

<b>Decision maker:</b>	<b>Cabinet member corporate strategy and budget</b>
<b>Decision date:</b>	<b>10 June 2019</b>
<b>Title of report:</b>	<b>Development and regeneration programme project approval for student accommodation at Station Approach</b>
<b>Report by:</b>	<b>Head of Economic Development</b>

## **Classification**

Part Exempt -

Appendices 3-8, 12 and 13 are exempt from publication by virtue of paragraphs 3 and 5 of Schedule 12A of the Local Government Act 1972 and it is considered that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

## **Decision type**

Non-key

## **Wards affected**

Widemarsh

## **Purpose and summary**

To confirm final approval of the project to develop student accommodation on Station Approach.

The council has entered into an overarching agreement with Engie Regeneration, a developer, to assist delivery of a programme of development and regeneration over the next ten years and potentially beyond. In accordance with that agreement, the developer partner has developed the project through the mechanism of a "New Project Request", progressing the project through "Stages".

The New Project Request developed by the council specified the council's initial requirements and its criteria for the development. These criteria, which were refined at the end of stage 1 of the new project approval process, will be met by the proposed project which is now ready for final approval.

On 13 December 2018 Cabinet confirmed that the preferred funding model for the project is for a commercial investor to provide funding for the construction and operational phases, with the

council acting as guarantor during the operational phases. Legal and financial due diligence on this preferred option, including the selection of a preferred funder, and the negotiation of final terms have been completed.

The report demonstrates how the Project Criteria set by the council have been met and that the completed business case demonstrates the proposal provides value for money.

## **Recommendation(s)**

**That:**

- (a) the stage two submission for the development of student accommodation on Station Approach (appendix 2) be approved and that a 125 year lease with a mutual break option at 50 years be granted to the external finance provider for a premium of £677,300 to enable the construction of student accommodation on the Station Approach site;**
- (b) the Project Criteria approved by cabinet on 13 December 2018 for the project to provide student accommodation on Station Approach, are confirmed as having been met as detailed at paragraph 12; and**
- (c) funding for the project be provided by M&G Investments with the council acting as guarantor during the operational phases. The Chief Finance Officer has completed legal and financial due diligence on this funding option, including the selection of a preferred funder and the negotiation of final terms, and confirmed that the funding model delivers for the council:**
  - i. a capital receipt for the leasehold interest in the site that reflects the best consideration that can reasonably be obtained; and**
  - ii. a best value solution for the project which meets the Project Criteria.**
- (d) the council enter into the Nominations Agreement for a period of 50 years as guarantor to Hereford College of Arts and in the first three years of the Nominations Agreement to provide nominations of students to occupy the student accommodation on the Station Approach site; and**

**authority be delegated to the acting Director for economy and place, following consultation with the Cabinet member contracts and assets and the Chief Financial Officer, to enter into all necessary legal agreements and/or the giving of securities or guarantees and take all operational decisions necessary to implement the above within the approved budget.**

## **Alternative options**

- 1 The council could choose not to proceed with the project. This would mean that the council would not be able to offer student accommodation to local higher education providers in Herefordshire in time for the academic year starting in September 2020, in this case, the Hereford College of Arts and NMiTE. Neither Higher Education provider is currently in a position to establish purpose built student accommodation by alternative means, and the lack of any provision would critically hinder their growth and/or adversely impact the availability of private rental sector accommodation for local housing needs with the loss of significant economic benefits to Hereford and the wider county. The council will be required to pay the cost of development that it has underwritten during the

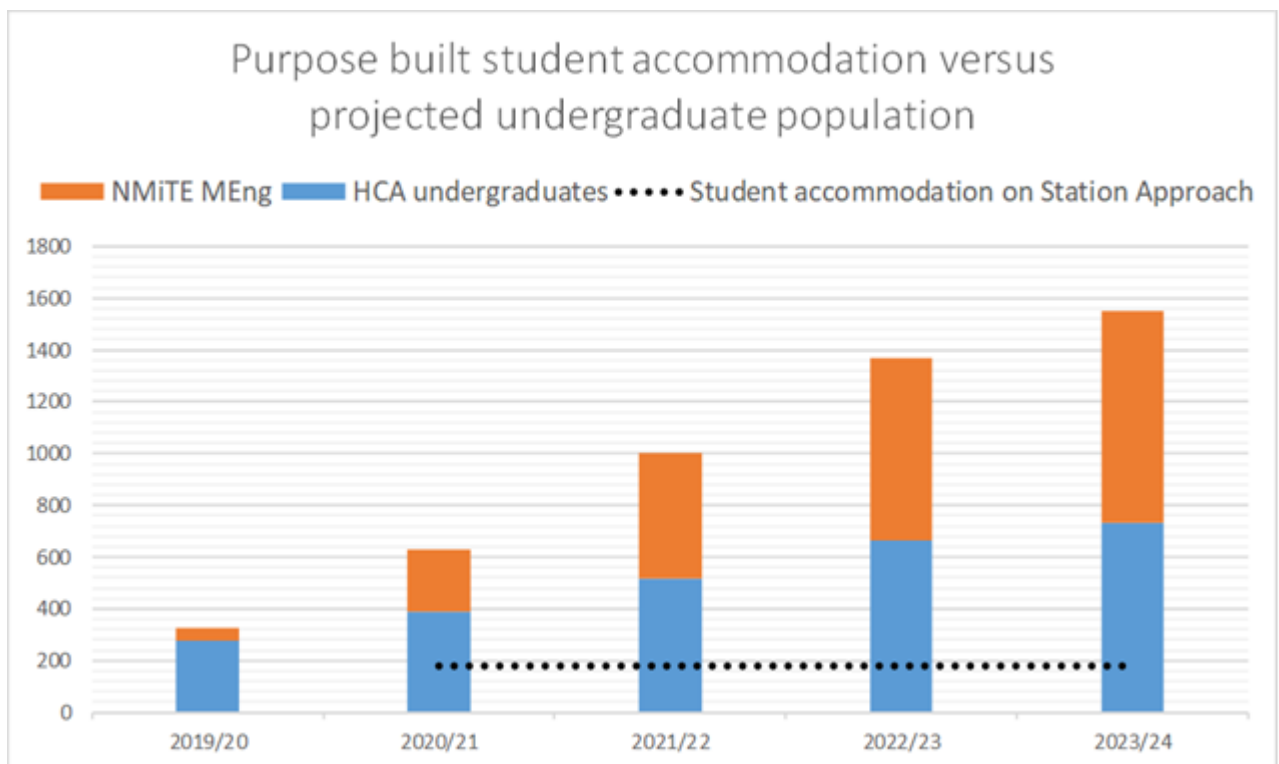
new project approval process (£1.405m see paragraph 44, Resources Section), and the council's relationships with its partners – developers, higher education providers, and investors – could be negatively impacted. The council would remain owner of the land and decide on alternative uses or retain the land for car parking.

