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Ex-Ante Assessment of UDF Investment in Cheshire & Warrington

A Final Report by Regeneris Consulting

Cheshire and Warrington Local Enterprise Partnership

Ex-Ante Assessment of UDF Investment in Cheshire & Warrington

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1. Introduction

1.1 Regeneris Consulting was commissioned in 2016 by the Cheshire and Warrington and Lancashire Local Enterprise Partnerships (LEPs) to prepare an ex-ante assessment of the proposed investment of ERDF allocations in each area to an emerging Urban Development Fund (UDF) developed and coordinated by the Greater Manchester Combined Authority (GMCA). This provides a source of debt finance to support strategic commercial development, and operates as a recycling funding instrument with repayments and interest contributing to a resource to enable further investment to be made.

1.2 The proposed Fund would build on the current North West Evergreen Fund which was delivered under the 2007-13 ERDF Operational Programme for the North West. It is understood that Cheshire and Warrington and Lancashire would be limited partners in a new UDF, and that investments in the two areas be made through the structures and processes currently being put in place by the GMCA.

1.3 Ex-ante assessment is a formal requirement to permit ERDF investment to made through a UDF. It is structured around two distinct strands. Block 1 provides the evidence necessary to demonstrate there are market failures in the provision of development finance, and that a UDF is an appropriate mechanism to address these failures. In addition, it demonstrates that there is a sufficient pipeline of potential projects that might meet the criteria for UDF investment, and identify the advantages and issues to consider in delivering UDF investment. Block 2 centres on the development of an investment strategy for UDF which should specify the requirement for investment and how its delivery will be coordinated and managed.

1.4 This report provides the evidence required in Block 1 of the assessment for Cheshire and Warrington, and specifically:

- An overview of the rationale for investing through a UDF.
- An assessment of the strategic context (socio-economic and policy) for investment
- A review of development market conditions to establish key development locations and types, and where market failures may be present.
- A review of development finance activity and the current state of the development finance market to identify the presence of any finance gaps and understand their causes.
- An initial assessment of project pipelines provided to the evaluators by the local authorities and explored with site promoters and developers where possible.
- A review of the added value of delivering investment through a UDF.
- A summary of the key lessons learned from the delivery of similar instruments elsewhere.
- Conclusions and potential options for Cheshire and Warrington to consider.

1.5 This is a final draft report which has been prepared specifically for Cheshire and Warrington Local Enterprise Partnership.

2. Ex-Ante Assessment Methodology

2.1 The European Commission has committed the EU to increase the use of Financial Instruments (FIs). Recent EU Structural Funds programme rounds have been marked by stronger emphasis on repayable finance over traditional grant funding solutions across several of the investment priorities to which ERDF programmes are directed. The rationale for this increased in the use of FIs centres on advantages which include:

- better meeting the need of investors
- securing a higher level of private sector leverage
- delivering greater economic benefit, financial returns in the form of repaid debt and interest which can be recycled in the future, and overall better value for money
- encouraging behavioural change in terms of the switch from dependence on grant
- the development of finance markets where they are weak or absent.

2.2 Urban Development Funds (UDFs), of which the current North West Evergreen Fund and its successor in the 2014-20 programme are examples, have become established as a distinct category of FI. They focus on the development of business sites and premises, together with the regeneration of urban areas. This section of the ex-ante assessment briefly sets out the rationale for the use of UDFs and their underpinning design principles. It then sets out the methodology for the Block 1 market assessment.

Rationale for Urban Development Funds

2.3 The concept of market failure is at the core of the rationale for investing through a UDF. The EU's guidance on the ex-ante assessment of UDFs specifies that sub-optimal investment situations and unmet investment needs have to be identified through the assessment as part of the justification for investment. The main factors that give rise to these conditions are summarised below.

Market Failures

2.4 The market failures that result in sub-optimal investment conditions and, in turn, unmet investment needs can be structural and cyclical. They may be evidence both at the level of individual developments (sites and premises) and at an area level. The table below summarises the different types of market failure present in development markets and whether they are structural or cyclical.

Table 2.1 Types and Causes of Market Failure

	Structural	Cyclical
Area	• **Information Asymmetry**: developers and investors are not fully aware of the risks and potential returns of investment opportunities in an area. This could give rise to perceptions of the area as being one of high risk and low opportunity, in turn reflected in investors' propensity to seek development opportunities and invest. • **Path dependency**: developers and investors are likely to value the benefits of sector growth and area regeneration in a different way to the public sector. They may be unwilling to take higher risks or bear the extra cost of developing specific sites and premises in an area regarded by the public sector as a key development location or a priority for regeneration.	• **High risk aversion in lending:** risk of restricted lending at points in economic cycle. Investment portfolios may be unbalanced as a result of excessive risk taking at top of cycle and adjustment leads to adverse borrowing conditions for developers. Retrenchment of investors to best performing markets (London) a feature of last recession with adverse impacts on development investment in Cheshire and Warrington.
Project Level	• **Coordination failures:** the time, cost and complexity involved in assembling larger sites will not readily be borne by the private sector. • **Positive externalities**: some of the benefits associated with bringing development forward valued by the public sector (eg. job creation) may have no bearing on decisions made by developers and investors. • **Negative externalities**: the benefits of removal of negative externalities such as dereliction, or land contamination are not valued by developers or their investors. Many of these barriers to development directly contribute to a lack of viability and serve as a deterrent to investment. • **Information Asymmetries in the Supply of finance:** these affect particular classes of investment (to greater and lesser extents according to the timing in the economic cycle). Where information asymmetries exist it may not be possible for lenders to cost effectively determine the costs and potential returns from a particular investment.	• **Withdrawal of appetite to invest in some business sectors:** Investor preferences for asset classes and sectors prone to change in economic cycle, with risk of retreat of investment in some sectors linked to overall portfolio rebalancing.

Viability Gaps

2.5 Factors specific to individual developments, together with the features of a wider area's development, can result in a financial viability gap. This gap occurs when the potential financial returns from a development are insufficient when set against development costs (allowing for developer's profit) and where it may therefore not be possible to secure finance at market rates. For specific sites, viability gaps may result from:

- **Excessive or abnormal site costs:** Typically including site clearance and remediation costs (frequently an issue on brownfield sites in more marginal market areas) and/or site infrastructure, for example where substantial new road infrastructure is necessary to enable development to take place.
- **Market conditions and projected revenues:** There may be specific problems relating to the target end-users for a particular site in terms of future income streams. For example, sectors where rental values are typically low, early stage companies where trajectory of the business is uncertain). Wider structural factors may also play a part. In areas where

markets for property are weak or emerging, low yields and higher risk profiles can lead to non-viable development on commercial terms and borderline development viability where the level of risk is unattractive to developers and financiers.

2.6 Viability gaps can therefore deter developers and investors and lead to investment situations where there are persistent problems in securing development finance. They do not necessarily constitute a market failure or justify public sector intervention in their own right. Unwillingness to invest in non-viable development constitutes rational behaviour by markets. Justification for public sector intervention can generally only be made on the basis that an investment would generate economic development spillover benefits recognised by the public sector. This provides an important part of the grounds for publicly backed development finance to support development with regeneration benefits to an area.

2.7 In such situations in should be clear that an investment would result in positive externalities or the removal of negative externalities. Positive externalities (such as encouraging enterprise, job creation or sector development) are not specifically valued by commercial developers and investors would not typically be expected to bear upon investment decisions. The presence of negative externalities (such as dereliction and contamination) will not influence commercial decision making. Public sector intervention can be justified where the value of economic-spin off benefits results in an acceptable return on investment for the public sector.

Finance Gaps

2.8 Market failures in development finance may occur when finance suppliers are deterred from making particular types of investment where they cannot easily or cost-effectively determine the risks and returns due to imperfect information. The cost of obtaining a clear picture of these risks and returns may be too high given the size of the proposed investment, or the developer may lack the necessary collateral to help the lender mitigate their risks.

2.9 This issue was amplified by the impact of the recent recession and financial crisis. Banks and other investors in commercial property were hit hard by market conditions, with bad debts on commercial property investments accounting for substantial proportions of losses incurred over the period from 2008 to 2013 when the UK economy's emergence from recession stabilised. This is reflected in evidence on the decline in UK banks' exposure to commercial real estate assets (Bank of England Financial Stability Report)[1]. The effects of compliance with the Basel III capital and liquidity requirements in balance sheets also contributed to a sharp brake on commercial development lending.

2.10 Generally, whilst the last 3-4 years have seen a return to debt finance and other structure finance provision for development, banks remain cautious in their investment strategies to avoid higher risk schemes and/or developers with a limited track record or insufficient collateral.

2.11 The initial development market response to the June 2016 referendum vote and the UK's decision to leave the European Union has created further uncertainty about future trading and investment conditions, with changes in the sterling exchange rate also impacting on investment decisions. Whilst the period post-referendum show that the economy has not returned to recession, and development activity continued to pick up, it is difficult to predict how investment activity might change as the UK moves towards withdrawal from the EU.

2.12 The assessment of development markets and development finance conditions in Cheshire & Warrington tests for evidence of both viability and finance gaps, and of market failures which may

[1] Financial Stability Report, July 2016, Bank of England

justify intervention through publicly backed development finance mechanisms including Evergreen.

Design of Urban Development Funds

2.13 The European Commission's implementing regulation for Urban Development Funds in the 2014-20 programmes specifies that they should be established as loan funds set up and managed by a financial intermediary, with contributions from ERDF programmes, the intermediary and co-investors.[2] An illustrative structure for UDFs is shown in the diagram.

Figure 2.1 Illustrative UDF Fund Structure

Source: Regeneris Consulting

2.14 The key principles, objectives and requirements for UDFs are set out in the Implementing Regulation and are summarised below:

- Investments made by UDFs must be into projects that are part of an integrated approach for a **sustainable urban development strategy**: this means that the fit of potential projects or developments with thematic and spatial priorities is particularly important as part of the ex-ante assessment.
- **UDF investment must take the form of a repayable loan:** The use of repayable debt finance provided on commercial or quasi-commercial terms (where the IRR is insufficient to secure finance) with projects able to demonstrate a revenue stream which will enable repayment.

[2] European Commission, Implementing Regulation (EU) 2016/1157, 11 July 2016 amending Implementing Regulation (EU) No 964/2014 as regards standard terms and conditions for financial instruments for a co-investment facility and for an urban development fund.

The Regulation specifies that loans may be made at preferential (ie sub-commercial) rates in assisted areas.

- **UDF investments should not crowd out private sector investment or other public sector funds:** as with all public sector backed interventions, UDFs must operate in an area of clearly defined and well-evidenced market failure. Projects supported by UDFs must have an Internal Rate of Return which is not sufficient to attract finance on a purely commercial basis.
- **UDF supported projects must have potential to attract additional funding from other public and private investors**: it cannot cover full development costs and requires a major funding contribution from the private sector (30% of total financing provided).
- **Scope to combine repayable finance with traditional grant finance:** there is scope to combine the provision of repayable commercial or quasi-commercial finance with grant where there is the need for the public sector assistance to address substantial upfront site preparation or infrastructure costs that the private sector would not be able to meet in its own right given the economics of the scheme.

2.15 There are various other investment model approaches (such as those including equity investment or some element of grant). The appropriateness of these models to meeting the type of demand identified in the market assessment will be considered as part of the assessment.

Greater Manchester UDF (Evergreen II)

2.16 In 2009 North West established a holding fund (North West Urban Investment Fund) for the region's JESSICA (Joint European Support for Sustainable Investment in City Areas), part of the 2007-13 ERDF programme. The European Investment Bank (EIB) was procured to manage the holding fund and to contract with two Urban Development Funds (North West Evergreen Fund for the North West excluding Merseyside) and Chrysalis on Merseyside.

2.17 The North West Evergreen Fund (Evergreen 1) was established by local authorities as limited partners in the North West to receive resources from the NWUIF to invest in Greater Manchester, Cheshire & Warrington, Lancashire and Cumbria. Its purpose was to provide debt finance to support commercial development and regeneration projects across the region. Its first-round capital was £60m, which had been fully committed by December 2015. As a loan fund, Evergreen 1 secures reinvestment capital through loan repayments and interest. These funds are now becoming available for further investment as early repayments materialise.

2.18 Greater Manchester's Local Enterprise Partnership committed in 2014 to allocate £50 million of its ERDF resources through its European Structural and Investment Funds (ESIF) plan to a successor to Evergreen I, along with £15 million to a low carbon investment fund.

2.19 The emerging UDF is understood to follow the same lines as Evergreen I. The now Greater Manchester Combined Authority (GMCA) is proposing to establish a new Limited Partnership to act as the Holding Fund that will be wholly owned by the GMCA. The Holding Fund will be serviced by the Greater Manchester Core Investment Team, with fund administration services to be procured. At this juncture, details of the Holding Fund's Investment Board are not available to this ex-ante assessment, but it is understood that it will have the same structure as the Board overseeing Evergreen 1, but with different members for the new fund.

2.20 As is the case with Evergreen 1 it is understood that the Holding Fund will be responsible for procuring fund managers for the two sub-funds (Evergreen UDF and Low Carbon). The responsibilities of the fund managers would be:

- Review the negotiation and structuring of financial deals in viable Urban Projects

- Monitor compliance and risk in accordance with EU rules;
- If required, manage the portfolio of investments to ensure the achievement of expenditure, output and financial return targets
- Review and where required manage appropriate exit strategies from Urban Project investments
- Perform fund administration tasks, including all relevant European Structural Investment Fund reporting requirements.

2.21 Details about the proposed mechanisms by the two areas would which Cheshire and Warrington (with Lancashire) might work through the Greater Manchester Holding Fund and fund management arrangements for a new UDF were not available for this ex-ante assessment. It is understood that they would effectively 'bid in' for investment related to their respective ESIF allocations to the emerging Fund. The indication is that the following arrangements will apply:

- Cheshire and Warrington with Lancashire would enter as limited partners in the new UDF.
- The two areas would have a seat on the Management Board for the Fund. The allocation of voting rights on the Board is yet to be determined, but it is assumed that it may reflect the respective contributions of the areas via their ESIF allocations to the UDF.
- As is the case with the Greater Manchester proposal, local authorities would have key responsibilities for developing the investment pipeline and identifying potential investments to the fund manager. This is effectively stage 1 of the investment process.

2.22 It is understood that arrangements for Cheshire and Warrington and Lancashire to invest through a new UDF would be developed as Greater Manchester moved into fund management procurement.

Block 1 Market Assessment Methodology

2.23 The Block 1 assessment which is the focus of this report determines whether or not market failures are present which might justify the use of a UDF investment mechanism. Its core purpose is to identify whether sub-optimal investment conditions are present and investment needs that are not being met in the market.

2.24 The conclusions of the Block 1 assessment are therefore expected to identify the size and nature of the investment gap, the rationale for public sector intervention and, where appropriate, the form of finance to address it. It should establish whether the UDF mechanism is the appropriate form of finance.

2.25 The methodology in this report responds to each aspect of the ex-ante assessment guidance[3] and is structured as follows.

Establish Strategic Priorities for Investment

2.26 The starting point for the assessment is to identify strategic priorities for public sector investment in sites and premises. The assessment provides a brief headline assessment of the socio-economic characteristics of Cheshire and Warrington to highlight the key drivers for growth behind which investment in sites and premises should be aligned.

[3] European Commission (2014) Ex-ante assessment methodology for financial instruments in the 2014-2020 programming period: Financial instruments for urban and territorial development, Volume V

2.27 The assessment then summarises the main strategies for Cheshire and Warrington, principally the European Structural and Investment Fund Strategies (ESIF) and Strategic Economic Plans (SEP), and what they indicate about locational and site-specific investment priorities. Where appropriate it comments on specific locational priorities and sites in more detail.

2.28 This section also summarises where these strategies identify a role for UDF (Evergreen) or the Growing Places Fund investment in Cheshire and Warrington. This provides part of what guidance on ex-ante assessment requires by way of identifying investment needs.

Performance of Development Markets and Supply of Finance

2.29 The ex-ante assessment guidance makes it clear that there should be an analysis of the performance of development markets, focusing on evidence on the demand for and supply of sites and premises, and the viability of development. The analysis should assist in identifying the main barriers to development activity and evidence of market weaknesses and market failures.

2.30 Alongside this development activity assessment, ex-ante evaluation also requires assessment of how effectively the supply of development finance is operating. This is central to identifying gaps in the supply of finance and the barriers which might be addressed through a UDF mechanism.

2.31 The methodology for this section draws on the following to build this picture:

- Desk-based analysis of land and property databases, commercial property reviews and local authority evidence. This provides a reasonably comprehensive review of the current state of the development market and recent trends. It covers the quantity and value of development across the area by broad category (office, industrial, warehousing) and in the case of Cheshire and Warrington, a brief summary of retail and housing markets responding to a need to consider the area's Growing Places Fund investment opportunities. Where available, it provides market indicators such as rental values and yields.
- Desk-based research on development finance markets, investigating the current picture and recent trends. It draws on national reviews and data sources, together with the limited quantity of local evidence to examine how the supply of development finance is functioning.
- Consultations with developers, commercial property agents, local planning authorities and the Local Enterprise Partnerships to provide insight into local opportunities and constraints, and to explore specific development sites where relevant. These consultations were also crucial in establishing the specific investment pipelines for the areas.
- Consultations with development finance providers, including the North West Evergreen Fund and a number of commercial real estate teams from major banks.

2.32 The conclusions of this section establish whether there is an evident need for public sector intervention through a UDF mechanism and the market failures and investment needs to which it should be targeted.

Assessment of the Development Pipeline

2.33 The FI Compass ex-ante assessment guidance on UDFs suggests that an indicative view of the project pipeline may provide part of the justification for investment through a UDF mechanism. Specifically, it suggests reviewing the project pipeline in target sectors to determine whether there is a sufficient pipeline that fits the objectives to be delivered.

2.34 The starting point for this section of the Block 1 assessment was to establish what Cheshire & Warrington regarded as its investment pipeline, with a particular focus on key development sites

and opportunities. Greater Manchester's Fund of Funds Investment Strategy recognises the key role that local authorities and the Greater Manchester Combined Authority will play in identifying the pipeline for Greater Manchester, and this ex-ante assessment looked to the Local Enterprise Partnership and local authorities as the primary source of information.

2.35 Local information about the investment pipeline has then been supplemented by the following:

- Desk based review of pipeline information drawn from sources published for each local authority area within Cheshire and Warrington (although limited information has been supplied in some areas).
- Review of promotional material for individual developments.
- Consultations with developers, local authorities and others about individual sites.
- Site visits.

2.36 It is understood that the Local Enterprise Partnership with the three local authorities has assembled an investment pipeline for its emerging Devolution Agreement proposal to central government. However, this pipeline was not yet available for the ex-ante assessment. Instead, the assessment has drawn on a combination of information about individual sites from local authorities, the consultations carried out as part of the Block 1 research and a review of development priorities material drawn from online sources. We have assumed that the devolution investment pipeline in its final form would provide an important source of information on the potential project pipeline should a decision be taken to proceed through a UDF mechanism.

2.37 The assessment found a mixed picture in terms of the depth of information available about the investment pipeline. To reflect this, the pipeline analysis in the Block 1 report focuses on key criteria to determine whether or not a project would be appropriate for investment through a UDF.

2.38 Summary information was sought about each site with, as far as possible, application of some of the more objective criteria which determine whether or not a particular site could fit within the criteria for a UDF. These criteria included:

- The site's fit with the strategic priorities and criteria set by the ESIFs and SEPs.
- Basic details about the site and proposed premises as far as this was available.
- Whether the proposed development and end uses were likely to be eligible for ERDF support and whether interest had been expressed in exploring UDF investment as an option.

2.39 In engaging directly with local authorities, site promoters or developers the assessment also sought to establish whether there would be a potential need for publicly backed development finance, either in the form of Evergreen or the Growing Places Fund in Cheshire and Warrington. This provided a filter in that it established where there may be viability issues or finance gaps, and the likelihood of being unable to secure finance via other means.

