WIRRAL COUNCIL

CABINET – 4th November 2010

REPORT OF THE INTERIM DIRECTOR OF CORPORATE SERVICES

Joint European Support for Sustainable Investment in City Areas (JESSICA)

1. Executive Summary

1.1 This report updates Cabinet on the proposals for establishing a Joint European Support for Sustainable Investment In City Areas (JESSICA) programme in Merseyside.

1.2 This report sets out the background to JESSICA and the process to date of working with the Igloo consortium to create a sustainable investment fund.

1.3 Cabinet are asked to consider the background information and note the importance of JESSICA as a future funding instrument and agree to provide 'in principle' match funding to a Merseyside portfolio of assets that will allow the sub region to access £30m of European Regional Development Fund (ERDF) monies to invest in development activity, subject to legal advice and specific conditions. For this we are being advised by Cobbetts LLP. The list of preliminary identified sites are contained within Appendix A of this report which is commercially confident.

2. Background

2.1 As detailed within the report to Cabinet on the 22nd July 2010, the development process for JESSICA has been long and protracted because of the complexity involved in the technical nature of the fund. JESSICA is a funding instrument that provides a financial loan to a development which will essentially be required to be returned to the fund, with a rate of interest. It does not provide GAP funding support as the money will not be offered as grant and therefore does not address market viability issues like other EU grants have. One of the biggest risk to Merseyside at this stage is that if the £30m of European Regional Development Fund (ERDF) monies invested in JESSICA in Merseyside is not spent, then this money will either bespent elsewhere in the North West or returned to the European Commission under 'de-commitment' rules.

2.2 JESSICA will enable the creation of an Urban Development Fund for Merseyside (the MUDF) with appropriate management arrangements. The fund will support the private sector and the main aim will be to use the Fund to lever in maximum private investment by sharing risks innovatively. The Fund will invest in the property market in the area where the commercial banks and institutions no longer have appetite but opportunity to make returns exists – it addresses market failure in the debt markets. Lending rates are extremely high at the moment and the Fund would provide an incentivised rate of interest to developers.

2.3 Given the levels of complexity, the lack of available sites in LA ownership and match funding, Local Authorities took a decision not to undertake the lead role for JESSICA themselves. The risks in operating an Urban Development Fund (UDF), taking accountable body status for both the ERDF and the UDF activity are significant for any Local Authority particularly give the current financial climate. The significant unresolved issues over the risks resulted in the decision to support a private sector bid rather than leading a public sector one. Following a procurement round operated by the European Investment Bank (EIB), the Igloo Consortium emerged as the only organisation to submit proposals to deliver the Merseyside UDF and secured approval from EIB to proceed to the Stage 2 Business Planning Process.

2.4 Members are asked to note here that the Rest of the North West JESSICA element will be managed by Manchester City Council on behalf of the other LA's in the North West. They will procure a private sector fund manager and have used a number of key assets alongside financial support from the Manchester Pension Fund. The Rest of the North West (RONW) UDF is allocated £20m of ERDF but the NWDA also allocated and additional £10m of Single Programme money to align to the RONW UDF making this model more 'workable' in the flexibility and ability to fund a slightly different type of project.

2.5 Officers explored the practicalities of this approach in Merseyside but a number of issues prevented a similar approach from being taken. The issues were raised with each of the Merseyside Regeneration Directors who all concurred that the risks involved to the Local Authorities made it preferable to work with the Private Sector. Initial discussions with the Merseyside Pension Fund were unviable at that stage.

2.6 Therefore, Merseyside Local Authorities Chief Executives made the decision to support in principle, a private sector led bid for UDF.

3. Current Position

3.1 For Merseyside, the Igloo Consortium is proposing to establish the Merseyside UDF (M-UDF) as a Company Limited by Guarantee. Igloo's

Consortium has a strong track record working together on other similar regeneration funds and consists of:

- Aviva as Fund Manager – one of Europe's leading Fund Managers and Institutional Investors. M-UDF will be operated by the Aviva team responsible for the Igloo Regeneration Fund and will have access to Aviva's investment analysis resources.
- Royal Bank of Canada as Banking Advisor - leading advisor and funder for infrastructure globally, specialising in PPP structures with access to both the capital and banking markets.
- Igloo Regeneration Limited as Investment Manager – manager of the Blueprint PPP in East Midlands and the Igloo Regeneration Fund. Igloo will manage the investment portfolio.
- GVA Grimley as Investment Agent - National market leading adviser in all aspects of commercial property and long-time retained advisor to Merseyside Authorities. GVA will work with local promoters to identify suitable investments.