- 2 The project could be approved with different financial arrangements. Specifically with the council sourcing the funds from PWLB borrowing for the project. This is considered in more detail in the business case (appendix 2). The option was considered to be feasible but less attractive for a number of reasons.
- 3 The council could fund the development directly. However, the timing of financial benefits towards the end of the project are less advantageous to the council; and the funds allocated to this project will not be available for other projects less attractive to external funders. Our developers have advised that such a change at this stage in the project development would delay the availability of the new student accommodation for one academic year and would incur additional costs, including construction inflation. The developers have advised that this could be in excess of £500k.
- 4 One of the advantages of utilising external finance is that a number risks are transferred to the financier, such as;
  - a. **Construction Phase:** The construction phase risks are passed to Cityheart Partnerships Ltd, such as managing any related delays in completing the construction, and additional costs through the construction phase.
  - b. **Rent setting:** The external funding model requires at the outset that the Special Purpose Vehicle (SPV) increases rents by the Retail Prices Index (RPI) (within the cap and collar) for the life of the agreement.
  - c. **Operating costs:** One of the features of the external funding model is that the risks associated with operating costs are passed to the SPV. This means that the SPVs are effectively taking the risk for the full 50 years on bad debts, energy, utilities, insurances, WiFi ,security, planned preventative maintenance, reactive maintenance, staffing, cleaning, grounds maintenance, health & safety and all the other services required under the Nominations Agreement.
  - d. **Inflation:** a tracking error between assumed interest and actual interest could cause financial stress.
- 5 The land could be made available to the Hereford College of Arts to develop the facility with the council taking the capital from the sale of the land. However, the college do not currently have the resources, the capital, or the capability to do this.
- 6 The council could sell the land to a developer with the expectation that they work with the college to develop student accommodation. Once the land has been sold, however, neither the council nor the college would be able to control development on the site. The development of the proposed project, with a range of external advice sought, has demonstrated that the development is not sufficiently commercially attractive until the projected growth in student numbers have been achieved. Therefore, it is very unlikely that a developer would establish a similar facility on their own.

## Key considerations

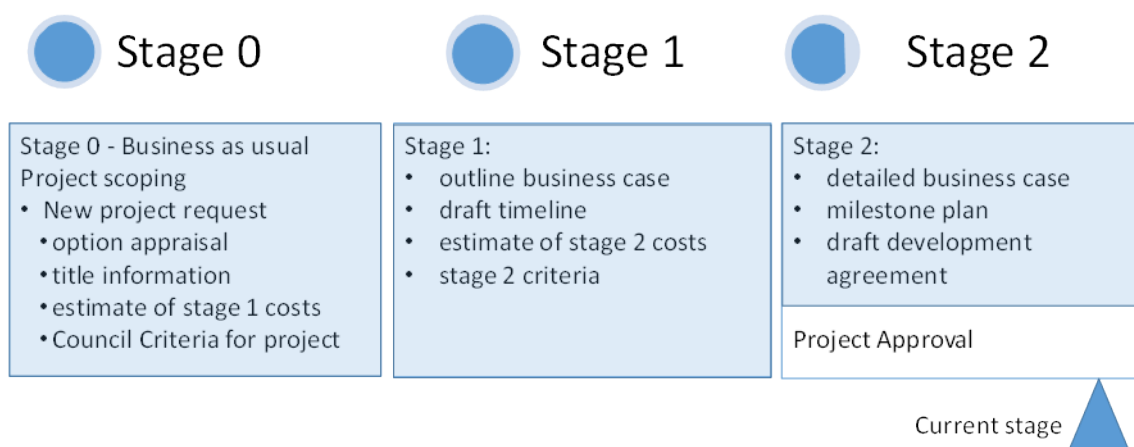
### Background

- 7 In 2016 Cabinet approved the commissioning of a developer to progress the development of suitable sites in its ownership including the capability to progress development funding. The Development and Regeneration Programme (DRP) is intended to support the delivery of the ambitious goals of the Invest Herefordshire economic development programme and support the council's financial sustainability and will include a mix of house building and regeneration projects that will be delivered over the next 10 to 20 years.
- 8 To enable the significant forecast growth in Higher Education a range of teaching and accommodation facilities will be required over the next 5 to 10 years. The following graph identifies the projected student growth numbers for both HCA and NMiTE (based on numbers provided by the respective organisations), against the level of accommodation that the station approach development will provide. Please also see appendix 9 an external report on student accommodation supply and demand undertaken by GVA to inform this project.
- 9 As the student numbers and demand grow it is anticipated that further phases of student accommodation will be required at other key locations such as the College Road Campus site the council acquired in early 2019.



