

# **Management Committee**

## **19 September 2017**

### **Asset Management - Hotels**

Confidential Appendix is NOT FOR PUBLICATION – by reason of paragraph 3 of schedule 12A Local Government Act 1972 (as amended)

## **For Decision**

### **Briefholder**

Cllr Jeff Cant

### **Senior Leadership Team Contact:**

M Hamilton, Strategic Director

### **Report Author:**

M Hamilton,

### **Statutory Authority**

### **Purpose of Report**

- 1 This report forms part of a suite of reports through which Management Committee has been addressing the regeneration of Weymouth. The report develops the current hotel management policy to enable a greater recognition of the contribution of the hotel portfolio to the local economy. The report enables Management Committee to authorise action to improve the diversity and quality of the borough's hotel stock, and to facilitate investment in the Council's hotel stock which will be crucial to improving the tourist accommodation offer, increasing the proportion of visitors who stay overnight, and to increasing the spending profile of tourists attracted to the town.

### **Recommendations**

- 2 (a) To authorise officers to negotiate the surrender of existing hotel leases drafted on internal repairing terms and the grant of new Full Repairing and Insuring replacement leases of sufficient duration to enable private sector investment in the individual businesses, underpinned by robust individual business plans;
- (b) To delegate to the Strategic Director, in consultation with the Briefholder for Assets and Finance and the Section 151 Officer, to review the Council's hotels and to instigate appropriate action to diversify and

improve the overall tourist accommodation offer in the borough, including taking back leases and/or changing use where appropriate, undertaking or enabling capital investment, re-letting or disposal;

(c) To otherwise retain the current hotel policy in respect of the remaining hotels subject to amendments listed at paragraph 14 below

(d) To permit flexible use of existing budgets to achieve accommodation stock improvements.

## **Reason for Decision**

- 3 To encourage and facilitate investment in the development of the town's tourist accommodation offer.

To provide an improved tourist accommodation offer in the borough and improve the quality of the Council's hotel portfolio.

To reduce maintenance and management liabilities.

## **Background and Reason Decision Needed**

- 4 The Council own 60 hotels in Weymouth which are leased on a variety of terms as set out below:

- 8 are held on 125 year leases at peppercorn rents; with full repairing and insuring terms;
- 35 are held on full repairing leases, of which for a number the Council is responsible for external decorations with ability to recharge;
- 9 are on up to 60 year internal repairing leases, where the Council retain responsibility for external maintenance.
- 8 are on 10 year internal repairing leases, where the Council retain responsibility for external maintenance.

- 5 The hotels are all in Grade 2 Listed buildings and across this portfolio there is a range of building condition. The listing of the buildings presents specific challenges regarding maintenance and refurbishment costs which are a significant consideration in the management of the stock. The hotel stock needs to be considered in at least four contexts:

- Economic impact – as a leisure destination and holiday resort, the provision of a quality and diverse accommodation offer plays an important role in the economy of the town as a whole.
- Business Vitality - the majority of the Council owned hotels are operated as small businesses, the success of which is important to the operators, the local economy, and the Council;

- Financial – The Council secures a revenue income from its hotel stock which forms a core part of the annual revenue budget. The total gross income from hotel leases was in 2016/2017 £1,062,660 with the net income of £645,000 after management costs.
- Built Environment – the Grade 2 Listed hotels are important in defining the physical appearance of the town centre and sea front.

6 This report seeks to establish an approach to managing the hotel stock which will see the Council retain and increase net revenue, and will to improve the diversity and quality of the tourist accommodation offer. The approach also seeks to encourage investment that will improve the economic outcome for the hoteliers and the Council alike by increasing room rates and occupancy levels.

### **Economic Impact**

7 To inform the implementation of the Town Centre Master Plan the Dorset LEP funded a number of studies including a review of the borough's tourism product offer, which was undertaken by Blue Sail. The consultants engaged with a range of businesses and stakeholders, reviewed market intelligence and undertook a detailed look at existing tourist accommodation. Blue Sail also engaged with hotel companies to explore investment potential. The study makes a number of observations which should inform the Council's approach to managing its hotel stock:

- Whilst employment in the hospitality and leisure sectors has grown in many seaside resorts in England (in the 5 years to 2014), in Weymouth it has declined. Weymouth is under performing relative to its peers, despite its natural assets.
- Tourism growth in Weymouth is constrained by the need for more accommodation stock, and the need for some of the existing stock to be improved.
- Although there are examples of good practice, the overall presentation of much of the hotel and guest house stock is dated. Elements of the Council owned hotels and guest houses are in the low rated coach holiday market or low value leisure break market. Operators are struggling to make the investments needed to attract higher spending visitors.
- In terms of tourist accommodation, Blue Sail recommend:
  - Upgrade hotels and guest houses, including repositioning some as boutique hotels and B&Bs
  - New branded budget and limited service hotels, and possibly a 3 or 4 star hotel on the Peninsula site
  - Enable the acquisition of sea front hotel by coach holiday companies
  - Development of luxury holiday apartments, including through the conversion of some hotels and guest houses.

