SHORT TERM JESSICA CONSULTANCY STUDY FINAL REPORT

JESSICA EVALUATION STUDY FOR THE NORTH WEST REGION

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Note to Reader: Certain commercially sensitive data has been removed from this report

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FOREWORD AND GLOSSARY

Foreword

This report has been drafted in order to be read as easily as possible by stakeholders without specialist knowledge of 'financial engineering products'.

However this study investigates complex, specialist areas of property and finance and therefore, although every effort has been made to make the findings as accessible as possible to a wide range of readers, the report does rely on a prior knowledge of regeneration finance in certain areas.

Glossary

CIL – Community Infrastructure Levy

DCLG – Department for Communities and Local Government

EC – European Commission

ECF – English Cities Fund

EP – English Partnerships

ERDF – European Regional Development Fund

HCA – Homes & Communities Agency

HF – Holding Fund

IRR – Internal Rate of Return

JESSICA – Joint European Support for Sustainable Investment in City Areas

LABV – Local Asset Backed Vehicle

NWDA – North West Development Agency

NWOP – North West Operational Programme

PPP – Public Private Partnership

PLP – Project Level Partner

PSP – Private Sector Partner

TIF – Tax Increment Finance

UDF – Urban Development Fund

EXECUTIVE SUMMARY

Introduction

With the 2007-13 ERDF programme likely to be the last of its kind in the UK the NWDA and regional partners wish to explore the options for deriving longer lasting benefits from EU funding for future investments. Accordingly the NWDA has expressed an interest in setting up a regional JESSICA fund with a value of circa £50 million (half ERDF cash and half land assets as match funding). Accordingly this study explores the potential for JESSICA in the North West.

JESSICA stands for Joint European Support for Sustainable Investment in City Areas and is a policy initiative of the European Commission (EC) which aims to exploit financial engineering mechanisms to support investment in sustainable urban development as a component of integrated regeneration.

UDF stands for Urban Development Fund and is the key 'financial engineering' model for JESSICA. UDFs are funds set up to invest in sustainable urban development primarily by combining EU funding and private sector equity investment, but also potentially by combining EU funding and other sources of public sector funding.

The Benefits of JESSICA and UDFs include:

- Mobilising additional financial resources and focus on sustainability;
- A holistic approach to regeneration balancing physical, social, economic, financial and environmental goals;
- Risk reduction through area uplift over the long term;
- Utilising financial expertise from the private sector;
- The potential creation of a revolving investment fund for future projects (as this round of Structural Funds could be the last it is critical that the funds are spent in the most constructive way possible).

The Four Scenarios

The principle role of JESSICA is to invest via debt, equity or rental guarantee (rent or capital receipt). Clearly this represents a shift from the more usual position of grant funding, generally for specific works often subject to an element of clawback.

As part of the study four actual schemes were reviewed in order to test the appropriateness of JESSICA:

- **Scenario A** - the project level partners currently are a private sector car park operator and a public sector agency and as such careful consideration will have to be given to the developer manager role. Given the nature of the scheme being almost exclusively office development an appropriate development partner with expertise in this sector should be procured, ideally to work with the landowners in a single entity. This will enable alignment of objectives through a procurement process with the partners sharing in risks and rewards.
- **Scenario B** –a scheme with an existing development agreement in place, but a 'gap' has formed relative to that position, consequent to market yield shifts. JESSICA could be used to provide a rental guarantee to effect a yield shift of the development. This scenario has also been explored based on the Heads of Terms agreed with the existing developer joint venture where the public sector is to provide land and funding to enable the scheme.
- **Scenario C** – there is a shortfall to provide enabling infrastructure as part of a broader regeneration scheme. Under this scenario we would anticipate the use of JESSICA to either provide development finance and/or a rental guarantee on the scheme that these infrastructure works would facilitate, utilising an existing delivery vehicle.
- **Scenario D** – the task for JESSICA in the long term would be to deliver enabling infrastructure allowing a significant expansion of the town centre, including the provision of a new bridge, the relocation of the West Coast Main Line rail line and significant highways works. Delivery is anticipated by way of 'traditional' public sector intervention, delivering infrastructure to facilitate development or via a voluntary development agreement with works underwritten by JESSICA on the proviso that the landowners/ developers are compliant with the terms of the development agreement.

  Whilst a traditional development agreement could be suitable for this development, given the phasing, scale and long term nature of the project (with associated risks of market shift) a more flexible joint venture vehicle based on corporate (as opposed to contractual) law may be more suitable.

Financial Model

A financial model was created for the Scenario B to illustrate how a JESSICA UDF could work for the North West. The model showed a JESSICA UDF approach enables the public sector to achieve an improved net cash position at the end of the development of £4.4 million. This is due to the more efficient nature of the UDF approach in sharing in future returns, in contrast to the grant funding approach which only generates returns if overage provisions are triggered. Should such clauses be triggered, the structure of the UDF would like still provide an improved return as it would be structured to further share in improved financial performance.

Conclusions: A UDF for the North West?

Core elements of this study were to answer the following two questions:

Q1: Could JESSICA be successfully used to unlock/ facilitate the implementation of regeneration schemes?

Q2: How might JESSICA be best deployed in the region? (ie Proposed Outline JESSICA Structure?)

Q1: Could JESSICA be successfully used to unlock/facilitate the implementation of regeneration schemes?

Yes. A number of scenarios (ie actual projects) have been explored in urban centres throughout the North West which have shown that JESSICA has the potential to unlock regeneration schemes.

This process has included the creation of a financial model which has shown that the potential returns from a JESSICA led investment approach provide a significantly improved return to the public sector over and above the returns (or lack thereof) of a grant funding approach. Although the projects identified at a UDF level did not generate returns that are attractive to the private sector on a pari passu basis, it is clear that a UDF approach will still enable NWDA to ensure that ERDF monies are able to make a bigger impact over the long term than a traditional grant funding approach. State Aid approval will be required should a layered approach to returns be created in which the private sector enjoys a priority over the public sector. If this is notified at the fund level there will not be a requirement to notify on a project by project basis over the life of the fund.

Q2: How might JESSICA be best deployed in the region? (ie Proposed Outline JESSICA Structure?)

As part of the process of considering the ideal structure for a JESSICA UDF it is worth considering existing SPVs that are already in operation and may provide the ideal or partial range of skill sets necessary to operate the UDF.

A review of delivery vehicles in the North West led to initial conclusions in favour of Liverpool Vision having potential to provide at least partial skill sets and services required by a UDF for their specific sub-region. This is particularly relevant for Merseyside which receives circa half of total ERDF funds in the Northwest which could be sufficient to create a dedicated UDF for the sub-region.

In respect to Merseyside using an existing vehicle such as Liverpool Vision, this could work by separating out the core functions of a UDF as follows:

Liverpool Vision	**Professional Fund Manager** **(or PSP Investor)**
Sustainable development role • Economic, social and environmental concerns • Testing integrated and sustainable development requirements of JESSICA • Ensuring fit with NWOP	**Finance and Investment Role** • Financial appraisal of potential investments • Ongoing monitoring of investments • General fund manager role (FSA regulations etc)

Clearly it will be essential the two to work closely together however it is likely a deadlock arrangement may be the best arrangement in which both parties seek to protect their own interests with the clear understanding that success will lie in the optimum investments that balance all of the investment criteria.

How Many UDFs?

Should a Liverpool based existing vehicle be utilised it would only be relevant to Merseyside sub-region. As such it will be important to consider how many UDFs could or should be created. There are pros and cons in each approach:

Option 1 – a single UDF for the whole of the North West

A single procurement would be less expensive to procure and to run and with a likely investment of £50 million by the public sector provides an attractive sized fund.

There is clarity about a single fund and a single UDF also creates the opportunity to cross subsidise between especially weak and strong areas of the region for investment.

Option 2 – two or more UDFs (in particular Merseyside sub-region)

Given the level of funding to the Merseyside sub-region (circa half of all ERDF funding) the case could be made for a single UDF for the Merseyside sub-region, possibly to be managed – at least in part – by an existing organisation such as Liverpool Vision.

Next Steps

As a result of the challenges of the credit crisis careful consideration needs to be given to the manner in which the UDF(s) for the North West are created. A potential 'road map' could include:

Indicative Timetable	
PMC Board approval	July 2009
Identify match funding	September 2009
Green Book appraisal complete	September 2009
NWDA board approval and PMC endorsement	September 2009
Central Government approvals	October 2009
Negotiation of funding agreement for Holding Fund	July – November 2009
Sign funding agreement	November 2009
Constitute Investment Board	October 2009
Drawdown/contribute funds to Holding Fund	November 2009
Selection criteria for UDF's	December 2009/ January 2010
Procure UDFs	February 2010
Due Diligence	Early 2010
Negotiate UDF Agreements	June 2010
Commit funds to 1st project	Quarter 3/ 4 2010

Initially this would be a purely public sector UDF to enable the NWDA to make progress, but in anticipation of market recovery and procurement of a private sector partner. In some respects it will make the UDF an easier 'sell' in due course as the UDF will not be 'blind' when it eventually is taken to market.

1 INTRODUCTION

1.1 OBJECTIVES OF THIS STUDY

This study reviews the rationale and commercial and financial feasibility of using the JESSICA mechanism in the North West.

Specifically it addresses the options, risks, costs and benefits of using JESSICA and in particular will address the following two questions:

1.1.1 Q1: Could JESSICA Be Successfully Used To Unlock/ Facilitate The Implementation Of Regeneration Schemes?

1. Analysis of how JESSICA could improve upon current investment/ funding measures in the Region to progress the Northwest Operational Programme (NWOP)
2. Review of four development schemes in the region; addressing specific questions in each scenario; establishing whether JESSICA could be effective
3. Identify and evaluate specific projects/ programmes consistent primarily with AA 3.2 and AA 4.3 of the NWOP, but addressing AA 1.3 of the NWOP as appropriate that could be supported by JESSICA

1.1.2 Q2: How Might JESSICA Be Best Deployed In The Region?

1. Options for implementation, (not in-depth analysis) e.g. adapting existing structures such as URCs or LABVs) including a recommendation as to the best way to take JESSICA forward;
2. Establish level of private and public sector interest in utilising JESSICA (at UDF level and at project level);
3. Assess and evaluate sources of match funding which might be available; how these assets might be incorporated into a JESSICA fund in line with the ERDF rules on defrayment; an analysis of how any land-based assets might subsequently be developed out in line with the relevant Action Areas of the NWOP culminating with a list of criteria which the land-based assets must meet in order to be included in a JESSICA fund.

1.2 PROJECT TIMING, PROCESS AND DELIVERABLES

A steering group of partners including the HCA, the EC and EIB's JESSICA Task Force will deliver in accordance with the following summary timetable:

Date	Meeting	Purpose
End February	Progress meeting 1	• **Data feedback** • Re-confirm objectives • Fill the gaps • Select detailed scenario
End March	Progress meeting 2	• **Structured workshop** • Initial findings • Brainstorm
End April	Final Report and Presentation	• **Conclusions**
Summer 09	3x Presentations	• **Dissemination**

2 ABOUT JESSICA AND URBAN DEVELOPMENT FUNDS (UDFS)

2.1 WHAT IS JESSICA?

JESSICA stands for Joint European Support for Sustainable Investment in City Areas and is a policy initiative of the European Commission (EC). The purpose of JESSICA is to support Member States of the EU to exploit financial engineering mechanisms to support investment in sustainable urban development in the context of cohesion policy.

JESSICA was launched with a view to providing the opportunity for Managing Authorities responsible for the current generation of cohesion policy to:

- Leverage additional resources for public and private partnerships and other projects for urban development;
- Contribute financial and managerial expertise from specialist institutions such as the European Investment Bank (EIB);
- Create stronger incentives for success by combining grants with other financial tools; and
- Ensure long term sustainability through the revolving character of the funds.

JESSICA is still relatively new and thus poorly understood. Some commentators believe JESSICA is 'an immensely powerful instrument…People who understand European funding do not understand the power of investing in projects that make a return on capital. People who understand making a return on capital have mainly not heard of, and often actively avoid, European funding'.[1]

The diagram below is an extract from an EIB presentation setting out the key components of JESSICA and provides a useful framework to the concept.

[1] Chris Brown, CEO Igloo Regeneration Igloo at European Week of Cities and Regions Oct 2007. See http://ec.europa.eu/regional_policy/conferences/od2007/doc/presentations/c/Abtract_Chris%20BROWN_09C07.doc

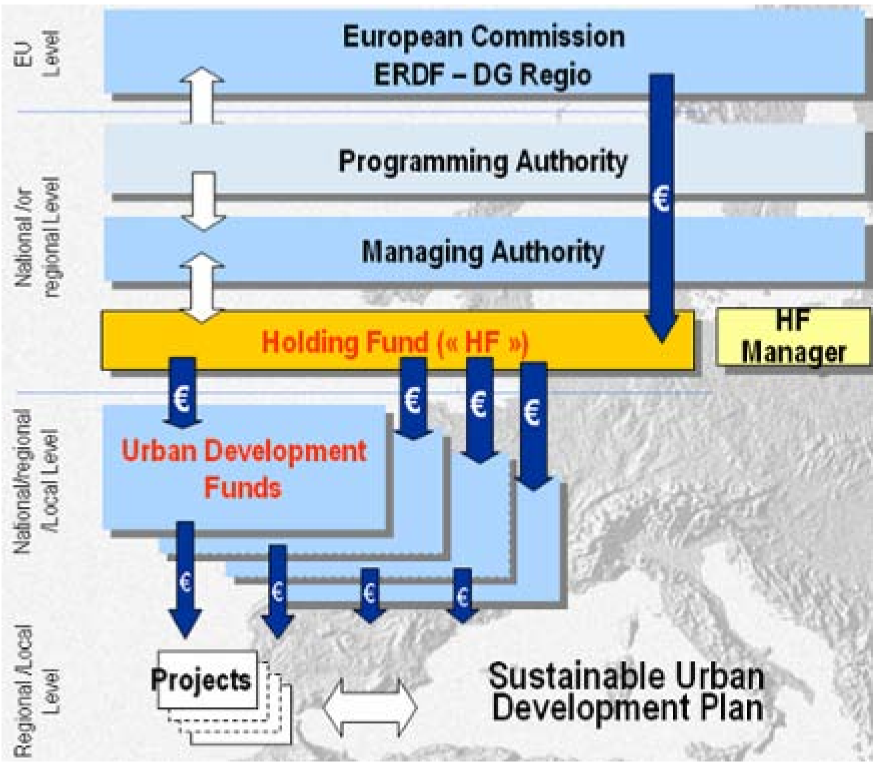


Fig 1 – EC and JESSICA Structure

2.2 WHAT ARE UDFS

According to the European Commission (EC), a UDF is a fund investing in public-private partnerships and other projects included in an integrated plan for sustainable urban development. The fund needs to demonstrate sufficient competence and independence for undertaking qualifying projects as well as sound financial backing. UDFs can be established at either a national, regional or local/ city level in response to integrated urban development plans, project pipelines and investor interests.