Assessment of the Value Added of FIs

2.40 The assessment of value added covers both the quantitative and qualitative dimensions of a proposed UDF, as well as its fit with other forms of public sector intervention and consistency with State Aid requirements. This element of ex-ante assessment sets out why a UDF approach is the appropriate response to meeting the investment needs identified, and the advantages in opting for this mechanism compared to a traditional grant approach.

2.41 The task was informed primarily through a review of the available evaluation evidence of similar types of FIs (including FI-Compass evidence). Consultations with developers, finance providers and

local authorities have also provided insight into the benefits that this approach brings to development. However, there is limited publicly available information on the implementation, performance and impact of UDFs at the current time.

Lessons Learnt

2.42 Assessment of the lessons learned from the delivery of similar instruments, including the North West Evergreen Fund, is the final component of the Block 1 research. This section of the report has again drawn on the review and evaluation evidence available through the EU's FI Compass resource, as well as other published reviews. There is limited evidence available in the public domain currently, and the assessment has also drawn on consultations with those directly involved in Evergreen and the Growing Places Fund investments previously.

3. Strategic Context for Investment

3.1 This section identifies the main strategic priorities for investment in Cheshire and Warrington. The need to invest through UDF and the Growing Places Fund in Cheshire and Warrington will be driven in part by strategic development priorities for the area, and key strategies therefore provide a source of information about the investment pipeline. In turn, UDF or the Growing Places investments will need to demonstrate that they fit with national ERDF programme and ESIF, Strategic Economic Plan and local strategic priorities.

3.2 This section is structured as follows:

- A summary of the strategic direction that the European Union's strategies and the national ERDF Operational Programme 2014-20 provide.
- A brief summary of the principal socio-economic characteristics of Cheshire and Warrington.
- The strategic policy context for future development in Cheshire and Warrington and the role that a UDF and the Growing Places Fund are expected to play.

3.3 The assessment in this section is based on the latest strategies available to the ex-ante evaluation. However, it is understood that Cheshire and Warrington is in the process of carrying out a refresh of its Strategic Economic Plan and this would be expected to update the position in terms of the area's investment priorities.

Policy and Strategy Context

3.4 The strategic framework for the potential investment of ERDF through the Urban Development Fund (Evergreen) mechanism and the Growing Places Fund is provided by ERDF programmes and by strategies and related strategic initiatives put in place by the Local Enterprise Partnerships and local authorities.

European Union Strategies

3.5 National and sub-national ERDF programmes, including Cheshire and Warrington's strategy for investing European Union funds, must demonstrate consistency with the priorities identified in European Union policy. For the 2014-20 ERDF programmes, these centre on the EU's 2020 growth strategy and the targets it sets for employment, innovation, education, social inclusion and climate/energy. The investment of ERDF in development through Urban Development Funds (Evergreen) is rooted in particular in employment, innovation and climate/energy.

Smart Growth

3.6 The EU set a target of achieving 3% of GDP invested in research & development and technological innovation by 2020, allied to higher employment rates and improved education. The Smart Growth strategy is driven by three initiatives which include:

- The EU's digital agenda: substantially increasing high speed broadband access and use);
- Innovation Union: focusing R&D and innovation activity on major societal challenges (climate change, energy and resource efficiency, health and demographic change) and strengthening each link in the innovation chain from blue sky research to commercialisation;

- Mobility of young people in education.

3.7 The UK's Partnership Agreement (2014-20) sets out how its plans for European Structural and Investment Funds will deliver the priorities set by the EU2020 strategy. On the R&D and innovation targets, the Partnership Agreement specifies that the improvement of R&D commercialisation and encouragement to firms to innovate should be the key focus of European Structural and Investment Funds linked to the 2020 strategy. The Partnership Agreement recognises a role for capital investment, specifically in the provision of incubator space and equipment.

3.8 The UK's approach to Smart Growth was driven by the 2011 national Innovation & Research Strategy for Growth and the 2012 Industrial Strategy. Both strategies emphasised the need to significantly strengthen the commercialisation of research and innovation, and pointed to investment in innovation structure amongst the priorities they identified.

Enhancing the Competitiveness of SMEs, the Agricultural Sector and the Fisheries and Aquaculture Sector

3.9 The UK Partnership Agreement points to the push for entrepreneurship that formed part of the EU's 2020 Strategy, with its emphasis on increasing export activity and improving access to business finance. No numeric target for SMEs was set as part of EU 2020, but the need to enhance SME competitiveness is identified by the EU as integral to its targets for jobs growth and is one of the 11 thematic objectives identified for EU cohesion policy.

3.10 The UK Partnership Agreement identifies a series of barriers to growth at which EU funds along with national policies and investment would be targeted. These are accessing finance, business advice, business incubator provision, supply chain development and sectoral support (including for agriculture, fisheries and aquaculture).

Sustainable Growth

3.11 EU2020 sets a series of targets relating to carbon emissions and sustainability. These include a 20% reduction in CO2 emissions compared with 1990 levels by 2020, increasing the share of renewables in energy consumption to 20% and moving towards a target for a 20% increase in energy efficiency. The 2020 strategy recognises both the imperative to tackle climate change and the benefits to the EU of being competitive in low carbon technologies.

3.12 In setting out how European Structural and Investments Funds will be used in the 2014-20 programmes, the UK Partnership Agreement focuses on developing infrastructure, promoting innovation and encourage demand for low carbon goods and services. It describes the potential to use the funds both to invest in renewable energy generation, to support the take up of low carbon technologies by businesses and to improve resource efficiency.

England ERDF Operational Programme 2014-20

3.13 The national Operational Programme (OP) sets the overarching strategy for the investment of ERDF between 2014-20 and the framework of priority axes to which England's ERDF resources are allocated. Our assessment focuses here on Priority Axes where the potential for capital investment is part of the suite of interventions, and **where a role for financial instruments such as Evergreen is identified.**

Promoting Research and Innovation – Priority Axis 1

3.14 The need for investment in research and innovation infrastructure is part of the rationale for investment in Priority Axis 1 (Promoting Research and Innovation). The OP points to evidence that infrastructure is important in commercial innovation and business-research engagement. It observes that such infrastructure investment has concentrated (and will continue to concentrate) in the South East, reinforcing geographic disparities.

3.15 The OP highlights the particular challenge that the private sector faces in this type of investment, with the high costs of developing facilities set against the nature of benefits which tend to be less certain than typical commercial development.

3.16 Furthermore, the OP recognises that a market failure, the status of R&D as a public good, research results in private benefits that are less than the social benefits from the investment. This militates against private sector investment in R&I infrastructure.

3.17 On the interventions earmarked by the OP, it specifies that investment in research and innovation structure could be supported with ERDF. It also points to potential to support business incubators where the hard infrastructure is backed by training, finance and technology. Priority 1 provides scope for capital investment to support innovation through technology transfer, applied research, technology development and demonstration facilities.

3.18 The targeting of Priority 1 ERDF investment and decisions about investment is to be guided by the national Smart Specialisation Strategy. The OP indicates that 'locally specific or niche specialisms' may be supported providing they are supported strong evidence, have sufficient scale to deliver impact and do not duplicate similar investments elsewhere. There is also reference to sustainable urban development strategies for City Regions being prepared which are likely to be a source of actions in PA1.

3.19 The use of financial instruments, including loans, is provided for in Priority 1.

Enhancing Access to, and use and Quality Of, ICT: Priority Axis 2

3.20 The rationale for PA2 is to increase the coverage of superfast and ultra-fast broadband and its take up and effective use by SMEs. It highlights both the challenges facing businesses in areas where broadband speeds are sub-optimal and the benefits to business competitiveness and growth of high speed broadband access.

3.21 Recognising that, without intervention, broadband coverage will not be extended commercially to peripheral areas, including rural and isolated communities, the PA acknowledges the priority attached by the EU to further extending coverage.

3.22 Interventions identified in PA2 cover both the physical delivery of superfast and ultrafast broadband networks, and the related services to business to encourage the development of ICT products and services, e-commerce and generally the demand for and use of ICT.

3.23 Whilst there is no immediate intention to use financial instruments, the OP is clear that this will be kept under review given the use to date of gap funding models.

Enhancing the Competitiveness of SMEs: Priority Axis 3

3.24 The focus of the justification for PA3 is on the range of barriers facing SMEs to form, expand and trade internationally. It emphasises the key role that SMEs play in both innovation and economic growth.

3.25 The barriers that are highlighted in the OP include access to finance, the need to expand the take up of business support, the under-representation of women in business start-ups. Information failures relating to start-up, commercialisation or exporting are also key to the rationale for PA3.

3.26 The potential for capital investment in PA3 is identified in Priority 3a, which includes 'the provision of land and premises for employment sites including incubator space, managed workspace, or grow-on space'. An identical activity is identified in Priority 3c (Supporting the creation and the extension of advanced capacities for products, services and development).

3.27 The OP points to the experience of JESSICA in the 2007-13 Programme for the use of financial instruments in the 2014-20 programme. It notes that, whilst these funds target the creation or refurbishment of urban infrastructure through urban regeneration and low carbon projects, investments have been made in SME premises.

Supporting the Shift Towards A Low Carbon Economy In All Sectors: Priority Axis 4

3.28 The OP provides an extensive justification for ERDF investment in PA4. The focus is on both England's productive capabilities and capacity in low carbon technologies, and on energy consumption that is more resource efficient and which makes greater use of renewable energy.

3.29 The potential for capital investment under PA4 is identified for several of its individual Investment Priorities:

- Investment Priority 4a - Focus on renewable energy generation, the development of demonstrators, distribution of renewable energy.
- Investment Priority 4b – Includes measures to improve energy efficiency and use of renewable energy by businesses. Specific actions include investment in building renovation and retrofitting for energy efficiency, together with renewable generation capacity.
- Investment Priority 4c – Extends the range of actions described in 4b to homes and public buildings.
- Investment Priority 4f – Investment in technology demonstrators and deployment of renewable energy technologies. The focus is on small scale innovation projects and SMEs.

3.30 The OP specifies that there is potential to use financial instruments for each of the four investment priorities described above. For IP4b and 4f the creation/refurbishment of urban infrastructure through urban regeneration and low carbon projects is described for the proposed use of financial instruments.

Cheshire and Warrington Socio-Economic Context

3.31 The Cheshire and Warrington LEP area has a population of 917,000 (2015), accounting for around 13% of the North West's total population. The area of around 870 square miles (2,250 sq km) contains three local authority areas (Cheshire West and Chester, Cheshire East, Warrington) and extends from Crewe and Malpas in the south to Warrington in the north, to the North Wales border with Chester in the west and to the pennine fringe in the east around Macclesfield.

3.32 The area was home to around 39,000 enterprises in 2015, the majority (89%) micro businesses with small enterprises (10-49 employees) accounting for a further 9%. There were 150 large employers (250+). Major employers include Bentley Motors, Tata, Vauxhall and Barclays, together with public sector employers including the three local authorities, health services and education facilities.

3.33 At 47 enterprises per 1,000 of its population, Cheshire and Warrington's business density was significantly higher than the North West (33) or Great Britain (38) in 2015. By comparison, the best performing LEP area on this measure is Buckinghamshire Thames Valley with an equivalent business density rate of 55. The SEP recognises that the area performs comparatively in terms of business start-ups. Data on the turnover of businesses in the area (Duedil) shows that 580 active businesses in the past year had seen turnover increase by 20% or more, and that they were distributed across the whole of the LEP area.

3.34 Increasing the area's Gross Value Added is central to Cheshire and Warrington's growth targets for its economy. The SEP and Devolution Growth Deal have set ambitious long-term target to achieve GVA per annum of £50 billion by 2040. The most recent government data show that it stood at just under £26 billion in 2014. There are related objectives for 2040 to increase the area's productivity to 120% of the UK average, and to generate 127,000 new jobs.

Figure 3.1 Cheshire and Warrington's GVA targets and performance

Source: Office for National Statistics; Cheshire and Warrington Local Enterprise Partnership, Strategic Economic Plan and Devolution Growth Deal

3.35 In terms of GVA per capita, Cheshire and Warrington stood at around £28,300 in 2014, ranking it 7th of the 39 English LEPs. This represented 113% of the UK average, with the LEP setting a target of reaching 120% by 2040.

Figure 3.2 Ranking of GVA per Head in 2004 and 2014 for Local Enterprise Partnership Areas

Source ONS

3.36 Current employment data (Business Register and Employment Survey) indicate that there were 472,000 employee jobs in Cheshire and Warrington in 2015, with around 328,000 of these full-time (69%). The data shows that service sector employment accounts for the majority of employee jobs in the area. Combined, ICT, financial services, real estate account for 42,000 jobs. Professional, scientific and technical activities, which includes a range of professional services activity, accounts for 44,000 jobs. The area retains an important presence for manufacturing, with around 40,000 jobs reflecting the presence of large employers such as Vauxhall and Bentley and a diverse range of smaller manufacturing companies operating across the area. Public sector employment also remains an important component of jobs in the area, accounting for 105,000 or around 22% of all employee jobs.

Figure 3.3 Current Employment by Sector, 2015

Source: ONS, Business Register and Employment Survey, 2016

3.37 In common with many areas, Cheshire and Warrington has seen a steady contraction in manufacturing employment, a trend recognised in its Strategic Economic Plan. The SEP points to manufacturing and engineering accounting for around 26% of employment in 1981. By 2015 this stood at just under 9%. This has occurred over a period when the service economy has seen its share of employment increase substantially, as the 2015 data suggests.

3.38 Given the importance of productivity in meeting the area's ambitious GVA targets, Cheshire and Warrington has made a priority of understanding where there is scope to drive up productivity in individual sectors. In this regard, the SEP points to room for productivity to increase in professional services, banking, insurance, chemicals, manufacturing and distribution. In other words, sectors which account for a large quantity of jobs in the area.

3.39 The second element of the productivity challenge for Cheshire and Warrington centres on its workforce. In 2015, there were 565,000 people aged 16-64 resident in the area, representing the core of the resident labour force. This represented 61.5% of the total population, slightly lower than the average for the North West (63%) and Great Britain (63%).

3.40 Of the area's total population, around 444,000 people were in employment, with 76% of the population aged 16-64 in work and 79% economically active. By comparison, these were higher rates than those of the North West (71.5% and 75.5%) and Great Britain (74% and 78%).

3.41 However, the most recent government population projections (ONS sub-national population projections 2014-based) suggest that the LEP area is projected to see a fall of 32,000 in its population aged 16-64 from 2014-39. This would represent a fall of close to 6%. This compares to a projected increase in this cohort of 5% nationally.

3.42 This ageing trend is not uncommon across the country, and it has been recognised in Local Plans in the area through provision for housing growth which exceeds the level implied by the population forecasts alone. In part, housing growth has a role to play in attracting larger numbers of younger, working people to live and work in the area.

3.43 Nevertheless, the area's Skills Strategy (2014) pointed to the challenge that it presents to the area's economy. With projections suggesting that there will be relatively little growth in the working age population compared with older (over 65s) people, competition for this labour resource will increase. With growing numbers of people likely to exit the workforce, the Skills Strategy also pointed to growing replacement demand for workers as a further challenge.

3.44 These key characteristics and challenges for the area point to the important role that developing both employment opportunities in Cheshire and Warrington and housing growth have to play in future years. These are clearly recognised as such by the Cheshire and Warrington Strategic Economic Plan.

Policy Context

Cheshire and Warrington European Structural and Investment Funds Strategy (ESIF) 2014-20 (April 2016) and Local Implementation Plan

3.45 Cheshire and Warrington's ESIF sets ambitious objectives for the area's economy and the rationale for investing ERDF. Its overarching aims are to establish the area amongst the strongest performing economies, nationally and internationally, promoting economic growth and boosting productivity. It emphasises the need to build on the area's strengths and opportunities but also to remove barriers to growth.

3.46 The headline economic targets set by the ESIF are to generate by 2012 an economy worth £26.6 billion, which employs 465,000 people. It aims to be an area which is 'a modern, strong, sophisticated and attractive location to live, work, invest and visit'.

3.47 Cheshire and Warrington's ESIF allocation are estimated to have a total current value of £144.7 million. Of this allocation, the ESIF strategy earmarks 55% or c. £78 million to ERDF.

3.48 From the outset, the ESIF recognises the role that development has to play in driving the area's economic growth. Amongst the strengths and opportunities identified by the SWOT assessment directly relevant to Evergreen are:

- Strategic investment sites available to meet demand for new and continued development to help retain existing and attract new businesses;
- Science park type developments with capacity for growth to meet demand;

3.49 More generally, the ESIF identifies strengths and opportunities relating to the area's strategic connections into the motorway and rail network, and the value for money it offers as a location compared with major cities.

3.50 On the challenges for development, the ESIF's assessment of strengths and weaknesses includes:

- Constraints on key sites limiting the development of new commercial space for companies
- Constraints on housing and employment sites from infrastructure and transport access, along with local congestion inhibiting investment at key locations
- Lack of recent speculative office, industrial and warehouse development limits opportunities for existing businesses to expand and therefore for the area to retain jobs

- Differential in residential and commercial land values hampers the ability to promote sites for employment use
- Intense competition from other areas to capture new development and inward investment.

3.51 There is also emphasis on innovation and smart specialisation. The SWOT analysis recognises that constraints on key development sites are amongst the main threats and weaknesses for the area's economy. Alongside this, its SWOT assessment also points to the costly legacy of brownfield land in the area's industrial locations.

3.52 The ESIF highlights five key locations for growth:

- **Warrington** – Recognising its recent expansion and success as a location for high value, knowledge-based business together with manufacturing, but also a diverse array of strengths in sectors including distribution and logistics, precision engineering, energy, telecoms and software, and business services.
- **Crewe –** Driven by its strategic location on the national rail network and the potential for growth linked to HS2, the High Growth City concept for the town and the Basford East and West strategic employment site (150 hectares) are specifically identified as development opportunities.
- **Ellesmere Port –** Highlighting its position on an industrial, science and technology corridor, part of the Atlantic Gateway and strengths in high value sectors including aerospace and defence, automotive, petrochemicals and energy, and applied R&D. There is reference to Thornton Science Park together with the town's proximity to Daresbury.
- **Chester –** The City's strengths in the tourism and leisure sectors, together with professional services and academia, are highlighted in the ESIF Strategy. There is specific reference to plans for the Central Business District, a development to which Evergreen contributed in the 2007-13 ERDF programme as part of the One City Place initiative.
- **Macclesfield** – Key sectors in and around the town include banking, finance, insurance and other services. The ESIF Strategy also points to the strategically significant Astra Zeneca site (Alderley Park).

3.53 Six strategic imperatives are identified, drawn from the Strategic Economic Plan, and summarised below.

- Specialisation and sectoral differentiation, exploiting science and technology strengths and delivering a manufacturing (advanced) renaissance.
- Attracting and retaining talent, recognising that housing, employment and quality of life will enable this.
- Being equipped for market and technology change
- Maximising growth assets, focused on property and place, making the most of sites, premises and development opportunities
- Boosting worker productivity
- Being internationally connected and engaged.

3.54 Spatial, strategic intervention priorities are also identified alongside the ESIF strategy's six imperatives. These are:

- The Atlantic Gateway in Cheshire and Warrington, the area extending from Liverpool to Manchester centred on the Manchester Ship Canal and the area around it.

- Cheshire Science Corridor, encompassing the Capenhurst Technology Park, Thornton Science Park, Birchwood Park's Nuclear and Forensics Clusters, Alderley Park and Jodrell Bank. This has now been established as an Enterprise Zone.
- The Crewe High Growth City initiative centred on Crewe, capitalising on the town's position on the HS2 network, its development land potential and its strategic role as the gateway between the Midlands and North West.

