

Public Report with Exempt Appendices
Cabinet

Committee Name and Date of Committee Meeting

Cabinet – 28 March 2022

Report Title

Forge Island Delivery Update

Is this a Key Decision and has it been included on the Forward Plan?

Yes

Strategic Director Approving Submission of the Report

Paul Woodcock, Strategic Director of Regeneration and Environment

Report Author(s)

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Ward(s) Affected

Boston Castle

Report Summary

To provide an update on the positive progress towards delivery of the Forge Island Scheme which is a key regeneration priority. This report will allow successful negotiation of commercial terms for the construction of the development to start.

Recommendations

1. That Cabinet notes the positive progress towards delivery of the Forge Island scheme and, to allow successful negotiation of commercial terms for construction of the development to start, it reaffirms the agreement of December 2018 to authorise the Strategic Director of Regeneration and Environment and the Cabinet Member for Jobs and the Local Economy (subject to confirmation by the Strategic Director for Finance and Customer Services that the final proposal is affordable within the Budget and Financial Strategy) to agree the final proposal for the scheme to be funded through a head-lease arrangement with an investor.
2. That a provision is made from the remaining balance of the Town Centre Investment Fund to provide a potential capital contribution to the scheme, as detailed in the exempt appendix 1.

List of Appendices Included

Appendix 1 Exempt Appendix – Financial Information

Appendix 2 Equalities Impact Assessment

Appendix 3 Carbon Impact Assessment

Background Papers

Agenda Report Pack, Cabinet, 17 December 2018, Item 15 Rotherham Town Centre Masterplan - Forge Island Agreements (Pages 297 - 311)

Printed Minutes, Cabinet, 17 December 2018.

Consideration by any other Council Committee, Scrutiny or Advisory Panel

No.

Council Approval Required

No

Exempt from the Press and Public

Yes

*An exemption is sought for **Appendix 1**; under paragraph 3 (Information relating to the financial or business affairs of any particular person (including the authority holding that information)) of Part I of Schedule 12A of the Local Government Act 1972 is requested, as this appendix contains sensitive commercial information with regards to costing for works and commercial agreements which could disadvantage the Council in any negotiations if the information were to be made public.*

It is considered that the public interest in maintaining the exemption would outweigh the public interest in disclosing the information, as the parties' commercial interests could be prejudiced by disclosure of commercial information.

Forge Island Delivery Update

1. Background

- 1.1 The Council agreed to enter into a development agreement with Muse Developments Ltd. in December 2018. The resolution agreed at Cabinet included a delegation to the Strategic Director of Regeneration and Environment and Cabinet Member for Jobs and the Local Economy as follows:

That the outlined financial approach to deliver the Forge Island development be approved and the Strategic Director for Regeneration and Environment be authorised to approve the final proposal in consultation with the Cabinet Member for Jobs and the Local Economy; subject to confirmation by the Strategic Director for Finance and Customer Services that the final proposal is affordable within the Budget and Financial Strategy and within the following parameters:

- *The initial rents the Council is entitled to receive from occupiers are greater than the initial head lease rent and*
- *The financial modelling over the 35-year period shows that the Council's anticipated income from the development exceeds the total anticipated head lease costs*

Since that date, Muse and the Council have been working together to bring forward a viable proposal to develop a leisure hub on the site that is within these parameters.

- 1.2 Planning permission for a scheme was granted in June 2020. The Council has completed the first phase of enabling works to allow the scheme to proceed, including demolitions to provide a clear development site, the construction of a fish pass and the construction of flood mitigation measures.
- 1.3 The site has been marketed to occupiers and pre-let agreements secured with The Arc Cinema and Travelodge. Heads of terms have been agreed with two restaurants and solicitors are instructed to complete pre-let agreements with those parties.
- 1.4 Muse is currently working on detailed design in preparation for awarding a construction contract.

2. Key Issues

- 2.1 The level of occupier interest has reached a stage where, subject to completion of both pre-lets currently with solicitors, the completion of detailed design and the appointment of a contractor, and the completion of an agreement with a funder, works to construct the cinema, hotel and restaurants can commence on site later this year. For this to happen all these elements need to be in place and the current programme is for this to be achieved by October 2022.

