

## **JESSICA**

Report to ESEP on the feasibility of JESSICA in  
Scotland

Note: Some case study details have been removed  
for confidentiality purposes within this version for  
publication.

13 July 2009

**Private and confidential**

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13 July 2009

Dear Gordon

**The feasibility of JESSICA in Scotland**

In accordance with your instructions, we have completed our study into the feasibility of the Joint European Support for Sustainable Investment in City Areas (JESSICA) approach in Scotland.

**Scope and nature of our work**

The scope and nature of our work, including the basis and limitations, are detailed in our Engagement Letter dated 23 March 2009. Our report to you is based on our review of data and information received from a range of organisations including the Scottish Government, Scottish Enterprise, European Investment Bank and the case study organisations. We have not sought to verify the accuracy of this data or information.

**Purpose of our report and restrictions on its use**

The report was prepared on the specific instructions of ESEP Ltd solely for the purpose set out in our Engagement Letter and should not be relied upon for any other purpose. Because others may seek to use it for different purposes, this report should not be quoted, referred to or shown to any other parties unless so required by court order or a regulatory authority, without our prior consent in writing. In carrying out our work and preparing our report, we have worked solely on the instructions of ESEP Ltd and for its purposes.

Our report may not have considered issues relevant to any third parties. Any such use third parties may choose to make of this report is entirely at their own risk and we shall have no responsibility whatsoever in relation to any such use. This report should not be provided to any third party without our prior approval and any third party should recognise in writing that we assume no responsibility or liability whatsoever to them in respect of the contents of our deliverables.

Yours faithfully



Jeff Thornton, Head of Scottish Government Services  
Ernst & Young LLP

## Glossary/abbreviations

Abbreviation	Name
CEB	Council of Europe Development Bank
CPPs	Community Planning Partnerships
CSG	Community Strategy Guidelines
EIB	European Investment Bank
ERDF	European Regional Development Fund
ESEP	East of Scotland European Partnership
ESF	European Social Fund
EU	European Union
EWG	Expert Working Group
Financial Engineering Instrument	Financial engineering refers to the use of innovative financial instruments for the regeneration of local economies
GDP	Gross Domestic Product
JESSICA	Joint European Support for Sustainable Investment in City Areas
LUPS	Lowlands and Uplands Scotland
Member State	Member States that are part of the European Union. For the Scottish application of JESSICA this will be the UK.
MoU	Memorandum of Understanding
NEET	Not Engaged in Education, Employment or Training
NPF	National Performance Framework
NRP	National Reform Programme
NSRF	National Strategic Reference Framework
OCPAS	Office of the Commissioner for Public Appointments in Scotland
R&D	Research & Development
Regulations	Structural Fund Regulations: Council Regulation (EC) No 1083/2006 of 11 July 2006 as updated
SPFM	Scottish Public Finance Manual
Structural Funds	Contain funds from the EU set up to target specific areas. The ERDF is the Structural Fund that will be used for part of the JESSICA programme.
SME	Small and Medium sized Enterprises
The Commission	The European Commission (formally the Commission of the European Communities)
The Council	The European Council
UDF	Urban Development Fund – the JESSICA delivery vehicle
UK	United Kingdom
URCs	Urban Regeneration Companies

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# 1. Introduction

This report was commissioned by ESEP Ltd, the administrators of the EU Structural Funds in the Lowlands and Uplands Scotland (LUPS) as a feasibility study into the application of the Joint European Support for Sustainable Investment in City Areas (JESSICA) in the LUPS area. The scope of the report is to answer three key questions:

1. How could JESSICA be successfully used to unlock/facilitate the implementation of regeneration schemes in the LUPS area of Scotland?
2. What is the optimal structure for JESSICA in the LUPS area of Scotland?
3. How would the preferred JESSICA Structure be delivered the LUPS area of Scotland?

The report is structured to answer these questions through the following sections, all beginning with a summary of the sections key findings.

**Table 1.1: Report structure**

Section	Content
1. Introduction	Containing a summary of the engagement brief and report structure.
2. Executive summary	Containing a summary of the key findings and recommendations in response to the questions provided in the brief.
3. Strategic context	Containing the political context of the Structural Funds in Europe, the UK and Scotland.
4. Introduction to JESSICA	Containing an introduction to JESSICA including the financial engineering mechanism, eligibility criteria, roles and responsibilities, necessary documentation and match funding requirements to demonstrate the benefits of JESSICA.
5. Case studies	Containing the key findings from the case studies undertaken with Clyde Gateway URC, Dundee Waterfront and Ravenscraig Ltd.
6. JESSICA in Scotland	Containing the case for JESSICA in Scotland and the specific benefits JESSICA could provide within the LUPS operating Programme.
7. LUPS JESSICA Eligibility Criteria	Containing an assessment of the proposed amendments to the LUPS Priority 3 eligibility criteria.
8. Structure of JESSICA in Scotland	Containing a detailed review of the Holding Fund and Urban Development Fund requirements to provide an options appraisal of the most appropriate structure for LUPS.
9. Capitalisation of the Holding Fund	Containing a review of the options available to provide match funding at Holding Fund level.
10. Project selection	Containing a review of the necessary project selection criteria and an options appraisal of the delivery methods.
11. The next steps	Containing an indicative timeline of implementation.
Appendix A	Case study: Dundee Waterfront
Appendix B	Case study: Clyde Gateway
Appendix C	Case study: Ravenscraig Ltd
Appendix D	References

The study has been informed by European and National guidance, three local case studies and input from the European Investment Bank (EIB).

## **2. Executive summary**

### **2.1 Introduction**

#### **2.1.1 Scope**

This report was commissioned by ESEP Ltd, the administrators of the EU Structural Funds in the Lowlands and Uplands Scotland (LUPS) area as a feasibility study into the application of JESSICA. The scope of the report is to answer three key questions:

1. How could JESSICA be successfully used to unlock/facilitate the implementation of regeneration schemes?
2. What is the optimal structure for JESSICA?
3. How would the preferred JESSICA structure be delivered?

#### **2.1.2 Introduction to JESSICA**

JESSICA is a financial engineering initiative developed by the European Commission (the Commission) and the European Investment Bank (EIB), in collaboration with the Council of Europe Development Bank (CEB).

JESSICA provides Member States with the opportunity to use European Regional Development Funds (ERDF) as an investment to support projects for sustainable urban development. The return on investment may then be used for other regeneration and development projects, providing a revolving fund. The investment may be provided by way of loans, equity or guarantees.

JESSICA requires the same national match funding levels as the existing ERDF Structural Fund – in Scotland this is 60%. It may be used as a repayable investment into eligible projects where they are part of an integrated urban development plan through Urban Development Funds (UDFs).

#### **2.1.3 Strategic context**

In November 2008 The Commission published an Economic Recovery Plan addressing the challenges of the current economic climate. It encouraged Member States to use the flexibility of Structural Funds to frontload the financing of projects and updated guidance on the use of financial engineering within Structural Funds to facilitate its recommendations.

The Scottish Structural Funds programmes are set within the context of UK and Scottish policies and frameworks. They aim to contribute towards the Scottish Government's objectives and the Lisbon Agenda through environmentally sustainable economic and social growth.

The LUPS ERDF Operational Programme Monitoring Committee is interested in applying £25m of ERDF into a JESSICA fund and has set up a Steering Group to lead the development of an approach to JESSICA in the LUPS area of Scotland.

## 2.2 How could JESSICA be successfully used to unlock/facilitate the implementation of regeneration schemes?

Three case studies – Dundee Waterfront, Clyde Gateway and Ravenscraig – were carried out as part of this report. The conclusion of these was that JESSICA would be a valuable addition to the existing range of funding methods for regeneration and economic development projects in Scotland.

Regeneration funding has traditionally been provided by central government in the form of non-repayable grant. Grant is most appropriate for projects which demonstrate no commercial return, such as public realm projects, or for bridging a gap in financial viability where the costs of a project exceed its end value – for example a new office development which costs more to build than it can be sold for. Where projects demonstrate limited risk and strong potential returns then private sector funding can also be attracted, sometimes in combination with grant.

Evidence from the case studies was that a number of projects within regeneration schemes fall within these two situations, yet there is no mechanism currently available to address this. An example is the first major SME office scheme in Clyde Gateway. It needs some grant to address ground remediation costs. It is expected that a bank may then lend around 50% of the end value of the offices. However, private sector developers consider the other 50% equity required too risky given the unproven market in the east end of Glasgow. JESSICA could provide this “missing” equity either in full or in part, alongside the private sector, to enable the project to proceed. If the predicted end value is realised, the JESSICA equity investment will be repaid.

Previously, such a situation would have meant either (a) grant funding being used to bridge the equity gap, with no repayment to the grant provider and limited incentive to monitor the investment and drive performance in the way equity investors do, or (b) the project would not proceed. JESSICA therefore fills a gap in the market and will allow a more efficient allocation of ERDF resources – grant can be used for non-commercial investments, and the JESSICA fund can invest in those elements of regeneration schemes where repayment should be possible.

Of course, many regeneration areas are risky investments; for this reason all the initial investments might not be repaid. The fund is likely to be an “eroding” revolving facility. For the Managing Authority (the Scottish Government) this nevertheless allows an initial investment to be recycled perhaps two or three times – still a significant improvement on a one-off grant payment.

The case studies produced candidate projects for JESSICA investment totalling around £50m. This is in the context of a potential national fund of £62.5m. This is consistent with the EIB’s suggestion that comparable experience in other parts of Europe would point to a small number of areas, perhaps two or three, receiving cash from a fund of this size.

Other benefits provided by JESSICA include:-

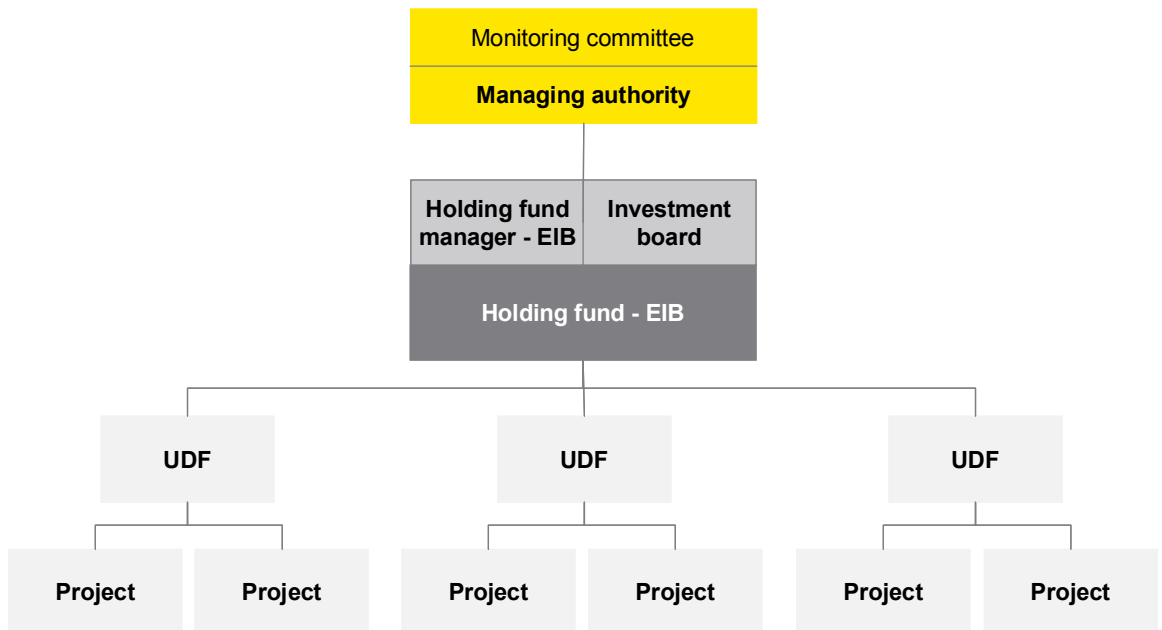
- ▶ A flexible type of investment – JESSICA is designed to make investment through equity guarantees or soft loans, This is not currently possible with existing ERDF grant, and allows the investment to be tailored to the specific project for maximum benefit.
- ▶ Acceleration of development – the ability of JESSICA funding could allow certain projects to proceed more quickly than they otherwise would. In the current market, the private sector is taking a risk averse approach to investment due to the lack of credit available and uncertainty over the future. JESSICA may provide an incentive to the private sector through the lower cost of capital available and the ability of the JESSICA investment to take a share of the risks and rewards.

- ▶ Immediate draw down of European Contribution – Where the Holding Fund structure is implemented and match funding is available on inception from the Managing Authority, the JESSICA contribution can be drawn prior to projects being identified. This was not possible under traditional ERDF.
- ▶ Complimentary use of other funding - It is not necessary for a project to be 100% funded by JESSICA and JESSICA may be used for projects that include components that would not be eligible for Structural Funds assistance, or components that may be funded through ERDF or by the European Structural Fund (ESF) where the regulations of other funds allow. In practice this also means that a JESSICA investment could be combined in the same project with traditional ERDF grant.

## 2.3 What is the optimal structure for JESSICA?

This study recommends the following structure for JESSICA in the LUPS area.

**Diagram 2.1: JESSICA structure**



### 2.3.1 Managing Authority

The Managing Authority for the LUPS area of Scotland is the Scottish Government. The managing authority is responsible for managing and implementing the operational programme in accordance with the principle of sound financial management.

### 2.3.2 Monitoring Committee

Each Member State is required to set up a Monitoring Committee for each Operational Programme. A Monitoring Committee is already in place within the LUPS ERDF Programme and it is not understood to require any structural amendments to implement JESSICA.

### 2.3.3 Holding Fund

A Holding Fund is an optional step within a JESSICA structure. A Holding Fund acts as an intermediary, managing the investment portfolio on behalf of the Managing Authority and appraising which Urban Development Funds (UDFs) and therefore which projects are eligible for financing, based on the pre-approved criteria. The regulations state that Holding Fund must be contained within a financial institution. On inception, the Holding Fund will enter into

a Funding Agreement with the Managing Authority and launch a call to potential UDFs who will prepare business plans for the Holding Fund Manager to evaluate.

The creation of a Holding Fund provides many potential benefits including the ability to draw down the ERDF contribution immediately as match funding is provided with the interest earned on this money used for project development or fund management fees. The current match funding rate for national public sector contribution is 60%. Full capitalisation of a Holding Fund at the outset would require the Managing Authority to pay the full value of ERDF plus match into the fund. The ERDF share of 40% would then be reclaimed from the Commission, typically within around three months. The addition of a dedicated Holding Fund Manager provides the Holding Fund with expert resource and the ability to strategically manage investment at a portfolio level.

This study concludes that due to the benefits offered, a Holding Fund should be established. Maximum benefit will be achieved where it can be capitalised on inception. Options were reviewed to assess the most suitable financial institution to act as Holding Fund Manager for LUPS. The EIB, international clearing banks and local financial institutions were interviewed. It was concluded that the EIB should be selected, based on their expertise, not-for-profit charging structure and the ability to avoid a lengthy European tendering process.