3.55 There are more specific references to key strategic investment locations later in the ESIF Strategy:

- Redevelopment of the Alderley Park site in Alderley Edge to create a Human Health Sciences Hub
- Developing a centre for smart specialisation in agri-tech at Reaseheath College
- Development of Warrington Waters as part of the Atlantic Gateway initiative
- Creating a new Faculty of Science and Engineering for the University of Chester and an associated High Growth Centre
- Creating the foundations to support Crewe to develop the High Growth City initiative, linked to the HS2 investment proposals.

3.56 The ESIF Strategy and the Local Implementation Plan specify allocations for Evergreen (JESSICA) funding. It is earmarked for two of the ESIF Strategy's priority axes (PA1 and PA3), and is relevant to specific investment priorities identified in each priority axis. Commentary on the role of Evergreen also refers to its potential to support 'low carbon construction, although no allocation for Evergreen is included in PA4 (Supporting the Shift to a Low Carbon Economy'.

Priority Axis 1: Strengthening Research, Technological Development and Innovation

3.57 Under a headline objective to drive up diversification, the ESIF sets the following specific objectives are:

- Building collaborative research between enterprises, research institutions, and public institutions.
- Supporting businesses, including social enterprises, to commercialise research and development.
- Investing in facilities and equipment supporting the collaboration and commercialisation activity sought under this Priority Axis.
- Innovating through advances and proliferation in Information, Communications and Technology.

3.58 In the original ESIF, capital investment was identified in Investment Priority 3 covering the development, connectivity and upgrading of innovation space, facilities, and equipment. This spanned associated green infrastructure, flood mitigation, digital connectivity, and transport improvements etc. where such developments were integral to the development of innovation space and facilities and the delivery of wider strategic sites.

3.59 The Local Implementation Plan provides further clarification on PA1 investment aligned to the England Operational Programme. On the strategic context, it emphasises the Cheshire Science Corridor, the Eight Great Technologies and Key Enabling Technologies , and smart specialisation. It also emphasises collaboration between enterprises, research institutions and public bodies.

3.60 On alignment with the national OP, the potential for capital investment is described under P1a *enhancing research and innovation (R&I) infrastructure and capacities to develop R&I excellence,*

and promoting centres of competence, in particular those of European interest. However, it appears also that there is provision for capital investment under P1b which covers an extensive range of activities relating to research and development and collaboration between business and the research base.

3.61 Further clarity is provided about capital investment in the description of priority activity:

- Again, it emphasises collaboration between universities and enterprises, and highlights Thornton Science Park and Alderley Park as examples.
- It highlights the importance of 'good infrastructure' including business incubation/grow on facilities with excellent connectivity and innovatively designed workspace.
- It indicates that calls for ERDF issued under PA1 require projects to demonstrate how they provide 'the right sites in the right locations with the right infrastructure, enhanced by the highest quality of life in order to attract the best talent to the area'.

3.62 Target beneficiaries for PA1 include:

- Organisations, principally SMEs, seeking enhanced competitiveness through innovation
- Research institutions seeking to commercialise new technologies and knowledge
- Entrepreneurs seeking to commercialise new technologies and knowledge
- Clients and consumers seeking the benefits of improved products and services.

3.63 The ESIF indicatively allocates £2.5 million of ERDF to Evergreen to support the activities described above.

Priority Axis 3: Enhancing the Competitiveness of Small and Medium Enterprises

3.64 PA 3 focuses on the growth and productivity of Cheshire and Warrington's SMEs. The range of objectives set for PA3 is broad, spanning enterprise culture and business formation, exporting and international business, innovation and the use of digital technologies, and boosting the contribution of SMEs in specialist industries where the area has existing strengths and capacities.

3.65 Three investment priorities are identified:

- 3a -Promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators.
- 3c - Supporting the creation and the extension of advanced capacities for products, services and development
- 3d - Supporting the capacity of small and medium sized enterprises to grow in regional, national and international markets and to engage in innovation processes.

3.66 Capital investment through PA3 is earmarked for incubation and grow on space. In the original ESIF, this was set out under Investment Priority 7. It described the need to 'ensure an adequate supply and quality of incubation and grow on space, at key locations, especially for high growth potential firms and community businesses/social enterprises, and support services where there is market failure or lack of sector support.

3.67 Indicative actions identified in IP7 included refurbishing, modernising and investing in new incubation centres or the development of drop in zones where SMEs could co-operate and have access to equipment for shorter periods. It also indicated support would be available for associated green infrastructure, flood mitigation, digital connectivity and transport improvements where this is integral to the development of incubation and grow on space and the wider delivery of strategic sites.

3.68 The target beneficiaries for support under this theme across are as follows:

- Owner-managers of SMEs
- Managers of social, voluntary and community based enterprises
- Entrepreneurs

3.69 The LIP qualifies the potential to invest through financial instruments (ie Evergreen). It indicates that there would need to be evidence of unmet demand for incubator space, managed workspace or grow-on space. It would only be provided only where combined with business support tailored to the growth needs of target occupants. This type of investment would also be targeted geographically and sectorally, and aligned with the smart specialisation strategy.

3.70 The ESIF identifies £2.5 million of ERDF to Evergreen under PA3, with £1.25 million allocated to each of investment priorities 3c and 3d.

3.71 The table below summarises the relevant activities where there may be potential to invest through the Evergreen mechanism, and briefly outlines the types of development where it may be deployed.

Table 3.1 ESIF Strategy Investment Priorities and Potential Role of Evergreen

Priority Axis	Potential Evergreen Allocation	Investment Priority	Investment Activities Relevant to Evergreen	Potential Role of Evergreen and the GPF
PA1: Promoting Research and Innovation	£2.5m £2.5m private match	1a: Enhancing R&D infrastructure[4] 1b: Promoting business investment in research and innovation	• Development, connectivity and upgrading of innovation space, facilities, and equipment with capability to serve as a platform or host for innovation and innovative relationships.	Focus on Science Corridor and research assets, including development and enabling infrastructure to support development. Investment could be in specific facilities or in sites directly linked to Science Corridor assets.
PA3: Enhancing the Competitiveness of Small and Medium Enterprises	£1.25m £1.25m private match	3c: Supporting advanced capacities[5] 3d: Supporting SME capacity	• Includes refurbishing, modernising and investing in new incubation centres or development of SME drop in zones. Also associated green infrastructure, flood mitigation, digital connectivity and transport improvements integral to development of incubation and grow on space and the wider delivery of strategic sites.	Grant funding likely to be preferred for incubator and may be limited scope to fund with ERDF. Speculative development unlikely. Need for business expansion space recognised in Cheshire and Warrington with limited supply of suitable industrial premises in key locations. Again, potential for Science Corridor related focus, plus targeting at space for advanced manufacturing, supply chain businesses.

[4] Note that relevant priority labelled Investment Priority 3 in earlier version. IP3 remains part of the ESIF and focus is investment in the development, connectivity and upgrading of innovation space, facilities, and equipment. The same description of investment activities has been retained in the April 2016 version.

[5] ESIF Strategy retains original Investment Priority 7 Incubation and Grow On Space for Growth which is priority most relevant to Evergreen investment

3.72 On the ESIF Strategy's output targets, UDF investment would be expected to directly contribute to the following:

- PA1: Target for Investment Priority 1a of 1,202 sq m of public or commercial buildings built or renovated and 71 researchers working in improved research infrastructure facilities. Priority 1b has 260 sq m of floorspace attached to it.
- PA3: Targets for Investment Priority 3a relevant to Evergreen include 3a (Promoting Enterpreneurship), 44 sq m, 3c (Supporting Advanced Capacities), 114 sq m and 3d (Supporting SMEs to Grow), 64 sq m. c relevant to potential Evergreen investment include 114 sq m. This target is for public or commercial buildings built or renovated. However, the expenditure profile given by the LIP identifies Evergreen against only 3c and 3d.

3.73 Across the ESIF as a whole, 1,500 of new floorspace to be created or improved is the target figure.

3.74 Finally, there is recognition in the ESIF Strategy's assessment of lessons learned that land and property interventions of the type which includes those supported by both UDF investment and the Growing Places Fund present some challenges, including high levels of displacement and deadweight. However, it recognises their role in remediation, improving environmental amenity and contributing to physical regeneration initiatives.

Priority Axes 2 and 4

3.75 The ESIF does not indicatively allocate ERDF to Evergreen for Priority Axes 2 and 4. However, there is potential for capital investment to be directed through both in the national OP.

3.76 Priority Axis 2 (Enhancing access to, and use and quality of, information and communication technologies). The aim of Cheshire and Warrington's PA2 allocation is to maximise connectivity by identifying a long-term programme of major investment in digital schemes and services. Capital investment in ICT infrastructure is provided for where gaps in private sector provision are identified and where barriers to SME growth linked to ICT infrastructure and connectivity exist.

3.77 Priority Axis 4 (Supporting the shift towards a low carbon economy in all sectors) centres on building Cheshire and Warrington's market in low carbon environmental technologies, goods and services, climate change mitigation and the imperative to embed resource efficiency in SMEs.

3.78 There are two activities identified in the ESIF where capital investment in buildings is identified, and they are consistent with the area's Low Carbon Action Plan.

- Building retrofit and energy efficiency, especially whole building solutions exemplifying next phase technologies which are near to market.
- Adoption of domestic energy efficiency and low carbon construction techniques, including ultra-low carbon exemplar demonstrator buildings.

3.79 The emerging Greater Manchester Evergreen 2 fund is directing an element of the area's ERDF allocation to PA4b (Promoting energy efficiency and renewable energy uses in enterprises). It is understood that this envisages investment in new, energy efficient buildings or renovations of existing buildings.

Cheshire and Warrington Strategic Economic Plan

3.80 Cheshire and Warrington Matters, the Strategic and Economic Plan (SEP) sets the 10 year priorities and targets for the area's economy. The vision for the area is captured in numeric targets: to increase the value of its economy to £26.6 bn GVA by 2021 (with a GVA per capital of 110% of the

UK average) and to create an economy worth £35.5bn GVA by 2035 with a GVA of 115% of the UK average.

3.81 A refresh of the SEP is now being carried out which sets a headline target to increase annual GVA to £50 billion by 2040, deliver 139,000 new homes, create 127,000 new jobs and increase productivity to 120% of the UK average.

3.82 Much of the rationale, vision and headline targets, strategic imperatives and investment priorities set out in the SEP are shared with the ESIF so are not repeated here. However, there is some additional detail or slight differences in description or emphasis between the two documents which are relevant to the area's development priorities.

3.83 These are briefly summarised in the table below, which shows the key strengths and opportunities for the area set against related weaknesses and threats.

Table 3.2 Relevant Strengths, Opportunities, Weaknesses and Threats

Strengths and Opportunities	Weaknesses and Threats
Integral part of Atlantic Gateway	Infrastructure constraints impeding logistics distribution and Superport freight movements
Potential superhub for HS2	Constraints on development sites
Key locations for high growth and sites for development at Warrington, Crewe, Chester, Ellesmere Port, Macclesfield	Constraints on development sites, lack of supporting transport infrastructure, costly legacy of brownfield land and industry
Attractive place to live and work	Unaffordable housing market in places, lower than average levels of housing completions
Diverse economic base Key sectors for growth: - Advanced Engineering - Life Sciences and Chemicals - Energy and Environment - Nuclear - Financial and Professional Services - Manufacturing.	Relocation of much of AstraZeneca R&D facility will have a negative impact on Cheshire and Warrington economy Transport infrastructure hampering development of sites

3.84 There therefore some clear and consistent messages about the factors constraining development in Cheshire and Warrington and its potential to capitalise on both its key physical assets and growth opportunities in key sectors.

3.85 The SEP pre-dated the UK's referendum on membership of the European Union and the subsequent decision to leave the EU. Whilst the outlook in terms of opportunities for new trading relationships and the challenges Brexit will present to businesses is as yet uncertain, there are potential impacts on current investments in the area by large companies with overseas ownership where access to the single market is central to their trading activity.

3.86 The SEP's overarching framework of investment priorities and programmes is set out in the diagram below.

Figure 3.4 Cheshire and Warrington Strategic Economic Plan, Strategic Imperatives and Intervention Priorities

3.87 Alongside the priorities described above, the SEP is clear that the area's knowledge assets will be critical to future growth. It singles out a series of facilities and institutions including the Waters Corporation's new Mass Spectrometry (MS) Facility near Wilmslow, the National Nuclear Laboratories and AMEC Laboratories in Warrington, Birchwood Park Nuclear Cluster, Bentley Motors in Crewe, and firms in the North East Cheshire Science Corridor. Key institutions include the University of Chester and its Thornton Research Centre facility (engineering), Manchester Metropolitan University, Jodrell Bank (University of Manchester Astrophysics), University of Liverpool Veterinary School.

3.88 The emerging SEP refresh also identifies 9 sectors regarded as key for Cheshire and Warrington. They include advanced manufacturing, chemicals, life sciences, energy & environment, digital and big data, logistics and distribution, finance and business services, agri-tech and caring professions.

3.89 The focus of the SEP's intervention priorities for the **Atlantic Gateway** initiative reflect its extensive geographic coverage. Those where the potential for physical development is identified include:

- Warrington Waters – Developments which expand Warrington Town Centre and sites along the Ship Canal.
- Warrington West – Focusing on Omega and Lingley Mere and energy, engineering, software and telecoms and logistics. The Growing Places Fund supported enabling investment in Omega's road infrastructure in 2013.
- Warrington East – Focusing on Birchwood Park and the nuclear cluster
- Chester Central – Focusing on the city's Northgate development and a new Central Business District. Evergreen investment was subsequently secured for the One City Place office development as part of the CBD.
- Ellesmere Port Strategic Regeneration Framework
- Reinstatement of the Halton Curve.

3.90 The second of the SEP's intervention priorities – **Cheshire Science Corridor** – also specifies the potential to invest in several facilities and sites including:

- Thornton Science Park and the development of a Smart Grid Demonstrator (energy)
- Alderley Science Park as a hub of human health science, R&D, technologies and processes.
- Greater Manchester & Cheshire Life Science Investment Fund, the provision of a £40m fund to support cluster development.

3.91 **Crewe High Growth City** is the third SEP intervention priority. Investment priorities for this initiative centre on the Basford West development area, development of the super hub station geared for HS2, strategic improvements to highways including new link roads and bypasses, skills and workforce development including the potential for a University Technical College (Bentley, OSL, Jacobs) specialising in engineering and design, and a bid to host the National Rail College in Crewe led by MMU.

3.92 The emerging SEP refresh sets Crewe and HS2 in the wider context of the **Northern Gateway Development Zone,** an area extending across the southern part of Cheshire East, Cheshire West (east) and North Staffordshire.

3.93 The development of infrastructure is also central to one of the two enabling programmes (Creating the Conditions for Sustainable Growth). The SEP highlights a series of priorities for transport (including HS2, for example) and housing development, together with other supporting infrastructure. The latter includes reference to the need to bring forward employment sites that fit the needs of key sectors and local businesses, and which attract investment.

3.94 Many of the investment priorities outlined in the SEP are carried through into a proposed package of investment for Cheshire and Warrington's Growth Deal, identified as a series of 'Foundation Investments. They represent the pipeline of investments to be brought forward for each of three main initiatives described above. The use of UDF investment or the Growing Places Fund is earmarked for

- Creation of a 'housing investment fund' (£97.5m) which would extend the area's Growing Places Fund through investment of Local Growth Fund resources. This project is described as one of the 'big ticket' investments for Cheshire and Warrington.
- A further phase of UDF investment to provide a fund to support investment in employment-led projects and developments aimed at disengaged young people and adults to support their entry to employment. This is linked in the SEP to the continuation of the North West Fund, and it may refer to the principle of recycled debt finance rather than the North West's Evergreen Fund, since the latter is configured to support physical development.

3.95 The scale of the investment proposed through the Local Growth Fund is substantial. The SEP outlines a commitment to invest £124.8 million of LGF, levering in a further £2.2 billion of private sector investment and £150m public investment. This would generate 72,000 additional jobs, support the delivering of 10,100 homes and 1.2 million sqm of floorspace.The latest LGF allocations (announced January 2017) saw Cheshire and Warrington allocated £43 million.

3.96 Since completing the SEP, the Cheshire and Warrington LEP is undertaking further work to determine whether it has the basis to implement an energy cluster development programme. This could be established as a fourth investment priority for the area reflecting the concentration of jobs (19,000), businesses (900), research and innovation activity taking place in the area.

3.97 Since the publication of the Cheshire and Warrington ESIF and SEP, there have been a number of initiatives which either represent progress in delivering the area's intervention priorities, or which are strategically significant for development in the area.

Enterprise Zone

3.98 Launched in 2016, Cheshire and Warrington's Enterprise Zone (Cheshire Science Corridor) designates five individual locations and sites across the area. The five sites are:

- **Alderley Park**: a 400 acre life sciences research and development facility which houses the UK's translational centre for anti-microbial resistance (AMR) and is the base of Innovate UK's Medicines Discovery Catapult. It is also the location for BioHub, an 86,000 sq ft specialist business incubator facility.
- **Birchwood Warrington**: 20 Hectares of sites which are part of the wider Birchwood complex, providing new industrial and warehouse space, and refurbished office space
- **Ellesmere Port**: a series of development sites in and around Ellesmere Port which are part of the area's Vision and Strategic Regeneration Framework. The Protos development (Peel) has secured Evergreen I investment to support the provision of road infrastructure for a major development focused on environmental technologies, energy generation, advanced manufacturing and distribution.
- **Thornton Science Park:** EZ sites are designated as part of the University of Chester's Thornton Science Park research and innovation hub. This includes vacant land cleared for development and buildings earmarked for refurbishment. Along with the University's science and engineering faculty, Thornton hosts the Intelligent Energy System Demonstrator project and is anticipated to accommodate the first Energy Security and Innovation Observing System for the Subsurface (ESIOS). It is understood that the extended area encompassing Thornton Park and Ellemere Port are the subject of a masterplan.

3.99 Targeted at science-based businesses and growing companies occupying premises on the sites, the EZ offers business rate relief and (on Ellesmere Port sites) enhanced capital allowances linked to Ellesmere Port's status as an assisted area.

Devolution Growth Deal (2015)

3.100 Cheshire and Warrington's Devolution Growth Deal bid sets out proposals to reduce demand on public services, enhance productivity and drive growth. The document identifies three spatial proposals:

- Mersey Dee Economic Axis – Merseyside, Cheshire, North Wales border. The document links infrastructure schemes across the border and employment sites in Chester, Ellesmere Port, North East Wales and Wirral. It indicates that there are 700 hectares of employment land, the potential to deliver 1 million square feet of prime city centre commercial space and to create 54,000 new jobs and 41,000 new homes by 2040.
- Warrington New City – The document points to potential to deliver 26,000 homes and 55,000 jobs in the surrounding are. It highlights Warrington's connectivity and its position at the HS2/WCML – Transnorth Rail intersection.
- Northern Gateway Development Zone - on a new HS2 Hub Station coming to Crewe and the area's success in science, engineering, rail and automotive, the objective set for Crewe

is to establish it as a 'high growth' and 'constellation city. The proposals essentially point towards a

3.101 On the broader range of proposals outlined in the document, it commits Cheshire and Warrington to providing some of the best new business locations and sites in the UK to enable business growth and investment, referring both to the EZ and to the potential to develop enterprise areas and local development orders in order to deliver strategic sites.

Northern Powerhouse

3.102 The emerging Northern Powerhouse concept to devolve powers and money from Whitehall to northern city regions in a bid to boost their economic performance. Investment in the north of England's strategic rail infrastructure is at the core of the Northern Powerhouse, taking in HS2 and potential for an HS3 linking Liverpool to Hull. The thrust of the initiative is to increase the economic growth potential of the north by capitalising on the potential for agglomeration effects through significantly improved links between the major cities.

3.103 Cheshire and Warrington's Devolution Growth Deal Bid positions the area as the 'Gateway to the Northern Powerhouse'. It points to the ambitious GVA and employment growth targets set for the area (£50 billion economy adding £27 billion a year GVA, creation of 127,000 new jobs) as its contribution to the Northern Powerhouse.