8 Whilst the development of hotel accommodation on the peninsula is being progressed, the other recommendations will require the Council taking a

different approach to the management of its hotel stock in order to make progress as explored later in this report.

- 9 Blue Sail observed that some of the local hotel operators are struggling to make investments required to upgrade their offer. Officers are acutely aware from discussions with hotel operators that the viability of some of the businesses is fragile.
- 10 At any point there will be a number of the hotel businesses being marketed for sale, where tenants are seeking to transfer their leases to a new operator in exchange for a substantial capital payment for “the business” often without regard to current lease liabilities and the capital required to make further investment to sustain and enhance those businesses.
- 11 In discussion with lease holders and their agents it is apparent that there are aspects of some of the leases which militate against business success, with lease term being prime amongst these, with banks being reluctant to lend to businesses if the lease is of insufficient length. Lack of security by virtue of the businesses being leasehold is also an issue.

### **Financial Issues**

- 12 The Council’s hotel stock generates an important revenue stream for the Council.
- 13 The Council derives the majority of its gross income (currently of £1,062,660 pa) from letting 52 hotels on commercial leases but much of its costs appertain to the management of just 17 hotels where it retains maintenance responsibilities. After management and maintenance costs the net income is around £645,000 on average but has varied dependant on actual levels of planned maintenance expenditure year on year. A provisional projected planned maintenance spend for the hotels over the next 10 years is assessed at £2.26 million and this compares with a current base budget of £1.55 million albeit that much of this expenditure falls towards the end of this period. The above figures also reflect a current budget of £18,115 for response maintenance and excludes depreciation.

### **Proposed changes to current Hotel Policy**

- 14 The Council’s existing Hotels Policy is framed almost exclusively from an asset management perspective, and does not address economic development opportunities. In terms of lease options, the policy identifies the following parameters and should be amended to state the following:
  - To retain the freehold interest in the portfolio of hotels and guesthouses currently owned by the Council;
  - To encourage tenants to convert from internal repairing leases to full repairing leases and to adopt the conversion of all leases to full repairing terms as a strategic objective;
  - To permit the grant of three alternative types of future lease

a) 125 year leases - to no longer grant 125 year leases in return for a premium and at less than market rent except in exceptional circumstances where the benefit to the Borough outweighs the retention of the income;

b) To grant leases of between 25 and 60 years on equivalent full repairing (including external painting) and insuring terms at market rents.

In parallel existing tenants could now be offered an opportunity to vary their leases to allow them to insure their premises directly. A series of changes would be required to be documented in a Deed of Variation. The principle requirements would include covenants changes to insure, to supply copies of all new or altered insurance policies, to note the Council's interest on each policy, to expending all insurance monies on reinstatement and failing that to hand over all insurance monies to the Council.

c) Renewal of existing internal repairing leases only in accordance with statutory rights albeit that the Council will seek full repairing leases on the grounds of good estate management having regard to the fact that 67% of the existing commercial leases have already taken full repairing terms on renewal.

- 15 From discussions with representatives of the hotel trade in the town, it is clear that leases of up to 60 years are generally required if the business is to be able to borrow funds to invest.

### **Opportunities**

- 16 If the Council is to facilitate an increase in the number, quality, and diversity of tourist accommodation in Weymouth, it will need to manage its existing hotel stock in a new way. To date, the hotel stock has been managed very much from a "property" perspective, with a focus on maximising revenue return. Whilst this approach is hugely important, we also need to recognise the role of the hotel stock in driving the local tourism economy. At times it will be necessary to take decisions regarding the stock which are more about driving economic development than driving revenue return.
- 17 Through the work undertaken to progress the development of the Peninsula it is clear that there is strong interest from the major hotel chains in investing in Weymouth. As the work on the Peninsula progresses, so it is timely to take steps to drive up the quality and diversity of the hotel offer elsewhere in the town. This will serve to maximise the additionality of the Peninsula development, rather than see it displace trade from the traditional guest houses and smaller hotels.
- 18 The Council has a number of strategies at its disposal through which it might secure improvement in holiday accommodation stock, improvement in business sustainability, and maintenance or improvement in asset performance. This needs to focus on the 17 units which are currently

undermining overall asset performance, albeit opportunities in other units should not be discounted.

19 Opportunities include:

- Renegotiating lease terms with existing lease holders where there is a clear business plan for investment and improvement. Such renegotiations would include lease durations necessary for investment and direct control of all maintenance by businesses (to a prescribed standard to protect the listed assets), with leases of up to 60 year full repairing leases becoming the norm. In order to meet the aim of improving the overall offer, it is considered essential that such renegotiations be dependent on robust plans for improvement and investment
- Where there is a clear business case, to acquire and invest in hotels with a view to securing a higher return for a better quality product, or disposal of selected hotels on long leasehold or freehold basis for residential or business uses to release capital receipt for ring fenced reinvestment in other stock. This will be of particular relevance in those small hotels with the most limited of existing facilities such as en-suites.
- Where there is a clear business case, redeveloping a number of hotels as high quality holiday apartments as a new element of the Council's tourist accommodation stock.

