Chrysalis Fund: 2014 – 2020 Ex ante assessment

Executive Summary to the Update Paper for proposed Urban Development Fund

23 March 2018

Liverpool City Region Combined Authority

Final

pwc

Important notice

This executive summary has been prepared under our engagement letter with Liverpool City Region Combined Authority (LCR CA) dated 28 November 2017. It summarises our findings as set out in our report dated 23 March 2018. As explained in our engagement letter, we accept liability only to LCR CA. We accept no liability (including for negligence) to anyone else in connection with our work under this engagement letter and the report may not be provided to anyone else.

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Executive Summary

As per requirements set out in Article 37 (3) of the Common Provision Regulations (CPR), the Ministry of Housing, Communities and Local Government (MHCLG) is required to publish a summary of the findings and conclusions of the Ex Ante Assessment Update prepared for the Liverpool City Region Combined Authority within three months of the report being finalised. This Executive Summary document has been written for this purpose. It should not be relied upon in its own right.

Background and introduction

PwC was appointed by the European Investment Bank (EIB) in 2014 to undertake two Ex Ante assessments for two[1] new Urban Development Funds (UDFs) for the 2014-2020 period for the Liverpool City Region (LCR). While, at the time, there was insufficient evidence to justify the establishment of a Low Carbon Investment Fund, there was sufficient evidence for a further UDF, referred to as Chrysalis Fund II. However, following the completion of the Chrysalis Fund II Ex Ante assessment report in 2014, the LCR did not progress the establishment of this proposed UDF.

The LCR Combined Authority (LCR CA) now wishes to revisit the 2014 Ex Ante assessment undertaken for the EIB, with a view to updating the evidence base for establishment of a UDF to support its application for £25m of ERDF funding for the UDF from Ministry of Housing, Communities and Local Government (MHCLG). LCR CA has accordingly appointed PwC to provide an update paper to the 2014 Chrysalis Ex Ante report (Parts 1 and 2) to re-test whether sufficient evidence still exists for the establishment of a further UDF in 2018.

The update paper covers the potential for the proposed new UDF to have broadened investment parameters including (a) real estate and property, and (b) low carbon focus, which were considered separately in the 2014 Ex Ante reports.

The work has been performed over the period 28 November 2017 to 23 March 2018. The update paper has been prepared from:

- Meetings with and documentation provided by LCR CA and Igloo as the fund manager of the Chrysalis Fund; and,
- Review and analysis of a variety of publicly available documents and a number of documents shared by LCR CA.

The production of the update report has been overseen by LCR CA officers, including the Lead Officer for EU related matters. The work undertaken has been a function of the level and quality of information available and PwC has not sought to verify or validate the information provided.

The impact of the UK's decision to leave the European Union has not been considered within the scope of this update paper.

References to State Aid should not be considered as formal advice. State Aid is a specialist area and legal advice should be sought.

[1] These were called Chrysalis Fund II and a Low Carbon Investment Fund at the time.

Part 1: Key findings

UDF funding

The new UDF will seek £25m of grant from the 2014-2020 European Regional Development Fund (ERDF) Operational Programme (OP) across the following Priority Axes (PAs):

- PA1: Research and Innovation – £1.9m;
- PA3: SME competitiveness – £13m;
- PA4: Transition to Low Carbon Economy (Energy): £10.1m

It will seek to source an equivalent amount of match funding from public and private sources, with a further £17m of recycled monies available from the Chrysalis Fund. Thus the aggregate funding supply in the LCR across the areas outlined above is £67m (comprising £25m ERDF, £25m match and £17m recycled).

Historic performance of the Chrysalis Fund

The performance of the Chrysalis Fund provides important context and precedent when considering the new UDF. Highlights include:

- The fund has made capital commitments of £34.3m across 8 loans. Of this, 6 loans totalling £17.2m (c.50% of total funds under management) have been repaid in full with 4 having been repaid earlier than the final maturity date. Two loans totalling £17.1m (c.50% total) have not commenced repayment yet and maturity is in late 2022. The fund manager is confident of repayment in both cases;
- The fund manager has calculated that its £34.3m capital commitment has been part of an overall £117m funding support package for the LCR. In other words, every £1 of Chrysalis funding has leveraged £3.4 for the LCR. In addition, the Fund has also created material additionality in a number of other cases through its role in capital structuring which the fund manager believes was pivotal in securing complex financing packages involving several different financiers with their own restrictions; and
- The fund has achieved 93% of its land remediation target, 66% of its job creation target and only 37% of its floor space target. The fund manager and LCR CA believe the targets were set at an unrealistically high level.

The launch of the Single Investment Fund (SIF) grant process in December 2016 had an adverse impact on Chrysalis's ability to deploy capital, resulting in no new loans being made in the past year. Thus the key learnings from the Chrysalis experience relate to the need for an integrated approach towards public sector investment in the LCR going forward. This is being considered through the SIF strategy development work currently underway at LCR CA.

Project pipeline

In relation to the real estate/property component (broadly covering PA1 and PA3), an assessment of the current Chrysalis Fund pipeline as prepared by its fund manager Igloo has found a total capital funding requirement of c.£368m across 18 projects in the LCR, of which Chrysalis / UDF type loans could provide c.£91m over the investment period. Of this:

- 6 projects with a total capital requirement of c.£210m are in 'pre-development' stage with a higher degree of confidence as viability has been established; the loan component of this is c.£36m; and
- 12 projects with a total capital requirement of c.£158m are in an earlier, 'viability' stage; the loan component of this is c.£55m. Three of these 12 projects have received in-principle grant commitments from SIF for ground remediation works.