### **2.3.4 Investment Board**

The Regulations do not stipulate the need for a governance body between the Holding Fund and Managing Authority. However, it is recommended that an Investment Board be set up to approve or reject the recommendations of the Holding Fund Manager relating to investment matters. This is likely to be by Ministerial appointment and should comprise experts in regeneration, economic development, finance, banking and policy. Its role will be similar to that of a credit committee in a commercial bank.

Currently, the Programme Monitoring Committee approve all ERDF allocations, therefore where this power is passed to the Investment Board, the PMC may be required to endorse any appointments.

### **2.3.5 Urban Development Funds**

An Urban Development Fund (UDF) is the entity into which a Holding Fund invests. The regulations state that it must be an independent legal entity to the Managing Authority. It can invest in eligible projects by way of equity, loans and guarantees. There are two options for the Managing Authority when considering the use of the UDFs within a JESSICA structure:

1. Managing Authorities request bids from projects and allow the Holding Fund Manager to facilitate the creation of appropriate UDFs – i.e. the Holding Fund Manager procures a project.
2. Managing Authority requests bids from pre formed UDFs – i.e. the Holding Fund Manager procures a UDF.

Scotland already has a range of delivery vehicles at local level which can act as UDFs. These include Urban Regeneration Companies and other local regeneration and development organisations, for example EDI Ltd, Fusion Assets Ltd and the Strathleven Regeneration Company. Most local authority areas contain one or more similar vehicles and where they do not, it should be possible to establish a new vehicle relatively quickly. It is therefore recommended that the Managing Authority does not dictate the UDF structure, but invites bids from UDFs. This will allow local delivery organisations to apply to the Holding Fund; strengthening and supporting existing projects and structures rather creating a tier of new organisations which may cut across current plans.

It is not anticipated that this approach should create significant tax issues; currently it is the responsibility of regeneration vehicles to structure transactions in the most tax efficient manner and this would continue to be the case. Where a local authority is used as project

company beneath a UDF, the local authority will be able to take advantage of its special taxation status, for example in relation to VAT.

### **2.3.6 Eligibility**

JESSICA investment is made through Urban Development Funds (UDFs) into eligible projects. To be eligible, projects must meet certain criteria which include:

- ▶ The date by which eligible expenditure must be incurred is the end of 2015.
- ▶ The project into which the investment is made must be part of an integrated plan for sustainable urban development.
- ▶ The project must meet the specific criteria listed under LUPS ERDF Priority 3 relating to urban regeneration.
- ▶ The use of the JESSICA funding as an investment must be eligible, and the project capable of providing a return.
- ▶ The necessary documentation must be in place between the parties.
- ▶ Match funding must be provided. The current priority axis national contribution rate is 60%,

The Scottish Government, as Managing Authority, is in discussions with the European Commission in relation to broadening the current eligibility criteria for ERDF funding under the LUPS Operational Programme Priority 3, Urban Regeneration. The proposed amendments are necessary and likely to be appropriate to allow a wide range of JESSICA investments. Under the previous wording, very few projects would have qualified. Two areas where further changes to the proposed wording would assist projects are:

- ▶ The definition of 'transport hub' may require further clarification if it is deemed to require multi modal transport considerations. In light of the current railway station redevelopment projects in Scotland that may benefit from the use of this structural fund, a more appropriate wording may be 'safe efficient transport facility'.
- ▶ There are a number of companies interested in using Scotland as a base within which to manufacture the hardware necessary to implement renewable energy supplies, e.g., wind turbines, due to its well placed geographical location. In order to benefit from this potential inward investment and further increase the number of eligible projects, reference to 'green design principles' may be amended to 'green design principles, for the use of renewable energy design and hardware manufacture or for support in the construction, operation or maintenance of renewable energy projects'.

## **2.4 How would the preferred JESSICA structure be delivered?**

The recommendation to establish a Holding Fund to act on behalf of the Managing Authority means the manager of the Fund will act at arms length from the Scottish Government. The Holding Fund Manager will recommend UDFs suitable for JESSICA investment to the Investment Board, which will approve or reject these recommendations.

The effectiveness of this process will depend on the ability of the Managing Authority, or other national bodies, to provide adequate match funding into the Holding Fund in order to draw down the JESSICA contribution. Once the Holding Fund is capitalised, the investment strategy and criteria must be developed to ensure that the Holding Fund Manager is able to evaluate the proposals in line with the Operating Programmes objectives. The criteria will be contained within the Funding Agreement between the Managing Authority and the Holding Fund Manager. The Funding Agreement is part of a suite of necessary documentation to deliver the proposed structure.

## 2.4.1 Procurement of the Holding Fund Manager

The Regulations allow the appointment of the EIB without a procurement process. The first step in appointing the EIB is the signing of a Memorandum of Understanding (MoU) between the Managing Authority and the Holding Fund Manager. Following the MoU, negotiations will take place between the parties to conclude the Funding Agreement.

## 2.4.2 Match funding requirements

In order to draw JESSICA funding from the Commission, 60% match funding<sup>1</sup> must be demonstrated. This match funding may occur at two levels where a Holding Fund is formed – at Holding Fund and / or at UDF level. The total funding – ERDF and match – must then be spent by the end of 2015.

### Match funding at Holding Fund Level

Match funding may be provided in the Holding Fund through cash, assets or a mixture of both.

#### *Match Funding using cash*

The provision of match funding in cash at Holding Fund level is the simplest, most effective solution. The ERDF contribution will only be provided when match funding is available. Assuming a 60% intervention rate, this would require £37.5m in cash to be committed as match funding. The corresponding 40% (£25m) also needs to be paid in at this point, but can be reclaimed, typically within three months in ERDF from the Commission and interest income will start to accrue. This interest income should pay for the costs of the EIB managing the JESSICA process.

Alternatively, the match funding could be ‘drip-fed’ into the Holding Fund over a number of years and the corresponding ERDF contribution drawn down when match funding becomes available. This would reduce the interest earned on the total fund to pump prime project development and pay for the Holding Funding Manager as the ERDF element could only be drawn to the extent match funding is available. It would also delay the provision of funds to projects and reduce the window for meeting the 2015 spending deadline. Many of the highest impact projects to which JESSICA could apply are large scale and will take several years to deliver.

Discussions with potential private investors (including large commercial banks) as part of the study found little appetite to provide match funding at Holding Fund level. Private investors prefer to invest directly into projects where they have clarity over the investment. On the basis of the work carried out for this study, it is likely that match funding will therefore need to come from the public sector.

#### *Match Funding using assets*

Assets such as land and buildings could be used as match resources. This is not likely to be a suitable long term solution unless the assets can be used within a project or can be turned into cash quickly for investment into the fund. Many land assets have lost significant value in the last year and selling these now would be at the bottom of the market. The land assets used need not be in the project areas so long as the resultant cash from the sale is applied to the eligible project. The case studies showed that looking to use land assets in the regeneration areas is not likely, in most cases, to be a solution due to the low values associated with land in these areas. For example, the main site identified in Clyde Gateway has been valued at £86,000. In many other cases land assets in regeneration areas are negatively valued, meaning they require subsidy to be developed. However, the case studies also highlighted that there are potential projects where land has higher valuations, for example Dundee.

<sup>1</sup> 100% of the intended fund value must be paid first before the 40% ERDF is reclaimed from the Commission.

It would, however, be possible to use land and buildings as a stopgap. If £37.5m of land and buildings could be identified and allocated to the Holding Fund (legal title need not be transferred), then the ERDF £25m could be drawn down. At some later stage, the land and buildings could be substituted for cash. The Holding Fund Manager would need to be sure this would happen, otherwise there is a risk of reaching 2015 and the match resources not being turned into cash and spent on projects. In this event ERDF would have to be repaid to the Commission.

The Scottish Government Regeneration Team, Scottish Government Property Advice Department and Scottish Enterprise were consulted as part of this study and invited to provide their thoughts on capitalisation of the Holding Fund under three options:

- ▶ Option 1 – The assets put into the Holding Fund would be those assets held for disposal, with the sale proceeds remaining within the Holding Fund to be invested in the UDFs.
- ▶ Option 2 – the assets put into the Holding Fund would be substituted in the future with either cash or other assets.
- ▶ Option 3 – the assets put into the Holding Fund would be used by the UDFs to invest in projects as a contribution in kind.

There was some interest from the public sector in providing assets into option 1, although it was noted that there were limited assets held for disposal by the Scottish Ministers due to their obligation to continually review property holdings and ensure that surplus assets are minimal. Another consideration was the requirements of the Scottish Public Finance Manual (SPFM). The SPFM obligates all Public Sector bodies in Scotland to obtain at least market value for assets being sold. To the extent that an asset is sold at less than the market value, this is classed as a gift and there is a charge against the revenue budget.

Where assets are used to capitalise the Holding Fund with the intention of substituting in the future with disposal proceeds, it is recommended that the Memorandum of Understanding clearly states that only the initial valuation amount will be substituted in cash – ie where an asset is valued at £10m in order to capitalise the fund, but is sold for £15m, only £10m of the cash received on sale will be put into the Holding Fund. The remainder should be returned to the body providing the assets.

The challenge presented by option 2 is the level of restrictions placed on the assets while they are temporarily in the Holding Fund and the risk associated with not finding suitable alternatives with which to substitute them. The level of restriction and the additional legal work required in using assets will require negotiation with the Holding Fund Manager but is expected to involve a restriction on sale or use of the site without Holding Fund Manager consent in the land registry. The Scottish Government did not feel that it had suitable assets available for this option, due to the low number of unused assets, or those upon which it would place restrictions. Scottish Enterprise was interested in further discussions on this option and in exploring how development and regeneration budgets may be used in the future across all areas of government.

The Scottish Government do not believe they have appropriate assets available to be used within JESSICA eligible projects under option 3. Scottish Enterprise is aware of a number of assets they currently hold that could be used for eligible JESSICA projects. Currently this land is sold into the regeneration projects at market price. Scottish Enterprise has confirmed an interest in further discussions on this option and how the spread of development / regeneration / infrastructure budgets across central government could be used to capitalise the Holding Fund.

The key challenge with using assets to capitalise the Fund is that the valuation of property is currently at an all time low, especially for assets held in development areas. Therefore, securing enough suitable assets to the value of £37.5m may be problematic.

Capitalising the Holding Fund with cash would be the preferred option, however the Scottish Government regeneration budget within this spending round is allocated. It is acknowledged that post the next spending review money could be allocated to JESSICA and substituted into the fund. The Big Lottery in Scotland has indicated an interest in providing some funding, although discussions are at an early stage and the contribution may be relatively small.

It is recommended that if cash cannot be found to capitalise the Holding Fund, option 2 is explored further with the interested parties.

### **Match funding at UDF level**

If match funding is not possible at Holding Fund level, it will be necessary to demonstrate that the co-financing amount is available at UDF level before the JESSICA contribution can be drawn. This is similar to the requirements to demonstrate match funding before traditional grant is applied for. Clearly this would reduce the new money for projects, as 60% would have to be raised locally.

Based on the case studies, this option is likely to rule out those UDFs without a significant cash/grant budget as the value of land held is often low and there is a distinct lack of cash available to provide match without diverting it from other projects. The requirement to find match funding at UDF level will therefore create bias by favouring those projects which are able to identify match funding.

Of the case studies, Dundee Waterfront and Clyde Gateway both had significant public sector cash funding programmes which could provide the basis of match funding. The most likely candidates to find match funding are the Urban Regeneration Companies, although many of these have already committed their budgets. A more detailed exercise would be required by each potential UDF to assess if and how match funding could be sourced locally. Under this approach, the 40% ERDF could not be drawn down until the local match funding was arranged. This would mean interest income being foregone for a number of months and the costs of the Holding Fund Manager would need to be met over this period by the Managing Authority. These costs are likely to be several hundred thousand pounds.

Evidence from the case studies and other regeneration projects suggests that match funding at UDF level would be a more complex and difficult approach. This, together with the associated smaller size of Holding Fund, would reduce the attractiveness of a JESSICA model. The EIB has indicated that a Holding Fund of around £50m - £60m is already small in comparison with other regions in Europe; below a certain scale the costs of set-up and ongoing administration become proportionately excessive.

## **2.4.3 Holding Fund selection of projects**

The selection of UDFs and their projects within which the JESSICA fund should invest will be a defining factor in the success of the fund as a revolving facility. A balanced assessment of many variables will be required to ensure that the Holding Fund Manager is provided with viable opportunities for investment that appropriately spread risk and returns across the programme.

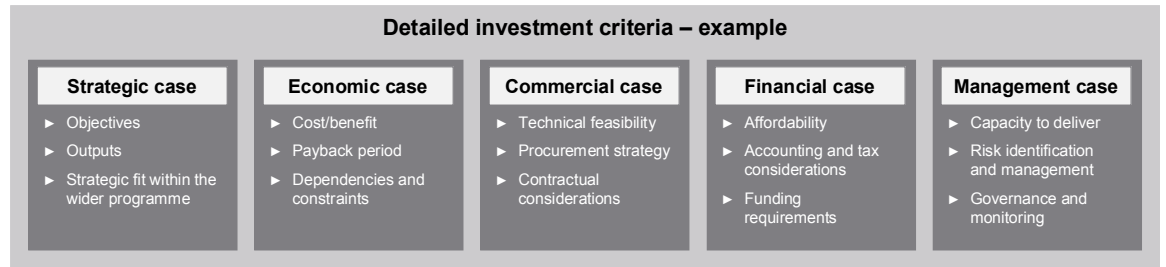
Under the preferred option, the Holding Fund Manager will launch a call for UDF proposals containing eligible projects. These business plans will be measured against EU and national eligibility criteria and national investment criteria.

### **Defining the investment criteria**

The investment criteria should be based on a number of factors that will be provided in the UDF business plan submission to the Holding Fund Manager. It is preferable that these criteria are not set in stone, but a degree of flexibility is allowed to ensure a balanced judgement across the submissions.

Consideration should be given to include the following as part of the investment criteria:

**Diagram 2.2: Investment criteria**



The case studies indicate that the potential UDFs would benefit from knowing these criteria in advance to ensure that they prepare the most appropriate business plan and application.

### Appraising the proposals

Three methodologies were reviewed that could be applied to assessing the projects with varying level of Holding Fund Manager support. The preferred option is structured open bidding. This approach involves an initial sift of applications based on high level tests of eligibility, followed by a request for more detailed proposals and business plans by shortlisted UDFs. These business plans would be completed with assistance from the Holding Fund Manager. This approach mirrors the pre-qualification and shortlisting approach common to most large procurement exercises. This approach allows the Holding Fund Manager to work with shortlisted UDFs to ensure their business plan submissions are as robust as possible.

#### 2.4.4 Recycling of investment

It is recommended that the repaid JESSICA investments be returned to the Holding Fund for re-investment, rather than a presumption that they are retained locally in UDFs. This approach allows for changes to national regeneration priorities over time and provides other areas with a fair chance to bid for follow up investments. As monies are repaid to the Holding Fund, it will be the responsibility of the Holding Fund Manager, guided by the Investment Board, to continue dialogue with potential UDFs and identify the best investment opportunities for any funds that become available.