3.2 The M-UDF will invest in accordance with an Investment Policy that provides a framework for that has been set in consultation with local partners and stakeholders. The Northwest Urban Investment Fund will screen investments. Please not that his framework will be based on the North West Operation Programme Investment Frameworks for Action Areas 3.2 and 4.2 (Strategic Sites).

3.3 The Igloo Consortium will be paid fees to operate the Fund which are:

- Substantially linked to Fund performance
- Funded to a large part out of the projects invested in
- Lower net cost than traditional ERDF management costs which tend to be around 3% of ERDF

3.4 The risk attached to the Fund will be managed by the Consortium as professional advisors. The risks include:

- Inability to secure match funding
- Inability to identify suitable investments
- Potential exposure to ERDF and State Aid rules
- Loss of funds due to poor investment selection

3.5 Cobbetts LLP have been appointed by The Mersey Partnership to provide independent legal advice on two parts of this process for Liverpool City Region partners. In the first instance, Cobbetts are providing advice on the best way to set out governance arrangements for the M-UDF in terms of how the Local Authorities are represented. Future reports will be brought back to Cabinet for decision on this aspect of the proposal.

3.6 Igloo's bid is progressing and the LCR Chief Executive's letter of support provided was a crucial enabling measure for allowing the submission to go forward. However, lack of clarity on potential sources of match funding for the bid have prevented the North West Urban Investment Fund (NWUIF) from awarding preferred bidder status to Igloo. At the last Investment Board meeting of NWUIF, it was agreed that a further extension of time to early November would be given to Igloo to enable them to work with the Merseyside Local Authorities and NWDA to attempt to address the match funding issue.

3.7 The main issue currently facing Merseyside JESSICA is the need to identify £30m UDF level match funding to draw down the ERDF from the Regional Holding Fund (RHF). This is an European Union regulatory requirement. Without addressing and resolving this UDF match funding issue, it will not be possible for the JESSICA fund to be set up and delivered within the sub-region. Cabinet are asked to note JESSICA's importance and the potential of bringing in significant amounts of private sector & external investment that will be attached to the £30m ERDF monies. JESSICA will also provide significant long term downstream benefits to LCR, particularly once the ERDF has been 'washed' through and wider scope of activity can be delivered and associated wider private sector investment and involvement that could be attracted.

3.8 Due to the importance of the UDF match funding issue, the EIB has requested to the Igloo consortium that an in principle letter of agreement/guarantee is demonstrated to address the match issue. The Rest of the North West (RONW) fund already has provided an in principle guarantee of providing upfront UDF level match funding.

3.9 Although there is a positive prospect that the European Commission will agree to an amendment in the regulatory requirements and allow match at 'Project' level and therefore negate the need for UDF level match, there is no certainty of this actually being adopted and the timescales for approval may be longer than envisaged – currently December 2010. Whilst project level match is clearly preferable, the uncertainty around the proposed change in regulations requires that alternative match plan be devised to demonstrate to NWUIF and EIB that there is credible investment proposition in Merseyside.

4. Next Steps

4.1 In order to offer an in principle letter of intent to provide 'holding' match funding it is important that Merseyside Partners fully understand the risks of doing this. To this end, Cobbetts LLP have been asked to advise on the potential risks of providing this match funding.

4.2 Alongside this, Officers will explore how an independent valuation of the asset portfolio can be conducted with the cost being met by the M-UDF. The assets would be used by undertaking the following strategy:

Title restriction' on assets placed within the fund and these assets used as 'holding temporary match' (£30m Portfolio)

4.3 A £30m portfolio of assets identified (not including assets with outstanding mortgages) and 'restriction of title' placed upon those assets in favour to the UDF. Local Authorities (L/A's) will retain ownership of all assets (and liabilities). The restriction on title will prevent L/A's from disposal of these assets whilst under restriction but there will be an option for authorities to seek consent to substitute assets or cash of equal value at anytime, thus allowing authorities to have the control to remove and change assets, but ensuring that there is a commitment from the L/A's to ensure that the level and value of match is maintained to enable the UDF's ERDF obligations to be adhered to. All assets will require an independent valuation.

