

**BRISTOL CITY COUNCIL
CABINET
6 SEPTEMBER 2016**

REPORT TITLE: ENGINE SHED 2 DEVELOPMENT

Ward(s) affected by this report: Central and Lawrence Hill

Strategic Director: Barra Mac Ruairí / Strategic Director: Place

Report author: Robert Orrett / Service Director - Property

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Purpose of the report:

Approval for the Council to enter in an agreement for lease from Skanska Developments also granting a new sub lease to the operator.

RECOMMENDATION for the Mayor's approval:

- 1. To agree that the Council will enter into an agreement for a lease from Skanska UK Limited subject to development and completion of Engine Shed 2 by Skanska.**
- 2. To agree that the Council will also enter into an agreement to grant a sub-lease to an incubator manager for them to manage and operate Engine Shed 2. Commitment on these two agreements for lease will be managed on the basis that there is no net revenue cost to the Council from the rent commitments over the length of the sub-lease.**
- 3. To authorise the Strategic Director: Place to approve the detailed terms of the agreement for lease and sub-lease following briefing of the Cabinet Member for Place, and to approve completion of the agreements.**

The proposal:

1. The Bristol Temple Quarter Enterprise Zone (BTQEZ) is a Council priority and pace of redevelopment is fundamental to overall success.
2. On 4 August 2015 Cabinet approved funds and a delegation to the Strategic Director: Place to buy strategic land in the BTQEZ to improve the quality and speed of regeneration delivered by the Council through strategic land ownership.
3. On 1 March 2016 Cabinet approved that the Council would enter into a joint development and land agreement with Skanska UK Limited relating to their land

ownership at Temple Meads, and the Council's land ownership the George & Railway and Temple Gate to achieve comprehensive regeneration and development of the land.

4. Heads of Agreement have been concluded with Skanska, and lawyers are engaged on detailed agreements. Skanska have committed significant resources to strong progress with the project in advance of completing legal agreements.
5. Development of Engine Shed 2 is the priority phase of the overall project.
6. Exempt appendix 1 is provided with confidential information for Cabinet to consider this matter.

Regeneration and Economic Growth

7. Bristol Temple Quarter, one of the largest urban regeneration projects in the UK, is set right in the heart of Bristol. With Bristol Temple Meads at its core, it is already home to rapidly growing clusters of small and start-up businesses, particularly in the creative, digital and hi-tech sectors.
8. The 70 hectare site was officially declared open for business by the Chancellor in April 2012, and the project will last for 25 years. There are various key sites in the enterprise zone, and a Spatial Framework has been created, illustrating how it might be developed over its life span.
9. Enterprise zones have been set up by the government to drive local growth and create jobs. They offer a range of incentives to businesses, such as business rates relief, simplified planning and superfast broadband. They also offer benefits to the communities surrounding them by unlocking key development sites, consolidating infrastructure, attracting business and creating jobs. All business rates growth generated by the enterprise zones is kept by the relevant local enterprise partnership and local authorities for 25 years, allowing them to reinvest in local economic growth.



Artist impression of Temple Gate Public Square. Image courtesy BCC City Design and Richard Carman

10. Alongside incentives for business growth and jobs creation, the zone will benefit from significant investment in infrastructure, including £21 million to improve the

vehicle, cycling and pedestrian access in the area; £11 million to provide superfast broadband for companies and £200 million for the citywide MetroBus scheme.

11. The Bristol Temple Quarter aims to attract 4,000 jobs by 2017 and around 17,000 over the 25 year lifespan of the project. In 2015, the 2,000 jobs mark was reached and over 300 businesses are already in the Zone, including prestigious Top 50 law firm Burges Salmon, IBM, Osborne Clarke, the Real Adventure Company and Kevin McCloud's HAB Housing.
12. The project is being delivered by four key partners:
 - West of England Local Enterprise Partnership, which is tasked with creating 95,000 jobs in the region by 2030.
 - Bristol City Council, the local authority with planning responsibility for the Zone.
 - Homes and Communities Agency (HCA), which owns several sites in the Zone.
 - Network Rail, who are responsible for Temple Meads railway station, a crucial part of the development.
13. Estimates suggest that around 400 new businesses could be accommodated in the area, leading to around 17,000 new jobs over the project's 25 year lifecycle. These projected jobs would be delivered alongside more than 240,000 m² of new or refurbished space, featuring offices, research and development space, new homes and retail units, an arena and a redeveloped, 21st century railway station.

