1 Purpose of Report
To approve the funding for and acquisition of the Premier Inn Canning Town as set out in this Report.

2 Executive Summary Outline
2.1 This report sets out proposals for the Council to enter into an investment arrangement with an Institutional Investor and Premier Inn Hotels Limited (Whitbread Plc). The proposal will generate significant annual revenue for the Council reducing the budget deficit, support community wealth building and facilitate in-borough development and regeneration.
2.2 The proposed transaction is a lease and leaseback arrangement between the Council (250 year Long Leaseholder), the Institutional Investor (50 year-long leaseholder) and Premier Inn /Whitbread plc as the tenant / guarantor of the Council (25 year lease with 20 year break clause).

2.3 No rent is payable between the parties until the new development is constructed and Premier Inn have entered their lease (exp. January 2021). Under this arrangement the Council would pay a guaranteed and indexed head rent to the Funder for the term. Simultaneously, the Council would receive a matching guaranteed and indexed rent from the hotel operator.

2.4 The rent payable by Premier Inn / Whitbread plc to the Council is higher than the rent payable to the Institutional Investor, providing a profit rent to compensate the Council for providing the rental guarantee - The Council is committing to guaranteeing a proportion of the rental income for a period of 50 years. The hotel operator assumes full operating maintenance, insurance and room occupancy risk for the term of the Premier Inn lease.

2.5 A key element of the proposal is that a profit rent of a minimum of £319,000 per annum would be generated for the Council with a £0 capital outlay and the Council retain an option to buy back the Freehold for £1 at the expiry of the lease with the Funder. The profit rent will rise in line with CPI and on the same basis as the rent from the occupational lease and is estimated to reach £842,500 by lease expiry and average £477,500 p.a. over the life of the lease.

2.6 At expiry of the lease with the Funder our advisors estimate the hotel will have a value of approximately £35m at that time providing the Council with a substantial asset with which to re-let or sell at that time.

2.7 The Medium Term Financial Strategy agreed by Council in February 2019 did not provide specific funding for Business and Growth initiatives. This proposal does not require the Council to incur capital expenditure. The Institutional Investor will purchase the asset and the asset will be leased to Premier Inns.

3 Recommendations

3.1 For the reasons set out in the report and its appendices, Cabinet, is recommended to agree:

3.1.1 To approve the forward commitment to purchase of an in-borough, 152 Bedroom hotel which will be let on practical completion to Premier Inn Hotels Limited with a guarantee from Whitbread Group PLC as per the terms set out in Appendix 1/2.

3.1.2 To approve the recommended funding / financing option from the Institutional Investor (Option 3 – see 4.6) to provide 100% of the capital required of £21.250m and additional transaction costs (stamp duty and professional fees) of £1.425m (£22.675m total) relating to the acquisition of Canning Town Premier Inn Hotel.
3.1.3 To approve the business case for acquisition following the positive outcome of substantial due diligence covering strategic, financial, property, asset and legal) which highlights the attractiveness of the investment.

4 Executive Summary – Key Terms

4.1 The opportunity has been presented to the Council under the revised Newham Investment Strategy (agreed by Cabinet on the 15th June 2017), in accordance with both the CIPFA Prudential Code Guidance and Counsel Advice (sought in March 2018) to participate in a hotel investment.

4.2 The Council has secured the opportunity to enter into an investment arrangement with an institutional Investor and Premier Inn / Whitbread plc to acquire a long-term income generating investment: a forward commitment to purchase a 152 bedroom hotel, located on a prime in-borough site, let to Premier Inn Hotels Limited with a lease guarantee from Whitbread Group PLC.

4.3 The transaction will be 100% financed by the Institutional Investor (Funder).

4.4 This investment supports three key Council policies and has the following investment rationale:

i) Assisting to reduce the annual budget deficit by generating stable and low-risk long-term returns increasing from £319,000 per annum at lease start and rising to £842,500 by lease expiry for the Council’s general fund. Averaging £477,500 per annum.

ii) Community Wealth Building - through local employment opportunities and the generation of 30-35 locally sourced jobs with a dedicated London Living Wage employer (as highlighted in Whitbread’s annual accounts 2015-16).

iii) Facilitating in-borough development and regeneration.

4.5 The overview of the real estate terms are as follows:

4.5.1 LBN propose to enter into a contract to purchase (by way of a long lease) a hotel premises at a new development, currently under construction, at Silvertown Way, Canning Town, London.

4.5.2 An Agreement for Lease is in place between Opal (Silvertown) Limited (the Developer/Seller/Landlord - “Opal”) and Premier Inn Hotels Limited (“Premier”), which became unconditional on 26 January 2018 and pursuant to which Premier will be granted an occupation lease following Practical Completion of the development (subject to more detailed terms and conditions).