UDFs are the key implementation tool for JESSICA initiatives. Although JESSICA UDFs are yet to be established in the UK, similar mechanisms including public/ private collaborations are already becoming increasingly commonplace through out the UK, increasingly referred to as Local Asset Backed Vehicles (LABVs) and defined by DCLG[2] as:

[2] DCLG Consultation Paper on City Development Companies, December 2006, s32

'funds, combining locally-owned public sector assets and equity from institutional investors, established to finance the delivery of major regeneration outcomes. It is envisaged that these vehicles, with their own boards and management teams, are constituted as limited partnerships. Similar funds have already been established at a regional level and have generally been owned 50/ 50 by the public and private sector partners. Property development and regeneration projects are delivered according to an agreed business plan established at the outset of the vehicle's life. Returns made by the vehicle are directed back into the LABV and shared on an equal basis between the partners.'

2.3 THE BENEFITS OF JESSICA UDFS

The rationale and benefits of the JESSICA approach have already been well articulated by the EC and EIB.

The stated principle aims are to make Structural Funds:

- more efficient and effective by using 'non grant' financial instruments, thus creating stronger incentives for successful project implementation;
- to mobilise additional financial resources for PPPs and other urban development projects with a focus on sustainability/ recylability; and
- to utilise financial and managerial expertise from relevant international financial institutions (such as EIB).

In addition, given this round of Structural Funds is likely to be the last that the UK will receive (given EU enlargement) it is absolutely critical that the funds are spent in the most constructive way possible. Given 'gap funding' techniques result in no financial return to the public sector, with the exception of overage agreements, it is essential that new methods are explored that enable social, economic and financial goals to be addressed. JESSICA UDFs offer the opportunity for balancing social and economic development goals with financial goals in order that projects emerging in 10, 20+ years may be financed through the revolving nature of the UDF.

Although JESSICA UDFs are yet to be established in the UK, similar mechanisms are already becoming increasingly commonplace through out the UK as a result of well recognised benefits that cover a wide spectrum of regeneration, financial and organisational issues. UDFs offer the opportunity:

- First and foremost for the public sector to share in financial returns through an investment approach which capitalises on the private sector's approach to financial appraisals and risk assessment leading to greater returns to the public sector. This is elaborated on further in the financial model section below.
- To incentivise a leading, institutional private sector investor and/ or development partner to deliver over the longer term – a critical element of regeneration;
- To leverage significant private sector investment and creating and 'packaging' an opportunity that ignites real enthusiasm with major developers and funds;
- For a more holistic approach to regeneration, drawing on the skills of the public and private sectors in order that the essential balance between physical, social, economic, financial and environmental goals is realised in the delivery of projects;
- To tap the creativity and enthusiasm of the private sector by building a genuine partnership rather than simply managing a process;
- To attract investors who are interested in the longer term returns potential from area based development;
- Exploit economies of scale (up to 30% on construction costs in some cases on large scale construction) in larger longer term projects;
- To reduce risk through area uplift over the long term and cross subsidisation between a large number of sites lowers the risk profile in comparison to undertaking individual projects or even phases of individual projects.

Clearly, this is a very different scenario to the traditional approach of grant funding in which a 'gap' in an investment profile – usually on single projects – means that the public sector makes an upfront 'gift' after with no return to the public sector unless overage provisions are triggered. The essential feature of UDFs is the treatment of former grant funding as an investment on which the public sector will expect to see a return i.e. a UDF investment is not the same as traditional grant funding which is in effect pure subsidy.

2.4 JESSICA HOLDING FUNDS

The regulations allow for Holding Funds to be established, which can be very useful to Managing Authorities in 'buying time' in those constituencies where UDFs have to be established from scratch.

Although the main focus of this study is to investigate UDFs in the North West, decision makers should be aware of the opportunities that Holding Funds offer. Under the terms of the new EU legislation, these funds represent 'eligible or qualifying spend' and can therefore secure investment in an area prior to an eligible UDF or project being identified that requires JESSICA investment.

A further benefit of the Holding Fund is that money is drawn down at the HF level, therefore enabling interest to accrue whilst the UDF is being established. Although the HF is managed by a suitably qualified Fund Manager and paid for their services (circa 2% depending on the size of the fund) any additional monies generated by the fund can be used for eligible expenditure.

A Holding Fund will also demonstrate to the private sector that funds are in place for project development thus providing greater clarity and certainty. Finally it provides for a dedicated Fund manager function that is tasked with overseeing the deployment of JESSICA funds. Match funding would need to be in place before any ERDF monies could be drawn down.

NWDA and EIB are currently in talks regarding a potential EUR €50 million (GBP £46 million) JESSICA Holding Fund for the region. The EIB and the NWDA signed a Memorandum of Understanding (MoU) on 29th January 2009 to this effect. The NWDA is also exploring with the EIB the potential use of EIB financial resources, where appropriate, to compliment the use of EU Structural Funds in the region.

The North West is the second English region to sign a MoU for a JESSICA initiative, following a similar agreement between the EIB and the London Development Agency in December 2008.

2.5 EXISTING UDF TYPE MODELS IN THE UK (AS CONTEXT)

Although currently there are no JESSICA UDFs established in the UK, NWDA previously established a PPP model that bears a number of parallels and is useful to consider as context.

Space Northwest was established by NWDA as a Public Private Partnership (PPP) to hold and manage its £130 million portfolio of investment properties. The Agency's core objectives were integrated into the vehicle's operation in a way that also enabled the private sector to operate and meet its primary objectives of producing a financial return. The PPP was established in December 2006 with Ashtenne Industrial Fund.

Other similar partnerships, sometimes referred to as LABVs (local asset backed vehicles) have been established by RDAs (EMDA, AWM, ONE) and by councils such as Croydon and Tunbridge.

In addition to Space Northwest, there are a number of other special purpose vehicles in the North West that have some potential in terms of acting as the UDF or integrating with the UDF to provide a potential foundation for the vehicle and to avoid duplication. These include:

- Kingsway Partnership
- New East Manchester URC
- Central Salford URC
- Liverpool Vision
- Furness West Cumbria New Vision Ltd (trading as West Lakes Renaissance)
- Elevate East Lancashire Limited HMR
- Hadrian's Wall Heritage
- ReBlackpool URC
- Cumbria Vision

The relevance of these vehicles to act wholly or partly as a UDF is considered further in Section 9, Conclusions and Recommendations.

2.6 APPLICATION OF JESSICA THROUGH EQUITY, DEBT AND/ OR GUARANTEES

One of the attractions of JESSICA is that it offers a flexibility of approach not available with traditional grant funding techniques. It is envisaged that JESSICA investment could take the form of:

- Debt - with subordinated returns facilitating the use of senior debt and arguably providing grant funding subject to the requirements of the fund.

- Equity – JESSICA could be used as an equity contribution i.e. as a co-investor in the scheme, again subject to subordinated return to senior debt and profit.
- As a rental guarantee and this could take one of a number of forms, a contractual guarantee, monies held on deposit/a bank guarantee or funding a lease.

2.6.1 EQUITY

JESSICA could be used as a co-investment in any given development scheme, with the UDF in effect being part owner of the scheme. In the case of a 10% investment in the scheme it is anticipated that the UDF would own 10% of the scheme and accept a commensurate level of risk with the co-investor around that element of investment.

It is anticipated that this model of equity contribution may be attractive to local authorities as they seek to unlock development sites in their ownership. We envisage that any return on equity will take a subordinated position to debt, but the return (in the event that the scheme is successful) will be higher than the return to debt. We anticipate that the equity contribution will bear a greater risk than debt i.e. the equity contribution may not be secured against assets.

2.6.2 DEBT

This is the provision of a loan, generally provided by a bank or other lending institution. In this case it is anticipated that JESSICA would provide an element of debt finance, possibly taking a subordinated return to other institutional debt.

We would anticipate that any debt would be secured against physical assets and in the event of a default on the loan the asset could be traded on to realise the return of the debt to the lender first – before the discharge of other debts.

Because of this level of security and the relatively low risk profile relative to the equity contribution we would anticipate a lower level of commercial return to debt.

JESSICA will have limited potential to act as a debt funder due to the size of the anticipated Holding Fund of EUR €50 million (GBP £46 million), although this should not be discounted as an option.

2.6.3 RENTAL GUARANTEES

Rental guarantees have been commonly used for many years by developers and investors wishing to maximises the value achievable in situations where the investment is not fully let.

The table below demonstrates hypothetically how the concept works and shows what effect applying a guarantee on the total income has on the end value of the development[3]:

- Option 1 - Building 50% vacant with no rental guarantee for the vacant space;
- Option 2 - Building 50% vacant with a 2 year rental guarantee for the vacant space.

	Option 1	**Option 2**
Income/Rent (per annum) from existing letting	£50,000	£50,000
Rental Guarantee (per annum) on vacant space	-	£50,000
Total Income/Rent (per annum)	**£50,000**	**£100,000**
Capitalisation factor (Return/Yield %)	13.33 (7.5%)	11.11 (9%)
Net Value	£630,400	£1,050,600
Less Total Rental Guarantee payment	-	£100,000
Net Value	**£630,400**	**£950,600**

An investor will pay a higher yield for Option 2 to reflect additional risk associated with the vacant space and potentially only 2 years income. By guaranteeing the rent for 2 years at a cost of £100,000 (£50,000 x 2 years), the vendor can in real terms realise an extra £320,200 on their development.

The rental guarantee would be treated in one of two ways;

- Total cost of rental guarantee is deducted from the sale price.
- The rental guarantee is held in an escrow account with interest accruing to the developer, and drawn down upon quarterly by the new owner until such times that the space is let at which point any remaining money reverts back to the developer. There are normally certain conditions that have to be met to assess the quality and suitability of a tenant and terms of the lease to prevent

[3] We have made the following assumptions:

1 Total income/ rent when 100% let: £100,000.

2 Current yield for capitalisation of rent: 7.5% and 9%.

3 2 years rental guarantee on the vacant space.

4 We have deducted transaction costs at 5.75%.

a weak tenant on a short lease signing, to allow the developer to remove the rental guarantee.

This principle of guaranteeing future rental income could be adapted and used to stimulate development on schemes that may otherwise not be bought forward for development. The guarantee could be structured in one of the following ways:

1. Development sold with a 5 year rent guarantee funded by JESSICA. Percentage of total guarantee repayable by developer. The amount payable is the difference between the sale value and the total development cost (including profit).
2. The developer builds the property on the premise that the JESSICA fund guarantees 50% of the rent until such time as the building is let enabling the developer to market the building with the comfort of guaranteed rent. Once the building is fully let the investment is sold and the JESSICA fund receives its money back or the difference between the sale value and total development costs (including profit).
3. The developer works out the total development cost (including profit). The JESSICA fund guarantees the rent for 10 years (in effect a lease) at a rent that when capitalised equals this total development cost, say 80% of ERV (taking benefit of the yield compression and thus higher rent capitalisation of having the covenant of JESSICA fund). Once sold the developer steps away and the JESSICA fund works with the new owner to sublet the property, with the new owner incentivised by benefiting from any rent increase achieved. As and when lettings are achieved the JESSICA fund takes its money back.

In each of these cases the JESSICA fund facilitates development by providing a rental guarantee. In each scenario if the building is successful the JESSICA fund will receive a return, however it is unlikely the JESSICA fund will receive 100% of the money invested.

Unfortunately in current challenging economic climes:

- A rental guarantee is only attractive if the purchaser believes the vacant space could be let up within the guarantee period. Thus rental guarantees are losing attractiveness.
- Banks and other lending bodies have become increasingly wary of lending on a rental guarantee.

- The rental guarantee would also need to cover the service charge and business rates on the vacant space (this can be up to nearly half of the rental value depending on location).
- The developer will only develop if they are going to make a profit. If the banks will not lend on a guarantee the developer will not build.

3 STAKEHOLDER AIMS AND OBJECTIVES

3.1 NATIONAL

It is anticipated that JESSICA will complement existing funding streams, notably ERDF (albeit ERDF monies are likely to form part of any JESSICA Fund), and RDA administered scheme specific gap funding.

3.2 REGIONAL

Northwest Operational Programme - NWOP

Over the period 2007 – 2013 the North West of England is set to receive around £521 million in ERDF support under the 'Regional Competitiveness' strand of the structural funds. NWDA has been delegated day to day strategic management and delivery of ERDF funding. The Northwest Operational Programme (NWOP) will be delivered through 5 Priority Areas, beneath Priority Areas 1 – 4 are 11 more detailed Action Areas (AAs). Each AA is driven by a comprehensive Investment Framework (IF) that details the types of activity to be funded.

Within the NWOP, Merseyside has been allocated a transitional 'phasing in' status, with a financial allocation of £212 million ring fenced to allow the area to adjust gradually to changes in funding provision. By 2011 the annual level of ERDF funding for Merseyside will be around 15% of for the 2007 level. As such the Agency is particularly focussed on the absorption capacity for interventions in these early years of the programme. The most suitable areas for intervention for JESSICA UDFs as highlighted in the brief for this consultancy study are:

- Priority 3, AA 3.2 – 'Developing High Quality Sites and Premises of Regional Importance' Priority 4, AA 4.3 – 'Employment Creation for Areas of Regeneration Need'
- Priority 1, AA 1.3 – 'Increasing Sustainable Consumption and Production'

Priority 3 - AA 3.2 – Developing High Quality Sites and Premises of Regional Importance

Priority 3 focuses on providing the conditions that will support the region's aspirations for sustainable economic growth, as set out in the RES by providing infrastructure (including sites for SMEs) and enhancing the region's cultural and visitor offer.

Action Area 3.2 is likely to be the main area of investment under Priority 3 and regional partners are keen to examine the potential for the use of JESSICA within this priority. It will support the development of Regional Strategic Sites and provide a portfolio of opportunities to increase regional competitiveness and GVA growth, and tackle the issues of brownfield land.

There are a number of regionally significant sites eligible for support under this AA, including amongst others:

Bolton Innovation Zone	Preston CBD
Central Park, Manchester	Rochdale Kingsway
Estuary Park, Speke, Liverpool	Salford Quays/ Irwell Corridor
Liverpool Pall Mall extension	Warrington Waterfront

Priority 4 - AA 4.3 - Employment Creation for Areas of Regeneration Need

Priority 4 aims to improve economic performance across the North West by linking job growth to areas and groups of economic inactivity. There is a strong spatial concentration of workless people across the region, with 90% concentrated in just 9 local authority districts and regional partners wish to examine the potential for the use of JESSICA within this Priority.

Action Area 4.3 specifically supports a targeted programme of employment creation in prioritised regeneration areas that face low employment rates.