In relation to the low carbon component (broadly PA4), there is the potential for the UDF to support investments that combine low carbon and real estate/property elements. However, there is a recognition by LCR CA that further skills and resource are required to accelerate such investment. It is in the process of establishing a Low Energy Hub and will be seeking to access new Technical Assistance (TA) support from central government for development of Low Carbon pipeline projects in early 2018.

In summary across Part 1, there is pipeline demand of c.£91m for UDF-style financing in the LCR in the investment period. This is in excess of the maximum £67m of funding supply from the Chrysalis Fund and the new UDF. Combined with independent market research, such as the December 2016 report by Cushman & Wakefield highlighting the need for new modern office space in the LCR, this suggests there may be scope for a new UDF.

Part 2: Key findings

Investment strategy

The findings of the 2014 Ex Ante assessment, which included the experience of the Chrysalis Fund, suggested that the permitted investments of a new UDF may include the following:

- **Sector focus:**
  - Development of site-specific infrastructure and site servicing to help de-risk projects;
  - Construction of new buildings and/or renovation of existing ones; and
  - Investment into low carbon projects linked to new development or regeneration that support the delivery of LCR's greenhouse gas emissions target and/or demonstrate energy efficiency improvements.

- **Investment products**: senior and mezzanine debt or equity / quasi-equity with a tenor of up to five years. Tenors of up to 15 years may be considered where outcome justifies the extended period. All funds to be invested by 2022.
- **Investment recipients:** predominantly private sector or public-private joint ventures.
- **Investment terms:** predominantly commercial terms, with the flexibility to invest at sub-commercial or preferential rates. There will be no minimum investment size, similar to that of the Chrysalis Fund.

The 2017/18 Ex Ante update findings in respect of the project pipeline suggest the investment strategy proposed in 2014 remained valid. The only possible addition is in respect of the UDFs support to the region's low carbon pipeline. The update paper finds that the UDF may invest in integrated as well as standalone low carbon projects, particularly if the pipeline matures through the establishment of the proposed Low Carbon Hub technical assistance facility, and the investment needs of these projects align with the wider development / regeneration strategy for the proposed UDF.

The timely deployment of capital against this investment strategy will be dependent on the LCR CA delivering an integrated approach to deployment of public sector capital and the successful implementation of the proposed Low Carbon Hub as outlined above.

Outcome measures

The key non-financial metrics for the UDF are based on the Priority Axes targeted. Potential targets for some of the metrics have been estimated below, based on extrapolation from the actual performance of Chrysalis as suggested by LCR CA.

PA	*Output Indicators*	*Possible targets for new UDF*
PA1 & PA3 (£15m)	C7- Private investment matching public support to enterprises (non-grants)	To be confirmed, possibly in conjunction with any proposed fund manager / advisor procured to support the activities of the UDF
	C8- Employment increase in supported enterprises	Up to 1,543 FTE
	P2- Public or commercial buildings built or renovated	Up to 28,999 Sqm
PA4 (£10m)	C30 – Additional capacity for renewable energy production	To be based on pipeline development

PA	Output Indicators	Possible targets for new UDF
	C32 – Decrease of annual primary energy consumption of public buildings	To be based on pipeline development
	C34 – Estimated GHG reductions	To be based on pipeline development

UDF governance

With effect from 1 January 2017 LCR CA took over as the Holding Fund manager for the Chrysalis Fund. LCR CA also took the place of the EIB in the overseeing its operation. The Chrysalis Fund is managed by the Igloo Consortium, who provide a combination of fund, development, investment and asset management expertise.

Learnings from the Chrysalis experience can be used to inform the governance of the new UDF. LCR CA will need to ensure effective oversight and monitoring of the performance of both the Chrysalis Fund and the proposed UDF upon its establishment. This will include building in-house capabilities to perform this function, and greater alignment with public sector funding in the LCR.

UDF design

Three key structural options were considered for the UDF in the 2014 Ex Ante assessment, and LCR CA has confirmed that these options remain unchanged:

No.	Option	Summary description
1	LCR CA investment decision making and management	LCR CA-led staffing and expertise to consider and process applications for funding, make investment decisions and undertake ongoing reporting and monitoring.
2	LCR CA investment decision making with external management support	LCR CA -led investment decision making, but could include external support from advisors, a financial institution (which may also act as a potential investor) and/or private sector fund managers, in respect of the investment management process and/or ongoing reporting and monitoring.
3	External investment decision making and management	UDF would be fully outsourced to a third party (e.g. a financial institution or private sector fund manager), with public sector oversight of the activities of the UDF limited to a Board of Directors on the Advisory Board (akin to the Chrysalis Fund).

These options have been assessed against a range of criteria, including deliverability, flexibility, ability to attract private sector and other sources of match funding, cost minimisation of fund management, better use of public sector resources available to LCR CA, consideration of a centrally led pipeline and project development across all funding streams available to LCR CA and credibility with commercial investors and developers.

Based on this analysis Option 2 has been selected by LCR CA as the favoured governance option for the UDF as it combines more effective direct oversight by LCR CA with the private sector expertise required for the UDF to have market credibility. However several considerations will need to be taken into account in deciding on the final preferred option. As emphasised above, LCR CA will need to strengthen and actively manage its coordination of the Chrysalis investment strategy, the UDF investment strategy and its other internally managed funds to pull together the most effective package of funds for projects going forward.

As key decisions regarding the investment strategy and structure and future governance of the proposed UDF are still to be finalised it is expected that updates prior to establishing the fund(s) will be required. This shall form part of the ERDF application and its associated monitoring and evaluation plan.

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