- 10 Cabinet identified the provision of student accommodation at a council-owned site at Station Approach as a priority project and on 27 July 2017 resolved to bring the project forward for consideration as part of the development and regeneration programme. This was subject to the council successfully completing contractual negotiations with Engie Regeneration Ltd on the overarching agreement. This was signed in June 2018.

## DRP – stage process



- 11 The project has been managed according to corporate project management standards using the council's project management system, Verto. The project ultimately reports via the Economic Development Delivery Board with weekly project boards held jointly with the DRP partners.

### Proposed development

- 12 The development of student accommodation on Station Approach was confirmed as the preferred development for this site in an options appraisal carried out as part of the one public estate programme.
- 13 The long-term customer for the facility is Hereford College of Arts (HCA), which has a proven demand for purpose built accommodation of the type proposed. The ability to offer potential students suitable accommodation is considered by HCA as important for the successful delivery of its expansion plans.
- 14 There is also a proposal that an allocation of rooms within the accommodation could be made available on a short term basis to students of the new higher education provider, NMiTE, thereby supporting the early stages of its development.
- 15 Both HCA and NMiTE have confirmed their interest in the project and a nominations agreement will be put in place with HCA and Herefordshire Council to underpin the utilisation and viability of the facility.
- 16 Property consultancy GVA has produced an analysis of demand for student accommodation in Hereford (see appendix 9). This provides assurance to the council and its developer partners as well as any potential third party investors that sufficient demand will exist for the facility on Station Approach.
- 17 In accordance with the overarching agreement, the proposals have been developed in line with the new project approval process. A New Project Request identified the council's criteria for the project. The stage 1 submission, which was approved by Cabinet on 13 December 2018, confirmed that these criteria could be met. A stage 2 submission (appendix 1) was, therefore, commissioned with a refined set of Project Criteria. The table below summarises how these criteria are met by the proposed scheme.

Criteria	Evaluation
A student accommodation block of up to 180 units	MET – Proposal comprises 178 units: 168 cluster rooms; 4 accessible cluster rooms; 3 studios; and 3 accessible studios.
A design and specification in line with normal market practice and demand, subject to other criteria set out here	MET – The proposals have been developed by organisations experienced in the student accommodation sector. Proposals are in line with schemes developed elsewhere in the sector and have some quality enhancements, principally through provision of a larger communal space on the ground floor which can be used for group study, exhibitions and evening / weekend recreation.
A design which is Equality Act compliant and which respects the requirements of students with diverse needs and promotes the wellbeing of all of its residents	MET – Design is Equality Act compliant. In particular, three standard and three accessible self-contained studio style units for students who prefer to be independent and four accessible cluster rooms. These respond to the College's requirements around the neuro-diversity of their student body and the design is being carefully considered to enhance the welfare of students who would find a cluster flat environment socially difficult but without isolating them. The studio rooms are located on the ground floor but still requiring access through the main Reception so there is a level of interaction with management and on-site staff. Lift access will be provided to all floors.
To achieve the earliest possible completion date to align with the commencement of an academic year	MET – A series of parallel activities are being undertaken on the project. The programme is currently based on a September 2020 occupation date. This is the earliest date that can be achieved.
To develop the project in liaison with higher education and further education providers identified by the Council including Hereford College of Arts and NMiTE	<p>MET – Detailed review meetings have been held with Hereford College of Arts (HCA) as the design has been developed. HCA are also providing outline proposals around art work installations that will be incorporated to support the planning application.</p> <p>Discussions have also been held with NMiTE over the potential for them to utilise the building for at least the first year.</p>
To identify funding options for the project	MET – An external investor has been selected for the project via a competitive process. An assessment of the funding model including a comparison to market rates has been provided by Arlingclose (appendix 5).
To identify options for the asset management of the accommodation	<p>MET – The council could manage the facility directly or use its development partner, Cityheart.</p> <p>Cityheart Living manage a number of student accommodation schemes across the UK. This will form the basis of an agreement for managing the completed facility, regardless of the funding structure.</p>
To identify ways to provide	MET – Following the relocation of the building to suit the