Engine Shed

14. It is proposed to sell the George and Railway site at Temple Meads, and neighbouring car park, to Skanska. Skanska will develop it to house the second phase of the Engine Shed project – Engine Shed 2. Skanska will provide or secure funding for the development and use their proven expertise to deliver the development project. Bristol City Council will lease the property from Skanska on a long term basis to secure the facility for the city; the Council will then lease the space to Science Research Foundation (SRF), part of the University of Bristol for the operation of Engine Shed 2.



Image courtesy BCC City Design and Blom Photography

15. The intention is that Engine Shed 2 will provide about 4,600 m² (50,000 sq ft) of accommodation. The Engine Shed concept is based on containing, curating and connecting a number of 'Components' to make up the whole. The mix of the Components will change over time to match the needs and opportunities that emerge. Skanska are aiming that the building is capable of flexibility in the longer term so that it may be adapted to changing needs. The intention is for the development to include a cycling hub and recycling space.



16. Engine Shed 1 opened in the Old Station at Temple Meads in December 2013, delivered by the Council, in partnership with the LEP and HCA, and leased overall to SRF. That arrangement was selected due to the proven experience and success that SRF and SETsquared (part of SRF) had already established curating incubator space. Set up to drive business growth in Bristol and the West of England from this highly accessible location, Engine Shed 1 has proved to be very successful. In its first year of operation alone, it added £7m of GVA to the West of England economy and provided workspace for over 300 people, despite having capacity to accommodate much less. This is testament to its success as a business incubator facility, with it supporting the award of world's best university incubator status to SETsquared, one of its foremost residents.

17. The role of business incubation is a key one, helping to drive business rates growth in the Enterprise Zone. Rates growth in the EZ in turn provides funding for investment in projects to support economic development, by directly supporting the West of England Economic Development Fund.

18. Within a month of opening, Engine Shed became fully occupied. Since then demand for space and incubator support in the Engine Shed has outstripped supply.

19. Between August – December 2013 Engine Shed received circa 10 enquiries for space at the facility that it could not satisfy and this trend has continued. Engine Shed has also been receiving enquiries from companies currently resident that need more space but are at a stage in their development where continued co-location with the services the Engine Shed offers the best guarantee of future growth, and this type of enquiry cannot be accommodated in phase 1.

20. The success of the Engine Shed model has also given rise to interest from other organisations in joint working to develop further incubator facilities. This includes the social enterprise sector wanting to set up an incubator for social entrepreneurs. Interest has also been received from the education and internet security sectors, amongst others.

21. Currently Engine Shed's capacity to fully contribute to economic growth is being

missed because it cannot meet this demand. Engine Shed 2 would resolve this and reduce the risk of the companies and incubators which Engine Shed is accelerating losing momentum because they have to leave the immediate cluster before they are ready, due to lack of space.