The Investment Framework for Action Area 4.3 details two strands of eligible activity focussed on supporting employment creation for areas of regeneration need:

Strand 1 - Support for development of employment sites in target areas;

Strand 2 - Support for integrated projects, which through physical investment will directly support employment creation focussed on local worklessness challenges.

The RES identifies the worklessness gap in the following areas:

- Barrow, Halton and Knowsley
- The URC areas of East Manchester, Central Salford, Liverpool City Centre, West Cumbria and Furness and Blackpool
- Housing Market Renewal areas (HMR) Liverpool/ South Sefton/ North Wirral; Oldham/ Rochdale; East Lancashire, Manchester/ Salford.

Priority 1 - AA 1.3 - Increasing sustainable consumption and production

Priority 1 provides business support and funds financial instruments which help improve the competitiveness of the region's businesses.

Action Area 1.3 will help reduce the environmental impact of SMEs and explore business opportunities merging from waste treatment, new forms of energy production, and other aspects of environmental improvement. Within this remit is the aim to prepare SMEs for business opportunities/ threats arising from climate change, prepare for future environmental legislations and policies and improve resource efficiency, waste treatment, new forms of energy production and other aspects of environmental improvement.

3.3 SUB REGIONS

Four hypothetical JESSICA scenarios were provided in the brief to enable us to provide tailored advice as to how JESSICA could best be deployed in the region. It was made clear to the stakeholders that these scenarios will not necessarily be eligible for JESSICA and are used as scenarios for the sake of example only.

- These scenarios are based on actual development schemes across the North West, and as part of this study the various local authorities and sub regional partners were met with directly to discuss the projects.

The aims and objectives of each of these stakeholders are addressed individually within Section 6, Qualitative Assessment.

3.4 HCA FUNDING POTENTIAL

There is a need to gain buy-in from other potential JESSICA partners, notably the Homes and Communities Agency (HCA), to ensure that the JESSICA has sufficient critical mass by inclusion of third party assets or funds.

In order for JESSICA to successfully deliver sustainable development and realise its recyclable potential, the fund will need to gain sufficient critical mass. The £50 million NWDA envisage investing in JESSICA is still a relatively modest sum, given the aspirations and scale of schemes that are to be delivered.

A workstream yet to be undertaken is the funding stream potential from the HCA. Further, given the Growth Point for housing status that the North West has been granted, it will be important to gain buy-in from the HCA.

3.5 LOCAL AUTHORITIES AND PROJECT SELECTION

In order for JESSICA to reach sufficient critical mass there is a requirement for a further workstream to engage with Local Authorities. This is to review their schemes and assets that may be appropriate for inclusion in any JESSICA funding.

It will be necessary to produce the criteria for project selection. Based on previous work done by the Welsh Assembly Government a set of criteria as follows is envisaged:

Technical Evaluation Criteria	
1	Policy fit (ie NWDA and EIB/EU)
2	Existence of sustainable integrated regeneration plans
3	Primarily public sector ownership (NWDA, Local Authorities, Universities)
4	Profitability (indicating internal rate of returns of 0-15%)
5	Commitment at the 'project level'
6	Scale/attractiveness to the private sector
7	Funds invested (defrayed) by 2015 (the ERDF 'qualifying expenditure')
8	Regulation compliant
9	Projects to be in a state of 'readiness'

Clearly further detailed work is required in regard to the evaluation (ie investment) criteria and bidding process to ensure projects emerge that both satisfy public policy and commercial investment criteria and is open and transparent.

Through this engagement process there will also be the opportunity to seek further investment from other public sector bodies through either cash or more likely contribution of property development assets at nil or discounted value in order to help catalyse development activity.

4 COMPLEMENTARY APPROACHES

New approaches to funding infrastructure are a hot topic in the UK, given housing and economic development imperatives, the tightening of national government spending and the reduction in future funding from the EU.

It is clear from this short overview that there are limited options available currently in the UK to public sector agencies seeking to bring forward large scale physical regeneration. Given the extremely challenging economic climate and subsequent impact on development activity it is recognised that any JESSICA initiative may need to be complemented by other funding initiatives.

It is not sought for JESSICA to replace traditional ERDF funding, rather to complement it. The following pages focus on some of the financing mechanisms and options available now or in the near future.

4.1 GRANT FUNDING

The principle of "gap funding" means that following a full appraisal of a developer's application for assistance, an amount is awarded that should be the minimum necessary to bridge the gap between development costs and forecast end value, and still enable the developer to go ahead. In physical development projects sometimes 'clawback' or overage arrangements are built in to ensure that some of the grant is repayable if a project makes greater profits than initially anticipated (however growing evidence indicates these mechanisms to be unreliable).

Gap funding therefore enables developers to go ahead with otherwise non-commercially viable projects on contaminated, derelict and disused sites, to bring them back into full economic use. Usually such sites are in areas of depressed market activity and, as a result, end values are lower than development costs.

4.2 PRUDENTIAL BORROWING

The introduction of the Prudential Borrowing framework from 2004 simplified the former Capital Finance Regulations and allows councils flexibility in deciding their own levels of borrowing based upon their own assessment of affordability. The framework requires each authority to decide on the levels of borrowing based upon three main principles as to whether borrowing at particular levels is prudent, sustainable and affordable.

Currently the majority of a council's borrowing whether Assembly supported borrowing or "Prudential Borrowing" will typically access funds via the 'Public Works Loan Board'. The Board's interest rates are determined by HM Treasury in accordance with section 5 of the National Loans Act 1968. In practice, rates are set by the Debt Management Office on HM Treasury's behalf in accordance with agreed procedures and methodologies.

A number of local authorities have discussed the possibility of exploiting these very attractive borrowing rates and taking a more active role in speculative physical development although to date we are not aware of any council that has taken a genuinely speculative role (i.e. for profit purposes) in relation to large scale physical development in the UK.

In due course, the most likely issue for local authorities will be whether or not to utilise Prudential Borrowing which can be arranged at highly competitive rates but remains 'on balance sheet' or more expensive bond financing which is off balance sheet and does not have recourse to the local authority in the event of default.

4.3 TAX INCREMENT FINANCING

The April 2009 Budget detailed that central Government is to formally examine the applicability of the Tax Increment Financing (TIF) structure for use in the UK. This builds on the growing awareness of the potential of TIF. A report for the Core Cities Group proposes innovations to the way infrastructure is financed in England to greatly increase the economic, employment and housing outputs that regeneration schemes can deliver. The joint report, *Unlocking City Growth*, is based on the findings of a nine-month study commissioned by a cross-party Core Cities Group, to review local authority financing tools for major urban regeneration projects, and how barriers to infrastructure funding impact on such schemes.

The report examined the Government's proposals for Business Rate Supplements (BRS) and the Community Infrastructure Levy (CIL), noting that further financing is needed for major schemes to achieve full potential. The report proposed a new tool based on the United States model of Tax Increment Financing that allows local authorities to borrow against future tax income to pay for infrastructure.

Although TIFs require primary legislation to be used by regional or local bodies they are a highly powerful tool that are being talked about with increasing frequency in the corridors of Whitehall with CLG said to be 'seeking pilots'. Most recently it has been announced that The All Party Urban Development Group inquiry will examine the state of regeneration funding and *"examine how new models including Accelerated Development Zones - adapted from the US Tax Increment Financing model – can be created. The introduction of the zones, which has been lobbied for by industry, would allow councils to borrow against the future tax revenue from new development in order to fund infrastructure projects. The cross-party group's sixth inquiry, Regeneration and the Recession: Unlocking the Money, will address concerns of a long-term shortage of private sector money due to caution among developers and more limited public sector regeneration budgets*."

Given their potency and the particularly challenging current economic situation it was agreed that TIFs should be considered in more detail here as complementary mechanism to JESSICA.

Although not core to the JESSICA exercise this study has also sought to explore what alternatives or complementary mechanisms are available, and we believe that TIF offers the most potential. Accordingly a short financial modelling exercise exploring TIF in the context of Pall Mall has been created, the details of which are at Appendix 4.

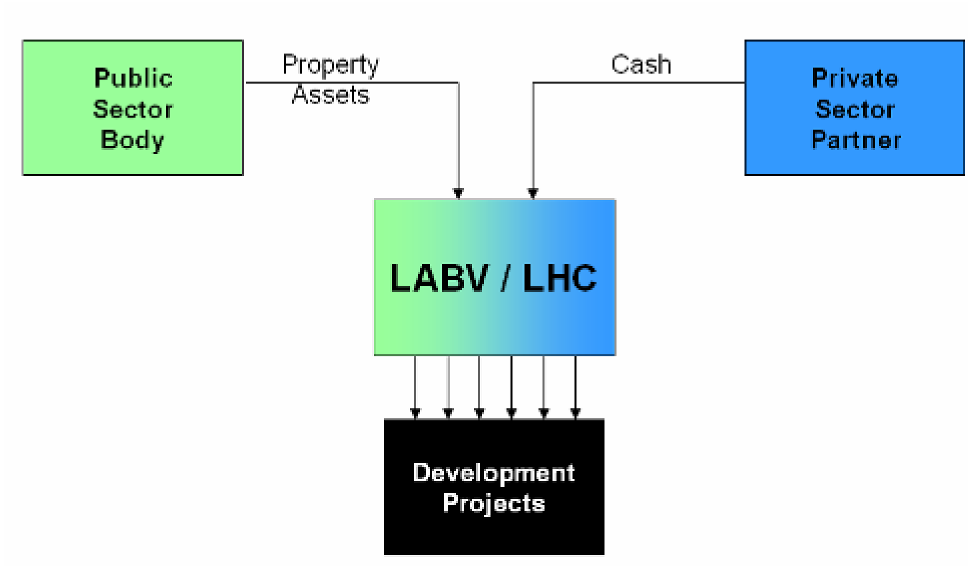
4.4 COMMUNITY INFRASTRUCTURE LEVY (CIL)

CIL is a tariff based levy paid by developers at the point at which planning permission is granted, in essence an attempt by central Government to formalise some of the more innovative methods being explored and introduced by a number of local authorities (in particular the Milton Keynes 'roof tax').

Clearly, given CILs are still at the consultation stage it is too soon to establish how much impact they will have in the real world. Given the paper asserts that CIL will be paid by developers and "complement" section 106 payments it is difficult to envisage CIL providing a genuine step change in the provision of infrastructure finance.

4.5 LOCAL ASSET BACKED VEHICLES (LABVS)

LABVs are special purpose vehicles owned 50/50 by the public and private sector partners with the specific purpose of carrying out comprehensive, area-based regeneration and/ or renewal of operational assets. In essence, the public sector invests property assets into the vehicles which are matched in cash by the private sector partner, as demonstrated in the figure below:



The partnership may then use these assets as collateral to raise debt financing to develop and regenerate the portfolio. Assets will revert back to the public sector if the partnership does not progress in accordance with pre-agreed timescales through the use of options.

Control is shared 50/50 and the partnership typically runs for a period of ten years, the purpose and longer term vision of the partnership is enshrined in the legal documents which protect the wider economic and social aims of the public sector along with pre-agreed business plans based on the public sector's requirements.

Four out of the nine RDAs have already established LABVs, these being One NorthEast (ONE), Northwest Development Agency (NWDA), Advantage West Midlands (AWM) and East Midlands RDA. Many local authorities are now investigating this approach, with the London Borough of Croydon being the first LA to establish a LABV in November 2008.

4.6 BUSINESS RATES SUPPLEMENT (BRS)

The BRS was proposed by local government tsar Sir Michael Lyons to provide local authorities in England and Wales with new powers to charge a variable precept on existing business rates to be spent on major public infrastructure.

For example, a two pence in the pound supplement on the business rate is set to be levied on most businesses in London to pay for Crossrail, a new railway route to be built through London.

Although BRS will require primary legislation, it is now likely it will happen as this is reported to be the only way the final piece of the financing cocktail can be found in the short term, given the official go-ahead for the project has been given by the Prime Minister. It is anticipated that those local authorities wishing to participate will be able to levy the first supplements by April 2010.

4.7 URBAN DEVELOPMENT CORPORATIONS (UDCS)

A revival from the 1980s UDC model, UDCs are limited life non-departmental bodies established by the Local Government, Planning and Land Act (1980) with a broad goal to secure the regeneration of specific designated areas. UDCs are given the ability to acquire, manage, reclaim and dispose of land and other property assets. To achieve these ends a UDC can carry out any business or undertaking for the purposes of regenerating the specific area. The UDCs have a term set for seven to ten years with a review after five years.

UDCs are funded by annual government grants and capital receipts arising from land and property sales. A number of cities which already have UDCs are finding success by relying upon their local authority, RDA and EP Partners for funding as well as planning and land assembly powers. UDCs also aim to bring in private sector investment to areas which were seen as having suffered long term decline and dereliction.

5 THE NEED IN THE NORTH WEST

The North West comprises the 5 regions of Cumbria, Lancashire, Greater Manchester, Merseyside, and Cheshire, and can be considered a region of contrast, with relatively low values outside of the Manchester conurbation. Economic trends are varied, with the region's two core cities, Manchester and Liverpool, experiencing strong economic growth whilst other parts of the region lag far behind the national average. The region's population is approximately 6.7 million, 11.4% of the total UK population.

The European Regional Development Fund (ERDF) has developed into a major stream to help redress regional imbalances. The North West region was awarded over £1.8 billion of Structural Funds in the 2000 – 2006 programming period, with government spending in the region accounting for more than half GDP, demonstrating both the level of need in the region and the significant opportunities that exist.

For the 2000-2006 funding round ERDF was £588 million for the North West Objective 2 programme and £650 million for Merseyside under Objective 1. Merseyside has historically received a significant proportion of ERDF funding as a consequence of the disproportionate economic impacts wrought by global restructuring.

ERDF funding for NWDA in the 2007-13 programme is circa £521 million. Of this, the Northwest ERDF (excluding Merseyside) is circa £308 million (circa 60%). Merseyside has 'transitional status' within NWOP (the North West Operational Programme for ERDF) and a ring fenced financial allocation to allow the area to adjust gradually. The Merseyside ring fenced 'phasing in' ERDF is circa £212 million – around 40% of the total ERDF available to the region under the current programme.

With the 2007 – 2013 programme likely to be the last significant ERDF programme of its kind in the UK, there are concerns that the resulting slowdown in the rate of government spending will disproportionately hit the local economies of the North East, North West and Wales, where government spending accounts for over half of GDP.

In addition to this there is concern that the current economic climate could further hamper regeneration across the North West. Average UK commercial property capital values fell by more than 25% in 2008 and some commentators predict they are set to fall by another 15% in 2009. The drop in value of over 45% from 2007 to 2010 will exceed the drop in the recession of 1990-92, when they fell by only 40%. From top to bottom, offices will suffer worst by 50%, retail property by 40% and industrial by 35%.

The implications of this on regeneration are evidenced by total property returns in regeneration areas seeing falls in values of 6% in 2007 and only 3.4% across the rest of England.