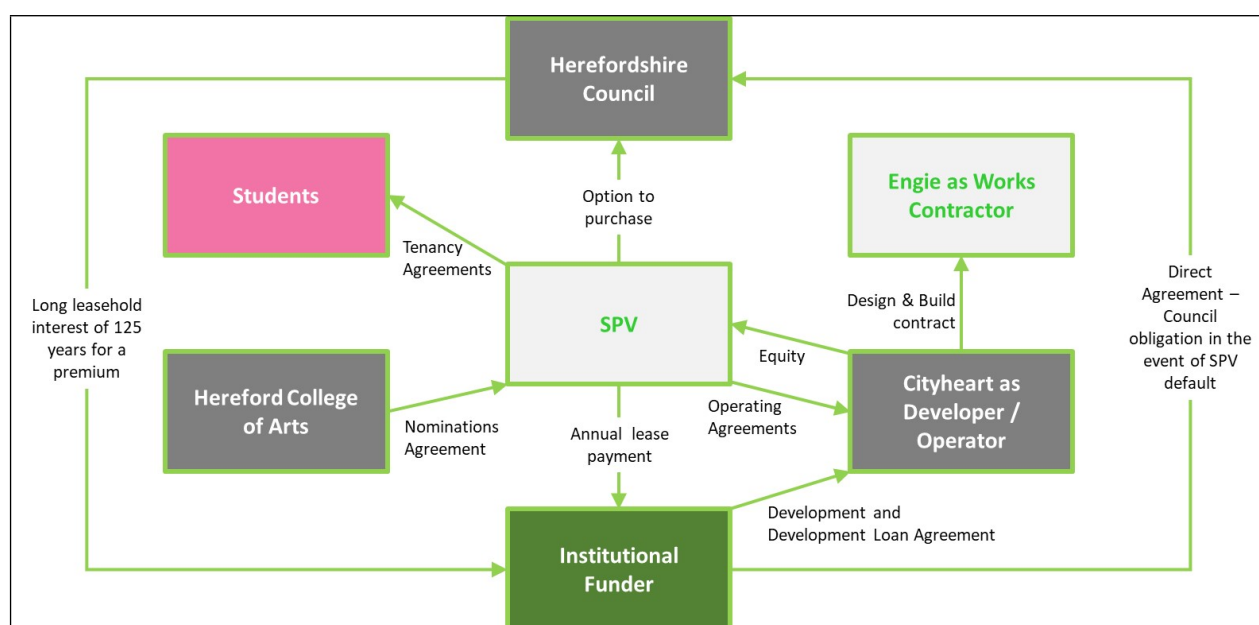
active frontage and a commercial viable amenity on the site	location of the sewer the previously identified commercial amenity on the site is now proposed to be a standalone ancillary commercial unit which may also be utilised by people using the station. Any commercial development would require a further planning application and agreement with the council.
To work with the council to ensure sufficient public parking supply is maintained and that this is clearly identified for potential users	MET – The council has identified alternative car parking within 5 to 10 minutes' walk of the station at Merton Meadow North. Improvements to signage to and from this car park have been included in the car park capital improvement programme recently undertaken. Users of the Station Approach car park have been informed of the proposed changes and alternatives offered by the council. In the medium term, proposals for a potential new multi storey car park are being considered on other nearby council sites. The car parking service have confirmed that there is sufficient capacity in the vicinity of the station in a number of car parks including Merton Meadow North and South, at the country bus station, and the Network Rail car park.
To provide a scheme which meets the requirements of BREEAM (Building Research Establishment Environmental Assessment Method) Good or above	MET – An expert BREEAM consultancy have been part of the design team from the outset of the project. This has ensured compliance with BREEAM Good requirements.
To provide the Council with options for the project to make an enhanced contribution to environmental sustainability, over and above that which would be required by relevant law or existing planning policy	MET – The proposals include measures such as fast charging points for electric cars so that staff and / or students can use these vehicles as they become more widely adopted. Consideration was given to PV installations for the roof but could not be achieved due to planning related conservation requirements for the design of the roof. Space and water heating is based on a micro-Combined Heat and Power (micro-CHP) installation.
To work with the Council to develop the evidential framework by which the Stage 2 Submission can be assessed against the Council's requirement to demonstrate best value and meet all other relevant legal obligations.	MET – From a financial perspective various measures are proposed to demonstrate value for money including an independent assessment of the optimum funding deal and the use of the development appraisal to draw together the various financial aspects of the deal to demonstrate value for money (appendices 5, 6, 7, 11). From the wider perspective of social value, the facility will provide support to the growth strategies of key Higher Education providers in the Hereford area. It will also make an important contribution to the regeneration of the city.

18 As the stage 2 submission meets the criteria the project is ready for final approval.

19 The council has undertaken a market testing exercise that confirmed that private investment is a viable option for the scheme. This identified a preferred investor. The preferred investor has carried out due diligence and the terms of the agreement have

been negotiated ready for agreement.

- 20 The project will be funded using an 'income strip' model. A long lease for the site will be provided to the institutional investor. Cityheart (the council's developer partner) which will undertake the construction of the scheme and an SPV established by Cityheart will operate the facility. The council's role will be to act as guarantor of last resort in the event that the SPV defaults on its obligations to the institutional investor. The council will receive an upfront capital receipt (£677k) for the value of the leasehold of its site to the SPV.
- 21 The council will retain the freehold of the site and will grant a long ground lease (125 years) to the funder to enable the development. This lease will have a mutual break option at the 50th year which will allow the council to bring the lease to an end for a nominal sum (£1). The break option is timed to coincide with the end of a lease granted by the funder to the developer in respect of the student accommodation building (the "under lease"). The under leases will have an aggregate term of 50 years.
- 22 As part of the financing of the scheme the HCA will enter into a long term nominations agreement with the operator of the scheme. The HCA will be obliged to nominate students into the scheme in order to secure the scheme's financial viability throughout the duration of the funding period. In the event that there is a future downturn in demand from students which is beyond the reasonable control of the HCA the council will work with the HCA and other partners to ensure that students from alternative FE and/or HE providers are encouraged to take up rooms within the scheme.
- 23 The council will also be a party to the nominations agreement and, in the first three years, it will have nomination rights for half the rooms in the facility. This will facilitate the accommodation of students from NMITE (or other FE/HE provider) in the facility.
- 24 The following diagram provides an overview of the proposed 'income strip' model



- 25 Financial and legal due diligence relating to the scheme is now complete (appendices 5, 6, 7, and 11). As the project is being financed externally, project approval is being based on a bespoke set of legal agreements. All the necessary project agreements have been drafted and included in appendix 3. Once the legal agreements between the council and



the funder are in place, the council will receive its capital receipt and an arms' length company ("special purpose vehicle") will be set up to manage construction and operation of the asset.