22. From the early success of Engine Shed, the contribution incubator space makes to economic growth in the Enterprise Zone, and the evidence of demand outstripping supply, there was an early commitment to initiatives aimed at providing additional capacity. This was supported by the HCA providing grant funding for the purchase of the George & Railway building and site, and the LEP approving £4m of Local Growth Fund 2 funding to support the inherent gap between the cost of providing additional accommodation and the commercially based returns that can be generated. The intention at that stage was that the Council would be the freehold owner of Engine Shed 2 and procure the construction project using Council capital and Prudential Borrowing. The approach has been changed in light of the broader objective to secure a potential to control the Station Approach site through a multi-site development arrangement with Skanska. This approach has been reinforced by the advantage of avoiding a further ask for Council funding and borrowing, which would not be supported at present.
23. As a short term solution, Engine Shed have leased land next to their building to house Boxworks. Boxworks features 20 container units providing temporary office space, and provides access to the business lounge and other facilities within Engine Shed. Bristol City Council supported the Boxworks scheme by granting Engine Shed £35,000 for enabling works on site. This provides a temporary increase in space but has a temporary planning permission and is located on land that will be released for redevelopment by its owners.
24. The concept of Engine Shed 2 has been developed as a long-term solution. Research by officers suggests that the private sector is unlikely to take on the entire risk of developing such a facility itself. The costs of providing dedicated business incubation support plus managing a multitude of tenancies, with many of the occupiers being fledging businesses from whom income is more at risk, makes delivery by the private sector alone less likely to be viable. The financial returns from the occupiers are insufficient to support the capital cost of a new build facility. To help the scheme come forward, Bristol City Council has secured the principle of £4m of Local Growth Fund round 2 funding from the LEP and Government to support its development. This incorporation of that grant will be a significant requirement for this project.
25. Engine Shed 2 is based on a similar occupancy model to Engine Shed 1, with the addition of grow on space, room to showcase the strengths of the area as one in which to invest, learn and/or live and – potentially, although discussions are still ongoing – the University of Bristol’s Centre for Innovation. It is intended that it will provide a mix of conventional lets, meeting rooms, incubator space and business lounge-like space for interaction between business people, the public sector and academia.
26. The Cabinet decision in March 2016 approved the overall arrangement to enter into a multi-site development agreement with Skanska. A critical objective for the Council via this arrangement was to use the Council’s existing site ownerships to

provide a means to secure future influence over the release of the key Station Approach site which continues to be fundamental to the future shaping of the Temple Meads locality, and the impact of that locality on the movement of people in the area. That in turn impacts on the successful regeneration of land around the station, which the Council has invested in to secure regeneration. A reasonable requirement from Skanska in agreeing to defer development of their Station Approach site was early progress of Engine Shed 2. This also is meeting pent-up incubator demand and building on achievement of Engine Shed 1.

27. It is proposed that Engine Shed 2 is brought forward on the George and Railway site, and neighbouring car park, at Temple Meads. Following receipt of an initial brief outlining potential space requirements commissioned by the Engine Shed team, Skanska have – at their own risk – prepared initial proposals for the new development. Skanska, the Council and Engine Shed team are working together to ensure that they are workable. It is important to note that whilst the priority in these discussions is to deliver space designed to meet needs of Engine Shed 2, the Council aims for the proposals to feature sufficient flexibility to be attractive to other occupiers should the operators of Engine Shed wish to terminate their lease at some point.
28. Skanska will undertake responsibilities as developer and for construction of the project. This includes procuring a design to meet the requirements of the Council and SRF, achieving viability for the project, and securing funding. The Council will need to enter into an agreement for lease in order that the project proceeds. The Council is requiring a long-term lease of 30-35 years so that this important, sustainable and flexible facility is retained for the city. The LGF2 funding and the investment capitalisation of the rent obligation from the Council will enable the construction cost to be met, and a slight discount on the level of rent commitment from the Council to be achieved. The project also needs to deliver a site value as the site was purchased by the Council under a grant agreement with funds from HCA.
29. The lease to the Council will enable completion of a sub-lease to SRF as operator of Engine Shed 2. The terms of leases are being negotiated. The lease to SRF is expected to be coterminous with their lease on Engine Shed 1. SRF will require a reduced rent in years one and two of the term to support their build up of occupiers and set up costs. This reduced rent will be a set allowance and SRF will carry the risk for the success they actually achieve. The rent beyond this will be the Market Rent. This will provide a risk premium for the Council in return for holding the overriding lease and enabling a reduced rent in the early years of the project. Over the length of the sub-lease the Council will achieve an aggregate position on rents paid and received that involves no net revenue costs.
30. The allocation of part of any operating surplus to a fund to support economic development, as is the case with Engine Shed 1, is intended.
31. The leases will complete shortly after the practical completion of the development project, at which point freehold ownership of the site will transfer to Skanska, or their funding partner.

