



Derby City Council

**COUNCIL CABINET**  
**16 March 2016**

Report of the Cabinet Member for Communities  
and City Centre Regeneration

# ITEM 12

## Innovation Hub Management and Operation

### SUMMARY

- 1.1 This report summarises the progress in establishing a new innovation centre that seeks to support the development and growth of transport engineering businesses – the iHub. This is the first building constructed within the city's new commercial and technology park – Infinity Park Derby.
- 1.2 Due to an initial tender exercise that was unsuccessful in attracting a facilities management provider, this report seeks approval for the facilities management of the iHub to be provided in-house by the Connect Derby Team. This would require a revenue budget of up to £131,000 in 2016/17, dependent on the factors outlined in the report.

### RECOMMENDATION

- 2.1 To note the contents of the report, particularly regarding the assumptions underpinning the cash flow forecast and associated benefits and risks for the Council.
- 2.2 To approve the management and operation of the iHub by the Connect Derby team, overseen by the iHub Board, subject to DCLG approval.
- 2.3 To approve the creation of a Council revenue budget of up to £131,000 from the Budget Risk Reserve that enables the successful operation and management of the iHub in 2016/17.
- 2.4 To request that further report(s) be periodically submitted to Cabinet, showing progress against the cash flow forecast.

### REASONS FOR RECOMMENDATION

- 3.1 The commercial market is not willing to take on the operation and management of the iHub under the terms proposed by the Council.
- 3.2 For the Council to manage and operate the building it will require the creation of a

revenue budget to cover initial deficits until the iHub breaks even.

- 3.3 The building is new and forecasting running costs accurately is extremely difficult. It is proposed that officers will bring a report to Cabinet later this year once the building's systems have been in operation for a while.

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**Report of the Strategic Director for Communities and Place**

**SUPPORTING INFORMATION**

- 4.1 The creation of a £11.8m purpose built innovation centre to help nurture the development and growth of transport engineering businesses was one of the key projects within the £40m Regional Growth Fund (RGF) awarded to Derby. This innovation centre, named the iHub, was designed and procured through a design competition. The centre comprises 45,000 sqft. Including 18 offices (ranging from 127 sqft. to 1,000 sqft.), 14 workshops (from 400 sqft. to over 4,000 sqft.), a large seminar and conference space, and five meeting rooms. Two of the workshops have been fitted with specialist equipment allowing the rapid proto-typing of products under technician supervision. The building will be home to Enscite, a partnership between the City Council and Universities to offer bespoke business support functions in transport engineering sectors.
- 4.2 The project is overseen by a Board chaired by the Finance Director at University of Derby, with members drawn from the City Council, University of Derby and Aston University. The building is owned by the City Council.
- 4.3 The construction of the building commenced in October 2014 and was largely complete by last October – within the programme and construction budget. The building has been designed and completed to a very high standard and offers state of the art facilities to allow it to act as a flagship development within Infinity Park Derby. Over the last 4-5 months the fit-out of the building has been undertaken whilst the utilities connections have been finalised.
- 4.4 Funding of the iHub and the first phase of Enscite comprised RGF (£6.7m), European Regional Development Fund (£5m), University of Derby (£1m) and the City Council's Capital Programme (£1.4m). State Aid regulations require the Council to derive no direct net benefit from the construction and operation of the building. Claw back mechanisms will prevail for a period of 15 years.
- 4.5 The Council intended to establish a contract with an external facilities management organisation that would, if successful, have ensured that these claw back provisions could be avoided. It was proposed that the organisation managing and operating the iHub would have taken exclusive responsibility for collecting rents and other income and paying all the bills. Unfortunately the tender process resulted in the receipt of no tenders.