#### 2.4.5 Documentation requirements

The regulations require a Funding Agreement to be signed between the Holding Fund and the Managing Authority, defining the investment strategy and wind up provisions. Under the preferred option the UDFs will prepare business plans to be evaluated by the Holding Fund Manager in line with this investment strategy and if successful sign a Funding Agreement with the Holding Fund.

### 2.5 Summary of recommendations

The key recommendations of this study are that:

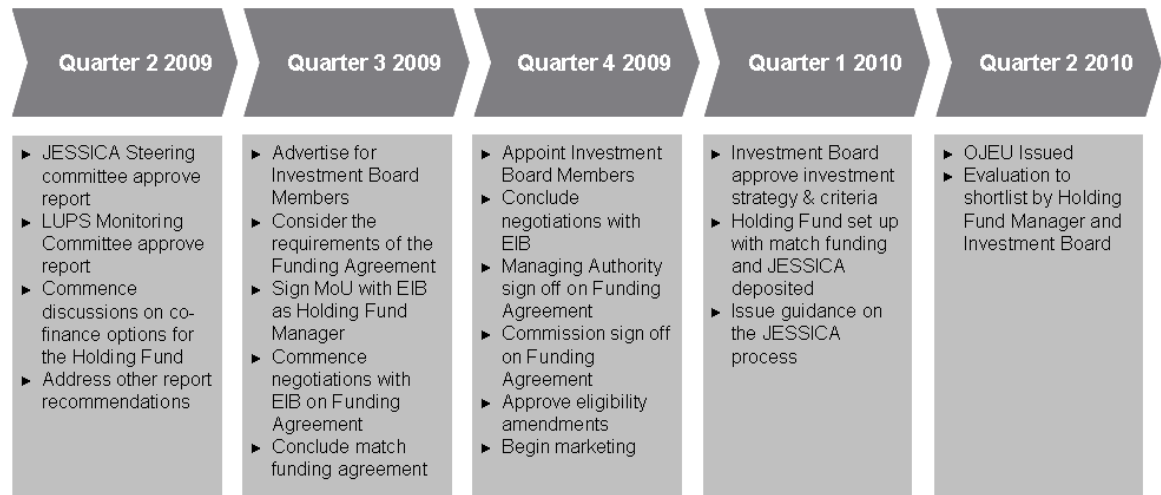
- ▶ JESSICA should be implemented in Scotland, as it has the potential to improve the funding and delivery of regeneration and urban development projects by providing investment funding to a wide range of schemes.
- ▶ A Holding Fund should be set up to manage the JESSICA process with the EIB as Fund Manager. The EIB would act at arms length from the Managing Authority and provide recommendations to a new Investment Board which will approve or reject investment propositions.

- ▶ The Holding Fund Manager role should be detailed within the Memorandum of Understanding and Funding Agreement, requiring a local presence in Scotland to develop local knowledge of the potential projects. The EIB fee should also be negotiated based on reasonable cost recovery for this presence and service, rather than blanket percentages. A reasonable target date for this would be August / September 2009.
- ▶ If possible, the Holding Fund should be match funded by cash from the public sector. No clear source has been identified through this study and further discussions will be required within the Scottish Government. If cash cannot be committed at the outset, alternatives include drip feeding cash over a longer period, the temporary use of assets or requiring local delivery bodies to identify match funding. The last option clearly reduces the benefit to projects by the level of match which has to be found locally, i.e. 60%, and there is no certainty that resources can be found at local level.
- ▶ Agreement is required between potential funders, including the Scottish Government and Scottish Enterprise, on an approach to providing match funding. As part of this, any discussions in relation to assets should address the issue of how increases in value from initial contribution values are dealt with. In the context of any discussion on its assets, the clear view of Scottish Enterprise was that any uplifts should be returned to them and not retained in the JESSICA fund.
- ▶ Bids for funding should be sought from regeneration bodies across eligible areas; it is anticipated that these will include Urban Regeneration Companies and other development vehicles. These bodies will act as 'Urban Development Funds' and invest in projects with the JESSICA funding.
- ▶ The Holding Fund Manager should use a process of structured open bidding, shortlisting initial applications and providing support to shortlisted bodies in developing their detailed business cases.
- ▶ The shortlisting criteria should be agreed with the Holding Fund Manager as part of the Memorandum of Understanding. These will include the core JESSICA criteria and additional specific criteria required by the Managing Authority. These additional criteria are likely to include strategic fit with Regeneration Outcome Agreements and the Scottish Government's Economic Strategy.
- ▶ The implementation of JESSICA in Scotland and the appropriate application or bidding process should be clearly communicated to all interested parties, for example hosting a workshop or information sessions pre launch.
- ▶ The Holding Fund Manager will use a typical set of business case appraisal criteria to assess proposals, these will include financial profile and expected returns, outcomes/impact, governance, delivery approach, technical feasibility and risk management. These will be set in conjunction with the Investment Board and approved by the Managing Authority
- ▶ No pre-set measures for business case assessment criteria have been suggested through this study; it will be important for the Holding Fund Manager to be able to exercise judgement in reaching a balanced assessment of the merits of different business cases. Whilst the ideal scenario is that all investments repay a return above the initial investment value, we do not believe that fettering the discretion of the Holding Fund Manager by specifying an artificially high target or hurdle rate of return is appropriate. Given the challenging nature of many regeneration investments, payback of the original investment may be the appropriate target for some projects. It is expected that the fund will invest in a mixed portfolio of projects in terms of return with payback as the floor; a balance of projects that contribute to sustaining and growing the fund and potentially some higher risk / higher return projects with key strategic significance or outcomes.

The key unresolved issue is the approach to match funding, specifically whether this can be found to capitalise the Holding Fund, or whether UDFs will need to raise this locally. While this is a policy decision for Scottish Ministers, other elements of the process are relatively straightforward and can proceed in parallel. This includes signing a Memorandum of Understanding with the EIB and appointing the Investment Board.

The timescale set out below shows that the first call for proposals could be made early/mid 2010, with the first JESSICA investments potentially being made later in the year. A common theme from all consulted as part of this study was that there is a demand for JESSICA now, and driving to meet or better these timescales would be welcomed by regeneration projects around Scotland hoping to benefit from the new approach JESSICA brings.

**Diagram 2.3: JESSICA timeline**



## 3. Strategic context

### 3.1 Highlights

- ▶ In November 2008 the Commission of the European Communities published an Economic Recovery Plan (the Plan) addressing the challenges of the current economic climate. It encouraged Member States to use the flexibility of Structural Funds to facilitate its recommendations.
- ▶ The Scottish Structural Funds programmes are set within the context of UK and Scottish policies and frameworks. They aim to contribute towards the Scottish Government's objectives and the Lisbon Agenda through environmentally sustainable economic and social growth.
- ▶ The Lowlands and Uplands Scotland (LUPS) area covers 93% of Scotland's population, with a European Regional Development Programme (ERDF) of €909.8 million for the period 2007-2013.
- ▶ The LUPS ERDF Programme has four priorities to address market failure in specific areas. This study is relevant to Priority 3 – Urban Regeneration. The Priority 3 budget is €253.8 million, and it is envisaged that, of this, around £25 million may be made available for a JESSICA funding mechanism.

### 3.2 European context

Over the past year, Europe has experienced unprecedented volatility in the financial markets with the solvency of major banks being called into question and the price of money increasing sharply. The availability of credit to businesses and households has decreased and consumer confidence is at an all time low. Recent reports suggest the Euro area and many Member States are already in recession, with a risk that this situation will worsen still further.

#### 3.2.1 European Economic Recovery Plan

In November 2008, the Commission published a European Economic Recovery Plan, outlining plans to address the impact of the financial crisis. The plan considered the difficulties of the wider economy and provided recommendations that seek to make Europe a key player in the global response to recent events. It calls on Member States to take advantage of the strengths of the European Union (EU) during these difficult times, referencing the existing framework offered by the Stability and Growth Pact of the Lisbon Strategy, the benefits of scale offered by the Euro and of Europe being the largest single market in the world.

The recovery plan announced a coordinated budgetary stimulus of €200bn, 1.5% of EU Gross Domestic Product (GDP) within the Stability and Growth Pact to boost demand and restore confidence in Member States. This was accompanied by an acceleration of structural reforms, grounded in the Lisbon Strategy, to stimulate and adapt the economy to long-term challenges whilst boosting the EU's long-term growth potential.

#### 3.2.2 Structural funds

Specifically, the plan recommended actions in the four priority areas of the Lisbon Strategy of people, business, infrastructure & energy and research & innovation. In the context of public investment, the plan acknowledged the pressures on national budgets and the risk that this may slow down the planned rate of investment. It recommended that the implementation of Structural Funds be accelerated to address this risk. To assist with this acceleration, the Commission proposed to increase its pre-financing of programmes and encouraged Member States to use the flexibility of Structural Funds to frontload the financing of projects. It further commits to other measures designed to facilitate the use of financial engineering instruments,

widening the possibilities for eligible expenditure including the use of energy-efficiency investments including where they fund social housing, which was not previously possible. These commitments were made policy by an amendment to the General Structural Fund Regulations in April 2009.

### 3.3 UK context

#### 3.3.1 UK structural reforms

The European Economic Recovery Plan called upon Member States to submit updated stability or convergence programmes. The Commission have now assessed these plans and the European Council (the Council) have provided their recommendations for each Member State.

The Council's assessment concluded that the United Kingdom (UK) economy has slowed significantly, falling from 3% GDP growth in 2007 to 0.7% in 2008. A further decline in growth was forecast for 2009, reflecting the impact of the financial crisis and the downturn in the housing market. The British Chambers of Commerce has subsequently predicted in January 2009 that, in annual average terms, there would be negative GDP growth of 2.2% in the year.

The Council has recommended that the UK pursue the implementation of structural reforms and in particular:

- ▶ ensure a sustainable fiscal position in the medium term, including fiscal consolidation measures geared towards enhancing the quality of public finances; and
- ▶ continue to implement plans to substantially improve skill levels and establish an integrated approach to employment and skills in order to raise productivity and increase opportunities for the disadvantaged.<sup>2</sup>

#### 3.3.2 The European Regional Development Fund (ERDF)

The ERDF is a Structural Fund that was set up 1975 to stimulate economic development in the least prosperous regions of the EU and has developed into a major instrument within the UK for helping to redress regional imbalances, raise productivity and increase opportunities for the disadvantaged. It is a major contributor towards the Lisbon Strategy, which committed the EU to become by 2010:

*“The most dynamic and competitive knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment”.*<sup>3</sup>

As a Structural Fund, the effective use of ERDF will therefore also be a major contributor towards the implementation of the Council's recommendations for the UK, and the overall success of the Lisbon strategy.

To be fully effective and maximise the value of Structural Funds, the ERDF programme must not only address the socio economic challenges of the UK, but link these to existing policies and priorities. Nationally, these links have been established at various levels to ensure that ERDF funding both compliments and builds upon existing policy.

Specifically, the UK ERDF Programme has been developed to fit within and alongside the following:

<sup>2</sup> Reference: Brussels, COM (2009) 34/2 Volume 1. Implementation of the Lisbon Strategy Structural Reforms in the context of the European Economic Recovery Plan – Annual Country Assessments

<sup>3</sup> Reference: Brussels, COM (2005) 24 Final

### **3.3.3 Community Strategic Guidelines (CSG)**

The CSG provide an indicative framework for the Structural Funds. The CSG recognise the need to pursue regeneration and development so that all areas can contribute to the jobs and economic growth agenda contained within the Lisbon Strategy and the need to address urban regeneration acts as a cross-cutting theme.

### **3.3.4 UK National Reform Programme (UK NRP)**

The UK NRP details how the UK is addressing the Lisbon Agenda. The UK Government's overall approach to encouraging national economic growth is based on improving productivity performance through an integrated series of policy measures.

The UK NRP highlights the need to encourage greater private and public investment as well as investing in a research base that is responsive to the economy, including sustainable industries such as renewable energy. The need to target areas of particular deprivation is also acknowledged with a commitment to an integrated policy approach to address the problems of the most disadvantaged areas.

### **3.3.5 UK National Strategic Reference Framework (UK NSRF)**

The NSRF provides the overall framework within which the ERDF Programme must fit within the Member State. It seeks to ensure that Structural Funds spending is consistent both with the CSG and the NRP for delivering the Lisbon Agenda.

The UK NSRF sets out the UK Government's central economic objective to *'raise the rate of sustainable growth and achieve rising prosperity and a better quality of life, with economic and employment opportunities for all'*.<sup>4</sup>

### **3.3.6 Local domestic policies**

The UK Structural Funds are configured to address the local challenges relevant to the operating programme. The relevant Scottish policies are summarised in the section below.

## **3.4 Scotland**

The policy context of ERDF in Scotland is similar to that of the UK as a whole, but addresses specific challenges for the area and reflects Scottish Government policies. This is reflected within the UK documents, with the UK NSRF having a chapter specifically for Scotland. The Scottish Chapter of the UK NSRF sets out the challenges and priority actions for the ERDF Programme under the Competitiveness Objective. An important element of this chapter is community economic development, particularly through the priority action for 'promoting community regeneration'.

The UK NRP emphasises the need to improve entrepreneurship and access to finance, highlighting the need to encourage private and public sector investment, targeting particular areas of deprivation. It makes reference to the Scottish Government Strategy 'Closing the Opportunity Gap' from 2004. This strategy aims to prevent individuals and families from falling into and to provide routes out of poverty by promoting community regeneration of the most deprived neighbourhoods and improving service delivery in rural areas.

### **3.4.1 Closing the Opportunity Gap**

In 2006, 'Closing the Opportunity Gap' was supplemented by the Scottish Government's 'People and Place: Regeneration Policy Statement'. This defined the regeneration challenge for Scotland:

<sup>4</sup> Reference: United Kingdom Cohesion Policy 2007 - 2013

*“Regeneration is a crucial part of growing the economy and improving the fabric of Scotland. Our aim is to turn disadvantaged neighbourhoods into places where people are proud to live. To turn places that have been left behind into places connected with the opportunities around them. To create areas of choice and areas of connection, rather than inward-looking places excluded from the wider successful Scotland around them. To build mixed and vibrant communities that sustain themselves.”<sup>5</sup>*

### 3.4.2 People and Place

‘People and Place’ stated that regeneration is central to achieving the main goal of sustainable economic development, integrating public, private, voluntary and community sector activities to achieve sustainable regeneration. It recognised that this can only be achieved through an integrated policy approach across multiple organisations that goes beyond investment in physical infrastructure and into one that considers the economic, social, physical and environmental aspects of regeneration. Further, it defined a series of geographic priorities for regeneration, these being the Clyde Corridor, North Ayrshire and Inverclyde. Subsequently, Urban Regeneration Companies (URC’s) were established in each of these areas to focus regeneration efforts.

### 3.4.3 Government Economic Strategy

The Government Economic Strategy sets out how the Scottish Government will support businesses and individuals in order to deliver the following Purpose:

***to focus the Government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.***

Sustainable economic growth refers to building a dynamic and growing economy that will provide prosperity and opportunities for all, while ensuring that future generations can enjoy a better quality of life too.

