the match funding for the rest of the project contributions is in place needs to be submitted to the Department for Communities and Local Government prior to a funding contract being offered.

31 The council have secured from the Marches LEP a £2.498m loan towards the project. The terms of this loan are still being negotiated, the council has requested that the

loan is offered on a 0% interest basis with equal repayments being made back to the LEP over 25 years starting one year from opening of the centre. The final repayment date is calculated as being 2045.

- 32 The final element of the funding package is £2m prudential borrowing by the council. This will be repaid by the service area over a 25 year period through net rental income generated by the project and business rates arising. The following table summarises the average annual revenue implications over the 25 year period:

	£000
Rental income	(325)
Business rates	(36)
Operating costs	140
LEP principal repayments	100
Council borrowing costs (principal plus interest)	121
Total	-

- 33 The repayment of the Marches LEP loan and the council borrowing will be funded through income generated by tenants of the centre and the business rates generated from the building. Independent advice has been taken with regard to the occupancy and rental levels that can be achieved within the completed building. This advice demonstrates that there is the ability within the project income to cover the repayments of both the LEP loan and council borrowing if both are taken out over a 25 year period.
- 34 Due to the operation of ERDF funding the council will be unable to dispose of the building for a period of 15 years from project completion without incurring clawback of some or all of the ERDF grant funding (initiated on a sliding scale depending on the point of sale within the 15 years).
- 35 The job creation and wider economic benefits accruing from the investment have been explained and quantified above.

Legal implications

- 36 The Council has powers under the Localism Act to carry out the activities described in this report. When the project is completed, legal advice should be obtained on whether the use of the relevant premises constitutes 'commercial' activity of the Council, which should be conducted via a company for the purposes of the Local Government Act 2003.
- 37 Relevant officers of the Council will be liaising with legal and procurement when required to do so during the process but more particularly on the following:
- The procurement of the contractor required to carry out the works, and related consultancy support. As indicated in this report, these procurement exercises must comply with the Council's Contract Procedure Rules and the Public Contract Regulations 2015. In addition to the usual reasons for such compliance, the compliance with these is expected to be a term in the relevant grant funding agreement applicable to the European grant described in this report.

- The other contracts described in this report, in particular the loan from the LEP and the ERDF grant funding agreement.

- 38 The intention is to go to the open market to select a preferred contractor to deliver the building refurbishment and renovation. The value of this contract is expected to be above the OJEU threshold for construction projects of £4.1m and the procurement advice is that the contract will have to be tendered via an OJEU compliant process.
- 39 Should the decision be made to proceed with this scheme, it is recommended that, wherever possible, prospective tenants are secured via agreements for lease legally obliging them to enter into leases once the building is complete. This would reduce the speculative nature of the project and ensures that an income is definitely to be secured by this scheme.
- 40 The leases of the units will need to be on full repair and insurance basis unless a service charge scheme is proposed and to be excluded from the security of tenure provisions of the Landlord & Tenant Act 1954 to ensure flexibility for the council and for prospective buyers of the freehold. Further professional advice is being taken to identify which is the most appropriate option.

Risk management

- 41 Contractors will be procured through an open competitive tendering process which will meet council and EU regulations, Project management is one of the contracts to be procured to oversee the development of the project including cost estimates, so cost overruns are not anticipated.
- 42 Failure to proceed with this development will have a negative impact on both the EZ and the council in terms of limiting the ability of the EZ to attract companies and investment.
- 43 There is a risk that revenue's may not cover the cost of operating the centre. The budget as presented demonstrates that the project will make a small operating profit each year. Should occupancy levels not meet expectations there is scope for a reduction in the annual operating costs with the current budget including a contingency of 10%.
- 44 Demand for start-up and grow on units has been established through previous commercial building projects within the EZ such as Skylon Court, a council led scheme opened in 2016 where all ten units were occupied within approximately six months of completion. All ten units remain occupied.
- 45 There is a risk that wider financial factors impact on the demand for incubation space or on the cost of repaying the borrowing. The council are negotiating with the LEP the ability to review the council's repayment of the LEP loan should external economic or financial factors impact on the ability for income to cover costs within the project.
- 46 Should the HE partner not proceed with the development and access centre the council will increase the amount of incubation space available for lease. This would enable approximately a doubling of the incubation space within the scheme and would provide a revenue income greater than the development and access centre.
- 47 There is a risk of cost overruns within the build programme, officers have had external advice on the capital costs and the revenue development appraisal.

Additionally KPMG have appraised the project as a part of the LEP's Growth Deal process.

Consultees

48 The EZ executive board. The board have agreed to support the incubation centre project at the Shell Store location.

49 Ward Member Comments.

- I am happy to see that the council have been in discussion with NMiTE and I would appreciate it if you could keep me updated on progress.
- I have no doubt the project will be of interest to a number of college/universities groups. However it does fits in very well with the unique education concept put forward by NMiTE and I would like to see a strong alliance between the enterprise zone and the new Herefordshire University.

50 Political Group Comments – no comments received.

Appendices

Appendix 1 – Location Map

Background papers

- None identified.