- 4.6 Officers have given careful consideration to the direct operation and management of the building and recommend that the building should be managed through the Connect Derby workspace management team. This will enable all the systems and procedures, agreement of lettings (supported by the Legal Services team) as well as the marketing (supported by BHPR) and commercial estate agency (supported by Russell Rigby & Co), to be implemented at the iHub. Connect Derby are already providing a basic interim support to the building and this will continue until staff recruitment and a restructuring exercise has taken place.
- 4.7 It is proposed that the Connect Derby team would work closely beside the Enscite team thus offering a broad spectrum of services to tenants and SMEs. This would include the operation of two workshops for rapid proto-typing and virtual reality design services – known as "FabLabs".
- 4.8 At the time of writing two tenants have agreed terms and a further 4-5 are in advanced negotiations. It is considered probable that by April over 60% of the offices and 10% of the workshops will be occupied. A draft Marketing and Communications Strategy has been prepared and its implementation will commence in March to stimulate wider recognition of the unique mix of facilities, services and partnerships that the iHub offers. It is likely, for instance, that the building will become an important new venue for meetings, seminars and events that will greatly complement the existing offer in Derby.
- 4.9 A cash-flow forecast that models all currently foreseeable sources of income and expenditure estimates that in 2016/17 there will be a deficit, based on current occupancy forecasts and existing obligations. This deficit will in part be met by a one-off contribution from the Regional Growth Fund. It is proposed that the remaining deficit of up to £131,000 is funded from the Councils Budget Risk Reserve for 2016/17.
- 4.10 The aim is that in the medium to long term, the iHub will be able to operate on a commercially-viable basis. Depending on the terms of a loan facility being adjusted, it is estimated that it could take up to three years to break even, with a reducing level of subsidy required in each of the preceding years pending the break-even point being reached. We will be working closely with the partners on the iHub project board to maximise the success of the project and minimise the level of subsidy required.
- 4.11 Clearly, with any new building of this nature, estimating items of expenditure and forecasting rental and other income is difficult. The utility and business rates alone are forecast to account for around one quarter of all expenditure. Only after the building has operated for 9-12 months or so will there be more certainty about the true energy costs. Only when the Valuation Office Agency has set the rental valuations will the NNDR for voids and communal spaces be known. Other risk factors affecting income and expenditure are set out in para. 4.14.

- 4.12 Beyond the commencement of the operation of the building, there are also plans being devised to realise additional income. These include the establishment of an on-site cafe facility, the enhancement of car-parking spaces (both on-site and off-site) and the marketing of the neighbouring 6.6 acres of land for complementary R&D uses. The Council has a Marketing Services Agreement with the adjoining land owner that would attract future capital receipts to the Council as plots are sold or leased. These payments would in effect, recover a proportion of the cost of "enabling works" – for instance the construction of access roads and services infrastructure, utilities and drainage etc.
- 4.13 The benefits to the city and to the City Council of this new innovation centre are summarised as follows:
- Attraction of new businesses to Derby
  - Support for the strategically significant engineering supply chain
  - Creation of additional jobs
  - Enhancing the growth prospects of many existing and new businesses
  - Additional business rate income (estimated to be circa £110-130,000 p.a.)
  - Creation of an asset worth multi-million pounds (say £4.8m to £6.3m at 2016 prices by year four)
  - Stimulation of development at IPD
  - Positive press and publicity (the building is already being considered for a local & regional awards).

4.14 The risks to the Council and associated mitigation measures are:

- The Government are not willing to let the Council manage and operate the iHub at risk of breaking State Aid regulations – officers from DCLG have responded on 3 March stating, *“The Council have conducted an OJEU-compliant process and no tenders were received. This is covered by regulation 32 of the Procurement Regulations which allows for a negotiated procedure to take place which covers the Council awarding the “contract” to itself. The proposed “wash through” argument is valid as long as the Council monitors profit carefully and re-invests it to cover future works to ensure there is no aid. There also appears to be “market failure” for people managing this type of project which has been evidenced by the failure to receive tenders.”* Furthermore, officers have been requested to submit a Single Tender Justification document and a verbal update will be provided to the Cabinet meeting if DCLG have responded since receiving this.
- The number of tenants thought to be interested in occupying the building is not realised if terms of occupation cannot be agreed with some of these – the implementation of a Marketing & Communications Strategy should alert many potential tenants to the prospect of moving to the iHub.
- Utilities bills are higher than anticipated – every effort has been made to benchmark the utilities costs against comparable properties, including other Connect Derby managed workspace. If utility costs prove higher than future service charges for incoming tenants may have to be raised or other discretionary expenditure reduced.
- Business rates costs to the Council, for voids and communal spaces, is higher than forecast – early contact with the VOA is to be made as soon as the building transfers to the Council's ownership.
- Repayment of the loan facility is requested without providing a holiday period – discussions with the lender have been held and the status of these will be verbally reported to the Cabinet.
- Future surplus is not generated in sufficient quantity to accrue a fund allowing re-investment back into the fabric and equipment within the building (i.e. a "sinking fund").
- Claw back provisions are triggered and the Council is forced to repay a sum of money to HMG or the EU – any surpluses generated from the operation of the building within the first 15 years of operation must not be transferred into any general revenue account of the Council to avoid this risk.