4.4 NWDA have adopted this approach in providing match for the Regional Holding Fund (RHF) and this 'holding temporary match' will operate on a similar principle to that of the RHF and assets will be placed within the Urban Development Fund (UDF) as a means to draw down the ERDF. These assets do not need to be developed as projects and do not need to development sites. NWDA have advised that a mixture of sites have been assigned as temporary match in the Holding Fund and that the restriction on title placed on these sites has not proven prohibitive.

4.5 Subject to change in EU regulatory requirements and agreeing to project level match, as projects are developed with their own match, assets within the UDF can be substituted and removed from the UDF and restriction lifted. If the EU regulatory requirements are not changed and project level match not permitted, it will be necessary for local authorities to have a Plan B as 'real match' will be required to allow ERDF to be invested. This will require Igloo and L/As to work together to identify which assets could ultimately become projects and be invested through the UDF structure to attract ERDF funding and provide the necessary match. In this scenario, the 'holding temporary' match assets will be substituted for by Plan B assets and JESSICA will effectively become a fund for public sector projects as it is unlikely that the private sector/banks would engage with this process by placing their assets within UDF (charge against them). It should be noted by Cabinet that there is a positive prospect of regulatory changes being made towards the end of this year and thus not require Plan B, although it is prudent at this stage to consider all options and eventualities.

4.6 The portfolio of assets temporarily matched into the fund by a restriction on title will have no risk of ownership change or claw-back (Subject to Legal Advice). All risks will be placed at project level by the UDF fund manager through a legal offer letter. In addition, if the UDF doesn't make investments into projects or the fund winds up, the restriction on title is removed from assets and returned back to the local authorities.

4.7 The main identified risk / liability to assets within the UDF, other than inability to utilize or dispose of the asset (whilst the title restriction applies) if substitute match is not available.

4.8 The 'holding temporary match' seems to be the best option for local authorities to consider at this stage in dealing with the UDF match issue.

4.9 However, Local Authorities also have the option of providing portfolio assets for UDF match that will also be directly developed as projects. This is an ideal scenario as both match level issue and project level delivery is achieved. There are also various options available to the UDF in the way it draw-downs ERDF from the RHF (project by project).

4.10 This option may be difficult to achieve for 1st round JESSICA investments due to project readiness & timescales for spend and delivery.

4.11 Assets that are delivered as 'projects' via the UDF will ultimately become the project level and subject to all contractual obligations of ERDF offer letter (performance, expenditure, claw-back) and loan conditions. The L/A would be entitled to a proportionate level of return once realized.

4.12 Whilst a considerable amount of work has gone into the development of a suitable arrangement for a Merseyside UDF, there is still a lot of work to do to ensure that the Local Authorities interests are reflected within the company limited by guarantee. If successful, the M-UDF will be exactly what Government are looking for in terms of a private/ public mechanism for generating economic growth on a sustainable basis. LCR partners will become members of the M-UDF under the current proposals but must be stated here that the Investment Board, which will consist of the private sector only, chaired by an independent private sector representative, will solely be responsible for investment decisions. This process will need to be managed very carefully to avoid potential conflict of interest and one of the immediate tasks is to set out a policy of how this will be managed. Further reports will be brought back to Cabinet on the matter in due course.

Wirral Match

4.13 Wirral Officers have undertaken an exercise to identify a potential £5m asset value of match funding. The sites that have been identified have development potential which could potentially become M-UDF 'projects'. The proposed sites are identified in Appendix A of this report (which is commercial in confidence).

4.14 Before committing Wirral Council to any definitive arrangement Officers will review the figures and sites as this exercise has been carried out quickly for indicative purposes. Some of the sites identified above could benefit from having the ability to finance development activity via the Merseyside UDF.

4.15 Additionally, to prevent any of these assets being locked into an agreement when market conditions determine that the assets can be brought to the market for development, a reserve list of assets has been identified. These assets do not have development potential but they do have a book value to allow them to be included as match funding. No assets will be tied up in this process that would prevent future development opportunity.

5.1 Risk Analysis

5.1 There are a number of risks in relation to Merseyside partners supporting the Igloo Consortium. In particular, these are:

RISK	Description	Control
ERDF De-commitment	If Merseyside cannot establish a suitable delivery arrangement for the Merseyside UDF, the £30m ERDF allocation would need to be spent elsewhere in the North West or worst case scenario, handed back to the EU under de-commitment rules in 2015.	To align the UDF with the emerging LCR Local Enterprise Partnership proposals and ensure the money is spent on viable Merseyside projects and to support the Igloo Consortia in establishing a fit for purpose Urban Development Fund for Merseyside
Local Authority Control	That the LA's do not have a role in the UDF that ensures it delivers against it original objectives.	To agree a governance structure for the UDF that fully reflects the Local Authorities interests in the delivery of fund activity in line with a robust investment policy
Round 2	Round 2 activity post 2015 can fund non ERDF activity as the money will effectively be 'recycled'. A new investment framework and a different structure will be required to deliver this.	To ensure LA's have a role within the development of a new structure for the role and that if the first round UDF has not delivered, LA's can influence EIB to look at re-procuring and re-designing the UDF arrangements.