- 26 There will be a development and operational management group, including representatives from: Cityheart; HCA; and Herefordshire Council, set up to monitor progress during construction and ongoing operation of the facility.

## **Community impact**

- 27 The council's corporate plan 2016-2020 includes support the growth of our economy as a strategic priority. The wider Herefordshire economic vision sets out an ambitious framework for economic growth within the county and is supported by the core strategy. Delivery of the core strategy and economic vision will rely on significant investment in a variety of developments across the county. The Herefordshire economy faces a number of significant long term challenges, such as a low wage economy (average wage 20% below the national) average, low productivity (Gross Value Added per head of population 23% below the national average), and an aging population (24% of the population over 65). The county is one of only 3 in the UK without a University at present. The development of Higher Education is critical to retaining/ attracting younger generations to study, live and work in the county, and to attract higher value industries and therefore employers to Herefordshire.
- 28 Supporting the corporate plan and economic vision, the council's property strategy for 2016 to 2020 includes the objectives to maximise the economic benefits of the council's property asset base and to support economic development and housing growth.
- 29 Successful implementation of the DRP has the potential to significantly contribute to the corporate plan, through support for the economic vision and core strategy, and the corporate property strategy by allowing the council to maximise the financial benefits that it receives from its development sites.
- 30 The project will contribute directly to the Invest Herefordshire objective to make Herefordshire a great place to study. The proposed project is consistent with the priorities of the Corporate Property Strategy, retaining the freehold of the site. The Council is receiving a lease premium which accords with the council's asset value of the station road car park. Health and Safety requirements during both the development and operation of the site will sit with the leasehold owner and/ or their contracted developers/ operators.

## **Equality duty**

- 31 Under section 149 of the Equality Act 2010, the 'general duty' on public authorities is set out as follows:
- 32 A public authority must, in the exercise of its functions, have due regard to the need to:
- a. eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act;
  - b. advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
  - c. foster good relations between persons who share a relevant protected

characteristic and persons who do not share it.

- 33 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. An equality impact assessment will be made available by Cityheart Partnerships Ltd.

## Resource implications

- 34 The lease premium agreed by the council is £677,300 which will be paid when the lease is entered into. A recent valuation has been provided to the council. This demonstrates that best consideration has been obtained by the council.

The preferred funding model for the project is an 'income strip' model. Under an income strip model, an investor pays a capital sum upfront to a special purpose vehicle to build the building and to commit to pay an indexed rent on a long, (fifty years) lease of an asset. At the end of the lease, the council has the option to acquire the building for £1. Control, operation and liability for repair remains with the Special Purpose Vehicle. Hence the institutional landlord merely 'strips' a proportion of the income out of the asset in return for forward-funding the development. A Special Purpose Vehicle (SPV), owned by our development partner has been established to operate the facility (see appendix 5 and 6 for a description of the model including assumptions). The benefits of using this financing model are that a number of risks transfer to the SPV. These include:

- Inflation
- RPI rent increase cap and collar
- Voids
- Bad debts
- Management costs
- Operating costs
- Lifecycle costs

- 35 The Chief Finance Officer has carried out legal and financial due diligence on this preferred funding option including the selection of a preferred funder and the negotiation of final terms. this is the preferred funding model and that it delivers for the council (appendices 5, 6, 7 and 11):
- a. a capital receipt for the leasehold interest in the site that reflects the best consideration that can reasonably be obtained (appendix 8); and
  - b. a best value solution for the project which meets the Project Criteria (see table at paragraph 15).
- 36 The business case which is required for project approval (appendix 2) considers the options for the site, and the benefits and costs of the project. This, together with the

Stage 2 submission (appendix 1), which shows how the project meets the Project Criteria.

37 The overall value of the scheme to develop student accommodation on station approach is approximately £19m (see appendix 6). There are, broadly, two ways that the scheme can be funded:

- a. Council's own finances, including council borrowing from Public Works Loan Board, if required; and
- b. Private investment – in particular 'utilise institutional investment with a council covenant'.

38 The trade-off between financing options summarised in the table below (see appendix 12 and appendix 13) and is, in summary, a trade-off between:

- a. External finance - achieves an initial capital receipt and transfers the construction risk and operational risk of the project to the privately owned SPV; versus
- b. Council finance – offering an opportunity to benefit from the projected operational surpluses towards the end of the life of the project while retaining responsibility for the construction risk and the operational risks throughout the life of the facility. Public works loan board (PWLb) repayments would be offset by the net rental income from the facility. However, any deficit between repayments and income would need to be funded from redirected revenue budgets. The assessment of project finance shows that the net present value of the project remains negative for over 30 years using PWLB borrowing and modest positive NPVs over 40 and 50 years, but these are assuming that none of the risks that we cannot share crystallise.