This Strategy is supported by targets to track progress in boosting Scotland's growth, productivity, population and participation, and in delivering on the desired characteristics of growth - solidarity, cohesion and sustainability. These targets link closely to the regeneration and sustainable urban development agenda which is central to JESSICA.

In order to deliver increasing sustainable economic growth, the Strategy identifies five Strategic Priorities that are internationally recognised to be critical to economic growth.

- ▶ Learning, Skills and Well-being
- ▶ Supportive Business Environment
- ▶ Infrastructure Development and Place
- ▶ Effective Government
- ▶ Equity

### 3.4.4 National Performance Framework (NPerfF)

As part of the 2007 spending review, the Scottish Government published the NPerfF. The NPerfF provides a unified vision and quantifiable benchmarks upon which the Government, contributing towards a single purpose *‘To focus government and public services on creating a*

<sup>5</sup> Reference: People and Place, Regeneration Policy Statement, Scottish Government 2006

*more successful country, with opportunities for all of Scotland to flourish through increasing sustainable growth.*<sup>6</sup>

The NPerfF is made up of seven high level targets relating to this purpose, broken down into five strategic objectives summarising the priority actions. These objectives will be measured by fifteen national outcomes that describe what the Government wants to achieve and forty five national indicators that will be used to track performance. The progress of the Government is tracked on the 'Scotland Performs' website to ensure continuing public accountability against these measures. A wide range of these targets and indicators relate to urban regeneration and economic development, continuing the themes developed in 'People and Place'.

A number of mechanisms contribute towards the delivery of regeneration outcomes set out in 'Scotland Performs'. Due to the multi-faceted nature of regeneration, many require the co-ordination of several stakeholders. Two such mechanisms are:

- ▶ **Community Planning Partnerships (CPPs).** These have been established at Local Authority area and set out how the relevant partners at local level intend to combine their activities to achieve regeneration outcomes. The CPPs are partnerships between key parties involved in local regeneration including the Local Authority, voluntary sector organisations, local Health Boards and other relevant bodies.
- ▶ **Urban Regeneration Companies (URCs).** Six 'official' URCs, backed by Scottish Government funding, have been established to deliver focused, integrated regeneration strategies. The URC's are partnerships of representatives from both the public and private sectors, to deliver physical, economic and social regeneration in specific areas. The six areas are Craigmillar, Clydebank, Raploch, Irvine Bay, Clyde Gateway and Inverclyde. A number of similar URC-type organisations have been set up locally in other areas of Scotland by public sector partners wishing to adopt similar mechanisms for regeneration. Examples include Fusion Assets Ltd in North Lanarkshire and the Strathleven Regeneration Company in West Dunbartonshire.

It is to vehicles such as these that changes to the use of Structural Funds may provide new opportunities to deliver a lasting legacy.

### 3.4.5 Scottish Economic Recovery Programme (ERP)

In March 2009, in response to the economic downturn and to continue to drive progress on the Government Economic Strategy, the Scottish Government published Progress on the Scottish Economic Recovery Programme. This focused on the need to increase short term demand in the local economy and provide immediate support to those most effected. The ERP included reference to the accelerated use of Structural Funds within the 2007-2013 programme to maximise support to SMEs.

The programme has six elements, designed to increase short term demand in the Scottish economy and provide immediate support to those businesses and families most affected:

- ▶ Reshaping capital spending plans
- ▶ Ensuring all government activity, including on planning and regulation, supports economic development
- ▶ Intensifying activity and support for tourism and Homecoming 2009
- ▶ Intensifying work around energy efficiency and fuel poverty
- ▶ Increasing advice to businesses and individuals

<sup>6</sup> Reference: National Performance Framework: Scotland Performs, Scottish Government 2007

- ▶ Improving financial advice to vulnerable individuals

### 3.4.6 National Planning Framework 2 (NPF2)

The NPF2 is an update to the 2004 National Framework that provided guidance for the spatial development of Scotland to 2025. The NPF2 extends the development plans to 2030 and outlines how the Scottish Ministers consider that the development and use of land should be implemented. The NPF2 draft for discussion was put to Ministers in December 2008 and its consideration was led by the Local Government and Communities Committee. Following their report to Ministers, the NPF2 is currently being finalised and publication is expected in Spring 2009.

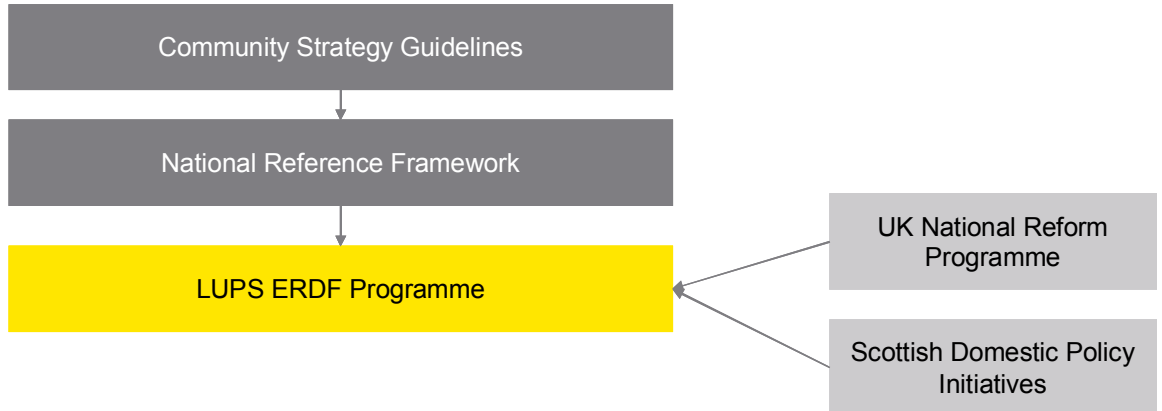
The draft NPF2 identified the key challenges that Scotland faces in accelerating its development including economic activity, climate change commitments and the use of new technologies. It addresses national infrastructure challenges and considers these by region, identifying special issues of national importance that cut across regional boundaries. It identifies priorities for each region and identifies the environmental impact of designated national development projects. It is intended that the framework will play a key role in aligning strategic investment priorities.

### 3.5 Lowland and Uplands Scotland (LUPS) area

The Lowlands and Uplands Scotland (LUPS) ERDF Programme is a fund of €909.8m for Regional Competitiveness & Employment over the period 2007-2013.

It is set within the context of the UK and Scottish policies detailed above, as summarised in the diagram below:

**Diagram 3.1: Policy context of LUPS ERDF Programme**



The LUPS area covers 93% of Scotland’s population with 4.7m inhabitants (2004 figures), with the main economic activity within the central belt area between Glasgow in the West to Edinburgh in the East. Of this population, 75% were in employment in the period March-May 2006, although this is likely to have decreased in recent periods as the impact of the credit crunch is felt across the region.

The LUPS ERDF Programme has a vision to *‘Encourage the growth of the region’s economy within a sustainable development framework and thereby enable all parts of the region to contribute to achieving the Lisbon Agenda goals’*.<sup>7</sup>

This vision is underpinned by four sets programme objectives, addressing market failure across four priority areas:

- ▶ Research and innovation

<sup>7</sup> Reference: Lowlands and Uplands Scotland ERDF Fund 2007 – 2013 – Structural funds operational programme

- ▶ Enterprise and entrepreneurship
- ▶ Urban regeneration
- ▶ Rural development

Each priority supports a range of eligible activities, all intended to be delivered in conjunction with appropriate partners and with the involvement of local communities.

Table 3.1, reproduced from the LUPS ERDF Operating Programme, summarises the challenges and key activities within each priority.

**Table 3.1: LUPS ERDF Priority axis summary<sup>8</sup>**

Priority	Challenge	Total public contribution (€m)	Summary
1. Research and innovation	<ul style="list-style-type: none"> <li>▶ Increasing benefits of higher/further education RTD</li> <li>▶ Improving RTD/innovation</li> </ul>	204.7	The ERDF will support significant projects that will underpin research and innovation in the region's key sectors, which include: aerospace, chemicals, digital media, electronics, energy, life sciences, and micro- and opto-metrics. Renewable energy will be given particular emphasis. This priority will focus on supporting high growth enterprises and research centres, and will encourage networking between small and medium sized enterprises (SMEs) and research partners.
2. Enterprise growth	<ul style="list-style-type: none"> <li>▶ Increasing the number of entrepreneurs</li> <li>▶ Addressing enterprise bottlenecks</li> </ul>	305.5	This priority will address market failure in access to finance (mainly risk capital). To enhance business competitiveness, the Programme will promote e-commerce and the use of energy efficiency systems.
3. Urban regeneration	<ul style="list-style-type: none"> <li>▶ Improving enterprise development in disadvantaged communities</li> <li>▶ Improving access to economic growth for disadvantaged communities</li> </ul>	253.8	This geographically targeted priority will address the needs of the most disadvantaged urban communities. Activities to promote physical regeneration will include improving workspace and training facilities.
4. Rural development	<ul style="list-style-type: none"> <li>▶ Increasing competitiveness of rural industries</li> <li>▶ Improving key support services for economic development</li> </ul>	127.8	The focus here will be on helping rural areas that share similarities such as low population densities, sparse settlement patterns and valuable natural heritage and culture resources. The aim is to strengthen rural industries and promote diversification, while supporting key shared services and tackling accessibility issues.
5. Technical Assistance		18.0	Technical assistance can be harnessed to help implement the Programme.
		<b>909.8</b>	

It is to *Priority 3 – Urban Regeneration* that this study relates.

<sup>8</sup> Reference: Lowlands and Uplands Scotland ERDF Fund 2007 – 2013 – Structural funds operational programme

## 4. Introduction to JESSICA

### 4.1 Highlights

- ▶ JESSICA is an initiative developed by The European Commission and the European Investment Bank, in collaboration with the Council of Europe Development Bank.
- ▶ JESSICA allows ERDF to be used as a repayable investment in the form of equity, loans or guarantees to support projects for sustainable urban development.
- ▶ Investment is made through financial engineering instruments known as Urban Development Funds (UDFs). These may be organised below an optional Holding Fund. The relationship between these parties is managed through a Funding Agreement and Business Plan as defined in the regulations.
- ▶ A JESSICA investment must meet certain criteria, in addition to the Operating Programme criteria. These include the need for the project to incur expenditure by 2015, to be part of an integrated urban development plan and to demonstrate returns.
- ▶ There are two key dates for any JESSICA model. The first key date is when match funding can be demonstrated, as this allows ERDF to be drawn down – it is beneficial for this to be as early as possible. The second key date is the end of 2015 when all JESSICA funds must have been spent in projects.
- ▶ JESSICA was established to provide a range of benefits, principal among these is giving managing authorities the ability to recycle ERDF funding several times rather than it simply being used as one-off grant. Recognising that fewer projects will meet the requirement for paying back the investment than previously qualified for grant, the eligibility criteria have been relaxed to allow a wider range of investment types.
- ▶ While a number of other parts of the EU are progressing with the development of JESSICA approaches, at the time of writing no JESSICA structure is yet fully operational.

### 4.2 History of JESSICA

JESSICA is an initiative developed by The European Commission (EC) and the European Investment Bank (EIB), in collaboration with the Council of Europe Development Bank (CEB).

JESSICA provides Member States with the opportunity to use ERDF EU grant funding as a repayable investment to support projects for sustainable urban development. The repaid investment, together with any associated returns, may then be recycled into other regeneration projects.

JESSICA was introduced in 2006 and the first completed JESSICA structures are due to be set up in 2009. The use of JESSICA is expected to be accelerated following recommendations contained within the European Economic Recovery Plan. The timeline below summarises activity to date:

**Diagram 4.1: JESSICA Timeline**

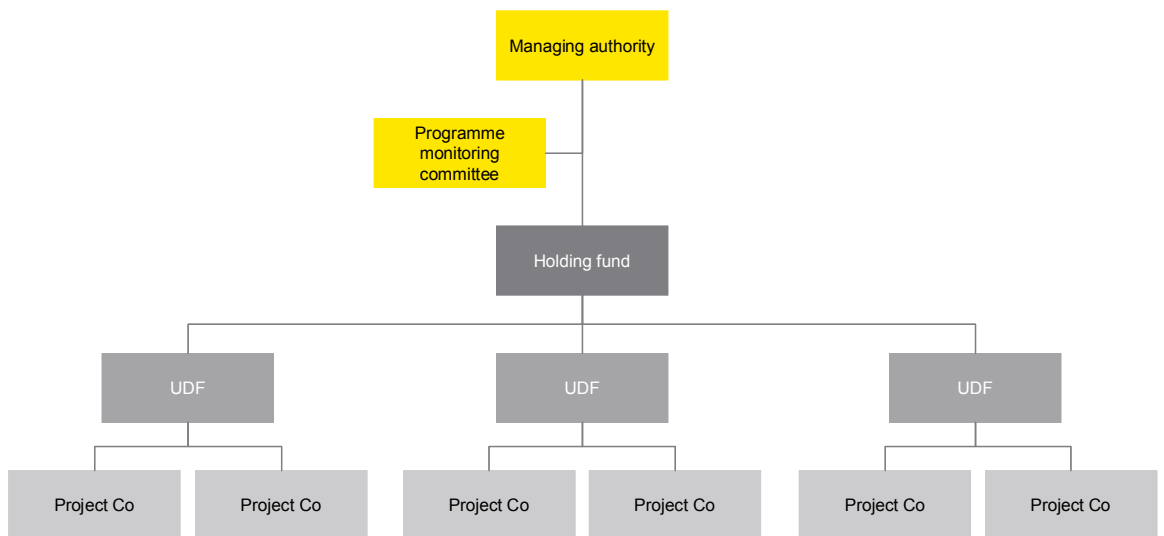


### 4.3 Structure of JESSICA

There are a variety of structures that can be used to deliver JESSICA investment and the most appropriate delivery structure for Scotland is considered in section 8.

The key parties in one possible model for a delivery structure are summarised below:-

**Diagram 4.3: Potential JESSICA structure**



#### 4.3.1 Managing Authority

The role of the Managing Authority is defined by the Regulations, which require it to be responsible for managing and implementing the Operational Programme in accordance with the principle of sound financial management. This is consistent with the responsibilities required for all Structural Fund activity.

In summary it is responsible for:

- ensuring that investments are selected in accordance with the agreed EU and national criteria;
- verifying that the projects are delivered and that Statement of Expenditure is recorded in line with the regulations;

- c. ensuring that there adequate accounting systems or records and procedures for monitoring and control, including audit requirements;
- d. evaluating the programme in accordance with the Regulations
- e. ensuring that the certifying authority receives all necessary information required for certification;
- f. supporting and guiding the work of the monitoring committee and providing necessary documentation;
- g. drawing up and, after approval by the monitoring committee, submitting to the Commission the annual and final reports on implementation;
- h. providing the Commission with information to allow it to appraise major projects.

#### **4.3.2 Programme Monitoring Committee (PMC)**

Each Member State is required to set up a Monitoring Committee for each Operational Programme, in agreement with the Managing Authority. The set up requirements and responsibilities are defined in the Regulations. The Monitoring Committee may have representatives from the Commission or the EIB and EIF where they are making a contribution.