A recent independent study *'The Credit Crunch and Regeneration: Impact and Implications'* found that northern and west midlands regions have been hit more badly than southern and eastern regions. The fear in the North is that regeneration schemes in less-favoured areas will be curbed by a retraction of public and private funding. This would dent investor and consumer confidence further; almost everywhere outside of central Manchester, rental returns are stagnating. There are a number of areas where public sector funds are required as a catalyst for regeneration, characterised by an economic void left by the collapse of traditional industries. Examples of areas across the North West that have been granted ERDF funding over the past 5 years are Kingsway Business Park in Rochdale, Estuary Business Park in Speke, Merseyside, North Manchester Business Park, Ancoats Manchester, Manchester University Core Technology Facility, Mere Grange Business Park, St Helens and Ramsden Business Park, Barrow in Furness amongst others.

The most heavily ERDF supported area is Merseyside and for this reason Liverpool is being used as a case study to illustrate the need for ERDF funding in the North West.

Case Study - Liverpool

In June 2008 King Sturge undertook an evaluation into the effectiveness and impact of public sector investment in the Liverpool commercial market on behalf of Liverpool Vision and the Northwest Development Agency. The public sector has invested heavily in the Liverpool commercial market over the last 10 years, and the report concludes that whilst this investment can be considered to have been both cost effective and valuable, Liverpool's office market is still not mature enough to go forward without a further degree of public sector support. The example of the Commercial Quarter Masterplan Area at Pall Mall is cited as one example where gap funding will be required to meet the viability gap. This district is seen as vital in creating the critical mass that will enable the Commercial District to function independently.

When Liverpool Vision was set up in 2000, it set 10 year targets for the impact of public sector investment. These are shown below against the direct outputs of the Commercial District office developments:

Commercial District Outputs	Outputs to 2007/8	Lifetime Target	Target Achieved
Jobs Created (Net)	1,422	1,149	ü
Jobs Safeguarded[4]	3,035	1,686	ü
New Floorspace (m²)	64,481	64,481	ü
Private Investment (£m net)	228.59	153.9	ü

It can be seen from the table above that each of the output targets has been exceeded and therefore the investment has succeeded, in so far as it has outperformed the targets.

Four schemes in Liverpool have historically attracted direct public sector investment in the Commercial District, these being 101 Old Hall Street, City Square, St Paul's Square and 20 Chapel Street. The following table sets out the total funding committed to these schemes from both NWDA and ERDF sources, the amounts subsequently repaid to give the NWDA contributions:

Project	Total Funding Committed (ERDF & NWDA)	NWDA Funding Committed	Total Funding Repaid	NWDA Funding Repaid	NWDA Net Grant Awarded	Gross Private Investment (£ million)
101 Old Hall Street	£3.75 m	£1.875 m	£2.72 m	£1.36 m	£515,000	39
City Square*	£5.6 m	£2.8 m	£0	£0	£0	49
20 Chapel Street	£9.9 m	£4.95 m	Subject to Re-appraisal	Subject to Re-appraisal	£4.95 m	68.89
St Paul's Sq Phase 1*	£9.08 m	£4.54 m	£0	£0	£0	42.82
St Paul's Sq Phase 2	£3.6 m	£1.8 m	£678,154**	£339,077	-£1.85 m***	40.91
Total	**£31.93 m**	**£15.965 m**	**£3.398 m**	**£1.699 m**	**£3.615 m**	**£240.62**

* Not drawn down
** Only partially drawn down but re-paid
*** Estimated receipt to NWDA based on a profit share arrangement final figure to be agreed on completion
Source: King Sturge report 'Liverpool Commercial District Public Investment Evaluation, June 2008

4 The safeguarded figure is gross in line with life time outputs as contained in the Liverpool Vision May 2005 Performance Plan. (These jobs numbers being factual i.e. representing actual jobs safeguarded).

The table above demonstrates the result of targeted public sector spend in the Liverpool central business district. For a total public sector funding commitment of £31.93 million, circa £240 million (gross) of private sector investment was leveraged in.

However, it is important to view these figures in the context of developments completed at the peak of the investment cycle, with the keenest investment yield achieved in Liverpool being 4.67% for the sale of City Square. As we are currently experiencing the worst recession since World War II, it is unlikely that yields will return to this level in the short or medium term. As such we have appraised the Pall Mall scheme at a yield of 7.5%, anticipating improved trading conditions than those currently experienced, reflecting the possible delivery timetable for the Pall Mall scheme. The decline in yield has a marked effect on capital values and development schemes such as Pall Mall may well require a greater level of public sector intervention in the short to medium term.

It is the financial investment in the infrastructure and public realm that has been considered to have been important to the improved overall impression of Liverpool's commercial core. The Liverpool market needs to ensure that there is continuity in development and Grade A stock is readily available. This will be imperative to attract inward investment and the proposals for the extension of the commercial core by the development of Pall Mall are critical to this.

6 QUALITATIVE ASSESSMENT OF THE FOUR SCENARIOS

As part of this study, four scenarios where detailed. In order to explore the implications for the use of JESSICA in different site specific scenarios and these are addressed in turn below.

The initial findings of this study reported in the meeting of 24 March were shared with the relevant stakeholders for their further comment.

6.1 SCENARIO A

The Project

The diagram below has been blanked out for confidentiality reasons, and the text below included in its place.

The project comprises a notable redevelopment site on the edge of one of the region's major cities. Part of the site (Plot A) is in public sector ownership and comprises parkland adjacent to an existing office development and open land tenanted by a car park operator for a surface car park. Plot B is owned by the private sector and is currently being used as a surface car park by the owner. Both Plots A and B are affected by contamination and geotechnical issues giving relatively high abnormal costs. In addition the owner of Plot B must retain a car parking facility as part of any redevelopment of the site. This could be achieved with a multi storey car park of 1500 spaces.

A financial model has been created to illustrate a number of options and variants with outputs focussed on comparative cash-flow and IRR returns with sensitivity analysis in relation to rental growth. In particular the model illustrates the quantum of investment of JESSICA / ERDF funds required to make 'illiquid' projects sufficiently attractive to the market.

Scenario Q1 – How could JESSICA be used to deliver:

a) The development of Plot A by the public sector undertaking the infrastructure works and then selling the plots to the private sector for development?

It is envisaged that the UDF (JESSICA) set up a project level partnership with a Project Level Partner ("PLP"). The PLP is assumed to be the land owner and will transfer the Plot A land into the project level partnership. The project level partnership will take forward the financing of the infrastructure works, with funding comprising of a mix of cash as equity (provided by the UDF) and senior debt (capped to 60% of the total amount required).

The ratio of land versus cash equity investment will determine the percentage of profits each party receives from the project. Whenever there is surplus cash in the project (after senior debt repayments) it is recognised as profit split between the PLP and UDF. Therefore no surplus cash is held at the project level. However the Financial Model ("Model") shows the value of the land to be negative. Therefore it has been assumed that the PLP would transfer the land into the project level partnership at nil value, and in turn this means that the UDF is entitled to all the profits from the partnership.

Profits arise from selling serviced plot sites, however the Model shows these serviced plot sites to have negative values also, so the UDF makes a loss on its equity investment in this scenario. The returns/losses are described in more detail in 'Scenario Q5'.

Clearly this is an overwhelmingly negative scenario that reflects the current market and the fact that the expense of the infrastructure incurred upfront does not share in the proceeds from the development of all the sites that realise benefit from the infrastructure.

b) The development of Plots A and B in a form of joint venture between the public and private sector?

ie the transfer of Plots A and B to a procured developer within a delivery vehicle with co-investment by the UDF of either equity or through a debt stake to enable the developer to deliver the project. The value of land is still assumed to be negative so it is transferred into the vehicle at nil value.

The UDF is assumed to take a 75% equity stake in the delivery vehicle and provides the procured developer with priority returns to enable it to reach a geared profit[5] that provides a 15% IRR. Any surplus profit after the procured developer has received a 15% return will go to the UDF (up to a cap of 15% IRR). Remaining profits are then shared equally between the UDF and procured developer. The returns/losses are described in more detail in 'Scenario Q5'.

Scenario Q2 – What delivery mechanisms would be used and how would the Fund be used to deliver the regeneration?

The delivery mechanism would not be the UDF – ie the urban development fund – as this is essentially a financial engineering mechanism and thus responsible for financing. Physical delivery would be provided at the project level by a local development partner that if not already in-situ would need to be procured to manage delivery and assume appropriate levels of market and construction risk.

The EU have been very clear on this point in their latest directives in respect of JESSICA stating their preference for physical delivery to be managed at the local or 'project' level. Accordingly developers even with significant financial resources would not be appropriate at the UDF partner level however should be encouraged to become involved in projects as delivery partners.

In the case of Scenario A careful consideration will have to be given to the developer manager role. Given the nature of the scheme being almost exclusively office development an appropriate development partner with expertise in this sector should be procured to work with the landowners ideally in a single entity in which objectives are aligned through a procurement process and the partners share risk and reward.

The nature of the mechanism could be a traditional development agreement however given the scale of the project and the need for phasing and possible change of direction depending on changes in the local market place and wider economy over life of the development a more flexible joint venture vehicle based on corporate (as opposed to contractual) law may be more suitable.

[5] Geared profit – profit after cost of financing

Scenario Q3 – What assumptions would be required in the phasing of development and disposal and what are the issues that have an effect on the delivery of the project?

The Model is predicated on disposing circa 100,000 ft² per annum. A rent of £20 ft² for the office accommodation has been assumed, with car parking at £1,750 per space per annum and a yield of 7.5% has been applied. Further assumptions on which the model is based are set out below following the setting out of the returns to the stakeholders.

Scenario Q4 – What effect would market conditions demand and availability of funding have on the delivery of the project?

Please refer to 'Sensitivities' appended below which reads more logically after an initial consideration of the base return profiles in Section 7 below. However the general effect of improved market conditions will be to improve the returns to the public sector in a grant situation (assuming overage is properly structured in transaction) and in a JESSICA UDF. Subject to appropriate structuring of the transaction we would expect JESSICA to show an accelerated improvement as it more directly shares in future improved returns when compared with the traditional grant approach whereby returns are achieved indirectly via overage clauses.

Scenario Q5 – What would be the indicative returns to both public and private sectors?

RETURNS FOR SCENARIO Q1A

ie development of Plot A by the public sector undertaking the infrastructure works and then selling the plots to the private sector for development.

Plot A ONLY	Project	UDF	Project Partner
Infrastructure Costs	(£12,555,523)	n/a	n/a
Net Land Sales/(Loss)	(£1,965148)	n/a	n/a
Profit/(Loss) prior to financing	(£14,520,671)	n/a	n/a
Total Equity/Land Contribution		£5,713,996[6]	£0
Cash Distributions/(losses) after debt		(£9,680,119)	£0
Project Profit/(loss) after debt		(£15,934,115)	£0
IRR		n/a	n/a

[6] This figure represents 40% of the funding required, the remaining 60% provided through debt.

It can be seen that even by enhancing the scheme by servicing the infrastructure costs, insufficient sales value is generated when disposing of the serviced plots. The alternative way to 'plug' this loss is to assume a level of grant funding is injected into the scheme. The amount of grant funding required would be £14,127,136, which is not recovered (the difference in respect of the number in the table reflects interest payments). The grant amount has been calculated assuming that it provides all the funding requirements in this option. The grant cash is drawn down on day 1 of the scheme and deposited into a 'cash' account earning 1% interest p.a.

Therefore, on this basis funding just Plot A through the UDF is not as financially attractive as straight forward grant funding of £14,127,136.

6.2 SCENARIO B

Introduction

Scenario B is a city centre site comprising a proposed scheme of approximately 10,219 m² (110,000 ft²) of B2 office space and a further 2,326 ft² (25,000 ft²) of A3 leisure space. Whilst the site appears on the face of it to be a single plot where gap funding of circa £1.25 million will need to be provided for site assembly, it is essential to realise that site sits immediately adjacent to a broader city centre retail led regeneration scheme, a redevelopment which will include the short to medium term loss of a significant quantum of office space.

The city council has confirmed that there is a public sector contribution of circa £8 million to this scheme, but that market shift has resulted in a further gap of circa £1.25 million, the return to the balance of the public sector assets being covered by an existing site specific development agreement.

As such for the long term maintenance of employment within Scenario B's city centre, the city council are keen to emphasise that this scheme is important and should seek to preserve in the order of 1,000 jobs in the city centre.

Scenario Q1 – How could JESSICA be used to deliver the development of the site in a form of joint venture between the public and private sector?

JESSICA could be used in one of three ways to support this scheme.

1. Equity – JESSICA monies could be used to co-invest with the site perhaps as a subordinated return providing the gap funding with a possibility of recovery.
2. Debt – rather than co-investing in the existing development agreement JESSICA monies could be used to provide debt in respect of the appropriate

proportion of the development costs. This debt would again be a subordinated return relative to senior debt and developer return.

3. Rental Guarantee – a rental guarantee could be provided in order to seek to affect a yield shift, bringing the yield in driving a higher capital value for the site. Rent guarantee would need to be modelled and this has been out with the scope of the current instruction. The key elements as detailed elsewhere in this report are covenant, level of rent cover, duration of rent cover, structure of rent deposit. As these are explored elsewhere they are not revisited here.

Scenario Q2 – What delivery mechanisms would be used and how would the Fund be used to deliver regeneration?

It is anticipated that the existing delivery mechanism of the development agreement would be utilised and this is modelled and reported in later sections of the report. Whilst this development agreement has not been completed the stakeholders were keen to see how JESSICA could work in a relatively small scale, self contained and deliverable scheme.

Scenario Q3 – What would be the indicative returns to both public and private sector?

This has been modelled and is reported in a later section of the report.

6.3 SCENARIO C

The vision is a transformation of circa 13 hectares of largely vacant land opposite on a Strategic Regional Site. The project requires significant upfront land assembly, public realm and infrastructure works to create a sense of place and achieve connectivity to facilitate a large mixed use development.

The public realm works at Phase 1 include the provision of a new footbridge and public open space abutting the area to be developed by the existing joint venture arrangement. It is proposed that there is a successive phase of public open space redeveloped. There is also to be a shortfall of circa £5.5 million in respect of the provision of Phase 1, and a significant shortfall in respect of Phase 2 open space with Phase 2 costs to be recovered pursuant to a Section 106 Agreement.

Scenario Q1 – How could JESSICA be used to deliver:

a) The development of the site in a form of joint venture between the public and the private sector?

The response to a development site within a private joint venture is the same as for Scenario B i.e. via equity, debt, guarantee or any combination of the above.

b) The public realm of the scheme in return for a share of any overage by way of an overage agreement?

Currently the city council is to procure the works and rely on recovery via the existing Section 106 contribution. An alternative would be for JESSICA to fund the works in return for an equity stake in the project.

Scenario Q2 – What delivery mechanisms would be used and how would the Fund be used to deliver the regeneration?

There are three main ways in which the JESSICA monies could be utilised to facilitate the delivery of the scheme.