3.104 On specific investment priorities, the Growth Deal Bid emphasises the potential position of Warrington as an HS3-HS2/West Coast mainline hub and to Crewe as an HS2 hub.

3.105 The Northern Powerhouse Investment Fund (NPIF) was launched in 2016 by the British Business Bank with North West, Yorkshire and Humber Local Enterprise Partnerships and the Tees Valley LEP. With a value of £400 million, the fund will draw together ERDF investment, British Bank funds, an EIB loan and other grant funding to provide debt and equity finance for micro, small and medium sized businesses. Cheshire and Warrington's ESIF allocates £13 million to the NPIF, with £5 million under Priority Axis 1, £5m in Priority Axis 3 and £3m in Priority Axis 4.

Northern Gateway

3.106 A new initiative in 2016 has launched the concept of a Northern Gateway Development Zone spanning the area across the boundary of Cheshire West/Cheshire East and Staffordshire. The initiative is anchored in the potential benefits that HS2 will deliver to Crewe and the potential for the wider area to benefit in terms of demand for housing and new employment creation.

3.107 It is understood that a growth strategy for the Northern Gateway is being prepared which will identify the potential to develop high value greenfield sites, deliver new development on brownfield sites and growth opportunities linked to the Crewe transport hub.

3.108 Cheshire features prominently in the initial prospectus issued by the Northern Gateway. This includes reference to geo-thermal energy generation in Cheshire East, the expansion of Winsford Industrial Estate (Cheshire West) with 75 hectares of developable land available, the Basford West strategic site (52 hectares with 22 hectares allocated for employment use).

Key Implications for the Ex-Ante Assessment

- Socio-economic data point to a strongly performing economy which has strengths in advanced manufacturing and engineering, financial and professional services, life sciences and chemicals, energy and the nuclear industry.
- Key challenge for the area is to drive up productivity and generate GVA growth reflecting its position as one of England's highest performing LEP areas
- Growth strategy for the area centres on three broad spatial priorities (Atlantic Gateway, Science Corridor, High Growth City) together with potential for an energy technologies cluster.
- Main locations for growth are Chester, Crewe, Warrington, Ellesmere Port and Macclesfield.
- ESIF and SEP point to need for investment in commercial development to address constraints on sites, encourage speculative development and provide sites and premises to attract and retain businesses.
- Opportunities to develop science and energy-based sites also highlighted.
- Wider infrastructure identified as key enabling factor, pointing to housing and transport infrastructure as investment priorities alongside employment site development.

4. Development Market Assessment

Introduction

4.1 This section provides an overview of recent trends in the commercial property markets of Cheshire and Warrington. The purpose of this is to establish where commercial development is working most effectively across the area, identifying the locations and sites which the evidence suggests are proving most attractive to the market. Conversely, it provides part of the evidence to determine where a deficit of development may point to market weakness and market failure.

4.2 Given the size and variation within Cheshire and Warrington, the analysis aims to focus wherever possible on specific locations, market areas and employment sites rather than providing general analysis.

4.3 The section draws primarily upon the following data sources:

- **Estates Gazette Interactive (EGi):** This data source provides data on deals and availability for commercial property. It records useful information such as the use class, the total floorspace, the date of the deal and the postcode of the site. EGI data is based upon information collected directly from property agents. It therefore offers only partial coverage of property market activity as it reflects only the activity of only agents that have participated, rather than of the property market as a whole. This makes it difficult to interpret some of the trends that this dataset highlights.
- **Local Authority Commercial Property Market Reports:** The three local authorities in Cheshire & Warrington all produce reports which looks at commercial property market across the area. These reports draw upon market analysis and consultations and provides a headline analysis of the balance between demand for and supply of different types of property in Cheshire and Warrington. The analysis within these reports has been used to supplement our analysis of the key property market datasets.
- **Consultations:** this desk-based analysis has been supplemented with insights from consultations with local authorities, the Local Enterprise Partnership, commercial agents and developers.

4.4 To reflect the scope of the Growing Places Fund, the analysis in the Cheshire and Warrington section has been extended to a summary of housing and retail development.

4.5 It should be noted that the research for this section spanned the period during which the UK voted to leave the European Union. The initial response of commercial property investors was reflected in falling share prices for developers and investment companies, and in initial uncertainty about the prospects for future development. Although the terms of the UK's withdrawal are yet to be determined, the overall picture is one of continuing uncertainty and this has been reflected in uncertainty about the prospects for speculative development and views on viability. The picture is mixed by property sector and location, however, with housing developers reporting continuing robust levels of demand, whilst office and industrial developers appear more circumspect.

4.6 In this regard, the present period might be regarded as one in which market conditions are atypical in terms of future investment prospects and the evidence presented in this section needs to be seen in this context.

Cheshire and Warrington

Office Market

4.7 The figure below shows take-up of office space (the total quantity of floor space which has been transacted) has increased between 2010 and 2015. Take-up stood at around 40,000 sqm in 2015, which although it was higher than the rate achieved in 2010 in recessionary conditions, it is notably lower than take-up levels in 2011 and 2012. Bearing in mind that data for 2016 is only partial, it suggests that the volume of take-up it is near 2015 levels.

Figure 4.1 Take-up of Office Space, 2010-16

Source: EGi Note: 2016 data is partial coverage given that there is delay in recording deals in EGi.

Increase in deals driven by smaller requirements

4.8 Around three quarters of office deals completed since 2012 were for floorplates of less than 250 sqm. This reflects the characteristics of the business base in Cheshire and Warrington and the large concentration of SMEs. It is these smaller deals that has driven growth in office take-up.

4.9 The number of large deals has been fairly volatile over the period, increasing substantially between 2010 and 2012, but then falling again since. Local commercial property market reports note that 2014 was a year in which there were a flurry of large deals for office space. However, in 2015 there were only 4 large office deals (over 1,000 sqm).

4.10 The pattern of these deals shows that the large office deals have been in the major towns and cities in the urban areas in Cheshire & Warrington particularly in Warrington and around Wilmslow and Macclesfield as these areas benefit from close proximity to Manchester. Chester, Warrington and Crewe accounted for over half of all office take-up between since 2010.

- **Warrington:** Birchwood and the town centre has been the main location for office development, mainly small deals – there were 72 deals for floorplates below 200 sqm in 2015. There were three deals above 1,000 sqm in 2015, the largest of which was AMEC Foster Wheeler taking over 2,000 sqm in Birchwood and AutoTrader taking 1,400 sqm in the city centre. In 2016, larger deals for offices in Birchwood include Firstsource (c. 1,100 sq m) and other, smaller lettings during the year including FOSS, Newsquest and Claranet.

- **Chester:** The city accounted for around half of total take-up and deals in Cheshire West and Chester in 2014. Chester Business Park is an important location for office deals, with three of the five large office deals (over 1,000 sqm) taking place here including GB Group taking 1,700 sqm. The park has also increased its provision for small businesses with the opening of refurbished office units accounting for a total of 3,900 sqm. In 2016, the North West Evergreen Fund backed One City Place development has seen RSM Accountants and Power Solutions UK taking Grade A space in the development.
- **Northwich:** Cheshire Business Park has continued its expansion with a number of mid-sized deals including Baluff Engineering purchasing a 650 sqm building, and iLLoom balloon taking up 570 sqm.
- **Ellesmere Port:** mainly small deals, although Essar Oil took 2,800 sqm of space at Thornton Science Park.
- **Cheshire East:** the focus has very much been on smaller deals in the past year, with 75% of deals for floor space of less than 465 sqm. Large deals have occurred in the main hotspots of Wilmslow, Macclesfield and Crewe including take up of 2,200 sqm at Norcliffe House in Wilmslow, and 2,100 sqm at Zurich House in Macclesfield.

Figure 4.2 Location of Office Deals, 2010-16

Source: EGi

Grade-A space

4.11 The location of deals for Grade A space (including newly built and refurbished spaces and very high quality second hand space) shows a similar pattern to large office deals, concentrated in the main urban areas. Northwich, Chester and Warrington account for over half of all Grade A office take-

up in this period. Overall, Grade-A office space accounted for around 25% of take-up (of the space in which information of Grade of space is available).

- In 2016 a large proportion of the take up of Grade A space occurred at Chester Business Park, although all of this was second hand grade A space. New deals for One City Place signal a positive response to the provision of Grade A space in Chester's emerging Central Business District.
- There are some small grade A units in out of town business parks in Poynton and Crewe.

4.12 Overall, there has been very little newly built Grade A space in Cheshire and Warrington in the period reviewed in this assessment.

Rental Values

4.13 The pattern of demand is also reflected in rental values for office space in Cheshire & Warrington. There is considerable variation across the area and the assessment has sought to capture the headline picture from published data and consultations. Some consultees have been specific about the level at which office rents become viable, pointing to £22-23 per sq ft in favourable locations before new office development becomes viable.

4.14 The overall message for Cheshire and Warrington is that there are not currently any locations where rental values are consistently exceeding the £22-23 per sq ft threshold, and that this has been reflected in the lack of Grade A speculative office development in the area since the recession.

4.15 On rental values in specific location, our research has found the following:

- Generally, office rental values are markedly higher in the northern area of Cheshire and Warrington reflecting its proximity to Manchester and to the metropolitan M62 corridor from Liverpool to Manchester. However, it is recognised that even these higher performing locations are not seeing Grade A rents exceeding £20, with £17.50 to £18.50 per sq ft the most widely cited figures.
- Wilmslow and Alderley Edge have been described as being the most viable office markets in Cheshire East. Rents of c. £17.50 per sq ft have been achieved in Wilmslow, a figure confirmed in Cheshire East most recent (2016) Commercial Property Market Review pointing to £17.50 per sq ft at Bollin House. Such values in Alderley Edge are being secured mainly for small offices (less than 100 sqm) located in the town centre. In Wilmslow, there are deals where rents have risen above £20 per sqft at Barrons Court and Springfield House.
- There were clear messages from consultees about the location delivering the highest office rental values for Grade A space. Rental values of c. £18 per sq ft were suggested as achievable at Birchwood, with one consultee pointing to the 2015 deal for space at Bridgewater House which secured £20 per sq ft. Consultees however described rental values more typically at £14-15 per sq ft elsewhere in Birchwood Park, figures that square with evidence from a review of agent marketing.
- Recent Colliers data for Chester suggests that city centre Grade A rents stand at around £15 per sq ft, with £17.50 per sq ft at out of centre business parks. One consultee pointed to a headline rent of £18.50 for a large floorplate at Chester Business Park. However, consultations for the ex-ante assessment has suggested that values of around £18-18.50 are likely to be realistic for new Grade A floorspace in central Chester in the immediate future.

- Elsewhere in the area, our review of EGi data suggests that there are isolated examples of rental values exceeding £20 per sq ft including small deals in Macclesfield and at sites in rural Cheshire. These are not typical though of rental values for Grade A office space in the area.

Figure 4.3 Office Rents per sqft, 2014-15

Source: EGi

4.16 Consultations with developers and commercial property agents have presented a mixed picture on the demand for office space and on market values in Cheshire and Warrington.

Supply of Office Space

4.17 In the past 12 months speculative development has occurred or been planned in all three local authorities in Cheshire and Warrington. This marks a change compared to the trend in previous years where little speculative development has taken place.

- There has been speculative office development for the first time in six years in Warrington. The town centre's Stadium Quarter development was started by the speculative Grade A space at Warrington's The Base incubator facility. This provides 15,000 of office space as part of the flagship initiative to bring office-based activity to the town centre.
- Speculative development is planned at Cheshire Business Park, with around 3,700 sqm of freehold office stock to be developed. The One City Place development has brought speculative office development, backed by UDF investment and the Growing Places Fund, to central Chester.

4.18 Overall, however, the assessment's review of the commercial property market data has confirmed the view of developer and commercial agent consultees that speculative development of new office space is very difficult to deliver in current market conditions. Consultees have pointed to the challenges faced even in Central Manchester which has seen a small number of new developments with end users in places, and a limited amount of speculative development, since the UK exited recession.

Industrial Market

4.19 The industrial market includes both (B8), light industrial and manufacturing space (B1c and B2). Although the requirements of occupiers of these different types of space may differ, the EGi's data on deals does not distinguish between them, meaning it is not possible to analyse demand for each type separately.

4.20 Data from the EGi was reviewed for this element of the analysis. However, its output was at odds with both other published evidence on the area's industrial property market and our consultations with developers and commercial property agents. The mismatch between the EGi's downbeat picture of deals and evidence from elsewhere could imply simply that a lower number of deals are being systematically recorded by EGi, rather than any structural pattern. Furthermore, rather than this being a reflection of falling demand, the data could be interpreted as an indication that take-up has been constrained by a shortage of supply of industrial space.

4.21 This appears to be confirmed by local authority area reports on the industrial market in Cheshire and Warrington. They point to high levels of industrial demand, with an increase in the number of industrial deals in all three local authority areas.

- In 2015 the number of industrial deals were reported to be at an all-time high in Warrington. The number of deals in Cheshire West and Chester was also higher than the previous year.
- In Cheshire East, take-up of industrial space in 2015 was 56% higher compared to the previous year, and 15% higher than the previous highest annual total.

4.22 The figure below shows the location of industrial deals since 2010 based on EGi data. Whilst there is a need for some caution about the overall picture they imply, it points to key industrial locations across the area.

4.23 The key concentrations of market activity have been in areas with good access to the transport network. There are notable concentrations of larger deals in Warrington, given its proximity to the M62 and M6, as well as a number of large deals located along the M6 in Crewe and Nantwich. Ellesmere Port has good access to both the road and sea network, and is therefore naturally an attraction for industrial space, as shown below.

- In Warrington, the 2016 Commercial Property Review for the area concludes that transactional deals reached 'an all time high' in 2015. Strong demand for space at Omega, a development backed by Cheshire and Warrington's Growing Places Fund which provided investment in the site's road infrastructure, saw speculative development of large floorplate warehousing facilities completed and sold, and purchases of land for development by occupiers (eg. Hermes). Large facilities are also operational for Asda, The Hut Group, Travis Perkins and French manufacturer Plastic Omnium. Other notable deals highlighted in 2015 included Patrizia's spec development of three new warehousing units at Birchwood Park (53,000 sq ft total). The most substantial number of transactions occurred at Woolston, amongst the highest profile an extension of Amazon' facility. The Grange Employment Area in Woolston has been the location of a number of large deals, with nine deals over 1,000 sqm in 2015/16.

- In Cheshire East, the borough's 2016 commercial property review is similarly upbeat describing the total take up of 119,000 sq m (1.28 million sq ft) as 'unprecedented'. a third of all deals in 2015 were for floorplates greater than 1,000 sqm. The largest deal was B&M Bargains taking 45,000 sqm at Midpoint Business Park in Middlewich. Consultees have confirmed that Midpoint 18 has continued to be amongst the best performing locations in the area, and have pointed to M6 linked sites in Crewe and Sandbach as the more attractive locations for industrial investment in the area. Crewe saw the second largest deal in 2015 for Wincanton's facility on Weston Road.
- Winsford and Ellesmere Port had the largest average deal size in Cheshire West and Chester. Notable deals include Tiger Trailers taking 9,700 sqm at Winsford Industrial Site and MPS's purchase of 5,670 sqm at Cromwell House. These were the exceptions however, as small deals dominated the industrial market. In 2014, over half of all deals were for floorspaces of 200-500sqm. Winsford Industrial Estate has been earmarked for future expansion to build on its continuing success, whilst sites in Ellesmere Port have been targeted for industrial development as part of the Cheshire Science Corridor Enterprise Zone and the Ellesmere Port Strategic Regeneration Framework.

Figure 4.4 Location of Industrial Deals, 2010-16

Source: EGi

4.24 Several consistent messages have emerged about the factors driving demand for industrial (B2 and B8) spaces across Cheshire and Warrington in the past 2-3 years:

- Large floorplate warehousing demand, most notably at Omega, and warehousing demand generally, reflects the expansion of online retail and the scale benefits of larger and more efficient distribution operations. The strong track record of B8 development around Crewe, Midpoint 18 (Middlewich) and Omega is linked to the excellent access these

locations have to the motorway network (M6, M62 particularly). Consultees suggest that this need for good quality motorway linked sites will continue to fuel demand.

- Development of the Liverpool Superport and the repositioning (or reinforcing) of Liverpool's role as an international freight and logistics hub has seen robust demand for warehousing space across much of the central North West region and the motorway corridors. In this regard, the pattern of development in Cheshire and Warrington is consistent with the area's role in the Atlantic Gateway initiative and it underlines the importance attached to the logistics sector in the SEP.
- Continuing demand for manufacturing and engineering floorspace in locations such as Ellesmere Port and Winsford, but also in Crewe, Congleton and other locations across the area, is also consistent with the evidence on the strength of manufacturing in the area, the priority the SEP gives it and recent growth in the sector in the area. The government's newly published Industrial Strategy green paper has further signalled the importance attached to capitalising on the UK's strength in advanced manufacturing, and to the infrastructure necessary to support this.
- One key issue highlighted by consultees is the difficulty of securing expansion or replacement space for businesses which have outgrown premises. Several consultees highlighted instances of companies in Ellesmere Port choosing to locate elsewhere because of a lack of suitable sites and premises in the area. This finding confirms one of the headline messages from our review of the data, which is that the flow of transactions may simply be limited by the lack of good quality sites and premises available. Several consultees have singled out the availability of larger sites in particular, pointing to the key role that they play in delivering economic growth objectives for the area.
- The robust levels of interest in deals also reflects market appetite for the freehold purchase of premises. Several consultees have been keen to emphasise that they are seeing strong interest from businesses seeking to own their premises, and that there is likely to be some untapped potential to deliver new industrial development which enables this. Again, interest in Ellesmere Port was highlighted but generally developers and commercial property agents have made this observation about the sector.

Grade A space & Rental Values

4.25 Since 2012 only around a quarter of all industrial take-up was for Grade A space. This is reflected in rental values, with the vast majority of deals achieving values of less than £10 per sqft. Our review of the evidence indicates that demand for lower grade industrial stock, and particularly smaller units, exceeds demand for Grade A space. Again, this may reflect the availability of Grade A stock across the area where speculative development of such stock appears to have been limited in recent years.

4.26 Consultees have cited values at c. £6 per sq ft for smaller scale industrial units (up to 15,000 sq ft) and £4.95 per sq ft for larger units as viability thresholds for development. Developers have pointed to a continued preference though for end users, and there appears to remain some caution in the market about speculative development, a situation not assisted by the uncertainty for investors that has followed the Brexit vote.

4.27 Despite these conditions, examples of new industrial speculative development taking place or planned for the area have been highlighted by consultees. They include Patrizia's units at Birchwood Park, a planning application for 150,000 sq ft of warehousing space on land on Winsford Industrial Estate and Black and White Developments' construction of 5 industrial units at Orion Park in Crewe, which were sold on completion in November 2015. This appears to be driven by

locations where rental values are exceeding the £6 per sq ft threshold – the data on deals points to both Birchwood Park and Orion Park achieving rents in excess of this figure.

4.28 Overall, however, the picture in terms of rental values is mixed, reflecting the wide range of stock (type, size and quality) that constitutes industrial premises, their end uses, the strengths and weaknesses of different locations. However, commercial property market reports indicate that in recent years, increased demand for industrial units combined with low levels of quality stock has resulted in an increase in rental values in 2015 compared to previous years. This has been confirmed in consultations, with consistent messages about appetite for smaller industrial stock including freehold, a shortage of Grade A stock and the continuing strength of the large scale logistics and distribution sector.