Student accommodation on Station Approach – funding approach	
External finance	Council finance
Initial capital receipt	
Capital receipt equivalent to site value	No capital receipt
Operational surplus	
Opportunity for the council to get some benefit from any operational surplus via gain share	Long term opportunities to benefit from any operational surplus
Strategic project risk	
Strategic project risk is managed by the council as guarantor	Strategic project risk remains with council as funder
Operational risk	
Operational risk managed by SPV	Operational risk remains with council as SPV owner
Construction risk	
Construction risk transferred to SPV	Construction risk managed by council

39 Using external finance will allow the council to focus its own funds on less commercially attractive developments.

40 In December, Cabinet identified external funding as the preferred funding model for this project. An external funder has been identified and satisfactory terms have been agreed.

- 41 The financial aspects of the deal can be thought of as having two dimensions:
- structure of the deal – organisation and ownership of the site and the building; and
  - financing of the deal – source and nature of the funds. There are a number of ways in which the scheme could have been delivered which are summarised in the tables below.
- 42 Special Purpose Vehicle (SPV) referred to in the table is an overarching term which refers to a legal entity (usually a private company limited by shares) created for the specific purpose of holding an asset or a debt, or delivering a service or a project. As the intention is for the scheme to be funded by private investment then the SPVs, which have been established by Cityheart Partnerships Ltd, will undertake all aspects of the scheme's delivery, from construction through to operation.
- 43 The relative advantages and disadvantages of all options are outlined in the tables.

### Structure of the Deal

Structure	Advantages	Disadvantages
Council sell the site to a private sector specialist student accommodation provider	No development or occupation risk to the Council  No call on the Council to finance the building	No current appetite from the private sector providers to develop in Hereford  No guarantee of delivery or quality
Council contract direct with Engie under a Design and Build contract and then own the building in the long term	Simple contract structure, relatively easy to implement  Council retain full control of development and management of the building	Council take all the construction and development risk  Council take full responsibility for managing and letting the building and voids risk probably via an arms' length company ("SPV")  Funding sits on the Council balance sheet  Not a Council core activity
Special Purpose Vehicle ("SPV") established which is wholly owned by the Council	Ring fences activities away from other Council role/duties  Council would benefit from the rental income  Facilitates the potential to dispose of the building in the future	Council take ultimate risk for construction, programme, occupation, payment of rent and management of the building  Funding sits on the Council balance sheet  Not a Council core activity  Requires Council approval to establish and get operational which could be time

		consuming and a risk to the programme milestones
Special Purpose Vehicle established and owned by a private sector organisation with the Council providing funding support	<p>All construction and development risk taken by the SPV</p> <p>SPV incentivised to perform</p> <p>Council input is solely around providing finance or contingent finance support</p> <p>Quick to establish because recognised by investors as a tried and tested route</p>	<p>No operational control</p> <p>An element of the financing may sit on the Council's balance sheet via contingent guarantee (to be reviewed)</p> <p>Long term arrangement (c35-50 years) which could be expensive to break</p>

### Financing of the Deal

Finance Option	Advantages	Disadvantages
Council use their own capital reserves	<p>Cheapest form of finance</p> <p>Council gets the benefit of the rental income</p> <p>Fully flexible term of investment - Council would be free to subsequently sell on the asset at any time</p>	<p>Council resources are limited in terms of overall economic ambition</p> <p>Council takes the investment risk</p> <p>Construction and delivery risks would ultimately sit with the council if contractor defaults or fails</p> <p>The council would have to amend the Capital programme</p>
Council borrow funds via Public Works Loan Board	<p>Likely to be second cheapest form of finance</p> <p>Potential to earn revenue mark up by on lending</p> <p>Council gets the benefit of the rental income</p> <p>Council could decide to subsequently sell on the asset to an external investor</p>	<p>Adds to Council's overall borrowing levels</p> <p>Council takes the investment risk</p> <p>Early years repayments not covered by income but over time rental income increases with inflation and repayments remain the same</p> <p>Long term arrangement (c35-50 years) unless Council sold it on</p>
Utilise institutional investment with a Council covenant	<p>Significant appetite from funders</p> <p>Number of similar projects elsewhere funded this way</p>	<p>Council required to provide contingent guarantee over lease payments on ultimate default (with alternative options) but mitigated via series</p>

	<p>Potential for initial capital receipt to Council and gain share mechanism</p> <p>Use of the covenant enables cheapest form of institutional finance resulting in lower rent levels and mitigates occupation risk</p>	<p>of step in rights from funder and security packages</p> <p>Long term arrangement (c35-50 years) which would be expensive to break</p>
Utilise institutional investment with a private sector covenant	No recourse to Council if project fails	<p>Most expensive form of finance</p> <p>Higher finance yield results in higher rents charged, all other things being equal</p>

- 44 If the project does not ultimately result in a capital asset the costs incurred will be reviewed and may need to be charged against the revenue budget. These costs are currently estimated to be £1.405m. These costs will be financed by the earmarked financial resilience reserve the status of which will be reported through the quarterly finance reporting to Cabinet.

<b>Capital cost of project</b>	<b>2019/20</b>	<b>2020/21</b>	<b>Future Years</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<i>Staff and due diligence costs</i>	<b>190</b>			<b>190</b>
<i>Additional design works for sewer</i>	<b>35</b>			<b>35</b>
<i>Construction and developer costs</i>	<b>19,240</b>			<b>19,240</b>
<b>TOTAL</b>	<b>19,465</b>			<b>19,465</b>

<b>Funding streams (base budget / external / grant / capital borrowing)</b>	<b>2019/20</b>	<b>2020/21</b>	<b>Future Years</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>

<i>DRP Capital Budget</i>	<b>225</b>			<b>225</b>
<i>External Finance</i>	<b>19,240</b>			<b>19,240</b>
<b>TOTAL</b>	<b>19,465</b>			<b>19,465</b>

### **Financial implications arising under legal project agreements.**

45 The council is the ultimate guarantor of the SPV under the Development Loan Agreement from practical completion of the construction. If the SPV defaults under the terms of the Development Loan Agreement the Funder can oblige the council to step into the obligations of the SPV under the loan agreement and the under lease. This will mean that the council will be responsible for payment of rent under the terms of the under lease, the rent currently being as set out in appendix 6. The council will also assume all obligation in relation to managing and maintaining the student accommodation building and facilities.