20 There are a number of sites which might be considered for early action in the context of the above:

21 7 hotels are at or near the end of their internal repairing leases. Officers are already commissioning terminal schedules of dilapidation to identify outstanding tenant liabilities as well as updating external condition surveys to ensure future liabilities are properly assessed. Officers are also assessing, in consultation with tenants, the opportunities to improve the existing accommodation. This enables effective investment management and several examples are cited from current investigations in the attached confidential appendix where options to progress opportunities are identified and recommendations as to the way forward in these cases are included.

22 Several other hotels have approached the Council with a view to extending existing leases and seeking consents for assignment. These are opportunities to again engage with tenants to address current liabilities and to identify improvement opportunities. A similar process is adopted here with officers providing standard requirements issued to those seeking lease assignment consents.

23 Implementing many of these proposals will enable tenants to assign their leases without overburdening new tenants by making sound provision for proposals to address liabilities and improve accommodation or bring forward opportunities for the Council or tenants to promote change of use plans in a structured and properly financed manner. The outcome for the Council will often be increases in net revenue, reductions in landlord and tenant maintenance liabilities and improvements in the accommodation offer. It will also generate capital to address existing liabilities or support investment in new accommodation offers.

## **Supporting Investment**

- 24 Recently there have been reported underspends on maintenance year on year. This results from a combination of issues including tenants resisting requests for scheduled works to their property to limited time windows and from changing circumstances when work has been scheduled such as tenant moves and renegotiated tenant leases transferring obligations onto tenants. In many instances tenants would prefer in particular to organise their external decoration directly. This is being addressed because the current Hotel Policy already permits tenants to vary their leases to address these issues but often the request to do so only arises when decorating years fall due.
- 25 Officers are actively encouraging tenants to take on external repairing decorative liabilities and to make the requisite lease changes because the Council believes that both parties benefit and the decorative standards will be maintained. It is evident that resource directed towards achieving this and the other policy recommendations in this report is likely to reduce the workload for maintenance in future. However, budgets will need to be retained for a few years while these transitions are funded and staff are required to deliver them.
- 26 Officers consider deployment of existing budgets to address the above recommendations is an option alongside ring fencing of some capital receipts to enable further investment and this will both support tenant improvements to accommodation as well as provision of new accommodation.

## **Other Considerations**

- 27 The financial model for implementing these strategies will vary from strategy to strategy and will need to be assessed on a case by case basis. For example, in determining whether to dispose of a particular hotel, it will be necessary to balance likely capital receipt against lost revenue stream and ongoing maintenance liabilities. Any disposals will therefore require a clear business case approved by the Strategic Director and the Section 151 Officer;
- 28 Sensitive engagement with existing leaseholders will be required to secure their support for both the overall strategy and for individual changes;
- 29 In disposing of selected stock, conditions will need to be applied to ensure that quality provision results, and that we do not see the introduction of houses in multiple occupations or other undesirable outcomes.

## **Implications**

### **Corporate Plan**

- A1. Facilitating inward investment to create more better-paid jobs
- A3. Supporting businesses through the recession and recovery
- A4. Regenerating and supporting vibrant town centres

- B3. Facilitating sustainable leisure, culture and community activities
- C2. Protecting and enhancing the built and natural environment
- D2. Adapting service delivery to the changed financial environment

## **Financial**

The Council will over time reduce its future maintenance liabilities, secure increased net revenues and reduce its management costs. Lease conversions and surrenders may require financial incentives such as rent free periods and accelerated revenue spend to bring forward some identified repairs.

## **Equalities**

None directly arising from this report.

## **Environmental**

None directly arising from this report.

## **Economic Development**

The Council will over time improve the range and quality of holiday accommodation in the Borough with concomitant benefit for all.

## **Risk Management (including Health & Safety)**

All individual improvement and development proposals will be subject to provision of robust Business Plans and will require approval by the Strategic Director and the Section 151 Officer;

## **Human Resources**

None directly arising from this report. Continued staff resourcing is required in Estates, Buildings and Facilities and Legal Teams to resource these proposals. Although this may not in itself require additional resources a view has been taken already to additionally resource the property team to address this alongside other workplan and project requirements but there may be implications for Legal resourcing too.

## **Consultation and Engagement**

None directly arising from this report.

## **Appendices**

Example scenarios of opportunities to improve the Weymouth Hotel and Guest House offer and the Council's management



## **Footnote**

Issues relating to financial, environmental, economic and equalities implications have been considered and any information relevant to the decision is included within the report.

**Report Author:** Martin Hamilton, Strategic Director

**Telephone:** 01305 252315

**Email:** [mhamilton@dorset.gov.uk](mailto:mhamilton@dorset.gov.uk)