<b>OTHER OPTIONS CONSIDERED</b>
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- 5.1 Officers considered re-tendering the facilities management service but this was felt to be unlikely to result in a positive outcome unless the Council was willing to take a share of the risks and to potentially offer an income guarantee. This option would also take around 4-6 months to follow an EU-compliant open tender process.

- 5.2 The second alternative option available to the Council is to place the iHub on the market for sale as an innovation centre. This would require any future owner to become responsible for the output targets – most notably to secure 131 new jobs and attract 17 new businesses to Derby. Any sale would also trigger a capital payment to the land-owner under the term of the lease with them. The iHub must assist the development and growth of Infinity Park Derby. Without the Council remaining in ownership of the building this outcome is less likely to be achieved. This option is therefore not recommended.

**This report has been approved by the following officers:**

<b>Legal officer</b> <b>Financial officer</b> <b>Human Resources officer</b> <b>Estates/Asset Management officer</b> <b>Property Maintenance officer</b>	Emily Feenan Amanda Fletcher  John Sadler
<b>For more information contact:</b> <b>Background papers:</b> <b>List of appendices:</b>	Alan Smith 01332 641624 alan.smith@derby.gov.uk None Appendix 1 – Implications

<b>IMPLICATIONS</b>
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**Financial and Value for Money**

- 1.1 The operation and management of the iHub has been very carefully considered. All measures to maximise income and minimise expenditure have been adopted. The forecast cash-flow has been benchmarked against other workspace facilities. It is believed that the Council will need to subsidise the first full year of operation of the building by up to £131,000 from the budget risk reserve. This is believed to be an achievable target – helping the Council to realise a number of important benefits as set out in para. 4.13 above.

**Legal**

- 2.1 State Aid – a key consideration from a legal perspective is the compatibility of the proposal with European Union (“EU”) state aid law. On 18 August 2013, Jason Coppel QC, provided Counsel’s advice on the compatibility with state aid law of proposals for the construction, development and operation of the iHub. Although Counsel’s advice focused on the compatibility of the Council’s original proposal to procure a FM company to manage the iHub with state aid law, consideration was also given to the possibility that the Council would ultimately end up operating the Centre.
- 2.2 Counsel considered that the most pertinent guidance in determining whether the iHub proposals are compatible with state aid law could be found in the decision of the European Commission known as the “German Incubator decision”, which considered a scheme broadly similar to the Council’s proposals for the iHub. The European Commission determined that provided the developer of the incubator hub (being analogous to the Council in the case of the iHub) and the manager of the incubator hub acted as conduits for aid to be passed to SME tenants and did not retain any advantage from the aid, then the arrangement would be compatible with state aid law.
- 2.3 Whilst the appointment of an third party FM company to operate and manage the iHub through a competitive tender process and on the basis that the company charges a market rate for its services, would arguably make it easier to demonstrate that the operator is acting as a mere conduit for aid, there is no state aid law reason preventing the Council from preforming the operator role. Furthermore, having undertaken a competitive tender process and not receiving any tender responses, the Council has demonstrated that as a result of market failure the only viable solution for the operation and management of the iHub (at least in the short-term) is through in-house Council operation, with initial revenue support.



- 2.4 In his August 2013 advice, Counsel stated that in the event that the Council did end up operating the Centre itself it would need to take steps to ensure that it does not, in the long term retain profits from doing so, in order to retain its own status as a mere conduit of aid to the users of the iHub. If the Council does retain the net profits of operating the iHub, then claw-back may become due to DCLG. At the point at which profits are generated by the iHub it is proposed that this surplus is accrued into a fund exclusively for re-investment back into the building and so back into supporting users of the iHub.
- 2.5 Occupancy Arrangements - The Council's legal services team will work closely with the Connect Derby team to agree the terms of tenancy arrangements.

## **Personnel**

- 3.1 The Connect Derby team has expanded from managing just one facility, Friar Gate Studios, to 6 additional facilities, including the Marble Hall. With the addition of the iHub, Connect Derby will manage a total of 7 business centres of a very diverse nature. In order to ensure the service retains the management resilience to operate successfully, the service will undergo a restructuring exercise involving the creation of an Assistant Centre Manager and other staff. Preparations are in place so that the recruitment and re-structuring will commence immediately following the Cabinet decision.
- 3.2 The Connect Derby team are currently providing an interim service in advance of the building being tenanted and fully operational. This service will be extended temporarily until such time as the recruitment of additional staff is in place. Note the interim service involves the utilisation of temporary overtime to existing staff together with support from temporary agency/ contract staff.