1. Within the existing joint venture arrangement, providing development finance or rent/ value guarantee, taking an equity stake within the broader project. It is anticipated that this would take form of a subordinated return.
2. The JESSICA monies could be utilised to provide a rental guarantee in respect of the existing scheme proposals by a regional developer, driving a yield to increase the value of the scheme facilitating payment of a contribution to enable infrastructure.

It is likely in a number of cases there will need to be a combination of approaches.

Scenario Q3 – What would be the indicative returns to both public and private sectors?

It is has been agreed with the stakeholders that indicative term profile will not be provided in respect of this scheme as the same has not been modelled.

6.4 SCENARIO D

Scenario D relates to a 30 year vision to expand a 70 hectare site close to a town centre developing approximately 2,000 new homes and circa 140,000 m² (1.5 million ft²) of mixed commercial space.

This would constitute a significant extension to the town centre and would crystallise massive infrastructure costs with particular regard to new bridges over the river crossing, the servicing of brownfield lands and the movement of part of the West Coast Mainline.

The first phase of this is a mixed use, retail-led scheme with a gross development value of circa £170 million as at July 2008 and development costs of circa £200 million (including CPO costs and developer profit).

Scenario Q1 – How could JESSICA be used to deliver:

a) 'Gap' finance to developers where commercial banks are only able/ willing to provide a proportion of the funds required?

The UDF could provide debt, taking a lower priority return to the public sector partner enabling finance for the project at more competitive rates effectively providing 'head room' for more traditional financing options.

It is anticipated that the UDF funds will provide debt carrying a higher level of risk than senior debt, facilitating commercial borrowing.

b) Support for the infrastructure costs on the basis that developer contributions to offset the public sector contributions are sought in the future as developer proposals are brought forward by way of for example s106?

JESSICA could be used to fund infrastructure in much the same manner as ERDF is currently utilised, with recovery through the traditional section 106/ overage approach or potentially through alternate recovery approaches as the same evolve. In the case of s106 recovery, it is likely that an agreement would need to be reached with the local authority in terms of how the s106 payments are returned to JESSICA.

c) Support for the upfront infrastructure and remediation costs to remove the abnormal development costs on the basis that development plots will then be marketed to developers, receipts received and potentially overage arrangements entered into to enable the UDF/ Holding Fund to share in any super profits subsequently achieved.

We anticipate that the JESSICA could fund infrastructure works and then be recovered through either a share of developer profit in respect of the enabled development sites or are pursuant to an overage agreement. Alternatively it could form part of an equity stake in any given scheme.

Scenario Q2 – What delivery mechanisms would be used and how would the Fund be used to deliver the regeneration?

The possible approaches are:

- Public sector lead - the ‘traditional’ enabling model which is detailed in response to question 1b. It is anticipated that public sector stakeholders could either elect to undertake direct development or utilise other delivery mechanisms for the delivery of physical works. JESSICA could serve as a banker to a consortium of developers/land owners working within a potential voluntary developer partnership. In this example it is anticipated that funding on favourable terms would be made available to land owners to facilitate the development of ‘their’ plot subject to compliance with the terms of a voluntary developer partnership.
- In the event that TIF (Tax Increment Financing) is introduced this would seem, because of the scope of the Infrastructure Costs an appropriate scheme for JESSICA to be utilised and assumed to be recovered using this mechanism.

Scenario Q3 – How could these delivery mechanisms be adopted to include scope for further public sector bodies who have a role in the overall site such as the Environment Agency to become involved to deliver, for example, enhanced flood alleviation and sustainable regeneration benefits to the area?

We are acutely aware that there is a tidal flooding issue with respect to much of the area of the 30 year vision for the site which is likely to require the engagement with the Environment Agency who may undertake a significant capital spend to enhance flood protection.

It is the view of King Sturge that other public sector bodies’ views can be incorporated. It is essential to realise that the private sector partner will wish to only deal with ‘one’ voice from public sector rather than a series of disparate and unaligned views.

There will be an issue of control which will need to be resolved between public sector stakeholders. This is particularly the case where there is a disproportionate equity/risk exposure for one or more stakeholders relative to others. For example if there are three public sector stakeholders owning respective 60%, 30% and 10% of the asset being committed, but only three places on a controlling Board, agreement will need to be obtained on how the risk/control are balanced.

Scenario Q5 – What would be the indicative returns to both public and private sectors?

This has not been modelled, in agreement with the stakeholders.

7 FINANCIAL MODEL

One of the four projects was selected to be financially modelled to illustrate as many of the key issues as possible. Scenario B was selected as the scenario most likely to illustrate application of the JESSICA principles. (Scenario A was initially considered but discounted given its scale relative to the proposed fund).

Given the challenging nature of the UK property market at the current time it was considered necessary to create two scenarios for the creation of the fund:

1. A **public private** UDF – ie where it is assumed that a private sector funding partner is procured
2. A **public public** UDF – ie in which a private sector funding partner is not procured and the NWDA proceed through support from other public sector bodies such as the EIB.

Accordingly, this section is set out as follows:

1 Generic modelling assumptions

2 Layering of returns approach

3 Scenario 1 – a public private UDF

4 Scenario 2 – a public public UDF

5 JESSICA as debt (as opposed to equity investment)

6 Financial model conclusions

7.1 GENERIC MODELLING ASSUMPTIONS

1 2% stamp duty will be incurred at the project level if there is a positive land value.

2 2.5% p.a. inflation has been assumed on all costs and values, including the land value transferred into each project.

3 7.50% p.a. senior debt interest with 0.5% arrangement fee.

4 1.00% p.a. credit rate

5 The UDF will incur management fees which are shared equally between the public sector partner and PSP.

6 The land sales within each project will incur a 2.5% disposal fee, if there is a positive land sale value.

7 The cash equity investment for each project will be split equally between the public sector partner and PSP.

8 The development costs include the following uplifts:

a. 14% for main contractors preliminaries

b. 5% for main contractors overhead & profit

c. 2.5% for contingency & risk allowance

9 Priority Returns mechanism within the JESSICA Fund

a. PSP capital return until it has covered its equity investment

b. The public sector partner takes remaining capital return until its equity investment is covered

c. The PSP takes any remaining capital return to enable a 10% IRR

d. The public sector partner then takes any remaining capital return to enable a 10% IRR also

e. The PSP takes 75% of the remaining capital return to achieve a 15% IRR

f. At the same time as no.5. the public sector project partner takes 25% of the remaining capital

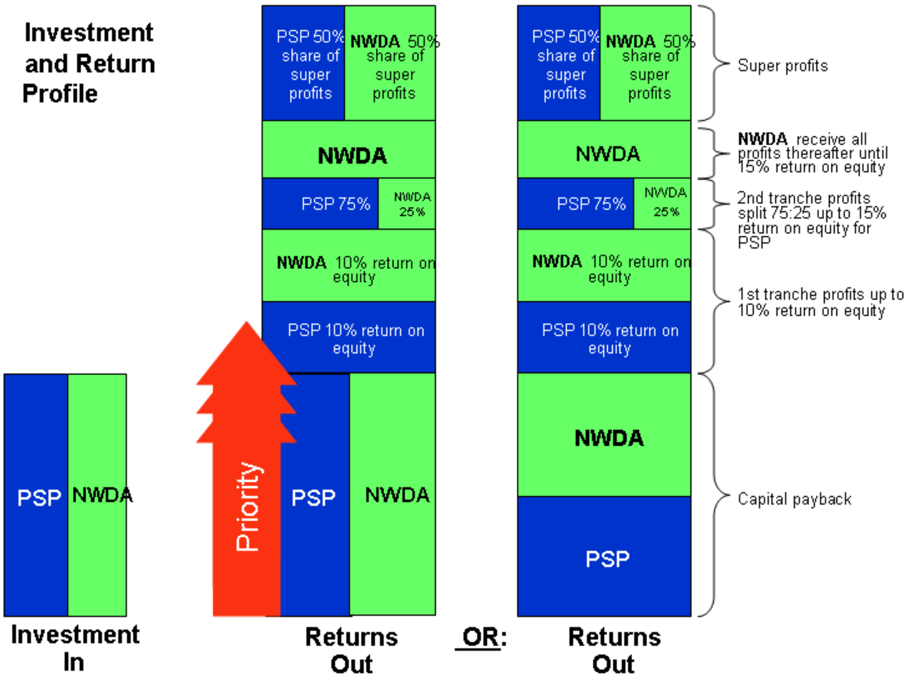
g. If the public sector partner hasn't got a 15% IRR by this point it takes any remaining capital to achieve this

h. Any surplus cash is then split 50/50 between the public sector partner and PSP.

7.2 LAYERING OR PRIORITISING OF RETURNS

As already discussed given the challenges of the UK economy at the current time and in particular the property market the concept of a fund being created in which the public sector will enjoy pari passu returns with a private sector investor is highly unlikely as the private sector simply will not invest at less than 15% IRR and the locations and projects emerging for ERDF funding invariably show lower returns as a result of market failure or extensive infrastructure enabling works. This situation is exacerbated by the macro economy which has made previously viable projects now undeliverable without some form of public sector subsidy,

Accordingly (as agreed in client meetings) one of the key assumptions central to the financial model is the concept of layering returns as illustrated in the diagram below:



Whilst offering a priority return to the private sector this approach generally provides greater potential for the public sector to share in future returns from the project than the traditional grant funding approach even allowing for overage. These principles are illustrated in the model and conclusions as set out below. The two scenarios set out below have been modelled on this basis.

7.3 SCENARIO 1 – A PUBLIC PRIVATE UDF

7.3.1 NWDA GRANT APPROACH

The following table was produced by the NWDA to summarise their approach to grant funding prospective physical regeneration projects:

Project Level	NWDA Grant
	15% of Inv. Value for
Leisure 26,112sqft at £20 - 22 psf/pa	
Gross Inv Value @ 6.75% yield	*7,906,933*
less purchasers costs at 5.75%	*429,928*
Net Inv Value	**7,477,006**
Car Park 85 spaces at 1,200 ea/pa	*102,000*
Offices 101,845 sqft at £18 psf/pa	*1,833,210*
Gross Inv Value @ 6.75% yield	*28,669,778*
Less purchasers cost at 5.75%	*1,558,877*
Net Inv Value	**27,110,901**
Grant	
Total Project Net Value	**34,587,907**
Costs	
Land Acquisition Costs	7,952,684
Planning Fees	545,000
Construction Costs	20,219,417
Professional Fees	1,652,908
Other Fees/Costs	5,953,517
Interest charges	1,167,759
Developers Profit	5,188,186
Total Project Cost	**42,679,471**
Cost/Value Gap	**-8,091,564**
Cost/Value Gap to be met by:	
Preston City Council (land in kind)	1,646,950
Lancashire County Council (land in kind)	932,837
Northwest Development Agency investment	5,511,230
TOTAL PUBLIC SUPPORT	**8,091,017**

In summary the approach assumes that ERDF monies will be granted to ensure a profit to a developer equivalent to 15% of the investment value created, which in the case of Scenario B indicates a cost/ value gap of over £8 million.

7.3.2 KEY ASSUMPTIONS FOR A JESSICA SCENARIO

For the JESSICA UDF model all assumptions used as the 'base case' grant funding model have been kept wherever possible however in order to illustrate the mechanism a number of further assumptions have been required:

<u>Project Level</u>

1 60% gearing as opposed to 100%
2 The project developer receives a priority return of 15%, after which the UDF receives the remaining monies.
3 Grant amount calculated to provide the PSP within the UDF with a 15% geared return
4 Development costs in the JESSICA approach are reduced by deducting developer's profit and lower finance costs

UDF Level

1 A running cost of £15k p.a. has been included
2 PSP capital return until it has covered its equity investment
3 NWDA takes remaining capital return until its equity investment is covered
4 The PSP takes any remaining capital return to enable a 10% IRR
5 The NWDA then takes any remaining capital return to enable a 10% IRR also.
6 The PSP takes 75% of the remaining capital return to achieve a 15% IRR
7 At the same time as above the NWDA takes 25% of the remaining capital
8 If the NWDA hasn't got a 15% IRR by this point it takes any remaining capital to achieve this.
9 Any surplus cash is then split 50/50 between the NWDA and PSP.

7.3.3 KEY OUTPUTS

A financial model has been created accordingly to compare and contrast the NWDA Grant approach with the JESSICA UDF approach.

	NWDA Grant Approach			JESSICA UDF APPROACH		
	(i.e. 15% of Inv. Value)			(i.e. 15% IRR)		
PROJECT RETURNS	**Project**	**UDF**	**Project Develope**	**Project**	**UDF**	**Project Developer**
Net Dev Sales (Inv. Value)	34,587,907	n/a	n/a	34,587,907	n/a	n/a
Dev Costs	42,679,471	n/a	n/a	36,844,038	n/a	n/a
Cost/Value Gap	**(8,091,564)**	**n/a**	**n/a**	**(2,256,131)**	**n/a**	**n/a**
Public Sector Grant (not via JESSICA)	8,091,564	n/a	n/a	4,350,000	n/a	n/a
Equity Contribution	n/a	n/a	n/a	9,769,818	7,327,364	2,442,455
Development Returns	n/a	n/a	n/a	11,863,685	8,854,183	3,009,503
Profit/(Loss) post financing	-	n/a	**5,188,186**	**2,093,869**	**1,526,819**	**567,048**
IRR after financing paid (geared)	n/a	n/a	n/a	13.90%	13.53%	15.02%
UDF RETURNS				**UDF**	**Public Sector**	**PSP**
Total Equity Contribution	n/a	n/a	n/a	7,327,364	3,663,682	3,663,682
UDF fees (shared equally)	n/a	n/a	n/a	30,000	15,000	15,000
Total Cash Investment	n/a	n/a	n/a	7,357,364	3,678,682	3,678,682
Total Cash Investment Returned	n/a	n/a	n/a	8,854,183	4,333,236	4,520,947
Profit/(loss)	**n/a**	**n/a**	**n/a**	**1,496,819**	**654,554**	**842,265**
IRR after financing paid (geared)	n/a	n/a	n/a	**13.24%**	**11.63%**	**14.84%**
Total NWDA/Public Sector Investment	(8,091,564)			(8,028,682)		
Total NWDA/Public Sector Cash Return	n/a			4,333,236		
Total NWDA/Public Sector Profit/(Loss)	**(8,091,564)**			**(3,695,446)**		

7.3.4 CONCLUSIONS FOR PUBLIC PRIVATE UDF

The summary results table above has been produced to compare and contrast returns from a grant approach versus a JESSICA approach for the stakeholders anticipated, namely NWDA, the public sector generally, a private sector developer (at the 'project level') and a private sector partner (PSP – at the fund level).

In addition to the assumptions listed in the introductory tables it should be noted that additional grants beyond JESSICA are required to ensure the development proceeds however the critical output is to measure the net cash position for the public sector at the end of the development.