In summary, the role of the Monitoring Committee is to:

- a. consider and approve the criteria for selecting projects and any necessary revisions;
  - b. review progress made towards achieving the operational programme targets;
  - c. consider and approve the annual and final reports;
  - d. propose revision or review of the operational programme to the managing authority;
  - e. consider and approve any proposal to amend the content of the Commission decision on the contribution from the Funds.
- ▶ Specifically, in relation to the set up of a JESSICA fund, the Monitoring Committee may be required to:
  - ▶ consider and approve the criteria for selecting the UDFs and Projects, in association with the Holding Fund Manager;
  - ▶ consider and approve the proposed amendments to the Priority 3 eligibility criteria;
  - ▶ monitor and review investments made by the Holding Fund, in particular the contributions to targets and objectives of the Operating Programme.

#### **4.3.3 Holding Fund**

A Holding Fund is an optional step within a JESSICA structure. The approach of the JESSICA initiative is to offer repayable investments through financial engineering instruments known as Urban Development Funds (UDFs) to invest in eligible projects. The optimum organisation of these funds is dependant on the type and size of the development that they finance, and the risk that it is required to take. A Holding Fund acts as an intermediary, managing the investment portfolio on behalf of the Managing Authority and appraising which UDF and therefore which projects are eligible for financing based on pre-approved criteria.

ERDF funds may therefore be drawn initially into a Holding Fund before onward distribution to UDFs. In order for this to take place, the Managing Authority must be able to demonstrate match funding is in place.

The role of the Holding Fund Manager will be negotiated between the Managing Authority and the Holding Fund within a Funding Agreement. It will be shaped by the proposed structure, project selection requirements and support to be provided to the UDFs.

The basis of the Holding Fund Manager role will include:

- a. Set up of a Holding Fund Investment Board made up of Managing Authority members to provide expert advice and review investment recommendations
- b. Negotiation of the Funding Agreement between the Holding Fund and the Managing Authority, including preparation of the investment strategy and policies in association with the Managing Authority
- c. Defining wind up provisions of the Holding Fund
- d. Launching a call for bids from potential UDFs
- e. Assessment of UDF business plans against investment criteria
- f. Implementation of approved investments into the UDF
- g. Negotiation of Funding Agreement between the Holding Fund and UDF
- h. Monitoring & reporting of the programme performance
- i. Adherence to national and EU UDF requirements
- j. Monitoring and recycling income
- k. Assistance in the interpretation of Regulations

#### **4.3.4 Urban Development Fund**

An Urban Development Fund (UDF) is a financial engineering instrument set up to invest in eligible projects within an integrated plan for sustainable urban development by means of equity, loans or guarantees. UDFs may also support urban projects receiving grant assistance from an operational programme but are not able to re-finance acquisitions or participate in completed projects. UDFs can be national, regional or urban funds, tailored to specific sectors or to specific projects. They may act as financing institutions providing simply funding or, at the same time act as development companies.

In order to ensure that the UDFs will use the resources from the structural funds in line with the urban policy objectives of the Managing Authority, the Managing Authority can set requirements within the Funding Agreement signed with the Holding Fund and will enter into a separate Funding Agreement with the UDF. The Regulations also allow the Managing Authority to be represented in the supervisory bodies of the UDF.

#### **4.3.5 Project company**

The project company is the company or organisation that will benefit from the JESSICA investment made by the UDF and will deliver the outcomes.

## 4.4 JESSICA eligibility criteria

At a European level, there are six key criteria that an investment must meet before JESSICA funds can be drawn:

- ▶ expenditure must be incurred and recorded in the **Statement of Expenditure** by the end of 2015;
- ▶ the project must be part of an **integrated plan for sustainable urban development**;
- ▶ the project must have sufficient **eligible component** expenditure and also take into account any **national eligibility criteria**;
- ▶ the **use of the JESSICA funding as an investment** must be eligible, and the project capable of providing a **return**;
- ▶ the **necessary documentation** must be in place;
- ▶ **match funding** must be provided.

### 4.4.1 Statement of Expenditure

The Statement of Expenditure records the cumulative expenditure over the life of the project. By the end of the JESSICA programme, the Statement of Expenditure will include:

- ▶ any payments from urban development funds for investment in public private partnerships or other projects included in an integrated plan for urban development;
- ▶ any payments for investment in enterprises from each of the abovementioned funds;
- ▶ any guarantees provided including amounts committed as guarantees by guarantee funds;
- ▶ eligible management costs<sup>9</sup>; and
- ▶ any substitutions or transfers into or out of the fund.

The Statement of Expenditure is completed and audited at the end of 2015. It is by this point that expenditure must have been defrayed at project level. There are therefore two key dates for any JESSICA model. The first key date is when match funding can be demonstrated to allow the ERDF to be drawn down into the structure – it is beneficial for this to be as early as possible. The second key date is the end of 2015 when all JESSICA funds must have been spent.

### 4.4.2 Integrated plan for sustainable urban development

The projects receiving JESSICA funding must be part of an integrated plan for urban development. There is no strict definition of what comprises such a plan by the Commission as it should be defined by Member States and Managing Authorities. However the guidelines provided recommend that the plan should:

- ▶ promote social inclusion;
- ▶ improve quality of life (including environment and housing);
- ▶ promote the development of new activities and job creation;

<sup>9</sup> Council regulation EC No 1083/2006 Article 78

- ▶ focus on groups which are most in need; and
- ▶ encourage all people to participate in the planning and delivery of services.

If a UDF is established for a specific Urban Development Plan, its activity can be limited to a specific area within the Plan.

#### 4.4.3 European project eligibility

The eligible projects in which JESSICA funding can be used are similar to those in which ERDF funding may be used. Additional guidance has been provided which broadens the range of possible investments. This is summarised below.

##### **Renewable energy and housing update<sup>10</sup>**

Expenditure is now allowed on energy efficiency improvement and on the use of renewable energy in existing housing in favour of low-income households in all Member States, with those admitted after May 2004 provided with additional flexibilities.

The current regulations allow a broad range of energy projects that are not classed as housing, but through which the housing sector may benefit, including:

- ▶ investments supplying energy via networks to all buildings in a defined geographical area such as district heating, networks and energy parks;
- ▶ services organised by public authorities which are part of an integrated urban development plan such as energy audits, monitoring and evaluation of buildings;
- ▶ support to R&D projects implemented by research institutes to develop environmentally friendly innovative solutions in the housing sector;
- ▶ demonstration projects for energy efficiency in the housing sector; and
- ▶ capacity-building for staff and information campaigns for consumers.

Within the transport and industry sectors, the ERDF can support energy efficiency and renewable energy interventions that make a substantial contribution to the reduction of energy consumption and greenhouse emissions.

##### **Mixed use projects**

It is not necessary for a project to be 100% funded by JESSICA and JESSICA may be used for projects that include components that would not be eligible for Structural Funds assistance, or components that may be funded through ERDF or by the European Structural Fund (ESF) where the regulations of other funds allow. The Regulations currently provide for the ERDF and ESF to finance actions falling within the scope of assistance to each other, however this is limited to 10% of EU funding for each priority axis. When this assistance is within a JESSICA structure, this may be increased to 15% under the Regional competitiveness and employment objective in respect of sustainable urban development.

There must be a clear audit trail to distinguish expenditure eligible under the Structural Funds from ineligible expenditure. This could involve the use of a separate accounting system or accounting code.

<sup>10</sup> COCOF 08/0034/02/EN Guidance note on the eligibility of energy efficiency and renewable energies interventions under the ERDF and the Cohesion Fund (2007 – 2013) in the building sector and housing

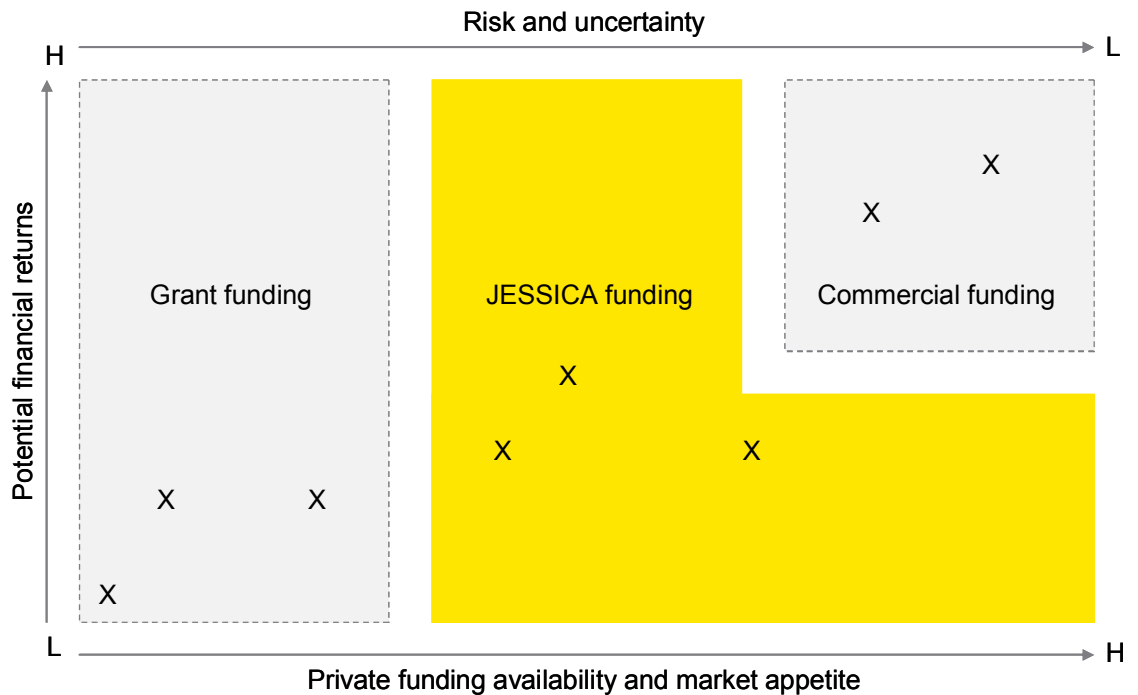
#### 4.4.4 Eligible investment

JESSICA guidelines assume that most projects capable of generating a level of commercial return will continue to be funded through private finance where possible. JESSICA is not intended to replace traditional grant funding in activities that produce no return, such as remediation and where projects generate no commercial returns. Such projects will not meet with the JESSICA eligibility criteria and will continue to be funded through grant funding.

JESSICA is intended to facilitate investments which fit the urban policy agenda, but which due to high risks, high financing costs or low revenue streams, cannot secure private funding without public sector involvement. In the current economic climate the ability of the private sector to raise adequate finance for large projects has decreased and there is a reluctance to embark on high risk projects. This provides many opportunities for JESSICA funding to assist in the delivery of urban regeneration and development projects.

Diagram 4.4 indicates the intended use of JESSICA funding in the current market.

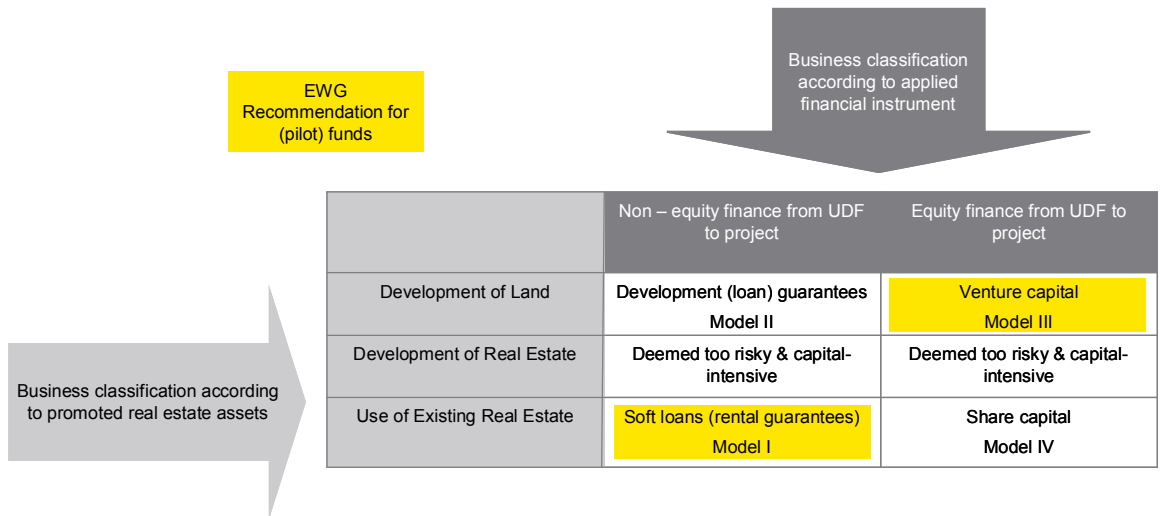
**Figure 4.4: Use of JESSICA Investment**



The diagram demonstrates that JESSICA should be used where risk and uncertainty are higher than acceptable to attract the private sector, but where the market retains an element of appetite to invest in the project.

JESSICA may be used to invest in eligible projects by means of equity, risk capital, loans or guarantees. The EU JESSICA Expert Working Group (EWG) recently presented four business models within which JESSICA funding could be used within a UDF. The diagram below summarises their recommendations published in March 2009 which concluded that pilot funds should focus on the use of Models I and III – i.e., venture capital and soft loans.

**Diagram 4.5: JESSICA EWG Investment Opinion**



This is not intended to constrain the type of investment, but provides informative guidance to Managing Authorities. The recommendations are based on views arising in the early stages of the development of JESSICA, particularly as it relates to investment in real estate.

#### 4.4.5 Project returns

A major benefit of JESSICA when compared to traditional grant funding is the possibility of creating a long term facility through which future projects may be funded.

The intention is that returns should be re-used for the benefit of urban development projects. For loan and venture capital funds, the returns include interest, loan repayments and capital gains.