- The 2016 Warrington Commercial Property Review shows that, for deals where details were disclosed, the highest rental values were achieved for industrial units at Winwick Quay, although these appear to have been for trade counter and leisure uses. Patrizia's unit at Cavendish Place (Birchwood Park) was let at c. £6.75 per sq ft, a figure which may reflect the Park's status as a premium business location for the area. The largest cluster of values suggested by the data is in the £4.20-£5.20 range. One consultee indicated that rents for new, larger warehousing stock were now reflecting the strength of this sector in Warrington and were exceeding £6 per sq ft, with second hand stock at £4-5 per sq ft.
- In Cheshire East, the 2016 Commercial Property Review points to the highest rental values being achieved in deals at Tytherington Business Park (£6.80 per sq ft) and Orion Park in Crewe (£6.05 per sq ft).
- In Cheshire West and Chester, rents are on average lower compared to the other districts, around £3-£4 per sqft. In part, this may reflect the stock of premises available in locations such as Ellesmere Port where consultees have pointed to lower rental values as an issue for development viability, but a factor which also means the area is cost competitive. A similar observation has been made about Winsford Industrial Estate, although the consultee did not estimate average rental values. A review of Cheshire West's 2015 Commercial Property Market Review suggests that rental values for deals in that year were around the £3.75 per sq ft mark. Elsewhere in Winsford

Figure 4.5 Industrial Rents per sqft, 2014-15

Source: EGi

4.29 Given the breadth of stock involved, it is clearly difficult to point to 'typical' rental values for Cheshire and Warrington. Where consultees have commented on industrial rents, they have typically pointed to the £4-4.50 per sq ft mark. Our review of EGi and commercial property reviews points to £4-5 as the most frequently occurring range.

4.30 However, consultees have noted that the prime locations (motorway linked, new development) are achieving £6 per sq ft plus. Some distinction has also been made, however, between larger scale industrial stock with rents of £4.50-£4.95 per sq ft, and smaller stock at c. £6 per sq ft, although consultees have suggested that the strong demand for larger scale warehousing space is seeing higher rents achieved for this type of property. Others have also suggested that end users are prepared to pay a premium on rents above market rates where the developments are particularly well located.

Supply of Industrial Space

4.31 As outlined above, a shortage of high quality stock has resulted in rising rental values. This is an issue that is prevalent across a much wider area than Cheshire and Warrington. Our consultations have also suggested that there is currently stronger demand for smaller, second hand stock than has been the case in previous years, which may also be attributable to general demand pressure for industrial premises.

4.32 The latest round of commercial property market reports suggest that there are indicators of a return to speculative industrial development in 2015, although this appears to be patchy and site/location specific.

- In response to this demand for high quality industrial units, particularly amongst SMEs, a further phase of speculative development has been delivered and sold on very quickly at Orion Park in Crewe. This includes a Total Developments/Stretton scheme and the Black and White Developments scheme. Our understanding is that rents of c. £6 per sq ft have been secured at Orion Park, a figure which is indicative of viable development.
- In terms of the volume of floorspace, speculative development in Cheshire and Warrington in the past year has been in Warrington. At the Omega site, a 30,000 sqm speculative logistics warehouse has been commissioned by LondonMetric. In addition, Patrizia's development of speculative units at Birchwood Park was highlighted to us by one consultee. Again, the area's 2016 Commercial Property Market review suggests that a rental value of £6.75 was achieved for a unit in this area in 2016, a figure which points to commercially viable speculative development.
- In Ellesmere Port, there is a mixed picture. A number of sites including the large Port Cheshire site and land at Hooton are currently being marketed with capacity for very substantial industrial and warehousing development. The area has a portfolio of sites offered to the market as part of the area's Strategic Regeneration Framework initiative and the Cheshire Science Corridor Enterprise Zone. Improvements to the road infrastructure at New Bridge Road secured Regional Growth Fund investment, and sites are earmarked for development at this location. However, it is understood that the costs of remediating sites or putting in place infrastructure, together with industrial rental values in the area, are a barrier to development coming forward.

Industrial Market Conclusions

- Demand for industrial space has increased throughout Cheshire and Warrington. This has been concentrated in areas with good access to the motorway network particularly around the M6 and M62.
- In the last year or so there has been a return to speculative development mainly in Warrington around already established logistics and manufacturing clusters.
- A lack of high quality large space has recently driven up rental values and contributed to rising demand for smaller stock. In other locations, industrial rents remain low, particularly in Cheshire West & Chester, and this continues to be a barrier to speculative development.

Housing

4.33 The picture of the residential development market in Cheshire and Warrington painted by the research for this assessment is a largely positive one. Consultees to the study have been very clear that, with only a hesitant return to speculative commercial development and uncertainty about the implications of the Brexit vote, the residential market will continue to be a focus for developers. It is seen as a safer haven for property investment, with consultees identifying a range of factors in the area including:

- The past under-supply of homes relative to demand in the area, with the past 2-3 years having seen a significant upswing in completions which are likely to reflect latent demand in the market amongst other factors.

- Cheshire and Warrington's good prospects for attracting young families with links to the major cities, although affordability pressures are recognised to be a barrier in this regard.
- The comparative strength or residential compared with commercial land values, with many locations in the area seen as having offering a premium for residential development given the level of demand for homes.
- Favourable lending conditions both for developers and for home buyers, with low interest rates and greater confidence about returns to investment cited as factors. The assessment has also suggested that banks and other investors have much greater appetite for residential development than commercial post recession.

4.34 Both total completions and the number of residential property sales in each of the three local authorities has increased year on year since the recession, with a particularly marked increase evident in 2014/15.

4.35 This increase in housing market activity has been concentrated in Cheshire East and Cheshire West and Chester. In 2015, the number of sales per 100 homes in each area stood at just over 16 in Cheshire East compared to 15 in Cheshire West and around 14 in Warrington. In 2012, these equivalent figures stood at around 10-12, underlining the growth in house sales relative to the stock of housing which has occurred in this period. In addition, over the past five years the number of completions has increased by 125% across Cheshire and Warrington (equivalent to 2,188 homes).

4.36 Although the rate of increase has been in Warrington compared to the other local authority areas, Warrington's recently completed Strategic Housing Market Assessment has pointed to a housing need figure of 839 dwellings a year over its local plan period, and delivery at this level would represent a step up on recent delivery rates in the borough.

Figure 4.6 Net Dwelling Completions in Cheshire & Warrington, 2009/10 – 2014/15

Source: Annual Monitoring Reports

Figure 4.7 Number of Residential Property Sales in Cheshire & Warrington, 2012-15

Source: ONS, House Price Statistics for Small Areas

4.37 Cheshire East remains one of the most sought after residential locations in the North West, and recent growth in the housing market in the past year is projected to continue.

- In 2015, 36 planning consents were given and planning permissions are now in place to deliver 11,000 homes across Cheshire East. Significant housing growth is currently sought in planning applications in Sandbach and Congleton, with each area accounting for 20% of total site consents.
- In addition, sites under construction means that there is projected to be around 3,000 homes delivered in the next five years. Again these are in the main town centres in the Borough with Sandbach, Congleton and Middlewich accounting for over half of these homes.
- Housing growth in and around Crewe is a core proposition of the Crewe High Growth City initiative, recognising the link between new homes and economic growth objectives for the areas as the town seeks to capitalise on HS2.

4.38 In Cheshire West and Chester, the borough's latest Annual Monitoring Report indicates that there were 1,769 net additional homes completed between 2015 and 2016. It reports also extant planning consents for 13,500 homes. Currently, the main areas of activity are in Northwich (2,600 units with planning permission) and Ellesmere Port (1,300 units with planning permission). In Northwich, there are major developments underway at Winnington Urban Village, Lostock Gralam and London Road (Northwich Marina). In Ellesmere Port, sites at Cambridge Road, Cromwell Road, the former Greyhound stadium and Ledsham Road are set to contribute to a housing growth trajectory which has seen sustained development on previously developed land around the town.

4.39 The borough's latest Strategic Housing Land Availability Assessment reports 180 housing sites in 2015 with the capacity to deliver around 3,000 homes. The majority of these are previously developed land (80%) with the remainder greenfield sites. Potential future housing development sites are concentrated in the west of the borough, including Omega south, Lingley Mere, Chapelford and the Gemini area. Omega Warrington has secured outline consent for 1,100 homes and the private and public services for a new community at Omega South. Muse has also secured outline consent for new homes as part of a reorientation of the Lingley Mere development site.

4.40 Consultees to the assessment have recognised that the viability of housing development sites is site specific, with development on brownfield sites subject what can be significant remediation costs and high land values attached to greenfield sites, particularly in the north of the area.

4.41 On the question of need for development finance, the general message is that market housing development tends to be well served by private finance, and that it is currently not a significant issue for housebuilders given development values and the strength of demand for homes.

4.42 However, affordable housing development presents a different challenge. Given constraints on the availability of public funding for affordable homes, changes to the housing benefits regime and viability problems for affordable development, there is recognition that publicly backed finance has an important role to play here. Viability issues highlighted in our assessment centre on the costs of site enabling infrastructure, and in some instances site remediation, both linked to the use of brownfield sites in urban areas. For smaller developers delivering affordable homes which lack the track record and asset base of larger builders, debt finance may provide an essential bridge to enable completions and sales to deliver returns on their investment.

4.43 Cheshire and Warrington's Growing Places Fund has already provided a source of debt finance for a number of developments:

- Kingfisher Square, Warrington (2013) - £0.23 million for the development of 12 units.
- Tower Wharf, Chester (2015) - £1.2 million in a development of 33 homes
- Edgewater Park, Warrington (2015) – £1.74 million for the development of 49 units

4.44 It is understood that there are further applications for GPF to support housing developments in the pipeline. Our assessment suggests that affordable development is likely to continue to generate potential investments for the GPF.

Retail and Leisure

4.45 Retail development activity and deal flow has been comparatively limited recently in Cheshire and Warrington. Consultees have pointed to the lasting effects of the recession and its impact on consumer spending and the continued growth of online retailing. Several have observed also that investors are looking to refurbish and improve existing assets, with the Crown Estate's Coliseum Retail Park, the Greyhound and Deva retail parks in Chester, and Alban Park in Warrington highlighted as examples.

4.46 Commercial property reports for the three areas indicates that in general the number of deals has been lower in 2015 compared to previous years, with an emphasis on smaller retail property investments. However there has been some variation in this across Cheshire and Warrington.

- Major new development is in motion in central Warrington in the Time Square development, a leisure and retail scheme led by Muse and Warrington Borough Council with a total development value estimated at £107 million.
- In Cheshire East, take up of retail space and the number of deals was lower in 2015 compared to previous levels, mainly due to demand for smaller space. The borough's commercial property review records a small number of large transactions in 2015, including Phoenix Park in Crewe as the largest (£6.6 million).
- In Cheshire West and Chester, there has been deal and development activity has centred on Northwich and Chester. The first phase of Baron's Quay in Northwich has been completed with Asda and Odeon anchoring the scheme. In Chester, the Deva and Greyhound retail parks have continued to see occupier leasings as units turn over, and the addition of a new development in 2016 (restaurant). The £300m Northgate scheme in central Chester secured consent in September 2016 and this will add 500,000 sq ft of retail and leisure space to the city centre.

Implications for the Ex-Ante Assessment

- Deal flow for offices has ebbed and flowed since 2010, although the last 2 years have seen some larger deals in key locations (Birchwood Park, One City Place), evidence of strengthening demand post-recession.
- Some locations achieving rental values in excess of £20 per sq ft, but the best performing locations (Wilmslow, Birchwood Park, Alderley Edge, Chester Business Park) are typically seeing £17.50-£18.50 per sq ft at the top end of the market.
- There is broad consensus that £22-23 per sq ft represents the rental value below which speculative development without the support of public funding is not viable. There are no current locations in Cheshire and Warrington achieving values at this consistently level such that speculative office development is justified, and **it is therefore difficult to see a role for a new UDF here**.
- Demand for industrial space has increased across the area. This has been concentrated in areas with good access to the motorway network particularly around the M6 and M62.
- In the last year or so there has been a return to speculative development mainly in Warrington around already established logistics and manufacturing clusters and on the best quality sites (Omega, Birchwood).
- A lack of high quality large space has recently driven up rental values and contributed to rising demand for smaller stock. In other locations, industrial rents remain low, particularly in Cheshire West & Chester, and this continues to be a barrier to speculative development.
- There remains strong appetite to invest in housing development, with land and development values significantly exceeding commercial values. Viability issues tend to arise on more marginal sites and those where affordable is the main or a significant component.
- Limited new retail investment in the area in recent years, although major schemes are in early phases or imminent.

5. Development Finance

5.1 It is a requirement of the ex-ante assessment to consider finance market conditions in the proposed intervention area, to assess the ability of private sector finance providers to meet developers needs and to identify any subsequent areas of market failure.

5.2 It is important to note that the supply of development finance varies substantially across different types of developments, different locations and different borrowers. In some of these areas the market works efficiently, and developers have been able to satisfy all their funding needs through commercial lending. However, there are areas of the market that are underserved commercially and as such there is a potential role for the public sector to intervene where the evidence suggests there is unmet demand for finance.

5.3 Pre-Brexit referendum, there were signs that the supply of finance was improving and returning to a healthier state following the recession and the financial crisis of 2008/9, following which commercial lenders started to withdraw from the development finance market. UK banks had a high level of commercial property exposure on their loan books and focus was put on carefully managing their positions, disposing of these risky assets and more generally rebuilding their balance sheets (in line with the requirements of Basel III[6]).

5.4 Regulatory changes acted as a further disincentive for banks to lend, The Financial Services Authority (FSA) changed how property assets were classified which increased capital charges for banks and made it much more expensive for them to engage in development finance lending activity. As a result of this, the appetite for new lending fell from its 2007 peak across all types of developments as demonstrated in Figure 5.1.

5.5 Post-Brexit referendum, the outlook for the economy is much less clear, the latest Financial Stability Report recognises that the UK will be subject to '*a period of uncertainty and adjustment*' and this has been evidenced by the changes in numerous market indicators such as exchange rates and the equity prices of UK banks.[7]

5.6 In the immediate aftermath of the referendum result, a number of high profile investors including Henderson Global Investors, Canada Life, Threadneedle, M&G Investments, AVIVA and Standard Life suspended trading in their property funds. Equilibrium (a North West England based wealth and investment firm) sold all of its commercial property investments. RICS Q2 UK Commercial Property Market Survey[8] also presented a negative outlook showing '*a significant deterioration in market sentiment following the Brexit vote. The heightened sense of caution is visible across both investment and occupier sides of the market, with uncertainty pushing rental and capital value projections into negative territory.'*[9]

5.7 More recent evidence points to some stabilisation in the market, a number of investors are beginning to re-open funds and believe the market is starting to correct itself. On a local level, consultations have told us that the referendum result did not have a long-term impact on their appetite to lend once initial uncertainty in the market had settled.

[6] Basel III is regulatory framework for the banking sector which aims to strengthen the ability to absorb economic/financial shocks through improving bank's capital positions while also improving governance and transparency within the sector.

[7] Financial Stability Report, July 2016, Bank of England

[8] Q2 2016: UK Commercial Property Market Survey, RICS

[9] Ibid., Page 1

Figure 5.1 Total Amount of Bank Loans Made by Allocation

Source: DeMontfort and CBRE

Sources of Finance

5.8 A typical commercial property finance deal is made up of both debt and equity. Debt is usually provided by Banks and the equity contribution will be provided wholly by the developer or in conjunction with a property fund or alternative lender. Insurance companies are also heavily involved in commercial development, although the extent of this is usually limited to lending on income-producing properties as opposed to providing funds to finance a development.

5.9 Each finance provider operates in different areas of the market, depending upon their investment strategies. Banks hold a dominant position in the provision of senior secured lending, usually in the form of revolving credit facilities[10] . However, such facilities are usually reserved for pre-let and pre-sold development activity.

5.10 Large established developers can also access capital markets through issuing corporate bonds, convertible bonds and private placements. Institutional investors such as pension funds and mutual funds will typically purchase the bonds, providing capital to the borrower. This source of finance is only available for developers with a strong balance sheet, seeking high levels of debt (the minimum amount of debt that can be raised on the wholesale bond market is typically £200m).

5.11 Property debt funds such as DRC capital, AXA and AgFe as well as peer-to-peer lenders are more active in the provision of leveraged loans, mezzanine and equity finance as well as lending for speculative developments due to their appetite for yield placing them higher up the risk curve.

Trends in lending

5.12 The availability of finance is typically dictated by the characteristics of the borrower, the stage of development and the location and end use of the site. The following considers trends that were

[10] A revolving credit facility (RCF) is a line of credit where the borrower will pay a commitment fee and can draw down funds as and when required. The balance of the RCF will fluctuate with the lenders cash flow position and can go up as well as down. It operates in a similar way to a personal overdraft.

emerging pre-Brexit. Given current market uncertainty it is unclear how these trends will evolve in the next couple of years.

Size of developer

5.13 Large listed property developers with a good track record are able to obtain finance much easier than their smaller counterparts and experience fewer constraints in accessing the finance they need. Those able to access capital markets can obtain large amounts of debt at a cheaper cost to a senior secured facility and for longer tenors.

5.14 These developers are able to fund activities via the capital markets due to their size, the strength of their balance sheets and their track record which all provide investors with the confidence they need to invest. Pre-Brexit, there was a compression of bond yields which was an indicator of rising investor appetite and suggested that there was a healthy amount of capital market funding available for the right type of developer.

5.15 Large developers are also able to use corporate facilities from UK and overseas banks to fund development activities (although overseas banks tend to focus their activity in London). As previously noted this is usually in the form of senior secured RCFs although some banks will also provide mezzanine finance.

5.16 On the other hand, smaller developers are generally underserved. This happens as a result of imperfect information. Perfect and freely available information would mean investors would know the risk of each investment failing and agree a commensurate rate of return with the developer. However, information is not perfect and investors tend to deal with this by dividing the market into classes of investment for which average failure rates are known. Some classes of investment where average risks of failure are perceived to be too high and returns too low to justify investment, will be excluded from the market. There are likely to be developments that could be profitable investments, but imperfect information means they cannot be distinguished from other riskier investments. Imperfect and asymmetric information give rise to a situation where the market does not provide adequate investment for firms, even when individually they might offer a good return on investment. This is known as 'credit rationing'.

5.17 This explains why banks tend not to lend to SME developers as they have characteristics that give rise to credit rationing, these are:

- **Track record and credit worthiness:** Smaller developers do not usually benefit from the same track record as larger more established developers and as such struggle to demonstrate past performance. This combined with insufficient collateral on which to secure a loan gives rise to uncertainty on the risk of the investment. Consultations suggested that an SME developer that does not have a spotless track record will find it difficult to obtain development finance.
- **Smaller debt requirements:** SME developers will generally need (and only have the capacity for) less debt to fund developments. The level of due diligence required, and the complexity involved in setting up development finance facilities, makes it prohibitively costly to lenders to provide debt below a certain size.

Type of development

5.18 As the real estate market recovered from the financial crisis, lenders returned to funding developments although bank lending is still largely restricted to pre-let or pre-sold developments. Activity is strongest for residential development in good locations were property is expected to sell reasonably quickly, and large scale, city centre commercial developments such as prime office

space and hotels. There is much less information on supply of finance in the industrial space, however, evidence in a study by the International Property Forum points towards more lenders being active in the supply of finance for industrial developments than that seen over the last five years (albeit this evidence is based on a small sample of lenders)[11].

5.19 The Bank of England's summary of business conditions for the UK as a whole[12] noted that despite robust occupier demand and rising rents in the commercial real estate market, they had not yet reached levels high enough to encourage funding for speculative development. Where such activity is taking place it is generally funded by overseas investors or specialist property funds, but only in the best locations.

5.20 In light of recent events, the outlook for speculative development is likely to be even more bleak. According to the UK Commercial Property Market Survey, *'On a UK-wide basis, occupier demand failed to rise for the first time since 2012. The headline net balance fell from +21% previously to a reading of zero in Q2'.*[13]

5.21 As Figure 5.1 above demonstrates, loan book allocations for speculative development is much lower than for commercial or residential developments. However, we cannot infer from the data whether this is due to supply constraints, lack of demand, lower debt requirements or a combination of these factors. Nevertheless, this is a market most UK banks have withdrawn from completely, or where they do lend it is restricted to low risk residential developments or office space in a prime location, preferably with evidence of strong potential occupier demand.