Consultation and scrutiny input:

a. Internal consultation:

Regular briefings are held with the Mayor and Deputy Mayor.

b. External consultation:

There are strong governance links via the Bristol Temple Quarter Enterprise Zone (BTQEZ) programme with stakeholders such as Network Rail and the Homes and Communities Agency (HCA). The Local Enterprise Partnership (LEP) is a key funder.

There has been consultation on the Spatial Strategy which includes this property, and there will be further consultation on that strategy, and any planning application for development of this property.

Other options considered:

1. No expansion of incubator provision – this option has been ruled out as incubator provision is fundamental to the growth for the city through Bristol Temple Quarter, demand and operating model have been established.
2. Other sites – a high level analysis of this site compared to three other sites in the *Bristol Temple Quarter Enterprise Zone Development Prospectus* has been carried out on behalf of the Council. There are pros and cons for each site but each of the others has significant timescale concerns and deliverability issues. Despite the separation of the George & Railways site from Engine Shed 1 by the road, it is considered to be the optimum solution.
3. No Council involvement – the evidence of market failure means that it is considered that Engine Shed 2 will not be delivered without Council involvement. Other public sector bodies might address this but there is no expectation they are willing or authorised to. The Council works closely with HCA on Bristol Temple Quarter. On Engine Shed 1, the agreed delivery approach was for the Council to be the direct partner. HCA has enabled the site acquisition of George & Railway and provided funding for that, but this is by means of the grant agreement approach.
4. Direct Council development – there are advantages to this as the Council would be freehold owner of the new Engine Shed 2 enabling permanent retention. This was the expectation when the general aim of Engine Shed 2 was being considered, and engagement with the LEP for the grant support was being progressed. However, this would involve a substantial financial commitment in excess of £15m capital. The Council is not currently in a position to make that commitment. There would also be resourcing pressure of this additional major project.

Risk management / assessment:

FIGURE 1							
The risks associated with the implementation of the (subject) decision :							
No.	RISK Threat to achievement of the key objectives of the report	INHERENT RISK (Before controls)		RISK CONTROL MEASURES Mitigation (ie controls) and Evaluation (ie effectiveness of mitigation).	CURRENT RISK (After controls)		RISK OWNER
		Impact	Probability		Impact	Probability	
1	Development of Engine Shed 2 is not progressed in the short term	High	High	The development approach adopted brings experienced resources and project momentum to Engine Shed 2. The site selected is already within Council ownership	High	Medium	Service Director: Property
2	The development project is not delivered by Skanska	High	Medium	The agreement for lease will provide contractual obligations on Skanska which will have been carefully considered by the parties before final commitment	High	Low	Service Director: Legal
3	The lease to the operator is not completed	High	Medium	The Council will not enter into the agreement for lease without confidence that it will complete the sub-lease agreement	High	Low	Service Director: Legal
4	Project costs overrun	High	Medium	The basis of the agreement will allocate this risk to Skanska as developer, moving it away from the Council	Low	Medium	Service Director: Legal

FIGURE 2							
The risks associated with <u>not</u> implementing the (subject) decision:							
No.	RISK Threat to achievement of the key objectives of the report	INHERENT RISK (Before controls)		RISK CONTROL MEASURES Mitigation (ie controls) and Evaluation (ie effectiveness of	CURRENT RISK (After controls)		RISK OWNER
		Impact	Probability		Impact	Probability	
1	Economic growth for the city falls below target	High	High	Seek to improve other components of Economic Growth activity	High	Medium	BTQEZ Strategic Directors Board
2	Development asset values are reduced	Medium	High	Work on alternative development proposals	Medium	Medium	BTQEZ Strategic Directors Board

Public sector equality duties:

Covered in Cabinet Report dated 4th August 2015, entitled Capital Funding for Enterprise Zone Property Purchases.