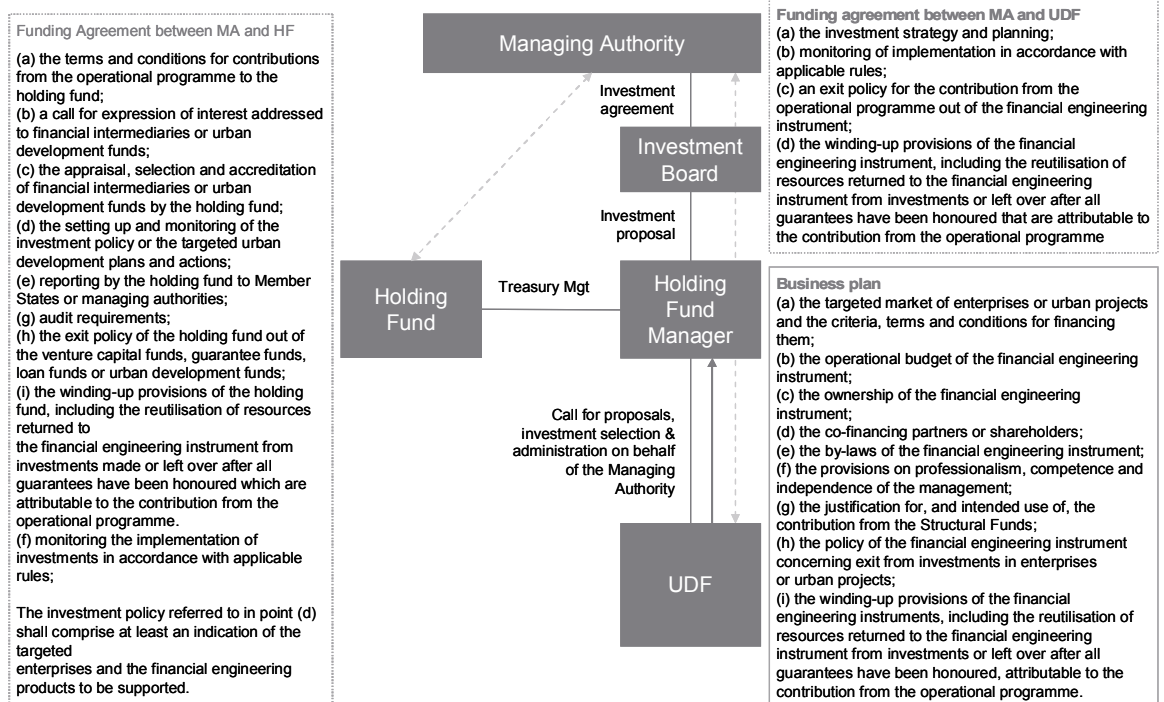
Where a contribution is made by the private sector, it is returned to the entity that contributed it and where there are co-partners or shareholders the returns are allocated proportionally according to the initial investment.

The returns will be recycled by the Holding Fund to invest in further projects across the entire region covered by the programme. This will ensure that the funds are used fairly across the entire area and will take into account changes in national investment priorities.

As JESSICA is used to invest in higher risk projects, it is expected that not all will generate a return. As such the programme could be viewed as an eroding revolving fund. It is possible that not all of the funds will be returned and the fund may gradually reduce over time.

#### 4.4.6 Necessary documentation

The documentation required depends on the delivery structure, however must include a Funding Agreement between the Managing Authority and UDF. The potential documentation and its content is as below:



#### 4.4.7 Match funding requirements

To be eligible for JESSICA funding, co-financing or match funding must be demonstrated. The current intervention rate within Priority 3 of the LUPS Operating Programme is 40% - i.e., 60% must be provided by alternative sources which may be from the private or public sector. The time at which the match funding is required to be demonstrated is dependant on delivery structure and is reviewed in section 9.

At the end of the programme, the Statement of Expenditure is required to demonstrate that the eligible expenditure made by the UDF into the project was also expended in this ratio.

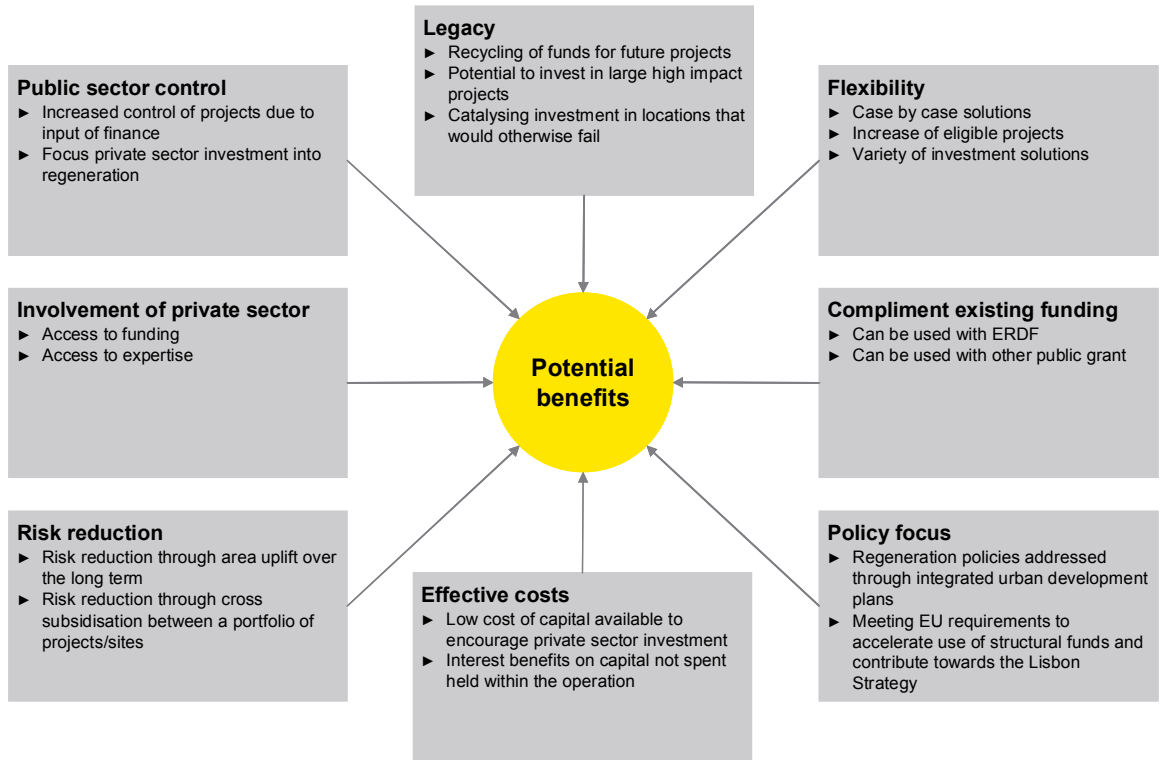
#### 4.5 Potential benefits of JESSICA

The Commission has promoted JESSICA across Europe as providing the following benefits:

- ▶ recycling of funds to create a lasting legacy of investment
- ▶ leverage of private sector funding, expertise and creativity while public sector control focuses the investment into regeneration and development
- ▶ flexibility of projects and investment types within clearly defined eligibility criteria
- ▶ compliments existing funding and can be used with ERDF or other public grant

There are many forms of JESSICA investment and the options for the most appropriate delivery mechanism for Scotland are appraised in section 8. However all delivery models should produce a consistent range of benefits at project level. These benefits are summarised in the diagram below:

**Diagram 4.2: General JESSICA Benefits**



This section has explained the general guidance and perceived benefits of JESSICA as promoted by the EC. Section 5 which follows sets out the findings from three Scottish case studies to examine whether these or other benefits could apply to a cross section of typical Scottish projects. Section 6 then draws on the case studies and wider experience to conclude on whether JESSICA has the ability to complement or improve existing regeneration funding models in Scotland.

## 5. Case studies

### 5.1 Highlights

- ▶ Three case studies were undertaken as part of this study – Dundee Waterfront, Clyde Gateway and Ravenscraig. These considered whether the general approach to a JESSICA structure, as set out in section 4, had the potential to benefit these projects.
- ▶ Local delivery organisations welcomed the principles of JESSICA. All were keen to participate in the structure and saw benefit at local project level.
- ▶ A wide range of projects were put forward as potential candidates for JESSICA investment. Local delivery bodies were keen to see a broad and flexible interpretation of the eligibility criteria, recognising in some cases that this may require further dialogue with the EC, for example in the area of investments in tourism and leisure projects such as marinas.
- ▶ Dundee Waterfront and Clyde Gateway had a range of projects which appeared strong candidates for JESSICA investment. Ravenscraig differed due the primarily residential and retail nature of the scheme. However the local partners presented linked alternatives as part of a wider ‘Ravenscraig Corridor’ integrated urban development plan, with a focus on developments in nearby Motherwell and Wishaw.
- ▶ The cumulative total investment potentially sought by the three studies, should all proposed investments meet JESSICA eligibility and investment criteria, would be £50 million. This is in the context of a national fund of around £62.5 million – estimated to be £25 million ERDF, potentially matched by a further £37.5 million in other resources. This indicates that choices may need to be made between maximising funding into a small number of areas and providing smaller investments into a larger number of areas.
- ▶ In the event that a Holding Fund is set up, it will be the role of the Holding Fund Manager to make recommendations in relation to who should receive funding, at arms length from the Managing Authority. These recommendations will be after assessing Business Cases on a range of criteria and forming a view on which provide the strongest overall package of proposals. This will include financial measures relating to likelihood of returns and non financial measures such as project outcomes and regeneration impact.
- ▶ The use of JESSICA investment in eligible projects has the potential to free up other grant or capital investment for projects that do not meet the eligibility criteria.

### 5.2 Introduction

Three case studies were undertaken as part of this study to assess whether the proposed JESSICA structure was complimentary to existing regeneration delivery mechanisms and would be practical to implement to deliver maximum benefits:

- ▶ Dundee Waterfront
- ▶ Clyde Gateway Urban Regeneration Company
- ▶ Ravenscraig Ltd

The three case studies are existing, long term multi agency regeneration projects that have been developed in the context of wider urban development frameworks. They cover a large geographical area within the ERDF priority 3 target area and have completed previous successful projects. The case studies represent different types of delivery vehicles including an Urban Regeneration Company, an unincorporated partnership between a Local Authority and Scottish Enterprise and an incorporated partnership between Scottish Enterprise and the

Private Sector. This has enabled a review of the proposed JESSICA structure from a variety of angles.

### 5.3 Methodology

Meetings were held with the local Case Study Teams (the Teams) to discuss their objectives and urban development plans. The Teams were briefed on the JESSICA study and projects were identified that may be suitable for JESSICA funding by assessment against European JESSICA requirements and Scotland ERDF P3 eligibility. The project scope was reviewed and the most appropriate type of JESSICA investment ascertained. Where possible, the investment was quantified and the potential rate of return noted.

The Teams were also given an opportunity to comment on the proposed JESSICA structure and discuss any specific challenges or opportunities they saw that may require further consideration.

A summary of each case study is provided below. The full studies are set out in Appendices A to C.

### 5.4 Dundee Waterfront

The Dundee Waterfront programme presents significant opportunities for JESSICA investment in a range of projects. The key delivery partners, Dundee City Council and Scottish Enterprise, have formed a Partnership Board, under the terms of a Partnership Agreement, to oversee the programme which involves large scale transformation of central Dundee. The Partnership Board will oversee a range of investments which will stimulate economic regeneration and business growth in the city.

Projects which may contain potentially repayable investment of some £20m are:

1. Provision of infrastructure and servicing to business plots in the Central Waterfront (£10m)
2. Steam pipes to provide heat from a Combined Heat and Power Plant to the Central Waterfront development (£2m)
3. Rental guarantees to developers building business space on the Central Waterfront (£unquantified)
4. Enabling infrastructure to open up the port site to a major inward investment opportunity (£5m)
5. Enabling infrastructure to allow the creation of a 300 berth marina (£1m)
6. Infrastructure to support the redevelopment of Dundee Railway Station (£2m)

A wide range of other investment is being made in the Waterfront; although mostly with less income generation potential than the projects identified above.

The key issues identified from the case study are:

- ▶ The projects suggested by the partners generally fit with the expanded proposed eligibility criteria. However, further clarification on the eligibility of the marina linked to tourism activity and the proposed expenditure on the railway station may be required.
- ▶ The use of a JESSICA investment provides Dundee Waterfront with the opportunity to divert funds currently allocated to the projects above into alternative projects or enhanced project scope.

- ▶ The review of projects highlights that JESSICA funding may need to be made available on an assumed nil return basis in risky long-term projects. If returns are required, these would merely have to come from public sector grant sources in most cases.
- ▶ Local delivery partners need to be made aware of the timescales and level of detailed information required to support projects as part of any application process for JESSICA funding.
- ▶ While the partners believe that cash could be disbursed appropriately on the projects identified by the end date of 2015, it may still be difficult for the application information to be developed in time for due diligence as part of a fixed bidding round date in the case of some projects.
- ▶ In order for JESSICA funding to be used, an Urban Development Fund (UDF) needs to be created. This must be a legal entity and cannot be a local authority or central government body, although it can have shareholders comprised of these. For Dundee, the partners have noted that Dundee Development Ltd, a Council-led development company, could be used as the UDF because the current Partnership Structure is unincorporated.
- ▶ If the required 60% of matching resources need to be identified at a UDF level then the most likely potential source is the £66m cash recently earmarked for the Central Waterfront. A possible scenario could be:
  - ▶ £12m of the £66m cash is committed to the UDF (Dundee Development Ltd) representing the 60% match funding.
  - ▶ This allows draw down of 40% or £8m in ERDF JESSICA cash.
  - ▶ The £20m funds are invested in the projects listed above.
  - ▶ The £66m cash 'pot' would be reduced by £12m. This is replaced by £10m drawn from the UDF to pay for infrastructure works in the Central Waterfront. A further £2m would have to be found to 'top up' the Central Waterfront budget otherwise there will be a funding gap. However, if the match funding rate was adjusted to 50%, then the reduction in the Central Waterfront budget of £10m will be offset by the matching JESSICA investment leaving no funding gap.
  - ▶ If a 50% matching rate could be achieved, then £10m of cash allocated in current funding agreements to the Central Waterfront would be diverted to the other projects (CHP, port, marina and station) but this would be replaced by a JESSICA investment of £10m. This does, however, reduce by half the amount of JESSICA which can be drawn to the local UDF level compared to the scenario where matching resources are provided nationally in a Holding Fund.
- ▶ This scenario could be implemented with or without a Holding Fund. If a Holding Fund was in place, the local partners would be keen to ensure that the full £20m was retained locally upon repayment.
- ▶ Scottish Enterprise also noted the possibility of Identifying land and property assets which could provide matching resources. It was noted that some local assets, for example residential development sites elsewhere in the city, could be considered for this purpose.
- ▶ If a Holding Fund cannot be capitalised nationally, then further work would be required to assess the potential for match funding at UDF level on the strength of land values or cash holdings.
- ▶ Greater impact will be possible in projects if matching resources can be identified nationally and contributed at Holding Fund level. Depending on the match funding rate

adopted, this could allow the delivery of an additional £10m-£12m of investment in the Dundee Waterfront.

## 5.5 Clyde Gateway

Clyde Gateway Urban Regeneration Company (URC) is a partnership between Glasgow City Council, South Lanarkshire Council, Scottish Enterprise and the Scottish Government, operating in the East End of Glasgow. Its projects are an integral part of the regeneration of the City that will host the 2014 Commonwealth Games.

Many projects within the URC Operating Plan are currently in the advanced planning stages, with the opportunity for early action outputs for a JESSICA fund. This case study focuses on one particular project, Site 1 in London Rd, as it currently requires re-planning following the withdrawal of a private sector investor. Identified projects that may meet with the JESSICA criteria and provide repayment on investment of £16.2m are:

1. Development of SME workspace on London Rd (£2.1m)
2. Development of business centre on Dalmarnock Rd (£0.6m)
3. Redevelopment of Dalmarnock Station (£4m)
4. Development of a multiple occupancy site with space for SMEs (£8m)
5. Creation of a skills centre (£1.5m)

A wide range of other projects are being undertaken by the URC and may be eligible in the future.