5.22 Alternative lenders are more active in the speculative development space as they are not subject to the same regulation as banks (which provides disincentives to lend in riskier areas) and tend to be much less conservative given their appetite for higher yields on lending.

5.23 The recent rise of Peer-to-Peer lenders is a positive development for the outlook of speculative development. These lenders are much more willing to lend speculatively and also have a particular focus on smaller schemes. Having said this, it is unclear what appetite these lenders will have following the Brexit announcement.

Location of the development

5.24 Following the recession, development finance became much more concentrated in London and the South East given that the property market in these areas were much less affected by the financial crisis. Lenders had little appetite to fund developments in other parts of the UK outside of the major cities. According to a report by CBRE[14], more recently lenders have shown an increased appetite for funding more regional developments, however, this is usually restricted to fully-let schemes. Despite this, London and the South East still dominate funding activity due to its underlying economic strength and growth in demand for both residential and commercial property.

Identifying Finance Gaps

5.25 We have undertaken a number of consultations with finance providers, developers and agents to gain a greater understanding of the specific challenges that are prevalent in the local area.

[11] UK Development Finance Review 2015, International Property Forum

[12] The Bank of England Agents' summary of business conditions 2016 Q2

[13] Q2 2016: UK Commercial Property Market Survey, RICS , Page 1

[14] Development Funding – Is it available? CBRE, 2014

5.26 The evidence suggests that developments being brought forward for either residential, commercial or industrial uses by a well experienced developer (that can also demonstrate a healthy cash position) will usually be able to secure the level of debt finance required. There are several active developers in Cheshire and Warrington, both large and smaller, who have a solid cash position and access to credit in the private market.

5.27 Despite this, there are some weaknesses in the commercial market detailed below that have been brought out in consultations. Each of these areas provides opportunity for a public sector backed fund to address finance gaps and market failures.

1 - Lack of appetite outside of major cities

5.28 Evidence suggests that much of the supply of finance for development activity in the North West is being concentrated in major cities, with Manchester holding a dominant position. Outside of the major cities in the North West development finance activity is being constrained by the presence of two market failures; information failure and path dependence which are closely linked in this instance.

- **Information failure:** Consultations suggested that, due to the relatively low levels of development activity in more peripheral areas, developers and investors do not have the same level of knowledge on which to base sound investment decisions. This can lead to deals being priced out of the market due to risk perceptions or preference to focus resource elsewhere in areas lenders are more comfortable with. Speculative development in the North West seems almost entirely focused on Manchester and Liverpool with banks being unwilling to fund these types of developments outside of these areas.
- **Path dependence:** This occurs where sub-optimal investment decisions are made because past decisions/developments have affected the options available to current investors and policy makers. Consultations with finance providers suggested that historically developers have been more active in major cities and less so in peripheral areas. Moreover, these areas have stronger local economic performance and are home to higher value business sectors. As a result of this, agglomeration effects arise and networks develop between businesses, financial institutions, professional bodies and developers creating the right financial infrastructure for investment activity to occur. Finance providers become more confident investing in these areas and as such continue to concentrate activity there as opposed to the more peripheral areas.

5.29 It has also been noted that the North West, perhaps with the exception of Manchester, has experienced a lack of presence from institutional investors who withdrew their activity in areas outside of major cities following the financial crisis.

5.30 There is a potential role for the public sector to take risks that the private sector will not. This will increase the supply of finance in areas that may be overlooked by commercial lenders where regeneration benefits can be secured. This could also have wider impacts and play a role in demonstrating the returns which can be secured in these market activities, stimulating activity among the private sector in future.

5.31 However, a portfolio with a high concentration of risky sites could result in a high number of defaults and limit the recyclable intention of the fund. This would have to be carefully considered and managed in any investment strategy.

2 - Poor infrastructure inhibiting deals

5.32 Our consultations suggest that a number of sites in the area are failing to be unlocked as a result of poor infrastructure that many of them are subject to. This increases development costs and when combined with the low rental values being achieved in the area (as noted earlier) results in the presence of viability gaps, causing market failure and preventing sites from coming forward.

5.33 Grant funding is considered to be the most appropriate mechanism to make these sites commercially viable. However, there are instances where the role of UDF can reduce viability gaps. Through providing sub-commercial rates on development loans, finance costs will be lower than with a commercial provider. On marginal sites this could tip the balance and bring them into commercial viability.

5.34 Even where viability gaps still exist, the provision of finance at sub commercial rates will reduce this, minimising the amount of grant funding required to bring the site forward.

5.35 We have seen evidence of this approach in Merseyside, whereby a developer has requested grant funding to bring a site forward and is requesting development finance from the Chrysalis fund at sub commercial rates which decreases the viability gap and results in a lower amount of grant funding being required.

5.36 Offering sub-commercial rates requires careful consideration of displacement of private lenders. It should not be the purpose of any public backed fund to displace private sector activity. Whilst a sub-commercial loan can reduce viability gaps, these should only be used in instances where banks are not willing to fund the development at commercial rates. This could be a useful tool for speculative development on sites with viability issues.

3 - Limited funding available at smaller debts levels

5.37 One of the key gaps in the supply of finance that we have observed is the ability of developers to secure debt at smaller amounts. Whilst finance providers state that they are willing to provide finance from £100k and upwards, the extensive due diligence and set up costs prove prohibitive and diminish returns to commercial lenders, especially in the sub £1m space. This results in a natural tendency for private lenders to focus on higher volume deals and limits the amount of funding available at lower levels.

5.38 There could be scope for the public sector to fill this gap by providing debt finance at lower amounts, although this is perhaps more suited to the needs of small housebuilders as opposed to development on strategic sites given the higher level of debt that is usually required to bring forward these sites for development. Finance requirements for major development sites are typically much larger than the sums of money that have previously been available through either the Growing Places Fund or UDF investment, although these can still play a part in the overall funding mix.

4 - Lower risk appetites

5.39 Commercial finance providers now have a lower risk appetite for property development and will take minimal risk when structuring a deal. Most banks will fund a maximum of 60% of the Gross Development Value of the site – although are more comfortable operating around the 50% mark. The remaining funding is expected to be provided by the developer upfront.

5.40 However, not all developers will be able to meet these requirements due to their own risk appetite falling in the aftermath of the recession or through simply not having the financial resource to do so, therefore a funding gap emerges. In the past, developers have turned to property funds to

provide mezzanine finance to fill this gap however, they have also been much less active since the recession and tend to focus their activity in London and the South East.

5.41 Funds such as UDFs and the Growing Places Fund may have a role to play here as bridging capital, and this is where they are seen as having the most potential where development is viable or of marginal viability, but banks or other investors will not commit. However, our consultations suggest that co-investing with the private sector in this way can at times be difficult due to wariness about the conditions, reporting requirements and administrative costs that come with these funds.

Implications for the Ex-Ante Assessment

This section has considered evidence from national data and consultations with local finance providers, developers and agents to assess the local market conditions for development finance. The analysis finds that there are four key reasons as to why developers may have unmet demand for development finance.

- Lack of appetite to lend outside of major cities due to information failure and path dependence
- Poor infrastructure creating viability gaps and making sites unattractive to commercial lenders
- Imperfect information causing due diligence to result in smaller loans being prohibitively costly to banks
- The financial crisis has lowered risk appetite from both banks and developers which is creating funding gaps
- All of these factors point to a role for the public sector to intervene to realise economic development benefits. However, the characteristic of the sites in the pipeline will determine whether or not a UDF will be the appropriate response.

6. The Potential Investment Pipeline

6.1 Cheshire and Warrington's specific requirements from the ex-ante assessment were to determine i) whether there is a pipeline of potential development investments which might be appropriate for the area's ESIF allocation of £5 million and its potential to be increased and ii) what potential investments might be suitable for future Growing Places Fund investment (£12.5 million).

6.2 The starting point for this element of the assessment was to identify a priority development pipeline for Cheshire and Warrington. The approach was to be driven by developments already established as key investments by the LEP and the three local authorities. It is understood that this is currently being agreed as part of the area's devolution agreement proposal.

6.3 However, this material was not available to the ex-ante assessment. In its absence, the assessment sought through a review of published material on key sites in the area, consultation with local authorities and dialogue with developers to establish a long list of development projects.

6.4 This section of the assessment first sets out the development opportunities and other investments identified in the process described above. Further analysis of the potential to invest through the Growing Places Fund will be provided with the final version of this report.

6.5 At this point, incomplete information is available about the potential timing, scale and value of the developments considered in this section. As a result, it is not possible in several to draw firm conclusions about potential investment needs for sites, and further information has been requested from the relevant local authorities and developers. It is possible also that there are projects which might come forward as candidates for UDF investment that have not been identified to us in the course of our work.

6.6 The assessment provides a summary of each development, its alignment with Cheshire and Warrington strategies and a commentary on how they meet key criteria for projects for which UDF investment might be appropriate. It gives a colour coded assessment based on the information available to date.

- Red: At this juncture these sites are assessed as not having the potential to form part of the UDF pipeline. In some cases, the location and characteristics of the site appear not to fit with one of the strategic priority locations, sectors and development types identified in the ESIF or SEP. The scale of the site and the premises it could accommodate may be insufficient given the typical size of UDF investment (£3m +). Evidence on commercial values may suggest a lack of potential for speculative development.
- Amber: The site meets at least some of the criteria which might make it appropriate for future investment through a UDF. Evidence that the site aligns with the ESIF and SEP is present. Some potential for speculative development may also have been indicated. In some instances, no detail has yet been given about whether viability and finance issues point to a need for development finance and the potential for a UDF or the GPF to be appropriate.
- Green: Site demonstrates strong strategic fit with ESIF and SEP. Potential for speculative development is evident. Developers have an established track record of large scale development, and/or previous experience with UDF investment and other public funds. Some evidence of viability issues with sites may also have been discussed, although development appraisal evidence has not been reviewed by the assessment.

Project	Location	Strategic Fit	Costs/ Development Value	Commentary	Assessment
Adlington Business Park Extension	Poynton	Expansion of strategic site, a business park currently occupied by broad mix of industrial, trade and office-based businesses. Infrastructure for expansion subject of LGF bid but not identified as key strategic location in SEP or ESIF.	£1.8m infrastructure costs	Modest opportunity to unlock additional 4 ha of land for office and industrial uses. No clear sectoral focus for what is a successful business park, and appears to be limited potential to meet criteria for UDF investment. Scale of site suggests not potential for UDF to be appropriate and would not meet strategic fit criteria. No indication of speculative development potential in area.	
Alderley Park	Alderley Edge	Key component of Cheshire Science Corridor and established strategic site of national significance. Strong fit with priority sectors (life sciences) and locations. Consistent with both PA1 and PA3 in the ESIF.	Costs and development value TBC	High performing business location with mix of new development and refurbishment to support transition from Astra Zeneca operation and 'big pharma'. Major developer (Bruntwood) has secured Evergreen through North West Fund. Market failure rationale for investment based on limited nature of market evidence about size and characteristics of SME life sciences sector so some risk aversion. Debt finance – UDF and GPF – could support further clearance of existing buildings and redevelopment/refurbishment to create SME premises. [Note – Site visit to discuss investment needs scheduled for 21st October].	
Congleton Business Park	Congleton	Extension of existing mixed employment area in town. Town and Business Park not identified as strategic	£5.8 m infrastructure costs	Cheshire East identifies potential for 13 ha of additional employment land for B1, B2, B8 uses as part of the extension of the site. Appears to be limited potential to meet	

		locations in SEP or ESIF, but project connected to Local Growth Fund bid for Congelton Link Road		strategic criteria for UDF investment. No discussion of potential investment needs.	
Crewe South East (inc Basford East West, Crewe Business Park & Industrial Estate, Weston Road)	Crewe	Strategic priority location for C&W; key development site linked to High Growth City; Fit with potential investments identified in PA3 (strategic sites)	£30m infrastructure requirement	Targeted for B1, B2, B8 development with 65 Ha land. Large site with complex infrastructure needs. No indication yet as to viability or finance gap, but potential to fit with UDF criteria and GPF. Advanced manufacturing indicated as one of target sectors for the site.	Further information sought from CEC.
Hooton Park	Hooton, Ellesmere Port	Strong strategic fit given location in Enterprise Zone and status of Ellesemere Port in SEP. Potential fit with PA3 given strategic site.	NK	Two plots totalling c. 9.ha for B1, B2 and B8 uses. Located in assisted area and benefits from Enhanced Capital Allowance. Site infrastructure in place, so no significant additional site costs involved. Out to market for development. Targeted at logistics, advanced manufacturing and environmental technologies users. Given rental values in EP, potential to be constraining factor on speculative development on site but size of site, proximity to M53/M56 and infrastructure are strengths.	
Macclesfield South (inc Land at Congleton Road, SMDA)	Macclesfield	Key location for growth identified in SEP. South Macclesfield Development Area is priority strategic project for the town. Tentative fit with PA3 (strategic sites) with business premises for SMEs	£4.5m estimated infrastructure costs	Masterplan for Development Area includes 10 ha of land for B1, B2, B8 uses as part of wider mixed residential and retail development. Uncertain about scope for UDF given mixed use development but could meet current criteria for GPF.	Further information sought from CEC.
One City Place	Chester	Key strategic location in ESIF and SIF, and site critical to Chester CBD.		Further phases of development at new office development critical to establishing city centre office market. Analysis of rental values suggests viability challenging and site	

		Strategic site so fit with PA3 in ESIF.		has key contribution to make to establishing profile of city for office market. First phase now being occupied so evidence of demand present. Targets key sectors (financial and professional services). Developer Muse has strong track record and has worked with Evergreen I and the Growing Places Fund.	
Protos	Ince	Priority sector (energy) and location (Science Corridor). Component of emerging, wider masterplan for area encompassing University of Chester Thornton Science Park facility. Possibly a fit with ESIF PA1 depending on end uses, but also low carbon/renewable energy investment priorities.	£170 million investment; Infrastructure cost TBC	Major developer (Peel) with track record of working with public sector. Secured Evergreen I investment to support development of road infrastructure to unlock early phases of a new type of development for C&W where market potential not yet certain. Potential to return to UDF for investment finance relating to substantial infrastructure costs for Phase 2.	
Radway Green (inc Radway Green, Radway Green Extension & Radway Green North)	Alsager	Effectively extends successful business park. Town not identified as strategic location but site part of High Growth City initiative reflecting position on M6 corridor.	£21.5m site infrastructure costs	8ha of additional employment land identified for potential B1 and B2 uses on former BAe Systems site. Cheshire East identifies substantial site remediation costs and infrastructure costs. No discussion about potential for UDF or GPF investment.	Further information sought from CEC
Thornton Science Park	Ellesmere Port	Key asset in Cheshire Science Corridor with potential to fit PA1 and PA3, but also low carbon through site's energy technology role.		30 acre development land with 93,000 sq m of research and commercial space. Significant refurbishment, upgrading of infrastructure required. Attracting commercial tenants and potential to develop new premises on individual plots. Masterplan still being developed and not yet specific opportunity to seek UDF or the GPF but need	

				to progress individual buildings and plots on an established site.	
Wardle Employment Improvement Area	Wardle	Expansion of established employment area. Rural location but linked in Local Plan to Crewe High Growth City initiative.	£6.75 million site infrastructure cost	Potential location for business in key sectors including agri-food and logistics, providing B2 & B8 employment space. Brief discussion with CEC did not suggest potential to emerge as priority for UDF.	
Winsford Industrial Estate (East)	Winsford	Location not identified as growth priority in the SEP/ESIF. Successful, mixed industrial site with potential for further expansion.	NK	Mix of c. 100 manufacturing, logistics and service companies on the Industrial Estate, although no specific sector focus. Potential for further expansion with 29 ha on western and eastern sites. CWaC review (2016) suggested interest chiefly for logistics/distribution uses. Could be potential for the GPF to support investment.	

6.7 The conclusion from this first review of projects is that there are at least three (Alderley Park, One City Place, Protos) where there is appetite to explore opportunities to secure debt funding through a UDF. On the basis of the information secured to date and given their past experience of working with the North West Evergreen Fund, the projects meet several of the key criteria for UDF investment and all have the advantage of developers who have worked with the North West Evergreen Fund previously.

6.8 Further information on some of the potential projects has been requested from the local authorities, project sponsors and developers. In particular, clarity on the potential investment needs for these sites and detail on the components of the development which might require funding should be provided with an updated draft of this element of the assessment. This is critical to testing the level of UDF investment likely to be involved and its consistency with the £5 million allocation specified in Cheshire and Warrington's ESIF, and the potential to extend this allocation.

Growing Places Fund

6.9 Additional consultations were carried out on potential Growing Places Fund investments. In addition to the potential for some of the sites identified above to be appropriate for GPF investment, some indication has been provided that the following projects might also be suitable:

- Nine housing sites located in Cheshire West and Chester where the proposed developments include 50% starter homes. Issues identified for each of the sites ranges from site and land acquisition costs, site remediation (demolition and clearance on brownfield sites) and site preparation costs. In total, the schemes have the potential to deliver 675 homes and the indication is that site preparation would run from 2016/17 through to 2018/19.
- The development of a new affordable housing scheme in Central Warrington, for which additional information is being supplied shortly by Warrington Borough Council.
- Additional investment in the Cheshire and Warrington Digital 2020 broadband project. This is a well-established strategic investment priority for the area, with an established track record of bringing together public and private sector investment.
- The development of employment at Hooton Park. An HCA owned site is being promoted as a development opportunity for 9 ha of employment land. The site meets key strategic criteria, in that it is targeted at logistics, advanced manufacturing and environmental technologies. Consultations have not suggested any immediate need for additional development finance to support the project, with development costs expected to be met by the private sector and no site-specific constraints or exceptional infrastructure requirements identified to us. Further discussion about this project is needed.

6.10 In addition to identifying specific projects which might be appropriate for the Growing Places Fund, the assessment has also sought views and considered GPF activity elsewhere to suggest alternative ways in which investment might be configured and used to support investments in Cheshire and Warrington. To date, the following broad themes have been identified:

- An option to 'top slice' the GPF in order to provide capital grant funding to SMEs seeking to redevelop and improve premises, or to purchase equipment and machinery. The research has pointed to examples of similar approaches in use elsewhere in England. Maintaining a majority repayable debt finance component could enable the grant pot to be topped up through principal and interest repayments.

- Deployment of GPF to provide follow on finance to SMEs secured through the North West Fund (debt and equity). This would broaden the range of end uses for the GPF, although the suggestion centred on follow up capital investment to support business expansion.
- Potential to extend the use of GPF to enable housing developments to come forward where there are significant components of affordable homes, including starter homes (see example above). This is a difficult issue, since a balance has to be struck between the considerable number of new housing sites likely to emerge in the next few years and the finite resource that £12.5 million of GPF represents. There is a risk of crowding out other potential uses for the Fund.
- Interest in the use of GPF to support public realm investment, with projects in central Chester cited as examples. Our understanding is that GPF has been used to support environmental improvements and public realm investment elsewhere (eg. Greater London Authority).
- The potential to use the GPF to support the development of new public sector hub buildings to rationalise premises and release local authority owned sites and premises for redevelopment.
- The potential for GPF to provide a finance source to establish secondary, revolving finance instruments. We have been guided by the use of GPF as grant to establish an SME finance instrument in South East England, which is understood to operate as a revolving fund.

6.11 Further evaluation by the LEP and its partners of the GPF investment pipeline will be necessary.

7. Added Value of a UDF

7.1 Whilst a reasonable range of ex-ante assessments of Urban Development Funds is available, experience of their delivery in the UK and elsewhere is still relatively recent. The result is that there is a limited body of evidence on the added value they have delivered in development finance markets and to regeneration and economic development objectives. This section draws on published evidence about UDFs (which is very limited) together with discussions with the small number of consultees who have engaged with Evergreen I in Cheshire and Warrington.