- 2.2 The two restaurant deals with solicitors are progressing satisfactorily with the principal terms having been agreed. Muse is continuing to market the remaining units which are attracting interest, giving rise to an expectation that further occupiers will commit to the scheme prior to opening.
- 2.3 Construction cost estimates have been regularly updated and soft market tested with appropriate allowances for inflation and current market conditions through to a start on site. In response to current market volatility and to limit risk pricing by contractors, Muse is working to appoint a contractor to engage during the design process and reach a negotiated price. It is considered that this approach is likely to produce the best possible price and greatest level of certainty around cost but would not prevent a further tender exercise being undertaken should an acceptable negotiated price not be achieved.
- 2.4 Jones Lang LaSalle (JLL) advising Muse and the Council on the process to secure an agreement with a funder, has reviewed the heads of terms set out in the Development Agreement between the Council and Muse and which provide the basis for the Overriding Head-Lease. Having regard to current market expectations and based on recent transactional evidence of the annuity market, JLL has advised that the terms continue to represent an institutional offer. However, remaining within the requirements described in 1.1 above, it may be possible to enhance the investment value of the scheme through variations on the head lease terms.
- 2.5 The first variation relates to the existing proposal for the Council to have an option to “buy out” the investor’s leasehold interest at the end of the head-lease for a nominal sum. The primary intention in the Council including this mechanism was to ensure that the Council was able to retain effective ownership and control of the site and its future use once the head-lease expired. The advice from the investment advisors is that many funds will prefer this to be a ‘put and call’ option rather than simply an option in favour of the Council i.e., it would be an obligation on the Council to inherit the site. This reflects the operating approach of the investors likely to be attracted to the scheme, which are specialist annuity funds who prefer an income stream for a fixed number of years without the residual asset to manage at the end of the annuity period.
- 2.6 The second variation relates to head-lease length. The existing proposals is for the Council to take a 35-year head-lease (subject to various pre-conditions being met). The investment advice received is that it would be advantageous to have flexibility to increase the head lease length to maximise the investment value.
- 2.7 An additional variation relates to the rent review provisions in the head-lease which is currently linked to the Retail Prices Index (RPI). It is expected that RPI will be effectively phased out by the Bank of England (BoE) as a relevant statistic from 2030. Whilst it will still technically exist, RPI will not be tracked by BoE and as a result, investors (particularly annuity funds) are viewing methodologies that move away from RPI to Consumer Price Inflation (CPI) or Consumer Prices Index including Owner Occupiers Housing Costs (CPIH)

more favourably. The advisors highlight that purchasers are likely to seek a clause in the Head Lease explicitly reverting to such alternative mechanisms post 2030. Addressing this at the outset of the lease, will provide clarity to funds and assist in maximising value.

- 2.8 The Council may have an option to adjust the head-lease rent upwards if the lettings income increases sufficiently or, alternatively, to reduce the head-lease rent by providing capital into the scheme. The former would increase the amount an investor would pay, potentially generating a development surplus after all costs, while the latter may be advantageous in that it would reduce the Council's head-lease rent, providing a greater "profit rent" (i.e., the surplus from occupier rents received over and above the head-lease rent, at the start of the development). This allows the Council to consider the relative merits of capital and revenue costs to deliver the scheme, but it must be noted that the amount of capital the Council can contribute to the scheme will be subject to applicable subsidy control law.
- 2.9 The investment advice indicates that adopting these flexibilities would provide the greatest possible opportunity to maximise the investment value, providing sufficient funds for the development to proceed as planned and potentially generating a development surplus for the Council.
- 2.10 The Council has further enabling works to complete prior to transferring the site to Muse ready for construction to start. These include survey work, break-up of the existing slab (the ground and sub-structures on the main island site), construction of a highway barrier protecting the flood wall, works to the existing vehicular bridge and the removal of the footbridge to Corporation Street. These works have been held back to keep the site in use for as long as possible prior to the main construction commencing but are now required.
- 2.11 Following commencement of this second phase of enabling works, the entire Forge Island site will not be accessible to the public and therefore the current car park and access routes over the site will be closed.

3. Options considered and recommended proposal

- 3.1 The delivery of the Forge Island scheme is a key regeneration priority and consideration has focused on how best to maximise the prospects of the scheme being delivered at the earliest possible date.
- 3.2 It is recommended that Cabinet notes the positive progress towards delivery and, to allow successful negotiation of commercial terms for construction of the development to start, reaffirm the agreement of December 2018 to authorise the Strategic Director of Regeneration and Environment and the Cabinet Member for Jobs and the Local Economy (subject to confirmation by the Strategic Director for Finance and Customer Services that the final proposal is affordable within the Budget and Financial Strategy) to agree the final proposal for the scheme to be funded through a head-lease arrangement.

The principal terms for the Strategic Director of Regeneration and Environment and the Cabinet Member for Jobs and the Local Economy to agree relate to the following the following

- i. A “put and call” arrangement at the end of the head lease.
- ii. Variation in the head-lease length.
- iii. Rent review provisions.
- iv. The level of head-lease rent (within the cap agreed in December 2018 that occupier rents must be greater than the head-lease rent).
- v. The level of capital contribution to the scheme (subject to applicable subsidy control law).
- vi. Other commercial matters that are within the parameters agreed in December 2018.