The council is also guarantor for HCA's obligations under the Nominations Agreement. If any of the following trigger events occur then the council is required to take on the obligations of HCA under the Nominations Agreement. This will result in a requirement for the council to nominate occupiers for 100% of the rooms or make a shortfall payment. This impact is mitigated through the ability of the council, if they have taken over HCA's position, to nominate "Alternative Occupiers" which is a wider definition than the occupier definition in the Nomination Agreement, which is restricted to students aged over 18. The trigger events are:

- i. HCA becoming insolvent
- ii. A Notice to Improve is served on HCA by the relevant regulator
- iii. In any three consecutive years HCA are required to make a shortfall payment which is equal to 1% or more of HCA for the year.
- iv. In any two consecutive years HCA are required to make a shortfall payment which is equal to 2% or more of HCA for the year
- v. In any year HCA are required to make a shortfall payment which is equal to 3% or more of HCA for the year

The council is, in its own capacity required to nominate occupiers (being students) for 50% of the rooms in the development for the first three years. In the event that the council is not able to fill 50% of the rooms then it will be required to make a shortfall payment. This payment is calculated on the basis of 89 (being 50% of the rooms) minus the rooms allocated to council nominated occupiers multiplied by 42 weeks (the standard length of a tenancy) multiplied by one hundred and forty one pounds (being the rent per week set out in the agreement). This

will be a call on the earmarked financial resilience reserve.

- 46 To support HCA in the early years of the project the council is providing further support through the terms of a supplementary agreement. This agreement caps HCA's liability under the shortfall payment provisions of the Nominations Agreement to £60,000 each year for the first three years and one hundred and twenty thousand pounds in years 2 to 6 of the development. If HCA are required to make shortfall payments over these caps the council will pay the SPV the difference. This will be a call on the earmarked financial resilience reserve. HCA will be required to repay any sums paid out under the terms of this supplemental agreement to the council on or before the twentieth anniversary of the date of the agreement.

## Legal implications

- 47 The project requires the council to enter into a wide ranging suite of documents in its role as freeholder land owner, ultimate guarantor of the SPV's performance under the financing agreements and guarantor of HCA's performance under the Nominations Agreement. If these parties do not fulfil their obligations the council is responsible financially for the project. A summary of legal project documents is set out in appendix 3
- 48 The project is to be delivered by the council's development partner Engie Regeneration who were procured through an EU compliant procurement process. The council entered into a legally binding overarching agreement with the developer in June 2018 and this project has been progressed in accordance with the process set out in that overarching agreement.
- 49 This report identifies the stages through which the project has proceeded, subject to approval by the executive, at each Stage. It is important to note the separation between executive and non-executive functions for a DRP project such as the one described in this report. The grant of planning permission on 8 March 2019 to the developer does not oblige the council to proceed with this project. The executive will determine whether or not the project should proceed. The determination of the planning application was a non-executive function and solely a matter for the council in its capacity as Local Planning Authority to determine in accordance with planning law and ordinary legal principles.
- 50 The overarching agreement provides a contractual framework within which the developer will incur costs and deliver services which enable the council's executive to assess whether a project should proceed. The overarching agreement requires the developer to set out its expected costs for each stage and essentially the council is required to underwrite these costs in the event that the council subsequently refuses to proceed with the project despite the developer demonstrably meeting the Council Criteria (termed an "improperly rejected project" in the overarching agreement).
- 51 The council has legal powers to enter into the legal project documentation set out at appendix 3 under section 1-4 of the Localism Act 2011 and other enabling legislation. This includes the power to provide funding, to give guarantees or other forms of security and to enter into all necessary legal agreements to give effect to the project in the terms described in this report. As well as its general fiduciary duty, in exercising its powers the council must always have regard to its duty under s3 of the Local Government Act 1999 to secure best value, which requires consideration of all relevant social, economic and environmental matters. The council does not have a statutory duty to provide student accommodation but the social, economic and environmental benefits of this project are outlined in this report and form the basis of the council's Project Criteria.
- 52 This project involves the grant of a 125 year lease to the Funder which **under s27 (2) (b) (i) of the Land Registration Act 2002** is a disposal of land which must satisfy the requirements



of s123 Local Government Act 1972 (which is replicated in the stage 2 criteria) and provide the best consideration reasonably obtainable. The council's own asset disposal policy has been considered and the value for the lease premium is supported by valuation advice obtained.

- 53 Given the guarantees that are being provided to both the SPV and HCA the council has obtained legally privileged external legal advice on any state aid risks that may arise from these guarantees (appendix 4)
- 54 The council does not have previous experience of development purpose built student accommodation and financing this type of development by way of external financing. The level of financing sought is at the lower end of that available from an income strip model and therefore there has only been minimal scope to negotiate on the terms of the headlease, the development loan agreement and direct agreement which means that they are more favourable to the funder than the council. This is because the council is ultimately responsible not the funder.