Projects with regeneration benefits and projects that cannot be supported by Local Authorities	That projects with the ability to generate commercial returns are given precedence over projects that have more regeneration benefits and strategic importance to LCR partners. There is also the risk of the M-UDF Investment Board supporting projects that cannot be supported by Local Authorities.	Officers from each LA will work with Igloo to identify potential opportunities with LA assets and private sector led schemes, particularly those that have secured other funding to address gap funding issues. There will also have to be agreement reached if projects have potential to create a conflict of interest with LA's. A policy will need to be adopted to avoid this situation.
Matched assets for the Holding Fund	That Local Authorities assets are placed at risk in being used as holding match funding.	That the risks are set out and a strategy for managing them is developed. Further legal advice is being souight.
The EC do not make the expected regulatory changes to the JESSICA rules	The holding match within the fund will be required to be replaced by projects that are classed as 'developable'. The main risk is that the projects could not be brought forward in time to meet the programme timescales.	A new strategy would need to be adopted at this stage. The worse case scenario Merseyside would have to allow the ERDF to be spent elsewhere in the NW of de-committed and lost to the NW region. However, the holding match would be 'repatriated'.

Legal Advice

5.2 Cobbetts LLP has been asked to comment on the risks to the LA assets with placing a restriction on title in favour of the holding fund. Cobbetts' initial in principle advice is that the risks to an LA in terms of losing rights and interests in the asset are minimal, provided the contractual arrangements and restriction itself are suitably drafted and provide appropriate flexibility. However for the restriction to have any value in terms of providing the match it will have to be designed to include the flexibility to replace assets with those of an equivalent value or cash. This in turn means that assets are not locked down and if the fund was unable to spend then the ERDF would be re-allocated or worst case, de-committed, thus potentially freeing the restricted asset from being tied in as match.

5.3 The point is that the assets are effectively security to hold against the £30m ERDF, to ensure that the ERDF may be gathered and spent at all. If it were not these assets securing the ERDF it would need to be something else, hence the need to ensure some flexibility.

5.4 It must be noted that any letter of in principle match funding would be conditional on a restriction on title being the requirement. If EIB were to require additional commitment, this would be brought back to LCR Cabinet. Further legal advice will be sought prior to progressing any further than the in principle letter.

6. Financial implications

6.1. At present, the only financial implications are the costs of the independent legal advice. Members have agreed to previously contribute £5,000 to a LCR fund that all LA's have paid into. Any additional costs resulting from the development of the project will be reported back to Cabinet.

7. Staffing implications

7.1. Existing Officer time will be required to support the development of this and to also support the private sector navigate the programme as and when it starts.

8. Equal Opportunities/Equality Impact Assessment (EIA)

8.1. The JESSICA programme will be compliant with ERDF regulations.

9. Community Safety implications

9.1. There are no direct Community Safety implications arising from this report.

10. Local Agenda 21 implications

10.1 None as a direct result of this report.

11. Planning implications

11.1 There are no direct planning implications arising from this report.

12. Anti-poverty implications

12.1 All of the activities outlined will help to reduce poverty and deprivation.

13. Human Rights implications

13.1 There are no implications arising directly from this report.

14. Social Inclusion implications

14.1 The approach outlined helps to promote social inclusion.

15. Local Member Support implications

15.1. There are no implications arising directly from this report.

16. Background Papers

16.1 Background papers to the JESSICA initiative can be obtained by contacting Alan Evans on 0151 691 8426.

Recommendations

Cabinet are asked to:

i.) Endorse the continued development of this project and receive further reports in due course

ii.) Agree to provide in principle 'holding' match funding to draw down ERDF to Merseyside to the value of £5m against Council owned assets (to be determined definitively once legal advice has been received). This will be subject to the analysis of the risks of placing a restriction on title of the assets identified.

iii.) A further report on this matter to be brought back to a future Cabinet.

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