4.5.3 Following the completion of the Premier Lease the lease to LBN will
complete and LBN will become the immediate landlord of Premier. For the avoidance of doubt, should practical completion of the development not occur, and/or the Premier Lease not complete, the contract can be terminated. LBN will have no legal interest in the Property until the legal completion of the lease between Opal and LBN.

4.6 The key terms of the transaction and legal documentation are set out at Appendices 1 and 2. In summary, this provides:

- **Location**: The hotel forms part of a substantial mixed-use development adjacent to Canning Town Station

4.6.1 **Agreement for Lease and Lease**

i. **Tenure**: 250-year lease to be granted to the Council from the later of practical completion of the development and the completion of the Premier Lease for the rent of a peppercorn.

ii. **Price**: Terms agreed for the Council to provide a forward commitment of £21.250m (on the basis of the 152 bedroom rent as stated above. If fewer bedrooms are in the completed development and the occupational tenant rent reduces, the purchase price reduces proportionately). A purchase at this level reflects a net initial yield of 4.36%, allowing for purchaser’s costs of 6.75%, subject to contract and exclusive of VAT. Galliford Try Partnerships are the Build Contractor delivering the scheme. The construction programme is targeting a practical completion date of January 2021, and a long stop date of April 2023.

4.6.2 **Occupational Tenancy**:

i. **Agreement for Lease** entered into with Premier Inn Hotels Limited to grant a lease with a term of 25 years with a tenant break option at the end of 20 years

ii. **Rent**: Agreed £988,000 per annum (£6,500 per room) (subject to 152 rooms being in the completed hotel - £6,500 per room and a pro rata reduction for any fewer rooms built.) If the hotel contains fewer than 120 rooms or more than 160 rooms when completed, Premier may terminate the Premier Agreement and the agreement with LBN will also then terminate.

iii. **Rent Review**: Five yearly upward only rent reviews linked to CPI index, capped at 5% per annum notional increase

iv. **Covenant**: Premier Inn Hotels Ltd is rated ‘5A’ by Dun & Bradstreet is the largest hotel brand in the UK with over 730 hotels. A wholly owned subsidiary of Whitbread Group PLC, Premier Inn provides in the region of 70% of Whitbread’s earnings and has been owned by Whitbread Group PLC for its entire duration (founded 1987).
v. Lease Guarantor: Whitbread Group PLC guarantee

4.7 Financing: Traditional PWLB funding options were explored, however due to the forward purchase arrangement; further investigation identified the potential for more attractive, alternative funding structures. The results of further investigation into alternative options, working with an Institutional Investor offers financing to cover the entire capital outlay of £22.675m (i.e. 100% of the funding required). The financing overview is as follows:

4.7.1 Newham agree terms to acquire the Long Leasehold of Premier Inn, Canning Town for £21.250m which generates a headline rent from the occupational lease of £988,000 p.a.

4.7.2 Simultaneously Newham agree terms for a long lease of 50 years with an Institutional Investor (Funder). Newham agree to pay the Funder a rent, beginning at lease start of the Premier Inn lease (January 2021), on rent review and indexation terms mirroring the Premier Inn lease – therefore insulating Newham from any negative cash flow movements due to inflation.

i. The rent paid to the funder is calculated as the headline rent (£988k) - the Council’s desired profit rent (e.g. £319k p.a) therefore making the Annuity Rent payable to the Funder of £669k p.a.

4.7.3 The Annuity Rent payable by Newham to the Funder is worth more than the Premier Inn rent because Newham’s covenant strength is better than Premier Inn’s. Therefore, the Funder will pay a much keener yield (e.g. in the region of 2.75% Net Initial Yield (NIY) (vs 4.4% NIY paid for the Premier Inn lease) for that income stream and lease structure.

i. £669k capitalised at c.2.75% NIY reflects a value of £22.74m (100% of the capital outlay for the transaction - including professional fees and stamp duty)

ii. Under the terms of the Long Lease the Funder will pay that amount to Newham who simultaneously (upon Practical completion of the Premier Inn in January 2021) use those funds to pay the Vendor of the Premier Inn the balance required for completion

iii. Therefore Newham will not have to provide any capital (£0) in this acquisition and will have locked in a minimum day 1 Profit Rent of £320k p.a. subject to Premier Inn meeting their rent obligations which are guaranteed by Whitbread PLC. This is seen as low risk, as Premier Inn and Whitbread plc both have a strong covenant.