Providing Finance to Unlock Development

7.2 The core purposes of investing ERDF through the UDF mechanisms is to supply the finance required to deliver development where market failures have resulting in viability and funding problems such that the private sector will not proceed alone.

7.3 Typically, the types of developments that secure UDF investment are affected by a complex mix of structural and cyclical economic, development and finance market failures. The precise factors involved are generally site specific and vary between locations, type of property and business sector, along with the characteristics of individual sites.

7.4 The squeeze on development finance that was triggered by the financial crisis of the late 2000s has almost certainly exacerbated markets failures in commercial development. Its effects on development finance have been direct, in that banks and other commercial real estate investors have operate under tightened lending conditions since the recession. They have also been indirect, in that the impact of recession on market appetite for development and on the pool of end occupiers requiring new sites and premises has led to a slow and uncertain return to confidence.

7.5 Given the relatively narrow focus of UDFs on developments which have marginal commercial viability, and the strict rules under which ERDF backed mechanisms operate, the range of developments which meet eligibility, viability and investment criteria is inevitably limited. Nevertheless, UDFs have a role to play in unlocking development where these criteria are met.

7.6 At this point time, there is insufficient evidence to establish whether the UDF investment product has been successful in meeting these conditions and delivering the objectives that the EU, EIB, central governments identify, although anecdotal evidence suggests that funds such as Evergreen in the North West of England and Chrysalis on Merseyside have faced challenges in achieving their lifetime investment targets.

High Levels of Leverage

7.7 A feature of the design of ERDF backed FIs is their ability to lever in substantial additional investment, both at the fund and at the deal level. Securing match funding at the level of the fund for UDFs can be challenging, as the instruments are less well established in the UK and have lacked a demonstrable track record. Nevertheless, a number of these have secured EIB fund level investment in the form of debt finance, as well as asset backed investment from public sector partners through the inclusion of land and property (although this has raised a number of issues). Ideally, ERDF will be no more than 30-40% of the total funding package, but this might be challenging to secure in practice.

7.8 More importantly, the UDF model involves the fund investing alongside site owners, developers and other funding partners such as banks, specialist property funds and potentially institutional investors. The contribution of a UDF should be no more than 20-25% of any specific investment

given the role in targeting schemes with marginal viability, supporting leverage of 4-5%. This would appear to be the main source of good leverage that UDFs have achieved.

Stimulating a More Active Development Market Locally

7.9 If UDFs are successful in unlocking development schemes with marginal viability, then it should help to stimulate economic activity, which in turn contributes indirectly to more active and viable development markets. They can also play role in demonstrating the returns which can be secured in this part of the market, encouraging more developers and investors to be active in these market areas. It can further help to mitigate the risks borne by these investors, either through the sharing of risk or through first loss arrangements (whereby the public sector bears initial losses if these were to occur, although the ability to do this is influenced by the FI and specific UDF regulations). This could draw in finance and expertise in the area.

Securing Specialist Expertise

7.10 UDFs require a great deal of expertise and professionalism in designing and delivering these complex public sector backed instruments. The fund managers who manage UDFs may bring expertise which is not available or is limited locally. The involvement of the private sector investors (including the EIB), where this has occurred, also helps to ensure more rigour in design and delivery.

Driving Economic Impacts

7.11 ERDF backed UDFs can be used to achieve a range of desirable economic development impacts through addressing market failure affecting the delivery of sites and premises to meet the current and future needs of the area's economy. The provision of an appropriate mix of sites and premises plays a critical role in stimulating enterprise in general, supporting the process of sectoral change, as well as generating higher value jobs which provide skill development and employment opportunities for local people.

7.12 Whilst the evidence on the importance of the availability of sites and premises is clear, the available evidence of the extent to which UDFs are successful and provide value for money in achieving these economic benefits is currently limited.

Recycling of Investment Returns

7.13 One of the key strengths of using ERDF backed FIs to provide finance rather than grant mechanisms is the potential to secure returns which can be reinvested (after the operational costs of the UDF are covered, depending on how these are funded). However, the ability to secure these returns for reinvestment will depend upon the nature of the UDF model, the underpinning investment strategy, the economic cycle in which investment occurs and the effectiveness of fund management activity.

7.14 There is very limited information on the rates of return and hence recyclable monies which the existing UDFs are securing. We are not aware of any publicly available projects of the expected financial returns for the UDFs in the UK which have operated under the 2007-13 ERDF programme. The experience from the SME business finance FIs suggest that whilst the earlier funds operating in previous programming periods have been criticised by the modest or lack of legacies, the more recent funds have been or are expected to be more successful in this regard.

Implications for the Assessment

- The publicly available evidence examining the experience of implementing UDFs, their impact and the forms of value added they provide is limited. The assessment of value added therefore needs to be treated with a degree of caution until more evidence is made available and tested.
- There are good reasons to believe that UDFs provide a sensible basis on which to secure various forms of value added including providing finance to unlock stalled and marginal development, to drive the achievement of a range of important economic benefits, stimulating a more active developer and development finance market, as well as the recycling of investment returns.
- The scope to secure these forms of value added will not be uniform across areas with different characteristics.

8. Review of Lessons Learnt

8.1 We have reviewed the available evidence from the evaluation and review of FIs used both generally in economic development and more specifically in terms of the types of interventions being considered as part of Block 1. As noted above, the evidence currently available on the development, delivery and impact of UDFs either in the UK or elsewhere in the EU is limited. We have also considered more general lessons for the use of FIs that do not have a focus on urban development such as the evaluation of the four UK JEREMIE funds and other business finance funds. Where appropriate we have substantiated this through key messages that have come from consultations we have completed.

8.2 The lessons have been organised in terms of: the evidence base; the design and approval process; the procurement and delivery; the monitoring, reporting and evaluation; and management and governance.

Key Lessons

Table 8.1 Key Lessons Learnt from Delivery of UDFs in the UK

Area	Lesson	Implications for the study
Evidence to Support Use of UDFs	Financial instruments are amongst the most complex ERDF backed instruments, with significant risks if not implemented in a well-planned and delivered in an appropriate manner. There needs to be robust evidence that they can be effective and efficient instruments in achieving their underlying goals and provide better value for money than the use of traditional grant mechanisms. Importantly, this evidence needs to be considered in the local context, which may differ significantly from that of other UDFs.	We have noted elsewhere that the evidence in the public domain about the impact and effectiveness and efficiency of UDFs is currently limited. This is a significant gap in our knowledge which needs to be carefully considered.
Design and Approval Process	**Need for robust business planning** There are few ERDF backed projects where the robustness of the market assessment and business planning is so important to successful delivery. The ex-ante assessment will provide some but by no means all of the information that partners require. The gaps in the information about the market and the viability need to be carefully considered as part of the decision-making process, with appropriate weight given to gaps in information and aspects of risks and uncertainty.	There is the need for partners to fill any key gaps which persist following the completion of the assessment and which have a direct bearing in the design of the investment strategy. The market assessment can only be a guide to the gap which public sector should be using ERDF to address and it is important for flexibility to be built into the design and delivery of the FIs which enable delivery to be adjusted if circumstances change over time.
	The size of the fund The optimum size of a UDF varies across the evidence base. A review of UDFs in the UK[15] suggests that UDFs should be at	The total size of the UDF should be determined by the project pipeline and investment requirements, available public

[15] Developing Interest: The Future of Urban Development Funds in the UK, Centre for Cities, March 2013

	least £60m in total if they are to invest in projects of sufficient scale and have significant impact. Despite this, the majority of UDF's in the UK do not come close to this kind of scale. For example, the East Midlands UDF established in 2009 has a total fund size of just £15m. What is clear from the evidence is that the size of the fund should be sufficient to have the required impact while also being able to justify the high level of start-up costs that will be incurred. Nevertheless, this needs to be balanced against the need for realism in terms of the time it takes to set-up schemes and commence investment, as well as the scale of potential demand which exists.	resources and the amount of matched funding that can be secured at the fund level. However, scale of operation is an important factor in the operational efficiency of the UDF, the scope to secure the necessary expertise and hence its ability to provide VFM. UDFs with overall fund sizes of less than £50m would need to be fully justified on the basis of their ability to address these factors.
	Balancing financial and economic returns For a UDF to be effective it must generate financial returns while also addressing market failure and producing economic and regeneration benefits. Evidence from the final evaluation of JEREMIE in Wales, for example, suggests that the original economic development targets were set unrealistically high and quite often achieving financial returns took precedence when making investment decisions.	The UDF needs to set realistic targets and be clear on priorities for intervention. It is important that the relationship between both types of returns is understood and there is a clear investment strategy that reflects this.
Procurement and Delivery	**Procuring an external fund manager** Evidence suggests that there are significant benefits in using established fund managers in terms of efficiency gains, skills and expertise, and profile in the market. In order to have more credibility among private investors and to be operated with the required financial acumen, fund management is more effective when procured to an experienced fund manager rather than being public sector led. Evidence used in the JESSICA North West of England ex-ante assessment[16] suggested that in order to attract interest from commercial fund managers, the public sector should not put in place too many restrictions during the procurement process.	It will be important for the potential interest from specialist fund managers to be market tested. Given the modest allocations to UDF in the ESIF, this could reduce interest amongst the fund management community.
	The project pipeline A pipeline of viable projects will allow the fund to be more effective from inception. A key message from Centre for Cities report is the need for a suitable pipeline of projects for the UDF to prevent delays	The assessment has pointed to a small number of potential development schemes which are likely to address the specific viability conditions which would underpin a UDF.

[16] Reference

	between setting up the fund and making investments. Despite this, UDFs to date have often found this to be more difficult than expected due to the limited number of shovel-ready projects to invest in.	
	Local authority engagement with fund manager Local authorities were the main source for identifying deals in Evergreen I. A good knowledge of Evergreen on the part of local authorities and dialogue with the fund manager helped to identify projects where it could be used. This was very successful in Greater Manchester where the large flow of deals was credited in part to the high levels of engagement between local authority officers and the fund manager.	It is important that all local authority economic development and planning officers understand the role of a UDF and are aware of the potential role that it could play on developments in their area. They should be encouraged to engage in dialogue with the fund manager and site owners/developers to discuss whether it will be required.
	Simple application process The original application form for Evergreen I went in to unnecessary depth which may have deterred some applicants. Over time, the fund manager got better at identifying the key criteria that applicants would need to meet. This meant they got better at screening potential projects and could simplify the application process.	The same application process that was refined through Evergreen I should be applied to a new UDF.
	Early engagement with the UDF board Ensuring that the UDF board got early sighting of projects once applications had been received was found to be important to support decision making. This allowed the board a chance to judge whether the development was a strategic priority at an early stage, and ensured that applications did not reach an advanced stage only to find out that it had been rejected by the board.	All applications for UDF finance should be submitted to the board at an early stage of the application process.
	Helping borrowers to navigate the ERDF process where necessary Some applicants for Evergreen I found the additional bureaucracy involved in using ERDF difficult to navigate. The fund manager was able to offer projects practical advice and make it as easy as possible for them to navigate.	The procurement requirements for appointing a find manager should state that the fund manager will be expected to provide support to projects to help navigate the ERDF application and monitoring requirements.
	A flexible investment strategy UDFs are most effective when they can be flexible in their investment approach and have a range of financing tools to address different challenges property developers face such as access to capital, cash constraints or high upfront costs. A UDF that can make use of debt, equity and deferred consideration on land assets will	What market failures area present in the identified pipeline projects. What types of finance are required? Presumably recommendation will be for flexible fund providing debt, equity and mezzanine finance.

	be most effective and will be able to fund a wider scope of projects. Not only should a UDF be flexible in the types of finance it can deploy but also in its investment strategy. This success factor is also identified in the EU ex-ante guidance methodology for Urban Development Funds and will be increasingly prevalent given the uncertainty within the property market that has emerged post-Brexit.	
	Timeline for delivery The timing of the ERDF funding programme may cause difficulty in fully investing the fund and realising returns. The funding programme finishes in 2020 and as such this leaves less than 4 years to make all identified investments. It will also result in a shortened realisation period as all outcomes will have to be reported by the end of 2022.	Do the number of projects suggest that this will be achievable? How viable are the identified pipeline projects– will they be able to deliver returns in the short to medium term
	Use of Remuneration to Drive Performance A key lesson from SME finance FIs has been the need to use a remuneration strategy for the appointed fund managers which includes a performance related component in order to drive good performance. However, this needs to be structured in an appropriate and realistic way in order to achieve the desired outcomes for the public sector, whilst being set at a level and form which attracts high calibre fund managers and motivates them to achieve.	Designing and setting performance frameworks for fund managers is a specialist area which typically needs expert guidance both at the procurement, contracting and delivery phases of a UDF
Monitoring, Reporting and Evaluation	**Regularly monitor KPIs that cover investment, financial and economic development targets** It is essential that a UDF is able to generate investment, financial and economic returns and robust monitoring systems should be in place in order to keep check of progress towards these.	The investment, financial and economic targets need to be clearly set out in the underpinning investment strategy and supporting analysis. The assumptions which have been used to derive these targets should be fully documented and justified through appropriate benchmarking.
	Information reporting should be transparent and easy to understand Evidence suggests that investors will seek clear, regular information on investment performance that will be easy to compare to other forms of investment information.	The format, scope and timing of monitoring reports should be agreed with the range of stakeholders. These will need to reflect the reporting and decision-making timescales of the respective investors.
Management and Governance	**An investment committee should be established with both private and public sector representatives** Governance that is partnered by both the public and private sector is essential in	The membership of board and investment committee should balance the interests and expertise that the groups require

	order to ensure that the UDF strikes the right balance between investing for economic development benefits with a commercial ethos. Private sector governance will also enhance the credibility of the fund and maintain engagement with the private sector.	to fulfil their governance responsibilities.

9. Conclusions and Next Steps

Key Conclusions

9.1 A total of £5 million of Cheshire and Warrington's ERDF resource is allocated for potential use as Evergreen investment, reference to the emerging UDF (Evergreen II) mechanism being put in place by the GMCA. The area's ESIF clearly points to weaknesses in the supply of good quality sites and premises, and to the constraints this imposes on the investment and economic growth that it seeks to generate. Conversely, both the ESIF and SEP point to a consistent set of strategic priority locations and sectors, where action to drive up investment in development should be focused.

9.2 The Block 1 research for Cheshire and Warrington has highlighted the continuing challenge faced by the area and developers active there in bringing forward new, speculative office development. However, the North West Evergreen Fund has already backed development at One City Place in Chester, and our review of the pipeline suggests that **there is a potential opportunity to draw on UDF resources** to support the key strategic objective of establishing a city centre office-led business quarter**.** Elsewhere in the area, there currently appear to be very few opportunities for new speculative office development, and no other projects centred on offices have been highlighted as suitable opportunities to invest through a UDF.

9.3 Both advanced manufacturing/engineering and the logistics sector are strengths of Cheshire and Warrington, recognised as such in the ESIF and SEP. There are a number of locations which are performing well (Omega, Birchwood, Orion Park) and where speculative development has returned. However, in many locations values of commercial land and rental values for industrial development have been slow to pick up after the recession, and the UK's move to leave the European Union has created uncertainty that is having a knock-on effect on investment appetite.

9.4 The assessment suggests that **there are industrial developments which could generate requirements for UDF investment**. Major development underway at **Alderley Park** matches a developer with a track record of working with the North West Evergreen Fund with one of Cheshire and Warrington's key economic assets in Cheshire Science Corridor. The Block 1 assessment has highlighted other development sites which meet the strategic criteria for UDF investment and where potential to work with the emerging Fund might be explored, but the pipeline is as yet not sufficiently well-developed to conclude with certainty that they would be appropriate projects.

9.5 Cheshire and Warrington is considering whether it has the assets and opportunities to develop an energy cluster and establish it as one of its core strategic priorities. The energy and environment sectors are already identified as one of the area's strengths in the SEP, whilst competitiveness in low carbon energy technology is a European Union priority. On the **Protos site, there is further potential to invest through a UDF mechanism,** with Peel Environmental having worked with the North West Evergreen Fund for its Phase 1 investment and substantial infrastructure investment required to drive the next phases of the development. Protos forms part of a wider masterplan for a key part of the Cheshire Science Corridor, including the Thornton Science Park site, and it is reasonable to conclude that both a UDF and the Growing Places Fund could contribute to its delivery.

9.6 Since completing the first draft of this report, the Cheshire and Warrington LEP identified an opportunity to increase the commitment of ERDF from its ESIF to at least £10 million. This would require:

- Agreement with the DCLG to change the allocation of ERDF to Evergreen from its current £5 million, since the change would have an impact on the ERDF outputs that the ESIF is

expected to generate. Our understanding is that there is some headroom in Priorities 1, 3 and 4 of the Cheshire and Warrington ESIF programme.

- Approval of Cheshire and Warrington's ESIF Committee since the change would reduce the ERDF funds available for partners in the area to bid into.
- Additional and new evidence on investor appetite for a larger size of fund and related, new evidence on the pipeline since the specified focus of this Block 1 research report was on a £5 million allocation.
- Agreement on the match funding for the project, either in the form of financing to match the ERDF resources at the level of the fund, or the match funding required to cover fund set up costs and operating costs if a co-investment model is pursued where ERDF investment is matched with investment in each deal.

9.7 It should also be noted that funds recycled in Evergreen I have the potential to be reinvested in Cheshire and Warrington. In principle, this appears to include the potential for follow-on investments in later phases of developments which may already have benefited from North West Evergreen support. Any future investment with these recycled funds would need to be consistent with the investment strategy for these resources. However, recycled Evergreen I funds cannot be used as match for subsequent Structural Funds programmes. This means that the ERDF component of recycled Evergreen 1 resources could not be used either to cover a new fund's running costs or as match funding for capital investments.

9.8 The scale of investment to be committed to a UDF and the ERDF priority axes under which this investment would be allocated are questions that would need to be determined by Cheshire and Warrington partners in the course of agreeing how they intend to proceed. We set out the potential options below.

Potential Fund Options

9.9 The completion of the Block 1 study represents a decision point in the process for determining whether, and if so how, Cheshire and Warrington's might invest part of its ERDF resources through an Evergreen mechanism. As part of the Block 1 research Regeneris considered the options available to Cheshire and Warrington in light of the conclusions of the study, the current state-of-play with its ERDF (ESIF) programme and developments in Greater Manchester's process of establishing an Evergreen II fund.

Option 1: Partnership arrangement with emerging Greater Manchester UDF

9.10 **Description:** In this option, Cheshire and Warrington would enter into a partnership arrangement with Greater Manchester, effectively investing its ERDF allocation through the emerging GM-led Evergreen II/Low Carbon Fund. The GM model will invest £45 million ERDF in priority axes 1 and 4 into Evergreen II and a further £15 million of priority 4 ERDF into a new Low Carbon Fund.

9.11 This option would see Cheshire and Warrington enter into a limited partnership with its allocation ring-fenced as part of a single investment strategy. It is understood that the Manchester arrangements were geared towards enabling Cheshire and Warrington together with Lancashire to participate by allocating ERDF from their respective programmes, with the procurement of fund advisory services to be amended to reflect this.

9.12 **Deliverability**: This option has several strengths as a way forward if Cheshire and Warrington decided to invest its ERDF resources into a UDF:

- Greater Manchester and its partners have previous experience of successfully managing Evergreen I, a mechanism in which Cheshire and Warrington were also partners. There is therefore a successful track record of collaborative investment on which to draw.
- Evergreen I has a set of governance and management arrangements, investment decision making experience and related procedures in place. This represents a tried and tested mechanism on which to build.
- On priority 1a, there is good alignment between the focus of GM's investment strategy on science and innovation assets and Cheshire and Warrington's proposed priority 1 allocation.

9.13 This approach would also benefit from the credibility in the market of working through an established investment infrastructure that has successfully demonstrated its ability to invest through Evergreen I.