## **IT**

- 4.1 There are no IT implications arising from this report.

## **Equalities Impact**

- 5.1 The building provides a safe access to all, with level thresholds throughout, disabled parking bays, split height reception desk and a lift to service all floors. There is a provision for both accessible toilets and ambulant disabled toilets with an integral alarm system linked to reception. In addition there is the provision of disabled refuges with a fireman's intercoms on the stair landing to provide a safe haven in the event of an emergency.

## **Health and Safety**

- 6.1 The building complies with the requirement The management of the iHub by an experienced team (Connect Derby) complemented by the off-site support from procured contractors for the mechanical and electrical and compliance systems should ensure H&S considerations are all addressed. There is provision in future years for eventual surpluses to be accrued for re-investment exclusively back into

the building so that it remains safe and fit for purpose.

## **Environmental Sustainability**

- 7.1 The building is designed to meet Building Research Establishment BREEAM "Excellent". The building incorporates a range of features to achieve a 46% reduction in Co2 emissions such as: 360 sqm. of photovoltaics; quality glazing; energy efficient boilers; LED lighting; natural rather than mechanical ventilation systems; electric car charging points etc. The centre will provide cycle shelters and cyclist changing and storage facilities. It is hoped that a local bus service will create a new route that runs past the building. There are several footways leading from the building into Infinity Park, the nearby communities and to connect to the Rolls-Royce aerospace campus to ensure connectivity for pedestrians.

## **Property and Asset Management**

- 8.1 The cost of undertaking all future reactive and planned maintenance of the building has been incorporated in the Centre's business plan and projected future budgets. Consequently there is no provision currently within the Council's building maintenance budget to meet the costs of any repair to the Centre. If the Centre is unable to break even after 2016/17 there will be an increased revenue pressure on the Council to meet the cost of future building maintenance and plant and equipment renewal.
- 8.2 A comprehensive Risk Log has been maintained throughout the construction of the building. Detailed Operation and Maintenance Manuals have been prepared and passed to the Council to ensure complete familiarity with the building fabric and mechanical and electrical systems.

## **Risk Management**

- 9.1 The risks to the Council and associated mitigation measures are:
- The Government are not willing to let the Council manage and operate the iHub at risk of breaking State Aid regulations – it is hoped that officers from DCLG will have confirmed the Government's position about this project in time for a verbal update to be provided to the Cabinet meeting.
  - The number of tenants thought to be interested in occupying the building is not realised if terms of occupation cannot be agreed with some of these – the implementation of a Marketing & Communications Strategy should alert many potential tenants to the prospect of moving to the iHub.
  - Utilities bills are higher than anticipated – every effort has been made to benchmark the utilities costs against comparable properties, including other Connect Derby managed workspace. If utility costs prove higher than future service charges for incoming tenants may have to be raised or other discretionary expenditure reduced.
  - Lender to the City Council requires annual repayment of the loan without providing a holiday period – discussions with lender should have concluded

before your meeting and will be verbally reported.

- Business rates costs to the Council, for voids and communal spaces, is higher than forecast – early contact with the VOA is to be made as soon as the building transfers to the Council's ownership.
- Future surplus is not generated in sufficient quantity to accrue a fund allowing re-investment back into the fabric and equipment with the building (i.e. a "sinking fund").
- Claw back provisions are triggered and the Council is forced to repay a sum of money to HMG or the EU – any surpluses generated from the operation of the building must not be transferred into any general revenue account of the Council to avoid this risk.

### **Corporate objectives and priorities for change**

10.1 The project aligns with the following priorities from the Council Plan:

- Enabling individuals and communities
- Raising achievement and skills
- Improving housing, supporting job creation and regenerating the city
- Being more commercial

It does so by creating a unique offer in the city which will help to support individuals and businesses to innovate, collaborate and succeed.

10.2 The project is an important component of the 2011-16 Derby Economic Strategy. The strategy seeks to build on the strength of the city's manufacturing and engineering heritage by creating a culture where enterprise thrives. This project will help to achieve one of the aims of the strategy to maintain Derby's role as a national leader in the advanced manufacturing sector.