The starting point in assessing whether a private sector developer would be willing to consider taking the market and construction risk for a project of this nature is their ability to project an internal rate of return (IRR) of at least 15%. Accordingly the model has been run to provide a 15% IRR to the project developer and assess what grant or JESSICA contributions are required from the pubic sector or UDF.

Although the scheme would require additional grant funding in addition to investment from a **JESSICA UDF the financial 'engineering' advantages of the investment approach is abundantly apparent in the net savings to the public sector over the life of the project**. This saving comes about simply as a result of the way that the private sector appraises risk and returns:

- The public sector (in conjunction with a PSP) invests in the project alongside the developer instead of just providing additional funds. Therefore it is entitled to a share of development profits.
- The developer achieves a return through development profit, i.e. property has to be built and sold before a profit can be achieved. The grant approach simply provides the developer with a guaranteed profit as a percentage of the final investment value and treats this is as a development cost.

7.4 SCENARIO 2 – A PUBLIC PUBLIC UDF

Given the challenging nature of the world economy and difficulty in raising private sector finance at the current time consideration is being given to the UDF being launched initially with public monies only – ie NWDA cash, property assets together with further investment from for example the EIB. This sub-section explores such a scenario.

7.5 JESSICA AS A DEBT FACILITY

JESSICA has been designed as a flexible financial engineering mechanism that may be applied as equity, debt or rental guarantee. Above we have explored an equity scenario for UDF investment. If we make the same development assumptions but with JESSICA investing on a debt rather than equity basis the model showed that this would be disadvantageous for JESSICA as its return will be capped to whatever coupon rate is charged on its financing, and any upturn in the market would only benefit the project level developer.

The model showed (in the public private UDF model) that if the developer provides all the equity and JESSICA provides all the debt it will receive a profit of £552,000 and 6.00% IRR only.

7.6 FINANCIAL MODELLING OVERALL CONCLUSIONS

In short a JESSICA UDF approach enables the public sector to achieve an improved net cash position at the end of the development of £4.4 million[7]. This is achieved because of the more efficient nature of the UDF approach in sharing in future returns which contrasts with the grant funding approach that does not.

This is the position excluding improved returns from improved financial performance that may trigger overage in a grant funding scenario. Even if there is an improvement in financial performance and overage provisions are triggered a UDF is most likely to be structured to further share in improved financial performance.

[7] Depending on public private or public public fund is created

8 MARKET TESTING

Two rounds of market testing were undertaken with ING Real Estate and Igloo Regeneration. Detailed accounts are at Appendix 3 however the general principles that emerged from the discussions include:

ING Real Estate Investment Management Michael Chadburn, Value Add Business Unit

- ING also has RED (Real Estate Development) which focuses on direct development and investment in developer JVs. The JESSICA opportunity would fall between 'Value Added and RED.
- Although their portfolios are broad the location in the NW is 'challenging'.
- The newer funds they are setting up in Value Added are seeking 15%+ IRR over 3-5 year play – but must be income producing and ideally an opportunity to do something with asset management and benefit from macro led yield compression. That said they may consider JESSICA in an improving market.
- It would be very helpful within ING to show that they've done this sort of thing before. Sectors – all sectors including residential (a specific fund for key worker and student) but ok as part of mixed use schemes.
- Urban (city size) – yes, i.e. no rural land funds.
- Infrastructure - they have an infrastructure fund – invests on a global basis with 5-6 other operators investing in toll roads to wind farms where-ever there is a secure income flow and government backing. But this is for existing (ie built) infrastructure projects.
- Structure – mostly experienced with the private sector rather than JVs with the public sector. Tend to be Jersey or Guernsey based investors with tax transparency through unit trusts, typically via a standard JV agreement.
- Blind or not – generally very important to be not blind in order to give it some tangibility.
- Required returns – 15% IRR as a minimum and still may not be enough as their investor clients are saying that if they are getting 15% IRR on built stock why take development risk on top?
- Priority – this sort of approach could be of interest.

- Timing – anything except prime is still pushing out in terms of pricing thus not investing.

John Tatham, Partnerships Director, Igloo Regeneration

- Igloo holds the general view that it is very difficult to make regeneration appraisals that stack up in this market and economy. Rather than modelling on current day costs and values (which show almost inevitably heavy losses) there is a need for a more progressive approach to development and regeneration appraisal.
- Otherwise in Igloo's view there is going to be a complete hiatus of development and regeneration, especially in the north.
- Returns – Igloo require returns of 20-30% whereas they were at 12% before the recession. They also point out that there is less point in investing in sites that require huge regeneration and infrastructure investment when there are many distressed assets, sites and indeed companies (developers) that are 'oven-ready' with infrastructure and/or planning actually in place.
- However in the medium term Igloo are still interested in JESSICA in the NW. Indeed they will shortly be raising equity to invest alongside JESSICA in which they envisage opportunities to go after distressed development opportunities and where they have positions leverage in grant and/or JESSICA funding.
- Priority – if priority return then they are willing to consider a hurdle closer to 17% plus some risk.

9 CONCLUSIONS AND RECOMMENDATIONS

9.1 KEY ISSUES / QUESTIONS

The core purpose of this study was to answer the following questions:

Q1: Could JESSICA be successfully used to unlock/facilitate the Implementation of regeneration schemes?

1. Analysis of how JESSICA could improve upon current investment/funding measures in the Region to progress NWOP
2. Review of four development schemes in the region; addressing specific questions in each scenario; establishing whether JESSICA could be effective
3. Identify and evaluate specific projects/ programmes consistent primarily with AA 3.2 and AA 4.3 of the NWOP, but addressing AA 1.3 of the NWOP as appropriate that could be supported by JESSICA

Q2: How might JESSICA be best deployed in the region?

1. Options for implementation, (not in-depth analysis) e.g. adapting existing structure such as URCs or LABVs) including a recommendation as to the best way to take JESSICA forward;
2. Establish level of private and public sector interest in utilising JESSICA (at UDF level and at project level);
3. Assess and evaluate sources of match funding which might be available; how these assets might be incorporated into a JESSICA fund in line with the ERDF rules on defrayment; an analysis of how any land-based assets might subsequently be developed out in line with the relevant Action Areas of NWOP culminating with a list of criteria which the land-based assets must meet in order to be included in a JESSICA fund.

9.2 Q1: COULD JESSICA BE SUCCESSFULLY USED TO UNLOCK/FACILITATE THE IMPLEMENTATION OF REGENERATION SCHEMES?

Yes. JESSICA has the potential to unlock regeneration schemes from a financial perspective. This has been illustrated in Sections 6 and 7 above in which various JESSICA led approaches to regeneration are set out in the context of the four scenarios.

9.2.1 Analysis Of How JESSICA Could Improve Upon Current Investment/ Funding Measures In The Region To Progress Northwest Operational Programme (NWOP)

This has been shown by the financial model which has concluded that the potential returns from a JESSICA led investment approach provide an improved return over and above the returns (or lack thereof) of a grant funding approach. In the case of Scenario A an improved 'net cash' position of £28.1 million is the result of opting for a JESSICA UDF approach.

It is important to note that the example projects identified above generate returns that are not attractive to the private sector on a pari passu basis. However it is clear that a UDF approach will still enable NWDA to ensure that ERDF monies are able to make a bigger impact over the long term than a traditional grant funding approach.

Equally important the UDF will foster a culture of investment and financial sustainability as opposed to grant funding and 'handouts' that will be essential to the North West as it survives without European Funding after 2013.

9.2.2 Review Of Four Development Schemes In The Region; Addressing Specific Questions In Each Scenario; Establishing Whether JESSICA Could Be Effective

Please see Section 6 above.

9.2.3 Identify And Evaluate Specific Projects/ Programmes Consistent Primarily With AA 3.2 and AA 4.3 of the NWOP, But Addressing AA 1.3 of the NWOP As Appropriate That Could Be Supported By JESSICA

Each Priority has an Investment Framework (IF), each with a specific purpose that has been developed with input from regional and local stakeholders, designed to guide the use of resources under the NWOP.

This section aims to evaluate the consistency of each of the scenarios (as provided in the brief) with each of the Action Areas, and therefore suitability for JESSICA allocations.

Each Action Priority has been dealt with in turn in relation to the four scenarios as set out in the tables below:

Consistency with AA 3.2 – Developing High Quality Sites and Premises of Regional Importance
The focus of this Action Area is to 'drive up regional competitiveness and GVA of the region' and is aimed at the following: • Clearance of derelict land and treatment of contaminated land • Provision of site servicing and related site infrastructure and site specific public transport facilities • Activities that support the development of high quality business environments • Support for marketing and promotion of specific sites Sites suitable for support must demonstrate that intervention is required due to market failure and must have potential to directly expand the region's knowledge based economy and high value sectors. It is considered 'highly desirable' that the Regional Strategic Sites are sustainable in environmental and economic terms.
SCENARIO A Scenario A is a Regional Strategic Site that will create circa 1 million ft² of brand new office accommodation. In particular it will demonstrate the creation of high quality business space, in line with the sub-regional URC's requirement that office accommodation be built to BREEAM excellent standards, thus ensuring that the site will also be sustainable in environmental terms to high standards. The creation of brand new Grade A office accommodation will be targeted at professional occupiers, and it is hoped that the scheme will attract firms not already located in the city centre. Thus this project demonstrates an important role in increasing the region's knowledge based economy. The scheme also offers potential to leverage private sector investmentThe redevelopment will also require extensive marketing and branding to create a sense of place, thus tying in with this Action Area's remit of marketing and promotion for specific sites. SCENARIO B Scenario B is a Regional Strategic Site that has been listed as significant under this Action Area. The city centre currently lacks brand new Grade A office accommodation, and so this scheme is instrumental in the creation of new high quality business environments, in turn increasing the city's regional competitiveness. The displacement of existing occupiers during the adjacent redevelopment poses a threat to the city centre with concerns having being voiced by the city council that occupiers may decide to move elsewhere, either to out of town locations or outside of the city all together. As such it can be seen that this scheme will be instrumental in retaining a proportion of the city's existing knowledge based economy whilst also offering the potential to attract new occupiers that previously wouldn't consider this city centre an office location due to its lack of Grade A offer. The development of the scheme will also create a new investment opportunity with the city thus offering the potential to leverage in private sector investment, which in turn is a key factor in economic sustainability. SCENARIO C Development will see the reclamation of circa 13 hectares of derelict land and is seen as an important stage in linking this run down area of the city centre. Proposals for the private sector development are still being re-considered in light of the current market, although funding is sought for public realm works that will enable private sector development in the area. Discussions with the developer show that proposals may include office, residential, and potentially hotel accommodation, although this will be dependant on market recovery. One proposal for the site being considered is a business village, with smaller courtyard office development which would create new jobs in the area and high quality business environments, in line with the objectives of this Action Area. In addition this scheme is consistent with the objective of provision of site servicing and related site infrastructure, with plans to include the provision of a new foot bridge across the River Irwell and public open space. SCENARIO D The development is a long term vision to expand the town centre by in excess of 70 hectares developing approximately 2000 new homes and circa 140,000 m² (1.5million ft²) of mixed commercial space. It will play an important role in improving the town's regional competitiveness and driving GVA. The expansion of the retail offer also will create new jobs in the region, which will further progress the objectives of this Action Area and have a significant impact on the town's economy.

Consistency with Priority 4, AA 4.3 – Employment Creation for Areas of Regeneration Need **AA 4.3's IF is to 'directly create employment opportunities for residents of target areas', and is aimed at:** • Creating local employment opportunities in, or very near to, areas of particular regeneration need • Help reduce level of worklessness in target areas • Projects will need to focus on priority areas in terms of worklessness and regeneration challenges within the region, and the RES identifies the following areas: • Barrow, Halton and Knowsley • URC areas of East Manchester, Central Salford, Liverpool city centre, West Cumbria and Furness and Blackpool • Housing Market Renewal areas Liverpool/ South Sefton/ North Wirral, Oldham/ Rochdale, East Lancashire/ Manchester/ Salford. Any additional areas must meet an 'alternative threshold', suggested as the proportion of working age population claiming key out of work benefits. The regional average is 13.9%, and so a sub-region will need to have above this level to be considered.
SCENARIO A This city centre is listed as a priority area and therefore qualifies under this AA, and in addition has a working age population claiming out of work benefits that compares unfavourably with the regional average of 13.9%. The creation of 1 million ft² of office accommodation will have both a direct and an indirect impact on employment opportunities and worklessness, with jobs created both in the planning, development, construction, and occupation of the development as well as the local services that will be serve the end users of the building. SCENARIO B This city has not been identified as a priority area and its working age population claiming out of work benefits does not meet the 'alternative threshold' of above 13.9% level of the working age population claiming out of work benefits. As such this scheme is not consistent with this Action Area's objectives. SCENARIO C This scheme is considered a priority area, and in addition has a working age population claiming out of work benefits which doesn't compare favourably with the regional average of 13.9%. This site will attract investment under this AA due to the potential to create local employment opportunities both in the actual development of the scheme and ultimately also in the end use of the uses to which it will be put. In addition the redevelopment will see the reclamation of circa 13 hectares of derelict land and environmental improvements. SCENARIO D This location has not been identified as a priority area and does not meet the 'alternative threshold' of above 13.9% level of the working age population claiming out of work benefits. As such this scheme is not consistent with this Action Area's objectives.
Consistency with Priority 1, AA 1.3 – Increasing Sustainable Consumption and Production **Priority 1 provides business support and funds financial instruments which help improve the competitiveness of the region's businesses. Action Area 1.3 aims to:** Reduce the carbon and environmental impact of SMEs Prepare SMEs for business opportunities/ threats arising from climate change Prepare for future environmental legislations and policies Improve resource efficiency, waste treatment, new forms of energy production and other aspects of environmental improvement.
SCENARIO A This Acton Area is focussed predominantly on SMEs and whilst we would envisage that the site, through the development of Grade A office space, will be targeted at predominantly larger multi national and national corporations, there is potential that smaller business may be attracted to the scheme. However we wouldn't anticipate this development significantly impacting the influence of environmental impact or resource efficiency of SMEs. SCENARIO B The scheme offers greater potential to attract SMEs, whilst at the same time aiming to attract larger organisations. As such this scheme offers the potential to assist SMEs in their environmental activity. However, following discussions with the city council we are aware that the displacement arising from redevelopment of the adjacent scheme will affect their occupier space within the city centre, and it is possible that they may seek to consolidate their functions withinthe location.

SCENARIO C
There are currently proposals for courtyard style office developments to be developed on the site, comprising smaller blocks of offices that will be more likely to attract SME businesses. Investment under this Action Area will be targeted at major strategic projects rather than unconnected piecemeal projects, so qualifying spend would need to be at the development level. For instance, a business officer located on site to educate businesses how best to reduce their environmental footprint.

