

Cabinet

13 July 2016

Salvus House: Durham City Incubator



Report of Corporate Management Team

Ian Thompson, Corporate Director of Regeneration and Economic Development

Councillor Neil Foster, Cabinet Portfolio Holder for Economic Regeneration

Introduction

1. The purpose of this report is to agree the purchase of Salvus House by the Council. There is an opportunity to progress the sale as a matter of urgency, in order to ensure potential tenants are not lost to the area. The report includes an update on progress to establish the Durham City Incubator for entrepreneurs.
2. Purchasing Salvus House by the Council would support the creation or safeguarding of up to 200 direct jobs and up to 500 indirect jobs in a new and emerging sector for Durham and would provide a clear demonstration of the Council's commitment to the successful economic development of the wider Aykley Heads strategic employment site. The longer the building remains empty then the greater the risk that key growing businesses in the area will relocate elsewhere.

Background

3. Salvus House is located at Aykley Heads in Durham City and was previously the purpose-built HQ for Sunderland Marine Insurance Company who vacated the building in April 2015. Built in 2005 and split over four floors, plus a mezzanine, the building provides a gross area of 32,500 sq. ft. of high quality office space within a 1.9 acre site with 100 car parking spaces.
4. Negotiations to purchase Salvus House have been ongoing since the summer of 2015 with a view to sub-letting to local professional service businesses whilst at the same time investigating the potential to establish within the building the Durham City Incubator (DCI), in a partnership already established between DCC, New College Durham and Durham University. At this stage, agreed funding included a £500,000 capital contribution and a 5% self-financing loan of £3.418m.

5. Protracted negotiations have been undertaken and agreement has been reached to acquire the building for £3.0m which is a substantial reduction from the owner's initial valuation of £6.0m.
6. The option to develop the Durham City Incubator (DCI) within Salvus House, in a partnership between the Council, New College Durham and Durham University, has now reached the stage whereby a business model has been agreed and an outline submission for ERDF towards the revenue costs of the Incubator is due to be submitted in September 2016.
7. The growing success of the Rivergreen Centre and the wider Aykley Heads area has already attracted the accounting firm Mazars, the NHS and Atom Bank. In particular, since Atom's announcement to locate in Durham City, there have been a number of interested parties who have enquired about co-locating at Aykley Heads. These companies include a crowd financing company, a marketing firm, a consultancy firm and an enterprise software company.
8. The provision of additional office space at Salvus House would complement the proposed activities on the wider Aykley Heads strategic employment site by helping develop future demand for larger scale operators coming to the area, as well as supporting companies coming out of the incubation space that also wish to grow in the area. These businesses, and those coming out of NETPark Net, would further strengthen the local economy.
9. Salvus House has four floors including a lower ground. The proposed Durham City Incubator, in partnership with DU and NCD would be located in the lower ground and possibly the first floor. The reconfiguration and refurbishment of this space to form the Durham City Incubator would be completed by June 2017. Each of the three main floors lend themselves to being let floor by floor or split into two wings and would likely accommodate between four to six businesses, (depending on incubator size) with one wing including a Business Durham operated collaborative working suite. This space would be immediately available to prospective tenants who it is anticipated would need on average three to six months fitting out time. The table below summarises the main types of office enquiries received in the last six months that would be suitable for Salvus House:

Company Type	Size required (sq. ft.)	Jobs
Banking	4000	40-45
Recruitment	5000	50
EYPS	250	2-3
Finance	3000	25
Health	2500	25-30
General Office	1500	13

10. The total cost of the project is now £3,394,000 and could be funded from a self-financing loan from DCC over 25 years at 4%. The finances for the project can be summarised as follows:

Capital

Salvus House	
Purchase Price	£3,000,000
Stamp duty	£144,000
Renovation costs	£250,000
Capital Costs	£3,394,000
DCC Loan	£3,394,000
Total Funding	£3,394,000

Revenue

	Yr1	Yr2	Yr3	Yr4
Occupancy	36%	56%	71%	85%
Finance Charge	0	217,257	217,257	217,257
Other operating costs	228,450	297,200	366,700	389,700
Total Expenditure	228,450	514,457	583,957	606,957
Total Income	(255,541)	(401,578)	(511,117)	(608,494)
Deficit/(Surplus)	(27,091)	112,879	72,840	(1,537)
Accumulated Deficit (Surplus)	(27,091)	85,788	158,628	157,091

11. The revenue funding table shows a maximum accumulated deficit that peaks in year three at £158,628. This deficit arises due to time required to gradually build up occupancy levels. Once occupied by year 4, the income and expenditure is self-financing.
12. The current operational model for Salvus House includes using 15% of the net lettable floor-space for the Durham City Incubator. This requires higher rents to be charged in the rest of the building in order to cross subsidise the incubation space and provide a more affordable option for young, new businesses.
13. The NELEP has indicated that it would consider providing grant support of circa £1million towards the DCI if there was an opportunity to increase the amount of incubation space within Salvus House. As a result, an expression of interest has been submitted to the NELEP that would see some 35% of the total building being used for incubation space. The support from the NELEP would predominantly cover the additional capital costs of providing the incubation space with further financial modelling needed to assess the impact of reduced rent from the incubation space on the current self- financing model. In particular, the NELEP would need to consider the current internal rate of return which is in excess of other projects being considered from across the LEP area.

14. The NELEP funding would only be secured later in 2016 and given the time pressures linked to securing Salvus House, there is a need for the Council to proceed with the purchase at risk. As a result, the final funding package for the project is likely to be subject to change.

Conclusion

15. The Council already has extensive experience in successfully managing modern, high quality business space at sites such as NETPark in Sedgefield and other sites such as Viewpoint in Consett. Creating the Durham City Incubator would build on this experience and enable a unique collaboration between Durham University, New College Durham and Business Durham to incubate young entrepreneurial driven businesses in Durham City, at Aykley Heads. This will further the development of the strategic employment site and aid the establishment of a service technology cluster.
16. The financial model for the project would suggest a revenue break-even point after 4 years based on the occupancy scenarios but with an accumulated revenue deficit to RED in the same period.

Recommendation

17. It is recommended that Cabinet:
 1. Confirms the purchase of Salvus House in advance of securing NELEP grant contribution; and
 2. Approves the funding package.

Contact: Simon Goon, Managing Director, Business Durham
Tel. 03000 265510
Gerard Darby, Asset Services Manager Tel. 03000 267024

Appendix 1: Implications

Finance -

The revenue implications of the commercial arrangement would be built into the medium term financial plan. The revised position indicates a self-financing arrangement could be achieved by Year 4 with short term financial support required up to that point whilst occupancy levels are reached.

Staffing -

There would be a requirement to recruit 2 additional staff with costs covered from the rent and as part of the service charge.

Risk -

The ability to generate a budget surplus is subject to a number of external factors, including the economic performance of businesses in the County and the impact on the demand for commercial properties. To mitigate this risk, Business Durham continues to improve its marketing and promotion of the business properties.

Equality and Diversity / Public Sector Equality Duty -

There are no implications.

Accommodation -

There are no implications.

Crime and Disorder -

There are no implications.

Human Rights -

There are no implications.

Consultation -

Close liaison is maintained with all the business tenants.

Procurement -

There are no implications as this is an acquisition by the Council.

Disability Issues -

There are no implications.

Legal Implications -

There are no implications