## Risk management

- 55 One of the advantages of utilising external finance is that a number risks are transferred to the financier, such as;
- a. **Construction Phase:** The construction phase risks are passed to Cityheart Partnerships Ltd, such as managing any related delays in completing the construction, and additional costs through the construction phase.
  - b. **Rent setting:** The external funding model requires at the outset that the Special Purpose Vehicle (SPV) increases rents by the Retail Prices Index (RPI) (within the cap and collar) for the life of the agreement.
  - c. **Operating costs:** One of the features of the external funding model is that the risks associated with operating costs are passed to the SPV. This means that the SPVs are effectively taking the risk for the full 50 years on bad debts, energy, utilities, insurances, WiFi (c.£100 per bed per annum on its own), security, planned preventative maintenance, reactive maintenance, staffing, cleaning, grounds maintenance, health & safety and all the other services required under the Nominations Agreement.
  - d. **Inflation:** a tracking error between assumed interest and actual interest could cause financial stress.

Risk / opportunity	Mitigation
The council decides not to approve the project	<p>The council's exposure to cost is limited to properly incurred costs of the approved programme development fee – approximately £1.1m</p> <p>The reputational cost of not providing the facility required by HCA will be mitigated through early discussion with HCA management</p> <p>The council will seek to minimise the negative impact on NMiTE by providing</p>

	<p>facilities elsewhere</p> <p>The council's will have to manage its relationship with its partners, including funding providers, as its credibility is likely to be damaged</p>
The September 2020 deadline is not met	The programme is tight and does not allow for any delays. The risk to the deadline is, therefore, real. Any delays, together with their impact must be communicated to stakeholders. A communications plan will be developed to help ensure that this happens.
During the development stage of the project (prior to approval) the costs are higher than anticipated due to the complexity of the project	Any increase in the programme fee to develop the proposed project (feasibility, designs etc) will have to be approved by the Cabinet member.
The council decides to use an alternative funding model	The project would be delayed by one academic year and there would be additional costs and implications for 2020 accommodation for NMiTe and HCA
Prior to signing the nominations agreement HCA may decide that they no longer require accommodation	The development phase of the project will be brought to a halt. The council will be liable for any development fees (feasibility, design costs etc) incurred costs agreed in the development programme fee.
NMiTE have no interest in the accommodation post completion and/or in the first three years of the development	The council will be required to make shortfall payments for its share of unallocated rooms. These payments will be calculated as $(89 - \text{no.rooms unallocated}) * 42 * 141$ (£) indexed linked
There is a radical change in the need for student accommodation	<p>The council has the right to step in if the SPV fails, including the situation where this is driven by a radical change in the requirement for student accommodation</p> <p>Ultimately if there is no longer a need for student accommodation then the council can use the facility for other purposes</p>
HCA becomes insolvent/enters financial distress	The council is required to step in to the Nominations Agreement in the place of the HCA and will be required to nominate 100% of the rooms or make shortfall payments. These payments will be calculated as $(178 - \text{no.rooms unallocated}) * 42 * 141$ (£) index linked

Cityheart fails as a company	<p>The council has the right to step in if the SPV fails, including the circumstance where its parent company fails.</p> <p>The council also has the option to acquire the SPV for market value if it proposed to be sold</p>
Sewer is damaged during construction	The construction risk in the project is transferred to Cityheart Partnerships Ltd under the external funding option – this would include risk of damage to the sewer
Failure to build in the timeframe	The construction risk in the project is transferred to Cityheart Partnerships Ltd under the external funding option – this would include risk of any delays to commissioning the facility
Private sector competitor in this area	It is anticipated that, as higher education develops, private sector investment will enter the market for purpose built student accommodation. However, the facility being provided is considered to be of suitable quality and price, offering good value, and will be subject to a nominations agreement with HCA
The 2017 red book valuation is no longer accurate	It is considered the 2017 red book valuation is still relevant as our appointed valuers have carried out an up to date assessment which confirms the previous value.

- 56 Risks are managed according to the council's performance, risk and opportunity management (PROM) framework, and recorded on a service risk register, being escalated to the directorate or corporate risk register according to the significance of the risk.

## Consultees

- 57 The local member has been consulted and is happy for the scheme to go forward. The local ward member has expressed support for the proposal to provide student accommodation on Station Approach, but requested reassurance that any impact on the availability of parking would be managed. The ward member also expressed concerns about the potential scale of the building. Hereford College of Arts have been closely involved in the development of the building specifications and discussions have also taken place with the NMiTE team, who are supportive of the project and have stated their interest in the facility for the academic year 2020/21 for a number of years.

## **Appendices**

Appendix 1 – Stage 2 submission

Appendix 2 – Student accommodation on Station Approach business case

Appendix 3 – EXEMPT FROM PUBLICATION – legal documents

Appendix 4 – EXEMPT FROM PUBLICATION – Station Approach initial state aid advice

Appendix 5 - EXEMPT FROM PUBLICATION Arlingclose finance model review

Appendix 6 - EXEMPT FROM PUBLICATION QMPF report 23 Apr 2019

Appendix 7 - EXEMPT FROM PUBLICATION Greenwoods Projects cost report

Appendix 8 - EXEMPT FROM PUBLICATION valuation report

Appendix 9 - Supply and Demand for Student Accommodation

Appendix 10 - HCA Strategy

Appendix 11 - External review of the operational cost assumptions

Appendix 12 - EXEMPT FROM PUBLICATION QMPF report 5 Dec 2018

Appendix 13 - EXEMPT FROM PUBLICATION QMPF report 5 Jun 2019

## **Background papers**

none