The key issues identified from the case study are:

- ▶ The projects reviewed generally fit with the expanded proposed eligibility criteria. However, further quantification of costs and repayment methods will be required to ascertain a payback period.
- ▶ A number of projects include the provision of SME space. Work has been undertaken by the URC that indicates demand for this type of development in the area, primarily due to the number of relocations required in carrying out its Operating Plan.
- ▶ The repayment of most projects is dependant on real estate values and therefore may be deemed to be risky. This is demonstrated by the requirement of the investment as equity and whilst the potential for high returns are available if sale prices are high, if guaranteed returns are required, these would likely to be provided through existing grant and therefore would impact on other projects.
- ▶ Many of the projects within the URC Operating Plan are scheduled for delivery prior to the Commonwealth Games, and therefore the requirement of eligible spend by 2015 should be achievable.
- ▶ Site 1 was identified as a potential early action project for JESSICA, however the URC would require clarity on the JESSICA timetable and application process within a reasonable timeframe in order to utilise it effectively.
- ▶ The JESSICA investment has been proposed as equity into an SPV with a private sector partner, however there has been no market testing to measure market appetite for this.
- ▶ The URC has charitable status and therefore would not be permitted to make the investment into projects that is required of a UDF. However, there is a trading subsidiary that is not covered by such restrictions and could be used as the UDF.

- ▶ The URC and its trading subsidiary has the skills and experience to deliver a business plan and the governance procedures in place necessary for a UDF. Therefore, it would be able to make use of its existing structure, without the need for the Managing Authority to duplicate the set up.
- ▶ If match funding is required, the URC do have assets and grant funding that could be used, however it was noted that capitalisation at Holding Fund level would assist the URC in enabling it to divert these funds elsewhere in its Operating Programme.

## 5.6 Ravenscraig

Ravenscraig Ltd was established informally in 1999 and legally determined a partnership in 2006 to deliver one of the largest regeneration projects in Europe. It is a Special Purpose Vehicle (SPV) set-up set-up between Scottish Enterprise, Wilson Bowden (now Barratt Developments) and Corus to redevelop an old steelworks site in Ravenscraig, North Lanarkshire. The Joint Venture agreement entered into is complex with an obligation on Scottish Enterprise, to administer, but not necessarily fund applications by Ravenscraig Ltd for public sector contributions to the project towards gap funding. The partners in the SPV, along with North Lanarkshire Council, have over the last 10 years developed plans for the site which will ensure that the site will contribute to the growth of the Glasgow Metropolitan Region.

The Ravenscraig Ltd case study identified few projects that could be eligible for JESSICA investment due to the large amounts of residential development within the current masterplan. However, discussions with the case study team identified projects within the wider Ravenscraig Corridor that may be eligible for JESSICA investment. The use of JESSICA in these projects would then free up other sources of funding that could be used within Ravenscraig.

The Ravenscraig Corridor consists of the towns Ravenscraig, Wishaw and Motherwell. The projects identified within this area that may contain potentially repayable investment of up to £14m are:

1. Infrastructure to support the redevelopment of Ravenscraig railway station (£2m total cost is £10m, amount which might be repayable to JESSICA based on car parking and retail revenues has yet to be quantified so Dundee benchmark of £2m adopted for the purposes of this study only)
2. Creation of a business centre in Wishaw aimed at SME's in the service sector as an incubator and for those relocating from facilities that are not currently fit for purpose or are constraining growth. (£0.73m)
3. Creation of a 'hub' that would house a range of accommodation for business and services for both the commercial and public sector. This would provide a central 'One Stop Shop' for the town, housing a public library, e-learning centre, employability and careers services as well as office space for SMEs. (£6.69m)
4. Development of the area between the western edge of Ravenscraig and Motherwell Town Centre (£ unquantified)
5. Infrastructure to support the redevelopment of Motherwell Railway Station (£ unquantified)
6. Development of owner-occupied offices at Drumpellier Business Park (£5m).

The key issues identified from the case study are:

- ▶ The projects within the wider Ravenscraig Corridor generally fit with the expanded proposed eligibility criteria, specifically in the provision of workspace for SMEs

- ▶ The return on investment is dependant on real estate values through sale or lease agreements, therefore JESSICA funding may need to be made available on an assumed nil return basis. If guaranteed returns are required, these would impact on other projects within the areas as they would be provided by re-diverted grant funding.
- ▶ There are many potential projects within the North Lanarkshire area, therefore clarity on the bidding process and timescales would be required in order to provide the most effective business plan.
- ▶ The projects that have been identified are in varying stages of planning and therefore as information becomes available, a more detailed review of the potential for JESSICA investment would be required.
- ▶ Where projects are already in the masterplanning stages and therefore would be likely to meet the requirement of eligible expenditure by 2015.
- ▶ In order for JESSICA funding to be used, an Urban Development Fund (UDF) needs to be created. This must be a legal entity and cannot be a local authority or central government body, although it can have shareholders comprised of these. This is not understood to be a major issue for the Council, with the use of a development company or SPV proposed, with the Council undertaking the necessary work. There is also the possibility of existing regeneration vehicles such as Fusion Assets being used as UDF.
- ▶ If the required 60% of matching resources need to be identified at a UDF level then the most likely potential source is a mix of existing assets owned by the Council or Scottish Enterprise and Council capital contributions.
- ▶ Match funding may also be provided by a private sector partner where the project was deemed attractive to them, e.g. the Business Park development.
- ▶ It was noted that match funding at Holding Fund level would be attractive to the development of projects and would speed delivery.

## 5.7 Overall conclusions

The key findings were mainly consistent across the three studies that JESSICA funding could be used effectively within the existing structures to accelerate the delivery of urban regeneration in Scotland. A total of £50 million in potential repayable investments were recorded. All case studies concluded that although match funding may be possible at project level, this may involve a number of complex transactions, would reduce local impact and that therefore match funding being identified at Holding Fund level would be preferred.

It should be noted that the findings from the case studies were based on assumptions as to the JESSICA structure and that the feedback provided by the case study teams is indicative of the level of uncertainty surrounding the JESSICA process and structure in Scotland that will be addressed as the process progresses. Due to time and information availability constraints, a detailed financial evaluation was not performed, and a detailed business case would be required to approve any investment.

Further specific issues raised across all three studies included:

### 5.7.1 Application and bidding

- ▶ *Timing of JESSICA*: key objectives related to the delivery of projects within the respective communities. Where projects have been identified as having potential for JESSICA funding, the impact of the JESSICA process on delivery should be reviewed. For example, where case study projects have proposed start dates of January 2010 and delay to this may impact the wider programme.

- ▶ *Eligibility criteria* – Clarification was requested on the inclusion of tourism and retail as an eligible activity. This has since been discussed with the JESSICA Steering Group and it is unlikely that the Commission will accept retail as eligible activity within P3.
- ▶ *Eligibility criteria*: The proposed changes to eligibility criteria (see section 7) generally fit well with the case studies, providing a number of potentially eligible projects.
- ▶ *Size of fund* – The size of the Holding Fund at around £62.5 million was felt to be small in a national context.
- ▶ *Allocation of funding* – It was agreed that investment should be needs driven and not spread too thinly across the country. Prioritisation should be given to key urban development projects.
- ▶ *Application process*: Guidance should be provided on the application process to provide transparency and manage expectations, for example the standard of business case required and the diligence any Holding Fund Manager will undertake in appraising applications.
- ▶ *Application process timing*: It was recognised that absolute clarity on application process and information required to support this was needed so that proposals could work towards this as soon as possible.
- ▶ *Number of bid rounds*: If the JESSICA fund is administered through bidding rounds, there is a tactical consideration of the order in which projects are put forward, in order to ensure large projects secure funding from a limited national fund first and do not miss out following a heavily subscribed first bidding round. Knowledge of this would also allow time to develop more complex projects.

## 5.7.2 Repayment

- ▶ *Relationship with ERDF grant*: Whilst JESSICA offers more flexibility in its investment criteria and uses than ERDF grant or other grant funding provided to the URC, JESSICA is required to be repaid. Therefore grant funding may be seen as preferable in some projects. This is consistent with the Managing Authority's view that an element of Priority 3 ERDF will be retained for use as grant.
- ▶ *Repayment return flexibility*: JESSICA would be deemed more attractive where the return on investment and payback period is more flexible than available with private sector funding. This would make JESSICA a viable option for projects of a long term nature, e.g., remediation and infrastructure, or where there is not a clear date for onward sale of assets.
- ▶ *Repayment return rate*: JESSICA funding in almost all cases would need to accept nil expected return beyond payback of the initial investment. However, overage-type clauses could be added to capture upside gains.
- ▶ *Repayment return payback period*: in most projects, repayment is not likely to occur for many years due to the long term nature of the programme. JESSICA should be able to support projects of this nature in order to have maximum impact.
- ▶ *Risk profile*: Private sector funding is hardest to secure for projects where the risk profile is uncertain or deemed as high risk. JESSICA should invest in regeneration projects that may be of higher risk where private investment is not available. In most of the projects this would involve JESSICA providing the full estimated investment value of the end use – not just an equity tranche – since the projects are likely to be too risky for bank lending.

### 5.7.3 Recycling of income

- ▶ *Benefit of recycling:* The opportunity for recycling JESSICA receipts was agreed to be an attractive feature, especially if returns could remain in case study area, although it was acknowledged that this may not occur (see section x for recommendations on recycling).

### 5.7.4 Land and property assets

- ▶ *Potential availability:* All three case studies noted a willingness of the public sector to consider the use of assets outside of the identified projects should match funding need to be identified at UDF level.

### 5.7.5 UDF structure

- ▶ *Restriction on legal structure* – It is not possible for most URCs to be a UDF due to the restrictions of charitable status, however it is understood that trading subsidiaries could be used, with the URC or other joint ventures as the Project Co if necessary.
- ▶ *Restriction on legal structure* – It is not possible for a local authority to be a UDF, however a development company at arms length from the Local Authority could be used, with the Local Authority as the Project Co.
- ▶ *Type of UDF* – The delivery bodies within the case studies have a wide range of potential projects that may be eligible for JESSICA funding and it will be important to ensure that the UDF covers the most appropriate areas to achieve maximum benefits.
- ▶ *Impact on other capital programmes* – There are projects currently within the geographical area that could utilise JESSICA instead of the currently assumed grant or capital funding. This would free up investment for other projects increasing the impact and speed of delivery of regeneration in the area.
- ▶ *Transparency:* some comments related to concerns over transparency for reporting purposes to the Board if sites, assets and funding from different projects were mixed into a single UDF, either locally or nationally. Consideration would be given to either single UDF per project, or thematic UDF within the urban development plan for similar projects.
- ▶ *National Thematic UDFs:* the case studies provided evidence that regeneration initiatives in Scotland are organised on a geographical basis and it would be appropriate to strengthen and support existing initiatives rather than create a complex new layer of beaurocracy which cuts across these. As such, the concept of Scotland wide thematic UDFs, while not rejected outright by the case study bodies, would be likely to be confusing and complex, with concerns that transparency may be lost. Local authority partners in particular would be unlikely to put assets into a national UDF due to potential loss of control and benefit to the local authority area.

## 6. JESSICA in Scotland

### 6.1 Highlights

- ▶ The case studies provided evidence that there is potential to provide a flexible revolving fund in Scotland – this could multiply the benefits of funding through recycling an initial investment several times.
- ▶ Many regeneration projects do have investment characteristics such as a forecast repayment from land development, albeit often risky and long term. Despite this, the approach to public funding has to date been grant-led in Scotland. JESSICA may provide a more efficient long term basis upon which to allocate resources – an investment fund being used for project with investment-style cash flows and grant funding used for non-commercial projects or gap funding.
- ▶ Due to the high risk nature of a JESSICA investment, some investments may not repay in full resulting in an eroding revolving fund. This is still an improvement on the current position in Scotland where public funding is provided exclusively in the form of non-repayable grant.
- ▶ Most commercial projects in regeneration areas are marginal in viability terms. They often require grant and do not deliver the returns on equity that will attract private investment. While an equity stake may be returned in many projects, requiring a commercial rate of return such as 15% return on a JESSICA equity investment will simply mean increasing the grant requirement to pay for this. It is therefore recommended that a high rate of returns requirement is not set. Overage-style mechanisms can be used to capture upside if it arises.
- ▶ JESSICA will be used in many projects as one component of a cocktail of funding sources – it sits between and complements grant and private sector investment and therefore fills a current gap in the market. No such instrument currently exists.
- ▶ The case studies have shown that Scotland already has a network of well-developed regeneration delivery vehicles. These could act as Urban Development Funds without the need to create additional layers of new bureaucracy. Supporting and reinforcing existing projects rather than setting up unnecessary new cross-cutting layers, as has arguably happened in regeneration in other parts of the UK, should be the focus in Scotland.
- ▶ As repayments may not occur for many years, it will be preferable for these to be collected at Holding Fund level and reinvested in stages based on the national regeneration priorities prevailing at the time. Recycling in perpetuity at UDF/local area level is too inflexible, fails to give others a fair opportunity to bid and does not allow for changing national priorities.

### 6.2 The case for JESSICA in Scotland

Public sector intervention in regeneration and development in Scotland has many success stories. Scotland is committed to maximising the benefits of Structural Funds in regeneration projects, its own national goals and those of the Lisbon Strategy.

JESSICA is intended to be used where there is an integrated urban development plan and therefore aligns with the LUPS ERDF Priority 3, 'Urban Regeneration' summarised in section 7. To date all ERDF funding has been provided to eligible activities in the form of up front grant, requiring no repayment. Whilst it is recognised that regeneration and development projects will not always be commercial ones, the use of financial engineering mechanisms in the Structural Fund may provide many benefits where returns are forecast.

These returns could be used to re-invest in future regeneration projects, and the terms of this investment are not restricted to the initial eligibility criteria. Recent changes to the use and application of financial engineering within the Structural Funds have resulted in JESSICA becoming a more attractive approach to regeneration and development in Scotland, allowing co-financing to be provided with cash or assets. It also provides the LUPS Monitoring Committee an opportunity to amend the eligible activities listed within the ERDF to reflect the prioritisation of sustainability within the Recovery Plan, increasing the number of projects that could benefit from ERDF funding.

The Scottish Government has provisionally expressed an interest in setting up a JESSICA Fund consisting of £25m ERDF within the LUPS area and a JESSICA Steering Group has been set up to assess the feasibility of a JESSICA fund.