9.14 However, the market research carried out in this study has not established that a pipeline of projects is present geared to investment through priority axis 4 (energy and resource efficiency in enterprises).

9.15 **Efficiency and Value for Money:** This option has the advantage to Cheshire and Warrington of the advanced work that GM and its partners have already carried out to establish Evergreen II and put in place the procurement for a fund advisory service. This means that some of the substantial costs of establishing the new fund have already been absorbed by GM, and this may reduce some of the up-front costs for Cheshire and Warrington compared with setting up its own UDF mechanism.

9.16 In addition, GM's established investment fund infrastructure should result in further efficiencies as Evergreen II become operational compared with alternative options. It has not been possible in the course of Regeneris's work to clearly establish what the scale of costs and any related efficiencies might be. However, the ex-ante assessment for Greater Manchester's Evergreen II and Low Carbon Fund indicates that the annual cost of running Evergreen I was £600,000, including project development costs, fund management costs and the associated legal and audit costs.

9.17 **Our understanding is that Greater Manchester has now proceeded with its procurement of a fund advisory service to deliver management of the Evergreen II and Low Carbon Funds. Legal advice has indicated that this option would now be very difficult to pursue.**

9.18 However, if Cheshire and Warrington opted to establish its own UDF (ie a separate and new ERDF project), it could explore further the potential to work closely with the Greater Manchester UDF since there is likely to be common ground in terms of investment focus (eg. science and innovation assets) and a track record of the North West Evergreen Fund having previously invested in Cheshire and Warrington on which to build. This might extend to the Cheshire and Warrington UDF operating through GM's fund managers, although this would be subject to an open procurement process.

Option 2: Individual Cheshire and Warrington fund

9.19 This option would see Cheshire and Warrington establish its own fund.

9.20 This would require a local authority to act as the accountable body for ERDF resources and specific arrangements to be put in place to manage and deliver UDF investment. This could take the form of in-house fund management or the procurement of external fund management and related specialist services.

9.21 This option has the advantage of enabling the area to exercise potentially greater control over how and what its ERDF allocations are invested in than approach in which it partners with others.

9.22 Under this option, there is also understood to be the potential to explore the establishment of a UDF structure that would enable a wider range of funds managed by the LEP to be channelled through it. This could include, for example, Enterprise Zone investments and the Shared Prosperity Fund.

9.23 **Deliverability:** Cheshire and Warrington does not have in-place structures and processes directly geared to ERDF investment through a UDF mechanism. In this regard this approach lacks the advantage of Option 1 in working with established governance and management arrangements.

9.24 However, there may be potential to build on arrangements already in place to invest Growing Places Fund and other capital funding programmes which have seen investment in commercial sites and premises.

9.25 There are also some relevant lessons from elsewhere on which to draw. The Sheffield City Region established a Fund using ERDF monies in the 2007-13 programme which brought together ERDF (c. £15 million) and £8 million of Growing Places Fund investment. Whilst the size of the ERDF allocation is larger than that currently proposed by Cheshire and Warrington, its coordination by Sheffield City Council the role SCC played as accountable body and its procurement of fund management services may provide insights to guide Cheshire and Warrington.

9.26 The risk, however, is that Cheshire and Warrington currently lacks the full range of skills and experience involved in Evergreen investment (for example, fund marketing and promotion, deal making, due diligence and other legal requirements, fund management and oversight). Fund management through an in-house approach may also bring challenges in terms of credibility in the market, whilst external fund management implies higher costs in delivering a fund.

9.27 **Efficiency and Value for Money**: This is likely to be the least efficient option since it carries with it both the costs involved in establishing and operating a fund, and the risks of a lack of a track record of delivering this type of investment fund using ERDF resources. In essence, it would require the funds to be established from scratch with upfront costs to be met by Cheshire and Warrington partners individually, together with ongoing operational costs and costs associated with fund management.

9.28 For Cheshire and Warrington, it is recognised that a fund of £5 million would be insufficient to justify the set up and operational costs involved. Consultation with the Local Enterprise Partnership has suggested that a fund of £10 million is regarded as the minimum allocation of ERDF that it considers to be appropriate. An increase in the size of the fund of this order would require the preparation of further evidence on market need and the investment pipeline, which would represent additional costs to the development of the project.

9.29 An in-house approach where fund promotion, deal making and fund management were delivered in house would reduce these costs, but bring the risk of a lack of appropriate expertise and systems in place to guarantee such a fund's credibility with investors and developers.

Option 3: Individual Cheshire and Warrington fund, joint procurement

9.30 This option would see Cheshire and Warrington establish its own fund, but work jointly with another region such as Lancashire or Merseyside to procure fund management services and potentially specialist services.

9.31 The core of this option is essentially the same as Option 2. It would require a local authority to act as the accountable body for ERDF resources, and arrangements for overseeing the implementation of the fund by procured fund managers.

9.32 **Deliverability**: This option poses the same risks as option 2 insofar as it would require a new fund to be established from scratch. Whilst Cheshire and Warrington has experience of capital

investment into commercial sites and premises, we are not aware of specific experience and skills linked to ERDF investment through a UDF.

9.33 It is also unclear whether there is likely to be sufficient alignment between the investment priorities in the Cheshire and Warrington ESIF and those of another area to facilitate the procurement of joint fund management services. There may be some significant variations between the investment focus for an external fund manager between areas, and this has the potential to add complexity and cost to this option.

9.34 As is the case with option 2, the advantage of this approach is the control it would provide Cheshire and Warrington over future investment. There may also be the potential to bring other funds managed by the LEP into the UDF which would increase its scale and remit, although this would further add to the complexity of managing the fund for an externally procured fund manager (ie deal-making across multiple funds with different targets, eligibility etc within the area).

9.35 **Efficiency and Value for Money:** This option would have additional scale benefits compared with option 2 through common fund management, although the set-up costs would still fall to Cheshire and Warrington.

Option 4: Partner with Another Area

9.36 In this option, Cheshire and Warrington would enter into a partnership with another area outside the North West to create a joint fund.

9.37 **Deliverability**: We are not aware that Cheshire and Warrington has any previous experience of this type of investment fund based on a partnership with an area outside the North West. Nor has this study established that there are new UDFs proposed in other areas which are at an advanced stage of preparation in the 2014-20 ERDF programme round where alignment with Cheshire and Warrington is apparent. This includes the West Midlands and Yorkshire and the Humber.

9.38 There would likely also be significant challenges relating to the alignment of Cheshire and Warrington's proposed allocations and the investment strategies of other areas, including the priority axes under which their allocations are made and their investment priority types. This would add to the complexity and costs of establishing such arrangements, and might limit the control that it is able to exercise over how ERDF is invested.

9.39 It is not clear how the potential to draw other Cheshire and Warrington funds into a joint UDF might work, although it is likely to add significantly to the complexity of setting up and managing the fund.

9.40 Furthermore, given the period that has elapsed since the 2014-20 ERDF programme was launched, it is likely that any such funds which have been established are already operational, or near operational. Given the complexity involved in an external partnering arrangement of this kind, it is unlikely to be practical at this stage.

9.41 **Efficiency and Value for Money:** This option would offer the potential advantages of partnering with an area which had already met some of the establishment costs of a fund and of economies of scale in pooling ERDF resources.

Option 5: Do Not Proceed With UDF Investment

9.42 **Description**: Cheshire and Warrington may consider re-allocating its ERDF earmarked for Evergreen through grant funding to support development.

9.43 **Deliverability**: Cheshire and Warrington has a good track record of committing and investing ERDF resources through grant funding. Consultation with developers and finance providers as part of

this Block 1 research report has signalled clear indications of current and future demand for grant finance. In particular, the role of grant finance to support the development of commercially more marginal sites in key locations such as Ellesmere Port has been highlighted. Grant funding is part of the finance mix that has enabled development sites to be unlocked, for example, where up front site preparation costs make development unviable or where a commercial market is emerging rather than well-established.

9.44 An alternative option to commit investment through the Northern Powerhouse Investment Fund, in which Cheshire and Warrington already has a stake, could also be considered.

9.45 **Efficiency and Value For Money**: Delivering ERDF investment in this way removes the costs to the ERDF programme and match funders involved in setting up and procuring fund management, legal and other administrative costs.

9.46 However, allocating ERDF resources for development through grant rather than repayable finance means that the benefits of generating recycled funds to invest further would simply not be realised.

9.47 The table below summarises these options. Whilst option 1 appears to be the strongest of the 5, it is now understood not to be deliverable given that Greater Manchester has launched its procurement for fund advisory services and the legal advice Cheshire and Warrington has received about proceeding on this basis. Options 3 and 5 look to be the solutions which are still practicable for Cheshire and Warrington.

Table 9.1 Summary of Options

	Deliverability	**Efficiency and Value for Money**
Option 1: Partner with GM	× (no longer feasible)	✓✓✓
Option 2: Individual C&W fund	✓✓	✓
Option 3: C&W fund with joint procurement	✓	✓
Option 4: Partner with another area	×	✓✓✓
Option 5: Do nothing	✓✓✓✓	×

Next Steps

9.48 This is a key decision point for partners in Cheshire and Warrington. This study has concluded that there are a small number of strategically significant projects where some appetite for repayable finance is evident. It has set out options for pursuing a UDF, although it is understood that option 1 is no longer feasible. This appears to leave two broad options:

- A stand-alone Cheshire and Warrington fund.
- Investment of ERDF resources through other means including grant funding.

A Cheshire and Warrington UDF

9.49 Establishing a stand-alone Cheshire and Warrington UDF would require a new fund to be set up from scratch. This section summarises the main steps in the process that would need to be followed to establish a fund, including estimates of the potential set up and operational costs.

9.50 Along with the small number of UDF projects, there is a lack of readily available, detailed evaluation evidence on the experience of other areas in establishing JESSICA projects and/or ERDF backed UDF projects, and on the implementation of such projects. Should Cheshire and Warrington opt to pursue this course of action, our recommendation is that it should engage with fund coordinators in Manchester, Sheffield and elsewhere as it develops its ERDF project and the mechanisms for delivering the fund.

9.51 **Costs of establishing a fund –** Set up costs would be dependent on both the approach selected and the extent of in-house v. external input into its development. In the case of the Sheffield UDF (2007-13 ERDF programme), Sheffield City Council developed the project, bringing in external specialist input on the more complex aspects of the process (eg. legal partnership agreements). The Greater Manchester Evergreen II project (2014-20 ERDF Programme) was developed by Manchester City Council (New Economy) and its partners who were able to capitalise on several years' experience with the North West Evergreen Fund.

9.52 Our broad understanding is that set up costs including ex-ante evaluation and legal services could be in the range from £60,000-80,000 (including ex-ante costs, legal services etc). However, this is based on a lead applicant body developing the project, so much depends on the capacity and resources of the developing body to establish the Fund and the time resource contribution involved. Furthermore, we cannot be certain about the potential time-cost to Cheshire and Warrington which would include all aspects of the project's development including the ERDF application.

9.53 Consultations for this study have pointed to a period of 9-12 months to get a fund up and running. Areas with previous experience of developing such Funds and bodies already delivering funds clearly have the potential to reduce up-front development costs and time, and there may be opportunities to engage with other areas where UDFs are operating to better understand the project development process.

9.54 The Cheshire and Warrington Local Enterprise Partnership and local authorities in the area have experience of delivering development finance (for example, Growing Places Fund, local authority capital investment programmes). Local authority officers are also understood to be engaged with the North West Evergreen fund through its governance structures. However, the area does not have previous experience of developing an ERDF funded development finance instrument, and this may therefore require external input to deal with some of the complex issues involved in setting up a fund (eg. legal agreements to establish partnership, state aid, procurement of fund management).

9.55 **Size of Fund:** Research published by the Centre for Cities in 2013 showed that, of nine UDFs established in the UK, the smallest was the East Midlands Urban Development Fund at £15m, although this project is understood to have been subsequently withdrawn.

9.56 The EU's FEI reports suggest that, whilst there may be a small number of examples of UDFs elsewhere in the EU of less than this value, the average operational programme contributions to specific UDFs with or without a holding fund amounted to c. £23 million, with structural funds' contribution averaging at £16.7 million. The same report shows that, of 51 such funds, only 6 were set up without a holding fund. In the case of Sheffield, Sheffield City Council directly procured a single UDF.

9.57 A review of the UK funds suggests that they were established with ERDF funding matched up front (eg. North West Evergreen Fund, Chrysalis Merseyside, SPRUCE Scotland, Sheffield City Region UDF). This is distinct from an approach in which match is effectively generated for each investment deal in the form of private sector and/or other contributions. Up front match is regarded as being a less risky and simpler funding structure for the commitment of ERDF resources.

9.58 Up front match funding has enabled UDFs to achieve a larger scale at inception. The evidence reviewed in this study points to several factors which favour larger scale funds. They include the larger deal sizes typical of commercial development investments, the need to have the ability to spread risk across an investment portfolio and credibility with private sector investment markets. This appears to be borne out by the evidence on the scale of UDFs already operating in the UK and elsewhere.

9.59 Where effectively a co-investment model is pursued, ERDF investment would need to be matched at the level of each deal. There are some risks in this approach and administering it is more complex than would be the case with a fund matched up front. It would require confidence that the investment pipeline for Cheshire and Warrington brought with it viable match funding. Whilst the ex-ante research for Cheshire and Warrington pointed to some appetite for future UDF investment in small number of strategic investment projects, further work on the investment pipeline, including likely match funding options, would be necessary as part of the Investment Strategy (Block 2).

9.60 The ex-ante evaluation for the Evergreen II Greater Manchester project, for example, highlights commercial bank lending, commercial and local authority pension funds, developer equity and the Growing Places Fund as potential sources of match for its investment pipeline.

9.61 **Operating Costs –** The Sheffield UDF specifies that the City Council has entered into a contract with the Jessica fund in which an annual cost of £20,000 covers its responsibilities as coordinator of the fund. These include a range of services including support to the Investment Board and local authority partners, advice on eligibility, pipeline development, promotion of the Fund and reporting. The appointed Fund Manager and the fee it receives for its service covers the detailed requirements associated with deals (ie due diligence) along with other costs including marketing, auditing etc.

9.62 **Fund Management Fees –** Details on fund management fees are difficult to obtain since they are commercially confidential and likely to be agreed in the course of the appointing a successful bidder through a procurement process. They may also take different forms; for example, including both fixed fee and performance related payments linked to deal flow and successful developments.

9.63 It is important to note EU regulation sets thresholds for the proportion of programme contributions that can be absorbed in management costs and fees.[17] For loan based financial instruments, the aggregate figure is 8% of programme contributions. The regulation specifies that the annual base remuneration is capped at 0.5%, with performance based remuneration at 1%.

9.64 The EU publishes reports on the implementation of financial instruments with ERDF resources. Its most recent report covers the period to the end of 2015. For the two English Jessica projects where information is provided, it suggests that to date, management costs and fees account for around 6% of total programme funds invested, figures we assume to cover set up costs as well as ongoing operational costs and fund management fees.[18]

9.65 The management cost and fee thresholds that apply to UDFs, the costs and complexity of establishing new UDFs, and the recognised advantages of larger scale funds underline the need for careful consideration to be given to the size of a potential stand-alone Cheshire and Warrington fund. A £10 million fund size would therefore be comparatively small and would bring a risk of excessive establishment and running costs relatively to the overall size of the ERDF allocation.

[17] Commission Delegated Regulation (EU) No 480/2014

[18] Summary of data on the progress made in financing and implementing financial engineering instruments reported by the managing authorities in accordance with Article 67(2)(j) of Council Regulation (EC) No 1083/2006 Programming period 2007-2013, Situation as at 31 December 2015

9.66 **Structures –** New governance and management structures would be required if Cheshire and Warrington opted to pursue a stand-alone UDF. On the face of it, the simplest approach would be to adopt the approach taken for the Sheffield City Region UDF. This was established with Sheffield City Council creating a Limited Partnership and setting a new company limited by shares (General Partner), essential the accountable body for the Fund. No holding fund was created for the Sheffield project.

9.67 Comprehensive fund management was then procured by the Partnership with CBRE appointed as fund manager. An Investment Board comprising representatives of the local authority and the LEP has an advisory role, receiving project and progress reports from the General Partner, with the GP approving investments brought forward by the fund manager.

9.68 Whilst the procurement of external fund management clearly carries with it a higher cost than one in which fund management might be provided 'internally' (ie by Cheshire and Warrington public sector partners), a competitive procurement of an external fund manager would offer advantages including a deal making track record, detailed knowledge of the market and a recognised profile with investors and developers. In this regard it would reduce the risk to the project compared with an approach in which development of the investment pipeline and key deal making responsibilities were delivered in-house. Of the JESSICA projects in the UK for which some information has been available to this study, each has put in place external fund management.

9.69 If Cheshire and Warrington partners decide to proceed with a UDF, there are several steps immediately required in advance of or in parallel to proceeding with the Block 2 stage of the ex-ante (Investment Strategy). They are:

- A decision on both the size of any allocation to UDF and the priority axes on which the ERDF allocation would draw. If the ERDF allocation is to be increased, this would require further evidence on the market failure/need rationale and the area's investment pipeline. If the intention is to proceed through priority axis 1 only, this has implications both for the evidence to demonstrate a pipeline of projects which meet P1 criteria, and further consideration of the implications for the area's programme output targets in P1.
- A need to quickly establish a strategic investment pipeline to enable Cheshire and Warrington both to work with developers and to provide the certainty about the appropriateness of investing ERDF through a UDF that will be necessary to secure approvals. A key lesson from the North West Evergreen Fund is that LEPs and local authorities have an important part to play in identifying potential deals. For UDF, this means clarity about its pipeline and then engaging with developers and the Fund Manager to push investments forward.
- Preparation of an ERDF application which would need to set out:
  - the preferred delivery model and justify its selection
  - which organisation is to be the accountable body
  - its compliance with ERDF regulations including state aid
  - match funding including fund management costs and fees.
  - its strategic fit with programme objectives
  - details on proposed governance and management arrangements.
- How other public sector funds might be aligned with UDF finance, including the Growing Places Fund. A lesson from the North West Evergreen Fund is that the use of funds as part of a wider package enables both the acceleration of delivery and scale benefits to be realised on larger and more complex sites.

9.70 Should the decision be to proceed with UDF investment, further discussion would be necessary about the evidence requirements (Block 1) and process for completing Block 2 (investment strategy).

Alternative Use of ESIF Allocation to UDF

9.71 The 'do nothing' option would effectively require the ESIF allocation to Evergreen II to be reallocated to other uses. Analysis of alternative uses for ERDF did not form a detailed element of the ex-ante brief. However, consultation carried out as part of the research did highlight ongoing interest in the availability of grant funding to help unlock development sites (where currently not commercially viable), and Cheshire and Warrington has a track record of capital investment through ERDF grant funding to support its strategic objectives.

9.72 There are a number of options if the decision is to pursue this option:

- Simply reallocate the ERDF so that it increases the funds still available to projects to bid in through future calls.
- Commission additional research to test the appetite and need for grant funding to support strategic development, including projects where the ex-ante research suggested some appetite for debt finance. This could be considered as part of further work that Cheshire and Warrington partners need to carry out to develop their strategic investment pipeline.
- Assess the case for increasing the allocation of ESIF resources to the Northern Powerhouse Investment Fund beyond the area's initial contribution to the Fund. This option would best be pursued through a review of the extent to which Cheshire and Warrington businesses are drawing on the Fund (ie interim review) once sufficient time has elapsed in the investment period. There may also be potential to commit ESIF and Cheshire and Warrington LEP resources to enhancing the capacity of the area to secure funds for businesses (eg. through additional capacity in business growth hubs or other intermediaries). Again, this option would best be considered once the early impacts of the Fund on Cheshire and Warrington have become established.

9.73 In sum, the key decisions for the Cheshire and Warrington LEP to take now are i) whether or not it intends to pursue ERDF investment through a UDF and ii) how it intends to reallocate ERDF resources allocated to a UDF in its ESIF.

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