Examples of activities that will qualify could include:

Activity that supports business to use resources efficiently
Activity that supports regional business to identify and implement CO2 reduction strategies
Investment in technology development focussing on near-market resources
Installation of micro-generation, energy efficient technologies
Projects that demonstrate value for money

SCENARIO D
Scenario D will see in excess of 70 hectares developed, thus offering potential for a variety of SMEs. See above.

9.3 Q2: HOW MIGHT JESSICA BE BEST DEPLOYED IN THE REGION? (IE PROPOSED OUTLINE JESSICA STRUCTURE?)

As the study has shown that JESSICA could work in the North West to unlock regeneration schemes (ie question 1), it is pertinent to consider the most beneficial, practical and cost effective method of implementing a structure for the UDF or UDFs. Although the scope of this paper is not to consider an in-depth analysis we set out below high level recommendations for a structure for implementation in the context of the questions set out in the initial brief.

9.3.1 OPTIONS FOR IMPLEMENTATION, (NOT IN-DEPTH ANALYSIS) EG ADAPTING EXISTING STRUCTURE SUCH AS URCS OR LABVS) INCLUDING A RECOMMENDATION AS TO THE BEST WAY TO TAKE JESSICA FORWARD;

Existing Special Purpose Vehicles (SPVs) in the North West

As part of the process of considering the ideal structure for a JESSICA UDF it is worth considering existing SPVs that are already in operation and may provide the ideal or partial range of skill sets necessary to operate the UDF.

The following table has been produced by the NWDA and summarises existing SPVs that have a regeneration remit:

SPV (and partners)	**PURPOSE**	**VALUE / ASSET MIX**
Space NW NWDA Ashtenne	Asset management of largely industrial estates in Merseyside & Cumbria	£160m industrial estates and land
Kingsway Partnership NWDA Wilson Bowden Developments	Business led mixed use development of Kingsway, Rochdale	£350 million / 170 acre site (NWDA has DTI approval for £34m to support development)
New East Manchester URC Manchester CC NWDA HCA	Leading / co-ordinating physical regeneration	None
Central Salford URC Salford City Council NWDA HCA	Leading / co-ordinating physical regeneration	None
Liverpool Vision Liverpool City Council NWDA HCA	The city's economic growth	None
Furness West Cumbria New Vision Ltd (trading as West Lakes Renaissance)	Deliver the New Vision for the sub region	None
Elevate East Lancashire Limited HMR	Housing Market Renewal	None
Hadrian's Wall Heritage NWDA One North East English Heritage Natural England	Development co to manage the Hadrian's Wall World Heritage Site and develop the economy of the Hadrian Wall Corridor	Assets limited to property and land related to project activities.
ReBlackpool URC Blackpool Council NWDA	Leading / co-ordinating physical regeneration	None
Cumbria Vision	Sub Regional Partnership, single direction to Cumbria Regeneration, galvanise public and private stakeholders	None

Key drivers or criteria for a 'fit' include:

- aligned purpose, ie physical urban regeneration,
- appropriate geographical (and thus political) boundaries, and
- legal constitution including ability to hold property assets and/or make investments.

Initial conclusions tended in favour of Liverpool Vision having potential to provide at least partial skill sets and services required by a UDF. This could work by separating out the core functions of a UDF as defined[8] by EIB (see 2.2 above) and in the context

[8] 'investing in projects included in an integrated plan for sustainable urban development…competence and independence…sound financial backing'

of Liverpool – for example – could unfold with a UDF structure and key responsibilities as follows:

Liverpool Vision	**Professional Fund Manager** **(or PSP Investor)**
Sustainable development role • Economic, social and environmental concerns • Testing integrated and sustainable development requirements of JESSICA • Ensuring fit with North West Operational Programme	Finance and Investment Role • Financial appraisal of potential investments • Ongoing monitoring of investments • General fund manager role (FSA regulations etc)

It is most likely that raising private sector investment will be easier if there is a distinct vehicle acting alongside Liverpool Vision (or one of the other existing SPVS) with a clear set of investment criteria designed to protect financial returns as well as social and economic etc returns and objectives.

It will be essential the two to work closely together however it is likely a deadlock arrangement may be the best arrangement in which both parties seek to protect their own interests with the clear understanding that success will lie in the optimum investments that balance all of the investment criteria.

Whilst in the past this balance between public and private sector interests has often been considered to be too conflictive, evidence from the creation of PPPs such as Space Northwest, Blueprint in the East Midlands etc.

In summary, the structure of the UDF in relation to the various stakeholders could unfold as follows in the longer term in which the PSP funding partner is actually secured after the first project has been committed and initially will be funded purely by the public sector UDF:

How Many UDFs?

Consideration has been given to the number of UDFs that should be created in the North West and is summarised in the table below:

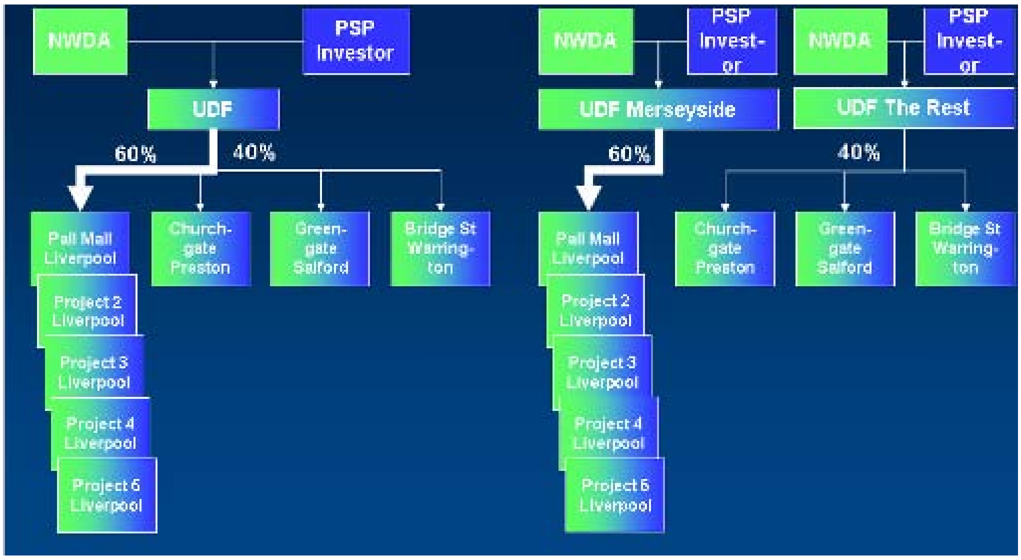
Benefits of a Single v. Multiple UDFs:

Regional (ie 1 UDF)	Sub Regional (ie 2+ UDFs)
• Only requires a single procurement meaning less expensive to procure and to run • A single UDF will clearly be less fragmented and thus less complex to adminster • Should enable a simple and clear relationship to NWDA and NWOP priorities • Local priorities/issues should still be satisfied at the project level • £50 m appropriate size for single fund (in normal market) • Creates the opportunity for cross subsidies between the weak and strong areas of the region	• Provides the opportunity to select and focus more strongly on urban focus (eg Liverpool, Manchester etc) • Potentially more politically attractive to local authorities • Opportunity to 'piggyback' existing SPVs • Multiple partners and UDFs could potentially be more innovative • Asssuming a private sector partner is found multiple UDFs indicates potential for multiple partners and thus the public sector will not be beholden to a single PSP • Potential stronger link to regional ERDF funding priorities

Possible UDF Structures

Although it is beyond the scope of this paper to conduct a detailed analysis initial consideration has been given to the structure of a UDF approach in the North West based on the benefits analysis set out above.

Given the quantum of public sector funding available - ie circa £50 million in ERDF cash and NWDA property assets, we believe there are likely to be only two options open to the RDA given the time and costs entailed in procuring a private sector funding partner and creating a UDF. These are summarised in the following diagram:



Option 1 – a single UDF for the whole of the North West

A single procurement would be less expensive to procure and to run and with a likely investment of £50 million by the public sector provides an attractive sized fund.

There is clarity about a single fund under the remit of the NWDA that all of the sub regions should be able to appreciate and understand. Given the fund is largely about financial issues it provides a clear and natural split of responsibility for the sub regional partners to focus on delivery and wider regeneration issues whilst the RDA through a JESSICA fund provides accessible long term regeneration financing.

A single UDF also creates the opportunity to cross subsidise between especially weak and stronger areas of the region for investment.

Option 2 – two or more UDFs (in particular Liverpool)

Clearly the Merseyside sub-region is a special case given the very significant level of ERDF funding they receive and as such the case could be made for a single UDF for the city areas, possibly to be managed – at least in part – by an existing organisation such as Liverpool Vision.

This would provide a very clear focus on the city enabling a greater level of local understanding and innovation. It is likely to be more attractive to the local authority.

9.3.2 ESTABLISH LEVEL OF PRIVATE AND PUBLIC SECTOR INTEREST IN UTILISING JESSICA (AT UDF LEVEL AND AT PROJECT LEVEL)

At the UDF (Fund) Level

The interest in JESSICA within the public sector at the fund (UDF) level is largely likely to be limited to the RDA. Through our discussions and meetings with the various stakeholders involved in the four scenarios detailed above it is clear that whilst there is an interest from local and sub-regional bodies this is largely concerned with ensuring their projects are relevant and eligible for as much funding as possible to enable projects to progress.

Through the market testing we have established an interest in JESSICA in principle provided satisfactory commercial returns can be made – ie in excess of 20% (this compares with c.12% only 18 months ago). On the assumption that a more balanced macro economy returns to the UK over the next short to medium term these sorts of returns expectations should follow the investment market yields and compress.

At the UDF Level

At the UDF level the private sector partners are likely to be developers and/or landowners from the private sector or council and other local public sector bodies (e.g. the fire and police authorities in most parts of the UK often own significant property holdings. We are confident that given the shortage of credit for physical development even in strong locations that the dearth of development finance from conventional sources will ensure that JESSICA will be oversubscribed.

9.3.3 Assess and Evaluate Sources of Match Funding Which Might Be Available; How These Assets Might Be Incorporated Into a JESSICA Holding Fund In Line With The ERDF Rules On Defrayment; An Analysis Of How Any Land-Based Assets Might Subsequently Be Developed Out In Line With The Relevant Action Areas Of NWOP Culminating With A List Of Criteria Which The Land-Based Assets Must Meet In Order To Be Included In A JESSICA Fund.

The principle source of match funding that will be available to JESSICA UDF will be the £25 million asset value that NWDA has earmarked to transfer to the fund. However it is worth noting that land assets invested at the project level may also be considered as match funding – we understand this principle is currently being considered by the EC for assets from both the public and private sectors.

In addition when the macro economy returns in the UK our market testing indicates that institutional investors will be interested in becoming a 50/50 co-investor in the UDF provided commercial returns are available to them either directly through the projects or indirectly through a prioritised return.

In order to ensure these assets may be incorporated in line with defrayment rules it is essential that monies are committed to be invested by 2015 (ie N+2 = 2013+2). Subject to clarification and confirmation by the Commission we understand that committed means included in a contractual arrangement with project level partners (ie a development agreement or partnership vehicle).

In order that the objectives and policies of NWOP are protected it will be necessary to include and enshrine them in the legal documentation that provides the basis for the UDF. This is usually done in respect to the overarching partnership (ie broad principles) and business plans for the individual sites and buildings (ie specifics). However it is important for the public sector to appreciate that the tighter the restrictions on the UDF during the procurement process the less interest is likely to be shown by the private sector funders.

All of the above will be subject to appropriate procurement processes.

10 NEXT STEPS – A PHASED APPROACH

Given the challenging economic climate and the views of property investors at the current time (as reflected in the market testing) careful consideration needs to be given to the manner in which the UDF(s) for the North West are created.

Assuming agreement to proceed (which is not yet confirmed by the NWDA), to establish a UDF the following headline tasks need to be completed.

Indicative Timetable	
PMC/ Board concept approval	July 2009
Identify match funding	September 2009
Green Book appraisal complete	September 2009
NWDA board approval and PMC endorsement	September 2009
Central Government approvals	October 2009
Negotiation of funding agreement for Holding Fund	July – November 2009
Sign funding agreement	November 2009
Constitute Investment Board	October 2009
Drawdown/ contribute funds to Holding Fund	November 2009
Selection criteria for UDF's	December 2009/ January 2010
Procure UDFs	February 2010
Due Diligence	Early 2010
Negotiate UDF Agreements	June 2010
Commit funds to 1st project	Quarter 3/ 4 2010

This timetable is only indicative and further detailed consideration needs to be given to the procurement and legal implications as well as to the EC's position concerning public only UDFs being created and operating until the macro economy recovers credit and investment is more readily flowing.

Accordingly, it is unlikely a NWDA UDF with private sector funding partner will be in operation until the second half of 2011. Whilst in some respects this is a frustratingly slow timetable it is not unusual given the range of approvals that are required – in particular regarding State Aid.

10.1 PROCUREMENT OF A PRIVATE SECTOR FUNDING PARTNER AT THE UDF LEVEL

The approach to procure the UDF partner will depend on whether the partner will provide services as well as investment and the nature of the services. The selection of candidates could include:

- Willingness and capacity to fund physical regeneration projects; (including the robustness of the candidates financial bid, ability to raise required funds and covenant strength);
- Ability to participate in the partnership (including acceptability of management structure and capability of key personnel proposed); and
- Commitment to NWDA objectives and policies as set out in NWOP.

10.2 ESTABLISHING THE FUND

In order to establish this fund, significant external resource is likely to be required:

- Lead consultants to advise on establishment of the public UDF and thereafter run the procurement process and co-ordinate input from other advisers and across NWDA and stakeholder
- Property advisers for valuation, market and due diligence work in respect of the initial project(s)
- Legal advisers for the fund structuring, State Aid and property legal due diligence
- Environmental consultants to undertake warranted investigations on the sites
- Cost consultants to help prepare appraisals for the initial project
- Accounting advice
- Policy advice

This approach to setting up what will in essence be a purely public sector UDF initially will enable the NWDA to progress as opposed to waiting for the market to return. In some respects the creation of the public UDF and commencement of Project 1 is likely to make the procurement of a private sector partner an easier ‘sell’ as the market testing has clearly indicated that a ‘blind fund’ (ie no initial projects) will be less attractive than a fund with some projects already in place.

If a UDF can be created by changing the role and/or constitution of an existing regeneration vehicle (eg Liverpool Vision) to take responsibility for major elements of the UDF then there should be the potential to save time and set up costs.

The costs to procure a private sector partner for purely funding purposes would be expected to be less, as opposed to a funding and development partner. If the NWDA launch a UDF with project or projects attached there could still be significant property based workload and negotiations to be supported and thus the total number of parties and transactions to negotiate and align could become quite considerable.

