

Finance and Resources Committee

10.00am, Thursday, 5 March 2020

Edinburgh International Conference Centre hotel and hotel school – business case

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| Executive/routine Wards Council Commitments | Executive 11 – City Centre 2, 31 |
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1. Recommendations

- 1.1 It is recommended that the Committee:
- 1.1.1 notes the proposed Edinburgh International Conference Centre (EICC) hotel and hotel school project as set out in this report and the business case;
 - 1.1.2 notes that there is no new call on Council capital or revenue budgets;
 - 1.1.3 notes that the project is forecast to generate sufficient income to meet all EICC Ltd capital replacement requirements as well as surpluses for redistribution to the Council in later years;
 - 1.1.4 notes that delegated authority would be granted to the Chief Executive (or any such other officer as they shall sub-delegate to) to proceed with the Agreement for Head Lease, the Agreement for Sub Lease, and any other agreements and actions required to commence the project;
 - 1.1.5 notes that the Strategic Delivery Agreement which would be entered into between the Council and Edinburgh International Conference Centre Limited (as referenced in the business case) would be presented to the Housing, Homelessness and Fair Work Committee for approval; and
 - 1.1.6 refers this report to full Council for its consideration of the Council proceeding with the EICC Ltd hotel and hotel school project.

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Chief Executive

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Report

Edinburgh International Conference Centre hotel and hotel school – business case

2. Executive Summary

- 2.1 This report introduces a business case for the Council entering into a 25-year head lease on a hotel of around 365 bedrooms that is being developed at The Haymarket Edinburgh by Quartermile Developments Limited. The Council will in turn sub lease the hotel to Edinburgh International Conference Centre Limited, who will operate the hotel under a Franchise Agreement with an international hotel brand as well as operating a hotel school based in the hotel in partnership with Edinburgh College.
- 2.2 The profits from the hotel will be used to fund the required capital investment in the Conference Centre. There is not expected to be any new call on Council capital or revenue budgets and the Council will not take on any risk associated with the construction of the hotel. In addition, profits are forecast for redistribution to the Council in later years.
- 2.3 The Committee is recommended to agree in principle that the Council proceed with the project as set out in the business case, to note that the necessary authority would be delegated to the Chief Executive to enter into all agreements and take all actions required to deliver the project, and to refer the report to the City of Edinburgh Council to approve the Council proceeding with the project.

3. Background

- 3.1 The Edinburgh International Conference Centre (“the Conference Centre”) is operated by EICC Ltd, a subsidiary of CEC Holdings Limited, a Council arm’s length company.
- 3.2 EICC Ltd forecasts that, over the 21-year period from January 2018 to December 2038, significant capital expenditure on the Conference Centre will be required. EICC Ltd’s operating surpluses are not forecast to be sufficient to meet this expenditure. A fund exists for investment in the Conference Centre, the Lothian Road Expenditure Trust, but this is only capitalised with £4.03m. In June 2018, the Council’s Housing and Economy Committee instructed officers to identify potential solutions to the capital funding challenge.

- 3.3 Council officers together with EICC Ltd officers identified a potential solution as being to secure (by lease or purchase) additional property with income-generation potential. Subsequently, the potential for the Council to lease a hotel which will be sub-let to EICC Ltd was explored. In spring 2019, the property developer Quartermile Developments Limited approached the Council with an opportunity for the Council to take a leasehold interest in a hotel being delivered at The Haymarket Edinburgh, a brownfield development site on Morrison Street. It is important to note that the development will proceed regardless of whether the Council is involved – the Council is not itself developing a hotel, or financing the development of one, or enabling an otherwise unviable hotel to be developed via its involvement.
- 3.4 In October 2019, the Finance and Resources Committee agreed the principle of the Council securing an interest in a hotel at The Haymarket Edinburgh as a means of funding capital expenditure in the Conference Centre and instructed officers to carry out due diligence on the proposal.