4.7.4 Upon expiry of the Long Lease (50 years) the Council will exercise their option to acquire the freehold for £1 which at this stage should be worth
c. £35m (provided by transaction advisors based off conservative assumptions on lease rental yield at expiry, see Appendix 5).

4.8 Newham were provided with a range of options from the funder which were summarised below:

<table>
<thead>
<tr>
<th>Financing Options</th>
<th>Term</th>
<th>Initial Profit Rent (to Newham p/a after financing costs)</th>
<th>Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>40 Years</td>
<td>£190,000</td>
<td>£10,820,000</td>
</tr>
<tr>
<td>2.</td>
<td>45 Years</td>
<td>£255,000</td>
<td>£12,440,000</td>
</tr>
<tr>
<td>3.</td>
<td>50 Years</td>
<td>£319,000</td>
<td>£14,460,000</td>
</tr>
</tbody>
</table>

4.8.1 Officers recommend proceeding with Option 3 which will generate maximum additional net revenue to the Council’s general fund of £319,000 per annum at lease start and rising to £842,500 by lease expiry (50 years) for the Council’s general fund. Over the period this averages £477,500 per annum.

4.9 The legal documentation is now fully agreed and upon approval, contracts will be exchanged and the opportunity secured for the Council.

4.10 Brunel Street Works is a substantial mixed-use development in a strategic location adjacent to Canning Town Station in East London. With the aim of reducing the Council’s budget deficit, this investment will generate additional revenue enabling the Council to invest in the achievement of its strategic objectives and delivery of mayoral pledges.

5 Key Considerations & Proposals

5.1 Key objectives of this investment is to:

   i. Create a stable and low risk long-term return.

   ii. Promote regeneration in the borough with the development providing a substantial new residential neighbourhood together with extensive retail, workspace and leisure accommodation.

   iii. The potential to build Community Wealth, creating 30 to 35 local jobs strengthening local capital (estimated from market data and in line market practice).
5.2 Background & Location

5.2.1 Brunel Street Works is a substantial mixed-use development in a strategic location adjacent to Canning Town Station in East London. With the aim of reducing the Council’s budget deficit, this investment will generate additional revenue enabling the Council to invest in the achievement of its strategic objectives and delivery of mayoral pledges.

5.2.2 The site has been identified to construct the new hotel at the Canning Town Regeneration area which is made up of several sites across an area of approximately 62 acres, in a strategic location adjacent to Canning Town Station in East London.

5.2.3 The project is being undertaken by Opal (Silvertown) LLP a Joint Venture between Thames Valley Housing and GallifordTry. The development will provide a substantial new residential neighbourhood together with extensive retail, workspace and leisure accommodation.

- 975 residential units (Use Class C3) in total
- Private Market Sale – Linden Homes - 340 homes
- PRS – Fizzy Living – 292 homes
- Affordable – London & Quadrant – 343 homes
- 152-bedroom hotel (Use Class C1) - Premier Inn
- 3,000m2 (GIA) of flexible commercial floor space
- (Use Classes B1, A1- A5, D2 and a nursery within Use Class D1) including a food store of up to 550m2

5.3 Sustainability

5.3.1 The hotel is expected to have an EPC rating, provided upon practical completion, of a minimum rating of B

5.4 Covenant

5.4.1 Premier Inn Hotels Ltd is rated ‘5A’ by Dun & Bradstreet is the largest hotel brand in the UK with over 730 hotels. A wholly owned subsidiary of Whitbread Group PLC, Premier Inn provides in the region of 70% of Whitbread’s earnings and has been owned by Whitbread Group PLC for its entire duration. Whitbread Group PLC guarantee

5.4.2 Both Premier inn Ltd and Whitbread Plc have low risk failure and delinquency scores and tangible net worth in excess of £35m.

5.4.3 Both the tenant and guarantor constitute high quality, low risk covenants in their own right and therefore together represent a low risk.

5.5 Rental Summary

5.5.1 The initial rent of £6,500 per room per annum reflects a fair current rent for the operator in line with recent lettings in the UK and below those recently agreed in Central London. Please see the leasing evidence
5.6 **Investment Summary**

5.6.1 The price agreed is in line with current market transactions for comparable properties (See Appendix 3).

5.7 **Transaction Structure**

5.7.1 The transaction has been structured as a forward commitment to purchase. This is a structure by which the purchaser (Newham) agrees terms with the Vendor (today) to purchase the hotel at an agreed price once it has been built by the vendor and achieved practical completion (targeted January 2021).