Eco impact assessment

The development will be designed and built to connect to the council's adjacent heat network, achieve BREEAM Excellent, be built to maintain a steady internal temperature when outside temperatures are above 30°C for five days or more and be resilient to minor flooding. During building works, a site waste management plan and nuisance avoidance plan will be implemented, as will any measures necessary to avoid disturbing any protected bat species that are present in the existing buildings.

There will be some harmful environmental impacts associated with the building works, but the design, location and transport links have the potential to provide accommodation with

lower environmental impacts than alternative buildings.

Advice given by Giles Liddell, Environmental Project Manager
Date 10 August 2016

Resource and legal implications:

Finance

a. Financial (revenue) implications:

The transaction has no recurring or one off revenue costs for the council. Bristol City Council will sign a long term head lease with the developer and a sub-lease with SRF. This sub-lease will more than cover the cost of the head lease providing a “risk premium” for the council.

The only risk to which the council is exposed is over the longer term. SETSquared will periodically have the ability to serve notice on the sub-lease. The risk of this occurring is most likely to be associated with their need for space. The risk of SETSquared not requiring this additional space is at present low. This is demonstrated by the success of Engine Shed 1 and the current need for space which is currently satisfied by Boxworks. This temporary provision of space will remain open until Engine Shed 2 becomes operational.

Further risk mitigation is provided by the proposed design of Engine Shed 2. The design will allow easy conversion to good quality office space of the type that is in high demand in Bristol. The risk premium charged will also buffer the council from any delay in the requirement to find a new tenant.

Advice given by Mike Allen / Finance Business Partner
Date 24 August 2016

b. Financial (capital) implications:

There are no borrowing or additional capital implications for the Council from this matter. The project will link to the sale of the freehold interest in the George & Railway property owned by the Council, purchased with grant from HCA, and triggering repayment of that grant from the land sale proceeds achieved.

Advice given by Mike Allen / Finance Business Partner
Date 24 August 2016

Comments from the Corporate Capital Programme Board:

Not applicable as no net capital implications.

c. Legal implications:

If the recommendations are agreed, legal advice will be needed to ensure compliance with relevant legislation. In particular to address the following;

- In negotiating the detail of the agreement to avoid this becoming subject to the Public Contracts regulation 2015(which would require a fully complaint tendering process)

- To ensure that the arrangement is and remains a property disposal.
- If the proposed agreement contains legally binding obligations (direct or indirect) on the developer/tenant to execute works specified by the Council and where there is some form of pecuniary interest (which will be very broadly construed) the proposed agreement for lease risks being classed as a public works contract.
- In the absence of any competition for the development agreement, in order to avoid any risk of a state aid challenge (on the basis of a failure to secure market value and so in essence provide a subsidy) the terms for the disposal of the site(s) should be certified by an independent valuer as representing market value. There is EU Commission guidance on this which would need to be followed.
- The terms of any property disposal would also need to have regard to the Council's general obligation to secure best value.

Advice given by Eric Andrews, Team Leader Corporate legal team
Date 12 August 2016

d. Land / property implications:

This proposal is to secure redevelopment of a property owned by the Council, subject to a grant agreement with HCA. It will be necessary to discharge the grant conditions, primarily to repay the HCA grant, in order to proceed. The structure proposed will enable the redevelopment of a building which has been a city eyesore for many years. Whilst the building is in Council ownership, the approach will not require the Council to provide the capital for the project nor to make a revenue funding contribution. The Council acquired the freehold several years ago with the HCA and would transfer the freehold to the developer provided that the redevelopment is secured. The Council would enable the building to be used for incubator or other agreed use for a long period by means of the lease it enters into.

Advice given by Robert Orrett, Service Director Property
Date 18 August 2016

e. Human resources implications:

There are no HR implications arising from this report.

Advice given by Mark Williams, Business Place, Strategy and Policy
Date 12 August 2016

Appendices

Appendix 1 Background document – Not for publication by virtue of paragraph(s) 3 of Part 1 of Schedule 12A of the Local Government Act 1972 (Information relating to the financial or business affairs of any particular person (including the authority holding that information)).