4. Main report

- 4.1 This report introduces a business case (prepared using the HM Treasury “five case” model) for the Council entering into a 25-year lease on a hotel of around 365 bedrooms (the biggest in Edinburgh) that is being developed at The Haymarket Edinburgh by Quartermile Developments Limited. The Council will in turn sub lease the hotel to EICC Ltd, who will operate the hotel under a Franchise Agreement with an international hotel brand. The profits from the hotel will be used to help fund the required capital investment in the Conference Centre identified above. EICC Ltd will also operate a hotel school based in the hotel in partnership with Edinburgh College.
- 4.2 The business case is to be considered as a private item given the commercially sensitive information it contains.
- 4.3 The Strategic Case chapter of the business case sets out the strategic rationale for proceeding with the project. The project aims to deliver six key benefits for the Council and for Edinburgh more widely: funding capital expenditure on the Conference Centre; generating an additional return on investment (profit); making EICC Ltd financially self-sufficient; enhancing the skills of tourism sector workers; contributing to the strategic development of The Haymarket Edinburgh; and attracting additional visitor expenditure to Edinburgh. The project will contribute to the fulfilment of two Council Commitments and multiple strategic aims, including the Edinburgh Economy Strategy, Edinburgh Tourism Strategy, and 2030 carbon neutrality target, for example by creating over 200 new jobs paying at least the Real Living Wage (making it an exemplar for well-paid, fair work).
- 4.4 The Economic Case chapter of the business case sets out the two options for delivering the project that were considered (along with the “do nothing” option) and the net present value and wider benefits of each, concluding that a Franchise Agreement delivers the best value, with a positive net present value. Sensitivity

analysis shows that the projected net present value remains positive under adverse market conditions up to a simultaneous decline in occupancy and room rate of 20%. The Economic Case chapter also sets out that The Haymarket Edinburgh was judged to be the only available location for the hotel fulfilling the requirements of close proximity to the Conference Centre, capacity of 350–400 bedrooms, and the ability to generate required profits in the required timeframe.

- 4.5 The Financial Case chapter of the business case models the costs and income of the hotel, including maintaining a reserve to cover lifecycle expenditure on the hotel. Costs during the pre-opening phase of the hotel (such as construction management, staff recruitment and the purchase of hotel supplies) will be met from EICC Ltd's cash balances, which will subsequently be replenished once the hotel is operational. In its first year of trading the hotel is projected to generate sufficient revenue to, when combined with key money received from the franchisor¹, enable the hotel to meet the projected running costs, pay taxes due, and to reinstate EICC Ltd's cash balances. In the longer-term, as revenues reach stabilisation, the projected profits will enable the capital expenditure requirements of the Conference Centre to be met in full and to build up a contingency reserve. Surpluses beyond this will be available for redistribution to the Council and, upon agreement, reinvestment in EICC Ltd. The hotel will remain profitable in most forecast scenarios albeit it could not sustain a deep prolonged fall in demand. There is not expected to be any new call on Council capital or revenue budgets for the duration of the project.
- 4.6 The Commercial Case chapter of the business case sets out how commercial relationships will be established in a manner that secures best value and at the same time ensures compliance with relevant legal and regulatory rules, including procurement rules. The Council will directly enter into a head lease agreement for the hotel to be developed, with the hotel being leased to the Council when construction is complete. The Council entering into such an arrangement is permitted under the relevant regulations, and commercially the only option, on the basis that The Haymarket Edinburgh is the only possible site meeting the requirements of the Council and EICC Ltd: (i) close proximity to the Conference Centre, (ii) a capacity of 350–400 bedrooms, and (iii) the ability to generate the required profits within the required timeframe. This approach has been subject to independent assessment by the Council's external legal and property advisers. The sub lease of the hotel to EICC Ltd will be on market terms mirroring those of the head lease entered into by the Council. EICC Ltd will then operate the hotel under a Franchise Agreement with a preferred franchise partner selected following an extensive selection process.
- 4.7 The Management Case chapter of the business case sets out how the project will be governed and managed. From the Council's perspective, the core relationship of the project is that between the Council and EICC Ltd, and this will be controlled by

¹ Key money refers to an upfront payment made by a hotel brand as a financial inducement to secure a franchise / management agreement. This payment is returnable should EICC Ltd cease to comply with the terms of the agreement.

three key documents: the EICC Ltd shareholders' agreement, the sub lease, and a new Strategic Delivery Agreement between the Council and EICC Ltd. A programme and risk register have been prepared. A framework has been developed for the management of the development of the hotel, for health and safety management, and for remedial actions in the case of construction insolvency, along with cost, risk, stakeholder, communications, environmental, and benefits management. EICC Ltd has set out how the hotel and the hotel school will be structured and operated.