5.7.2 Under this structure the purchaser exchanges contracts with the vendor on the forward commitment but completion is delayed until the Vendor has completed the build to an agreed specification. Therefore, the Vendor remains as Landlord for the duration of the build but is obligated to agree key terms such as changes to specification with Newham and the tenant prior to implementation. This is also explains why Newham do not appear as the Landlord on lease documentation.

5.7.3 This structure is advantageous to Newham as the Vendor is obligated to deliver the development and Newham have no exposure to the development build costs.

5.7.4 For clarity under this transaction structure the funding would be provided simultaneously on completion of the Forward Commitment between Newham and the Vendor. Therefore, Newham will not have to invest any capital in the transaction on completion.

5.8 **Financial Implications**

5.8.1 The financial modelling provided by the Council Treasury advisers indicate the initial rental income the Council will receive from Premier Inn will leave a revenue stream of £319,000 per annum at lease start and rising to £842,500 by lease expiry (after 50 years) for the Council's general fund. This averages £477,500 per annum over the duration of the lease.

5.8.2 Use of PWLB was considered as a funding option. This would require the Council to borrow the funding capital upfront, creating a period of two years before Practical Completion during which the Council would have the financing cost but the investment will not be generating revenue.

5.8.3 The Council has been presented with an alternative funding option to cover the entire capital outlay of £22.675m (i.e. 100% of the funding
required) by an Institutional Investor. Their proposal is as follows:

1. Newham agree terms to acquire the Long Leasehold of Premier Inn, Canning Town for £21.25m which generates a Headline Rent from the Occupational Lease of £988,000 p.a.

2. Simultaneously Newham agree terms for a Long Lease of 50 years with an Institutional Investor (Funder). Newham agree to pay the Funder a Rent, beginning at lease start of the Premier Inn lease (January 2021), on rent review and indexation terms mirroring the Premier Inn lease – therefore insulating Newham from any negative cash flow movements due to inflation.

   i. The Rent paid to the funder is calculated as the Headline Rent (£988,000) - the Council’s desired profit rent (e.g. £319,000 p.a) therefore making the Annuity Rent payable to the Funder of £669,000 p.a.

3. The Annuity Rent payable by Newham to the Funder is worth more than the Premier Inn rent because Newham’s covenant strength is better than Premier Inn’s. Therefore, the Funder will pay a much keener yield (e.g. in the region of 2.75% Net Initial Yield (NIY) (vs 4.4% NIY paid for the Premier Inn lease) for that income stream and lease structure.

   i. £669,000 capitalised at c.2.75% NIY reflects a value of £22.74m (100% of the capital outlay for the transaction)
   ii. Under the terms of the Long Lease the Funder will pay that amount to Newham who simultaneously (upon Practical completion of the Premier Inn in January 2021) use those funds to pay the Vendor of the Premier Inn the balance required for completion
   iii. Therefore Newham will not have to provide any capital (£0) in this acquisition and will have locked in a Profit Rent increasing from £319,000 per annum at lease start and rising to £842,500 by lease expiry for the Council’s general fund. Averaging £477,500 per annum

4. Upon expiry of the Long Lease (50 years) the Council can exercise their option to acquire the freehold for £1 which at this stage should conservatively be worth approximately £35 million.

5.8.4 The Institutional Investor has provided 3 finance options in line with the following table:

<table>
<thead>
<tr>
<th>Financing Options</th>
<th>Term</th>
<th>Day 1 Profit Rent (to NEWHAM p/a after financing costs)</th>
<th>Present Value</th>
</tr>
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</table>

9
<table>
<thead>
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5.8.5 The report recommends the Council approves finance option 3 which will generate the highest profit rent over the life of the lease.

5.8.6 The Council is required to provide a rent guarantee to the Institutional Investor. As the Council has a stronger covenant than Premier Inn or guarantor Whitbread, the Institutional Investor will offer a lower interest rate. The Council is not exposed unless Premier Inn (and subsequently Whitbread Group PLC) are unable to meet payments to Newham.

5.8.7 The Medium Term Financial Strategy agreed by Council in February 2019 did not provide specific funding for Business and Growth initiatives. This proposal does not require the Council to incur capital expenditure. The Institutional Investor will purchase the asset and the asset will be leased to Premier Inns.

6 Policy Implications & Corporate Priorities

6.1 The completion of this investment will help to improve the resilience of the Council, generating an average stable revenue stream for the Council of £477,500 p.a. over the next 50 years. This acquisition and income supports:

- The Council’s service delivery,
- Achievement of Newham’s strategic objectives and
- Realisation of mayoral priorities.

7 Alternatives considered

7.1 The only alternative considered is that the **Council does nothing** due to a lack of alternative in-borough’ investment:

*Council does nothing* - The Council will withdraw its offer on the property, losing the certainty of revenue that will be generated from this transaction.