APPENDIX A – THE SCENARIOS

Appendix A has been removed for confidentiality reasons

APPENDIX 2 – EXISTING SPVS IN NORTH WEST (SOURCE NWDA)

SPV	PURPOSE	SIZE (VALUE)	ASSET MIX
Space NW § NWDA § Ashtenne	**Main focus** - Asset management of a portfolio of largely secondary industrial estates clustered in Merseyside & Cumbria. There is minimal development opportunity. The secondary function is the promotion of Liverpool Digital and Liverpool Science Park as part of the knowledge based economy. As such both assets have a restrictive science led 'Gateway' policy.	Circa £160m at December 2006 (PRP formation).	42 mixed occupation reversionary industrial estates plus Liverpool Digital (circa 500,000 ft²) and in excess of 15 acres of associated development lands.
The Kingsway Partnership § NWDA § Wilson Bowden Developments (Joint Venture Agreement)	**Main focus** – J.V entered into in June 2002, with a time frame of 15 years. Objective is to facilitate the comprehensive development of the large Kingsway site through proposed business focused mixed use development to create approximately 8,000 new jobs. Kingsway is one of the Northwest's 26 strategic sites, as defined by the NWDA. It is located at a strategic position adjacent to Junction 21 of the M62 motorway, within the borough of Rochdale.	Kingsway is a £350 million, private sector investment. NWDA has in place a DTI approval for £34,317,944 to support development.	Kingsway site 170 hectare (420 acre) gross area, with a 115 hectare (285 acre) net developable area. Will create 3,071,732 ft² of industrial and distribution space, 295,867 ft² of office space and 196, 435 ft² of retail and leisure space with a current allocation of 300 units for residential purposes, Kingsway has a total commercial floor space (B1/B2/B8) 3.6m ft².
New East Manchester Limited § Manchester City Council § NWDA § HCA	**Main focus** – Urban Regeneration Company established in 1999, with the aims of leading physical regeneration, co-ordinating and integrating social, community and economic initiatives and promoting the area to new businesses and residents.	NWDA provides an annual allocation to support agreed Investment Plans	No direct land holdings

Central Salford URC § Salford City Council § NWDA § HCA	**Main Focus** – Urban regeneration Company established in 2005 to attract investment and co-ordinate regeneration and redevelopment in the wards of Kersal, Broughton, Irwell Riverside, Orsdall, Langworthy, Claremont and Weaste, and Seedley.	NWDA provides an annual allocation to support agreed Investment Plans	No direct land holdings
Liverpool Vision § Liverpool City Council § NWDA § HCA	**Main Focus** – Amalgamation of Liverpool Vision, Liverpool Land Development Company and Business Liverpool in 2008 to establish the new Economic Development Company. Primary aim to accelerate the city's economic growth and provide leadership on the economy.	NWDA provides an annual allocation to support agreed Investment Plans	No direct land holdings
Furness West Cumbria New Vision Limited (trading as West Lakes Renaissance)	**Main Focus –** Urban regeneration Company for Furness and West Cumbria. Established to deliver the *New Vision* for the sub region stretching from Morecambe Bay to the Solway Firth.	NWDA provides an annual allocation to support agreed Investment Plans	No direct land holdings
Elevate East Lancashire Limited	**Main Focus** - A Government Hosing Market Renewal Pathfinder set up in 2003, with an expected life of 10-15 yrs.	NWDA provision to support economic development.	
Hadrian's Wall Heritage Limited § NWDA § One North East § English Heritage § Natural England	**Main Focus** – development company established in 2006 to manage the Hadrian's Wall World Heritage Site and develop the economy of the Hadrian Wall Corridor.		
ReBlackpool Urban Regeneration Company Limited § Blackpool Council § NWDA	**Main Focus** – Urban regeneration Company. Tasked with the delivery of the Blackpool Resort Masterplan; a 15yr regeneration plan. Launched in 2003, the Masterplan aims to	NWDA provides an annual allocation to support agreed Investment Plans	No direct land holdings

§ HCA	transform the resort into a world class visitor destination.		
Cumbria Vision	Sub Regional Partnership established by NWDA in 2005. Aims to bring a single direction to Cumbria's Regeneration Agenda, galvanise public and private stakeholders and promote Cumbria.		No direct land holdings

APPENDIX 3 – MARKET TESTING

ING Real Estate Investment Management Michael Chadburn, Value Add Business Unit

General

ING also has RED (Real Estate Development) which focuses on direct development and investment in developer JVs (eg a major development in Chester, Belfast, Stevenage and other JVs). The JESSICA opportunity would fall between 'Value Added and RED .

Their current focus is to come out of sites or 'weather' sites where they see longer term development potential. Thus in broad terms they would have very limited interest at the moment. ie they are seeking opportunities without development risk.

Although their portfolios are broad the location in the NW is 'challenging'.

The newer funds they are setting up in Value Added are seeking 15%+ IRR over 3-5 year play – but must be income producing and ideally an opportunity to do something with asset management and benefit from macro led yield compression.

That said they may in an improving market consider JESSICA though some thought at ING would need to be given to who would lead it. It would be very helpful within ING to show that they've done this sort of thing before. They tend to set up funds in which they get new investors in – ie a mix of external and ING funding (generally easier if they exclude ING money).

Sectors – all sectors including residential (a specific fund for key worker and student) but ok as part of mixed use schemes.

Type of projects – varies from fund to fund in terms of development or risk; JVs sometimes as short as 18 months; others to benchmark against IPD; opportunistic – but not development directly.

Urban (city size) – yes, ie no rural land funds.

Infrastructure - they have an infrastructure fund – invests on a global basis with 5-6 other operators investing in toll roads to wind farms where-ever there is a secure income flow and government backing. But this is for existing (ie built) infrastructure projects – ie they will not fund development just wish to acquire the cash-flow streams.

Some funds are interested in 20-30 year funding streams – eg if a housing association was throwing a blanket covenant over the whole development.

Structure – mostly experienced with the private sector rather than JVs with the public sector. Tend to be Jersey or Guernsey based investors with tax transparency through unit trusts, typically via a standard JV agreement.

Blind or not – generally very important to be not blind in order to give it some tangibility in order that ING can sell on (though at the moment there is a preference to have blind funds as the market is still falling and thus do not wish to be tied to any assets)

Required returns – 15% IRR as a minimum and still may not be enough as their investor clients are saying that if they are getting 15% IRR on built stock why take development risk on top? eg if you are buying off 8%+ IRR for UK recovery stock eg in the City, at some point over next 5 years the yields will come in and there is the prospect of 12-15% returns. Also where there are refurbishment or vacant parts of developments rather than whole scale development.

Priority – this sort of approach could be of interest.

Timing – anything except prime is still pushing out in terms of pricing thus not investing. See above for development opportunities.

Finally – they have a fund that invests in property that will benefit from infrastructure improvement eg in the area surrounding the Chunnel they project improvement in towns on SE coast with reduced commute times to London and so chance to benefit from this. 50% will be in SE and are trying to raise £200m equity and geared. However this fund is parked for time being 'but just dusting off' now in time for upturn and opportunities such as Glasgow for Commonwealth Games. In this fund they can invest 25% in pure development (this fund is a JV with an Australian Investment House).

John Tatham, Partnerships Director, Igloo Regeneration

<u>General</u>

Igloo holds the general view that it is very difficult to make regeneration appraisals that stack up in this market and economy. Rather than modelling on current day costs and values (which show almost inevitably heavy losses) there is a need for a more progressive approach to development and regeneration appraisal.

This includes looking at site from the perspective that it is possible to actually commence with some of the general regeneration work that does is not overly expensive – eg outline planning, some consultation, but not infrastructure provision. In this way Igloo are seeking to be ready for when the market upturn when it eventually arrives. Or at least be ready for pre-let opportunities when they present themselves.

Otherwise in Igloo's view there is going to be a complete hiatus of development and regeneration, especially in the North.

Returns – Igloo require returns of 20-30% whereas they were at 12% before the recession. They also point out that there is less point in investing in sites that require huge regeneration and infrastructure investment when there are many distressed assets, sites and indeed companies (developers) that are 'oven-ready' with infrastructure and/or planning actually in place.

However in the medium term Igloo are still interested in JESSICA in the NW. Indeed they will shortly be raising equity to invest alongside JESSICA in which they envisage opportunities to go after distressed development opportunities and where they have positions leverage in grant and/or JESSICA funding.

Sectors – Igloo invest in mixed use in the fringe central locations of the UK's 20 largest cities.

Investment and development – Igloo's preference is to invest in development however they also consider investment assets where they are investing in nearby development opportunities that will benefit from area uplift.

Structure – the JESSICA UDF principle is acceptable to them.

Priority – if priority return then they are willing to consider a hurdle closer to 17% plus some risk (for Olympics at 18% -

APPENDIX 4 - TIF FUNDING MODEL 'ADDENDUM'

CONTEXT

The concept of TIF funding was introduced above in section 4 which also discussed the possibility of TIF being used to supplement a JESSICA fund (this is not actually possible as the use of TIF relies on primary legislation however its use here is explored hypothetically).

WHAT IS TIF?

TIF enables local authorities to pay for an improvement (usually infrastructure, transport etc) in a specific area by raising debt finance paid for by the property tax revenue generated by that improvement. Whilst TIF is extensively used in the US (49 out of 50 states) it has not been used in the UK. It is reputed to be the most popular form of financing for infrastructure in the US.

HOW TO USE TIF

A TIF is created by the following key steps:

1. A geographic area is designated (the TIF district) and a plan for specific infrastructure improvements within the TIF is created
2. Debt (TIF bonds) is arranged to pay for the improvements
3. Higher property values and new development is stimulated resulting in higher values thereby resulting in higher property based taxes, ie business rates and council tax
4. The higher (incremental) tax revenues over and above the level before the TIF is used to service the debt

WHY USE TIF?

The overarching goal of TIF is to support and guide the limited public finances available for assisting regeneration. The most successful TIFs are where they are used as a public policy tool rather than simply a financing mechanism – ie resources are viewed as a community leveraging opportunity to direct the flow of development. Allegheny, California, Milwaukee and Wisconsin are widely acknowledged as municipalities that adhere to strong public policy guidelines when using TIF.

Often TIF is used to advance regeneration priorities such as targeting investment and development, creating industry niches, catalysing new markets for non-existent services, cleaning up brownfield land and creating or retaining jobs in support of economic development.

There are a number of drivers behind the widespread adoption of TIF in the US. The decline of urban areas in the 1970s and 1980s; reduced federal grant funding and voter opposition against new taxes combined to make TIFs a highly convenient political tool. TIF debt does not count against American municipality's constitutional debt limit.

WHEN TO USE TIF?

Most state laws provide that TIF may be used as a tool to eliminate 'blight' [9] when redevelopment cannot be accomplished by private enterprise alone (often referred to as the "but-for" test). Most large scale projects have usually been joint ventures between the public and private sectors, the TIF being used only to finance the public contribution to the project.

TIF is usually used to finance a variety of costs and improvements pertaining to public infrastructure, land acquisition, utilities, planning costs.

WHO USES TIF?

TIF in the US is governed by state law not federal law. As mentioned, 49 states have now adopted TIF enabling legislation. Whilst this is a clear indicator of its popularity it is important to keep in mind that TIF is a local tool and each state's statute is different. As mentioned the jurisdictions of Allegheny, California, Milwaukee and Wisconsin are particularly noted for their progressive use of TIFs).

In practice the promoter of a TIF can be the local authority or the development agency. In the US, many municipalities organise TIFs through their economic development arms and have a 'well oiled' process to help developers organise themselves in advance of contacting the public sector with a project that they consider has TIF potential.

QUANTITATIVE FINANCIAL MODEL FOR TIF AND JESSICA

As part of the process of investigating the potential for JESSICA in the North West a financial model has been constructed. This can be found later in this report in see section 7.

Although the core purpose of this study has been to investigate JESSICA an 'addendum' financial model has been constructed to illustrate the joint use of TIF as a supplement to effectively complement the JESSICA investment. The details and findings of this model may be found below.

TIF Financial Model

Using base case Scenario Q1b Option 1 it was calculated that £30,523,572 of grant funding would be required to achieve the project an ungeared IRR of 15% which in turn provides the UDF with at least a 15% IRR.

An 'addendum' financial model has been created which assumes that this grant money may be raised through a TIF mechanism. It has been assumed that a senior debt provider (eg the EIB) has lent the £30,523,572 and is to be repaid through a TIF mechanism (in essence the future business rates generated from the new development).

The funding structure utilised is that the debt provider provides the full amount, stated above, and rolls up interest during the development period. The results below show the repayment terms when utilising the TIF route.

THE TIF FINANCIAL MODEL

TIF FUNDING ASSUMPTIONS

1 87.50% of gross rental income applicable for business rates

2 Business rate percentage 48.50% (applied to 87.50% of gross rental income)

3 Business rate growth of 3% p.a. with annual uplifts

4 3 months rate relief post development of commercial building

5 Senior debt rate during development 7.50%, also a 0.50% arrangement fee applied

6 Senior debt rate post development of 6.50% p.a.

7 The debt has no fixed debt service profile, and the business rates (100% or 50%) all go towards paying interest post development and amortising the debt as soon as possible.

8 Grant monies assumed to be required day 1 of development

[9] Usually defined as an area with a predominance of buildings which are deteriorated or a predominance of economically unproductive lands or buildings the redevelopment of which is needed to prevent further deterioration

TIF IMPACT

TIF Route	100% of business rates utilised	50% of business rates utilised
Amount Borrowed	£30,523,572	£30,523,572
Total Repayment (incl interest)/ Amount of Business Rates utilised	£77,477,507	£106,523,214
Total number of years of repayment	18.00	28.25
Number years after development end of repayment	1.75	12.00

The table above shows that if 100% of future business rates generated can be steered towards the debt provider, 1.75 years after total development ends (ie 18 years after the funding is required) the debt will be repaid. Alternatively if only 50% of business rates are utilised a further ten years is required (ie total of 28.25 years for repayment). In each case this will enable the UDF and procured developer to both achieve a 15% geared IRR.

KEY QUESTIONS

Beyond the obvious issue that TIF enabling legislation is required in the UK the above computations raise some very interesting questions about the use of TIF to enable councils primarily to take a more hands on and entrepreneurial role in catalysing large scale physical regeneration. In the absence of alternative grant or other investment funding will the local authority be willing to forego circa £30 million worth of local tax revenue[10] in order to ensure an important physical regeneration project is delivered?

The immediate response may be 'no', until it is considered that:

1. the wider economic and social benefits of ensuring the delivery of the project out-weigh the financial costs
2. if the council elected not to provide TIF funding they would not receive the rates income anyway as the project may founder
3. following repayment of the TIF debt the business rates will revert to the council anyway and as such they will in the long term be cash positive.

[10] This raises a sub-question of how local taxation is collected and distributed. If TIFs were introduced in the UK it would be essential to include principles in the legislation that tied some of the risk and reward to the local authority. Although this would mean a quite significant step in financial devolution for the UK it has been recognised by both commentators and government themselves that the performance of our core cities has been restricted by an overly centralised approach to local government financing.