- 4.8 In addition to the business case, further information, including copies of the external advice and reports referred to in the business case, has been made available to elected members in a confidential data room in advance of the committee meeting. This includes external legal advice from CMS and James Goudie QC (external legal advisers), reports from Avison Young (an external real estate adviser), and a report from Colliers (an external hotel adviser).
- 4.9 The business case concludes that the project aligns with the Council's strategic aims; that the project secures best value and represents the best of the options available; that the project is affordable and fundable; that the project is commercially viable and can be procured in line with relevant regulations; and that the Council and EICC Ltd can successfully deliver the project.

5. Next Steps

- 5.1 Subject to approval by full Council, the Council will enter into the Agreement for Head Lease, the Agreement for Sub Lease with EICC Ltd, and all other agreements needed to deliver the project as set out in the associated business case. A Working Group comprising officers from relevant Council service areas (Economic Development, Estates, Finance, Legal, and Procurement) and representatives from EICC Ltd has been established to take the project forward. The composition and membership of the group will be kept under review to ensure it has the appropriate set of skills and experience to successfully deliver the project.
- 5.2 A full project programme is set out in Annex C of the associated business case.
- 5.3 Project updates will be provided via annual reports and business bulletin items along with EICC Ltd's annual reports.

6. Financial impact

- 6.1 The report recommends that the Council approves the principle of the Council entering into a head lease agreement on the hotel and into a sub lease agreement with EICC Ltd that will mirror the terms of the head lease. Financial modelling carried out to support the business case shows that the hotel will generate sufficient profits to meet rental payments in full.

- 6.2 The hotel is expected to be profitable from its first year of operation. There will be additional costs for EICC Ltd during the pre-opening phase, but these will be covered by EICC Ltd's cash balances. There is therefore not expected to be any new call on Council capital or revenue budgets.

It is forecast that the hotel will deliver sufficient net surpluses over the project lifespan – covering two years pre-opening and 25 years of operations – to fund the Conference Centre lifecycle capital expenditure over that period and build up a contingency reserve. Residual surpluses remaining after funding capital expenditure on the Conference Centre and other agreed priorities (such as required capital expenditure on the hotel and any funds retained by EICC Ltd for projects as agreed in line with its business plan) will be returned to the Council in a tax-efficient manner.

- 6.3 There is a risk that the profitability of the hotel could be eroded by adverse market conditions. A range of scenarios have been tested and it has been found that the hotel could broadly sustain a 20% decline in occupancy alongside a 20% decline in room rate. The hotel could not sustain prolonged extremely adverse market conditions, but the external advice received by the Council from its property advisers is that a downturn of this magnitude or this duration is highly unlikely.
- 6.4 The proposal for the hotel school is still under development and exact costs are still to be quantified. Discussions are ongoing with Edinburgh College, the Student Awards Agency Scotland, and the Scottish Government regarding potential funding sources, but it is anticipated that all costs associated with the hotel school can be met from the income it will generate from course fees and other items.

7. Stakeholder/Community Impact

- 7.1 The principal project stakeholders and the strategy for managing good relations with each are set out in the Management Case chapter of the associated business case.

8. Background reading/external references

- 8.1 "EICC – Capital Expenditure Requirements" – report to the Housing and Economy Committee, [24 January 2019](#) (B agenda)
- 8.2 "EICC – hotel and hospitality training school opportunity at The Haymarket Edinburgh" – report to the Finance and Resources Committee, [10 October 2019](#) (B agenda)

9. Appendices

- 9.1 Appendix one: EICC hotel and hotel school – business case (to be considered in private, given the commercially sensitive information contained in it)