7.1.1 The Council is under no obligation to purchase the property and could look for other investment opportunities. However, it is considered that this purchase represents a good opportunity to generate income and to contribute to reducing the budget gap.

7.1.2 The in-borough pipeline of investment opportunities is very limited, and the property is available now and ready for exchange and completion.
following 3 months of thorough due diligence. If the Council did nothing, it would not be liable for the rent guarantee.

7.1.3 Properties take time to acquire and choosing not to purchase the property will impact our ability to generate income. Withdrawal from this purchase would affect the overall pipeline and delay achievement of the strategy.

7.2 As a reference, only two opportunities of interest have come to market in the last 9 months ‘in borough’. Given the limited in-borough pipeline of investment opportunities this could be the only viable opportunity for acquisition this year.

8 Consultation

Name of Lead Member consulted: Cllr. Terence Paul
Position: Member for Finance and Corporate Services
Date: 22nd February 2019

9 Implications

Financial Implications

9.1 Changes to the Capital Finance Regulations in March 2018 and to the CIPFA financial code restricted the ability of Councils to borrow in advance of need. The Council retains the ability to borrow for other purposes and as set out within the legal implications, has the powers to undertake the transaction.

9.2 The anticipated return of £319,000 per annum at lease start and rising to £842,500 by lease expiry for the Council’s general fund. This averages £477,500 per annum.

9.3 The institutional Investor is financing the acquisition at 100% of the outlay (£22.675m) and requires an initial rental of £669,000. Premier Inn will pay an initial rent of £988,000 per annum; both rentals will be subject to five year CPI rent reviews with a cap on increases, protecting the Council from exposure to rent increases.

9.4 In return the Council will provide a rent guarantee to the Investor – that is if Premier Inn (or guarantor Whitbread) are unable to meet the annual rental payments the Council will meet the shortfall. The strong covenant of the companies means this is a low (but not no) risk.

9.5 The site will be opted to tax – that is VAT will be charged on rents.

Risks and Sensitivities

9.6 The financing arrangement with the Institutional Investor (to provide 100% of the capital outlay) for this transaction offers an improved risk & sensitivity
profile:

9.6.1 Valuation ‘locked in’ at day 1

By securing this financing with an Institutional Investor Newham are effectively insulated from the underlying movement in value of the hotel as it is being ‘leased’ to the Funder at pricing terms agreed prior to completion.

9.6.2 Minimum Profit rent fixed at day 1

By fixing the day 1 profit rent and lease terms with the Institutional Investor at lease start the minimum profit rent for the Council can be locked in at lease start providing a low risk and growing income return for the Council for the duration of the lease.

9.6.3 Covenant / Rent Exposure

i. The Council remains exposed to the covenant strength of the Premier Inn / Whitbread plc. If they were to fail the rent due to the Institutional Investor would still be payable.

ii. The Council do benefit from a strong tenant in Premier Inn limited and a strong guarantor from Whitbread plc which reduces this risk.

iii. As one of the largest hotel operators in the UK and strongest covenants in the sector they are institutionally acceptable and certified low risk with a D&B 5A rating.

iv. The risks have therefore been mitigated by focussing on quality as far as possible.

Legal Implications

9.7 The Council has the power to acquire land by agreement under s.120 Local Government Act 1972 where the acquisition is linked to the discharge of its functions or for the benefit, improvement or development of Newham (which may be also be future benefits). The Council also has a power of investment (which includes investing in property) also linked to the discharge of its functions under s.12 Local Government Act 2003. It is a requirement of s15 Local Government Act 2003 that the Council has regard to guidance issued or specified by the Secretary of State in respect of using this power. The Secretary of State has issued guidance entitled “Statutory Guidance on Local Government investment (3rd Edition)” (“the Statutory Guidance”) which became effective from April 2018 onwards.

9.8 In light of the economic, social and environmental benefits that are identified in this Report arising from the acquisition the Council has the appropriate powers to purchase the hotel in accordance with section 120 Local Government Act 1972. Further, the Council is not constrained by the Statutory Guidance in seeking to borrow to acquire the premises since it is neither proposing to borrow in advance of need nor is it borrowing purely in order to profit from the investment, since the principal reason for investing is around delivering job creation and regeneration within the Council’s area.
9.9 The Newham/Opal Lease and Premier Inn occupational lease are in institutionally acceptable forms and reflect the agreed terms;

9.10 The title being acquired is good and marketable.

9.11 The collateral warranties to be provided from the contractors will be in an institutionally acceptable format.

**Equalities Implications**

9.12 The Report has no specific impact on Equalities/Diversity