3.3 It is also proposed that, to allow flexibility to adjust the level of capital contribution to the scheme and allow the completion of the second phase enabling works, a capital budget approval is made from within the existing town centre investment fund capital approval.

3.4 An alternative option considered is not to agree any variation in the heads of terms set out in the development agreement. Evidence of investment deals since 2018 and current market expectations suggest that while funders will bid on the terms set out in 2018, offering some flexibility may successfully generate more advantageous bids for consideration. A rigid approach to the 2018 terms would not give the necessary flexibility to achieve the best deal possible in the current market and is not therefore recommended.

4. Consultation on proposal

4.1 Consultation has also taken place with Muse Developments Ltd as the Council’s development partner on the scheme and Jones Lang Lasalle for professional advice on the current investment market.

5. Timetable and Accountability for Implementing this Decision

5.1 It is anticipated that Muse and the Council will agree heads of terms as described above with a funder during May 2022.

5.2 This will allow the Council to enter into an agreement to take the overriding head lease (as agreed by Cabinet in December 2018) to commence on practical completion of the development. This is anticipated to be in June/July 2022 subject to these commercial matters being agreed.

5.3 Subject to matters described in 5.2 (above) construction will start in October 2022 allowing practical completion and handover to tenants for fitting out by January 2024. At this point the Council’s head lease will commence.

6. Financial and Procurement Advice and Implications

- 6.1 The changes proposed in the parameters of the development appraisal will benefit the viability of the scheme to an institutional funder. Financial Services appraisal has confirmed the changes can maintain a scheme that falls within the terms set by Cabinet in 2018 though the scheme could potentially require and benefit from a capital contribution from the Council towards the capital cost of the scheme.
- 6.2 The exact details of the final head lease will be subject to commercial negotiation but agreement on the headlease is today realistically within reach. Muse has made sufficient progress such that the scheme is on the threshold of final design, is in progress to be fully costed and can be marketed to obtain full funding from institutions and therefore, subject to delegated approvals be built and let.
- 6.3 Although the final actual total cost has not yet been identified and a funder has not yet been found, this was always to be the case. However, with preparations reaching this stage, the final details being progressed can allow the Council to make final consideration of the relative merits of adjustments to deliver the scheme and also to enter into negotiations for the final scheme to be agreed and implemented.
- 6.4 The exempt Appendix 1 provides additional information on the agreement, the financial implications and modelling of different scenarios.

7. Legal Advice and Implications

- 7.1 The legal implications have been clearly set out in the body of the report and the external solicitors acting for the Council will provide advice that ensures the terms of the development agreement with Muse are fulfilled.

8. Human Resources Advice and Implications

- 8.1 There are no direct human resources implications arising from this report.

9. Implications for Children and Young People and Vulnerable Adults

- 9.1 There are no direct implications for Children and Young People and Vulnerable adults arising from this report.
- 9.2 Consultation has highlighted that “things to do and see” in the town centre is important to young people with a cinema high on the list of amenities that young people would like to see delivered to improve the town centre offer.

10. Equalities and Human Rights Advice and Implications

- 10.1 A screening assessment and an Equality Analysis Form is attached.

- 10.2 Further consultation will be carried out with protected characteristic groups to inform the final detailed design of the scheme and to monitor the ongoing equalities impact of the development.

11. Implications for CO2 Emissions and Climate Change

- 11.1 A carbon impact assessment is attached.
- 11.2 The development is expected to achieve a BREEAM Very Good rating and is located on a site that is within walking distance of the bus interchange, tram train and railway station. The development will reduce the need for travel outside of the borough to access facilities which are not currently available in Rotherham.

12. Implications for Partners

- 12.1 There are no direct impacts from this decision on the delivery of services by partners. The delivery of the Forge Island scheme is widely seen as an important catalyst in regenerating Rotherham town centre and progress towards delivery is likely to be welcomed by partners.

13. Risks and Mitigation

- 13.1 The Council's development partner maintains detailed risk registers with respect to development and delivery of the scheme.
- 13.2 The purpose of this report is to seek flexibility for the Strategic Director of Regeneration and Environment and the Cabinet Member for Jobs and the Local Economy to agree the most advantageous commercial terms, balancing risk and affordability to enable the development to be delivered.

14. Accountable Officers

Tim O'Connell, Head of Rotherham Investment and Development Office

Approvals obtained on behalf of Statutory Officers: -

| | Named Officer | Date |
|--|----------------------|-------------|
| Chief Executive | Sharon Kemp | 14/03/22 |
| Strategic Director of Finance & Customer Services (S.151 Officer) | Judith Badger | 10/03/22 |
| Assistant Director, Legal Services (Monitoring Officer) | Phil Horsfield | 10/03/22 |

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