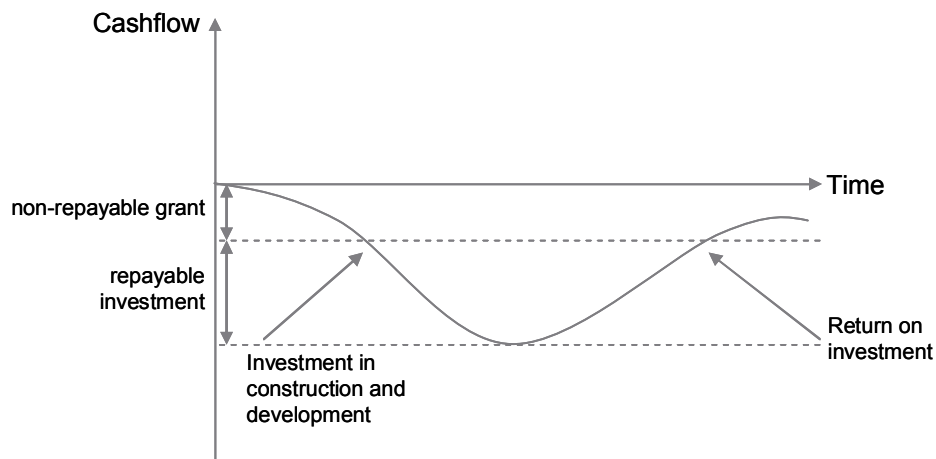
### 6.3 JESSICA benefits in Scotland

In addition to the general benefits of JESSICA reviewed in section 4, evidence from the case studies and wider experience shows that JESSICA has a number of specific benefits in Scotland:

#### 6.3.1 Better aligning with the cash flow profile of regeneration projects

Within Scotland, investment into regeneration projects is currently made through many delivery vehicles. Currently, this investment is made by the Scottish Government through up front grant contribution requiring no repayment<sup>11</sup>. For many projects, this traditional reliance on grant does not take account of the long term cashflow profile, with many regeneration plans demonstrating a steady cashflow decline during the early years, followed by an increase in the later years as projects become operational and begin to provide a return. This is demonstrated in diagram 6.1.

**Diagram 6.1: Traditional cash flow profile of regeneration projects**



While the precise form of this curve will vary from project to project, this shape of cash flow curve is common to almost all long term regeneration plans in Scotland – large up front investments with some form repayment as sites and developed/sold and private sector interest rises.

An investment using JESSICA funding will need to demonstrate the potential for, at least, repayment before the investment is granted. However it is acknowledged that this may be part of a wider project that also requires an element of traditional grant funding. The split of the existing ERDF allocation into investment and grant funding would allow regeneration projects to use grant for projects which generate no commercial return and investment where

<sup>11</sup> Scottish Enterprise has in many cases used 'clawback' mechanisms, particularly in relation to land transfers; however core central government regeneration funding has been grant-led for many years

repayment would be possible. It will ensure that best value is derived from the contribution into the project and provide the Managing Authority with a clear focus and direction, providing a more efficient long term basis upon which to allocate resources.

### **6.3.2 Creating a regeneration legacy**

The concept of JESSICA as an investment fund is in keeping with the direction of national policy for regeneration in Scotland.

Where a project can deliver a commercial return, this return can be recycled at a national level to deliver future regeneration projects, increasing the impact of national regeneration. There is currently no investment fund for regeneration in Scotland and a revolving fund may provide significant benefits in the current economic climate.

As repayments may not occur for many years, it will be preferable for these to be collected at Holding Fund level and reinvested in stages based on the national regeneration priorities prevailing at the time. Recycling in perpetuity at UDF/local area level is too inflexible, fails to give others a fair opportunity to bid and does not allow for changing national priorities.

### **6.3.3 Flexible returns**

Where JESSICA is to provide investment into projects in order to make them attractive to the private sector, it is likely to take the form of risk capital. Risk capital is characterised by the potential for high returns, but also high failures. Insisting on a high rate of return will not be conducive to regeneration. Most commercial projects in regeneration areas are marginal in viability terms. They often require grant and do not deliver the returns on equity that will attract private investment. While an equity stake may be returned in many projects, requiring a commercial rate of return will simply mean increasing the grant requirement to pay for this.

It is therefore possible that a JESSICA investment provides no return above repayment of the original investment or provides no repayment at all. This will impact on the revolving nature of the fund, decreasing its overall value.

### **6.3.4 Leveraging private sector investment**

In times of budget cuts, it will be important to leverage all forms of investment, maximising the opportunities to unlock private sector investment through the increased ability to borrow and utilising innovative EU investment strategies such as JESSICA. The case studies undertaken for this report, detailed in section 5, confirm that this approach to funding regeneration projects is a popular one.

The provision of JESSICA risk capital/equity as a 'buffer' could make the difference in many projects between the private sector investing or not. This applies in particular to banks, as loan to value ratios have fallen and capital rationing increased.

### **6.3.5 Utilisation of existing regeneration structures**

Major urban regeneration projects are successfully undertaken using ERDF grant through a number of delivery vehicles such as URCs, local authorities and joint ventures. The set up and administration requirements of a JESSICA investment are of a similar nature to ERDF, but provide more flexibility in the form of investment and type of project into which it can invest. The existing delivery structures have a clear regeneration focus, many potential projects and the experience to deliver. Therefore the implementation of a JESSICA structure through UDFs will complement the existing structures without the need for additional complex organisations. The optimal structure for JESSICA in Scotland is reviewed in section 8.

It is clear that a JESSICA structure in Scotland has the potential to provide many benefits and taking into account the risks associated with a low or nil return, the introduction of eroding revolving fund remains an improvement on the current funding mechanisms where no

repayments are forecast or received. Providing that the national eligibility criteria remain aligned to national objectives and that the investments are made to protect the value of the fund, JESSICA appears to be a complimentary funding mechanism to the delivery of strategic urban regeneration in Scotland.

## 7. LUPS JESSICA eligibility criteria

### 7.1 Highlights

- ▶ LUPS Priority 3 is the axis within which JESSICA may be implemented. Its objective is to focus actions on sustainable development in the urban areas of need.
- ▶ In order to incorporate the recent update to eligibility criteria, it is proposed that amendments are made to the wording Priority 3.
- ▶ The proposed wording was reviewed in line with guidance and in the context of the case studies.
- ▶ The proposed amendments increase the number of projects potentially eligible for JESSICA investment.

### 7.2 LUPS Priority 3

Scotland has well defined eligibility criteria for all axes within the current Operating Programme. However, in response to the calls from the Commission to accelerate the use of Structural Funds, and in order to incorporate the recent update to eligibility criteria, it is proposed that amendments are made. It is intended that these amendments increase the number of projects eligible for structural fund assistance, speeding up delivery of projects.

Priority 3, Urban Regeneration, is the axis within which JESSICA may be implemented. Its objective is to focus actions on sustainable development in the urban areas of need. The eligibility criteria are split to reflect two sets of activities:-

- ▶ Linking urban areas of need with areas of opportunity – by ensuring that people living in less privileged areas can benefit from employment and training opportunities across the region
- ▶ Improving the potential of urban areas to develop – by encouraging enterprise start ups and Small and Medium Sized Enterprises (SMEs)<sup>12</sup>

Under Priority 3 a level of spatial targeting has been implemented to ensure the best use of the limited funds available. Areas are reviewed annually, with eligible local authorities meeting two criteria:

- ▶ the 10 authorities with the biggest share of the worst 15 per cent of deprived neighbourhoods
- ▶ the 7 authorities with the worst incidence of people Not Engaged in Education, Employment or Training (NEET).

The following local authority areas are currently eligible for support under ERDF Priority 3:

**Table 6.1: LUPS ERDF Priority 3 Eligible Areas**

Clackmannanshire	North Ayrshire
Dundee	North Lanarkshire
East Ayrshire	Renfrewshire
Edinburgh	South Lanarkshire
Fife	West Dunbartonshire
Glasgow	West Lothian
Inverclyde	

<sup>12</sup> Lowlands and Uplands Scotland ERDF Fund 2007 – 2013 – Structural funds operational programme

## 7.3 LUPS Priority 3 eligibility

The table below highlights the current and proposed amendments to the Priority 3 wording. The proposed amendments are in bold italics.

**Table 6.2: LUPS ERDF Priority 3 current and proposed eligibility criteria**

Linking urban areas of need with areas of opportunity	Improving the potential capacity of urban areas to develop
Support for locally based job brokerage schemes that aim to match disadvantaged individuals with employment opportunities	Support for <b>development</b> , refurbishment and enhancement of locally based training/learning and e-skills centres <b>(NB the development of training/learning &amp; e-skills will only be allowed if it forms a component part of an integrated urban development plan)</b>
Supporting safe transport hubs to link areas of need with those of opportunity	Support for <b>development and</b> refurbishment of <b>existing</b> facilities and workspace to make them suitable for new or established SMEs (especially those that employ “green design” principles) <b>(NB the development of workspace will only be allowed if it forms a component part of an integrated urban development plan)</b>
Support for investment in increased local access to ICT facilities within communities with the intention of improving skills of local people seeking to re-enter the labour market and increasing access to web based public services	Support for <b>small-scale</b> conversion and adaption to industrial sites and business centres/facilities that offer employment or training opportunities to people living in targeted areas (especially those that employ “green design” principles)
<b>Support for projects that promote clean and sustainable public transport to link areas of need with areas of opportunity. (NB this activity will only be allowed if it forms a component part of an integrated urban development plan).</b>	Support for <b>small-scale</b> energy production from renewable energy technologies in response to local energy needs
	<b>Support for measures that stimulate energy efficiency in multi-family social housing (priority will be given to projects that form part of and integrated urban development plan). Further justification to follow</b>
	<b>Support for projects that invest in the rehabilitation of the physical environment (specifically work around the decontamination and servicing of brownfield land and gap sites but only if it can be demonstrated that the end use of the land is linked to ERDF eligible activity. This activity is eligible only as a component part of an integrated urban development plan and excludes development of public realm unless a reasonable and direct physical link is made with ERDF eligible activity).</b>

### 7.3.1 Comments

The amendments were reviewed in line with the guidance and informed by the case study projects contained within section 4. The following comments are noted:

- ▶ The amended wording increases the number of eligible projects, particularly those in the area of renewable energy.
- ▶ The definition of ‘transport hub’ may require further clarification if it is deemed to require multi modal transport considerations. In light of the current railway station redevelopment projects in Scotland that may benefit from the use of this structural fund, a more appropriate wording may be “safe efficient transport facility”.
- ▶ There are a number of companies interested in using Scotland as a base within which to manufacture the hardware necessary to implement renewable energy supplies, e.g.,

wind turbines, due to its well placed geographical location. In order to benefit from this potential inward investment and further increase the number of eligible projects, reference to 'green design principles' may be amended to 'green design principles or for the use for the use of renewable energy design and hardware manufacture or for support in construction, operation or maintenance of renewable energy projects'

Additional comments on the proposed amendments are:-

- ▶ It may be necessary to update the financial tables in line with the amended wording.
- ▶ It may be necessary to update the target outputs, taking into account the change in scope of eligible projects.
- ▶ Additional information may be required within 'Support for measures that stimulate energy efficiency in multi-family social housing (priority will be given to projects that form part of and integrated urban development plan)' where it currently states 'Further justification to follow'. This may be updated in line with recent Regulation update COM(2008)838 as reviewed above in section 4.
- ▶ The Managing Authority is intending to review the areas within P3 on an annual basis. The Programme Monitoring Committee will consider a proposal that the 13 areas listed as eligible in 2009 will remain eligible to submit integrated urban development plans to a JESSICA holding fund for the rest of the programming period, even if they fall out of the current ERDF P3 spatial targeting criteria. This amendment would allow those areas that have begun to draw up a JESSICA proposal to continue to benefit from the fund where the activity is eligible.

## 8. Structure of JESSICA in Scotland

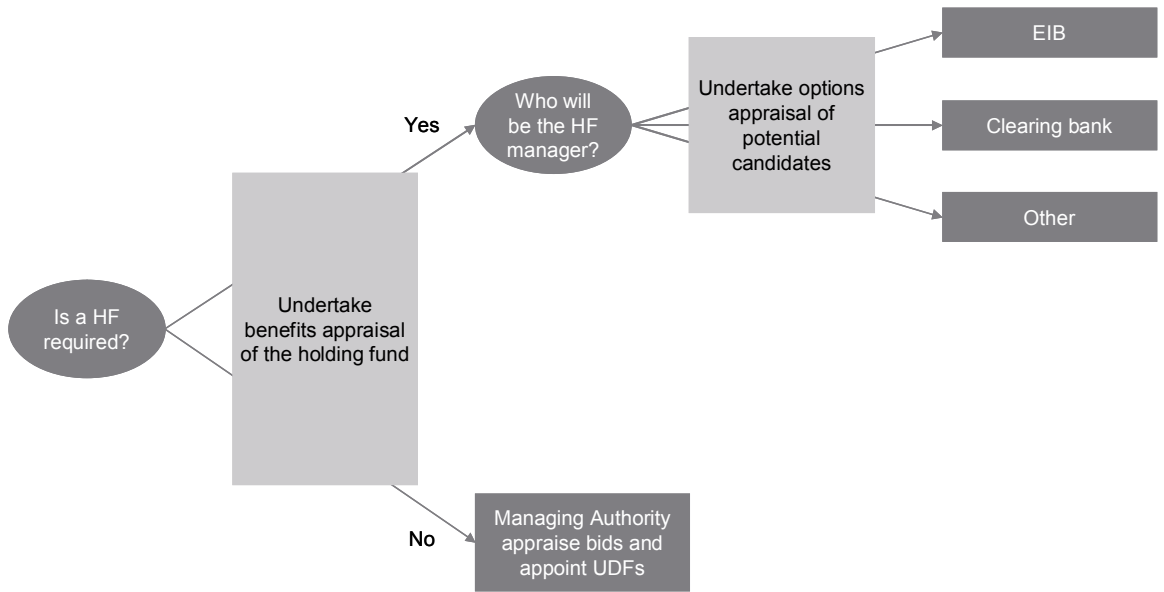
### 8.1 Highlights

- ▶ JESSICA investment is made through Urban Development Funds (UDFs) into eligible projects. The UDFs may be organised through a Holding Fund.
- ▶ It is recommended that a Holding Fund be established in Scotland for the LUPS area. A Holding Fund provides many benefits to the Managing Authority including expertise and treasury management of funds in a single account, but there are challenges including the administration required in set up and the cost of a dedicated Holding Fund Manager.
- ▶ The Holding Fund Manager is appointed by the Managing Authority to manage the investment portfolio in line with the Funding Agreement. A range of financial institutions have been considered for the role, with EIB recommended as the preferred option.
- ▶ It is recommended that an Investment Board is set up to work with the Holding Fund Manager, providing independent expertise and support. The membership of the Investment Board will be by Ministerial appointment and is likely to be subject to the public appointments guidelines in Scotland.
- ▶ A UDF is required to be an 'independent legal entity' able to loan money and it is therefore anticipated that local authorities and charities would not be appropriate vehicles to act as UDFs. The UDF's operations in relation to JESSICA are governed by agreements between the partners and a Funding Agreement with the Holding Fund and Managing Authority.
- ▶ A Holding Fund Manager may be required by the Managing Authority to procure a UDF ready made, or combine projects into a UDF of its choice. A range of options were considered, with the former option involving the use of existing regeneration structures recommended as the preferred option.

### 8.2 The Holding Fund

The Holding Fund is an optional step in the set up of a JESSICA structure, and the Holding Fund Manager may be a number of financial institutions. The decision process for the adoption of a Holding Fund in Scotland is represented in the decision tree below.

**Diagram 8.1: Holding Fund decision tree**



This section assesses the two key questions shown in the decision tree.

## 8.3 Benefits appraisal of the Holding Fund

### 8.3.1 Advantages

There are many benefits of creating a Holding Fund, and these are maximised where the co-financing can be placed into the Holding Fund on inception in order for the JESSICA element to be secured. These benefits are summarised below.

**Table 8.2: Financial benefits**

Earning power of the Fund	Where the full contributions are deposited in the Fund on inception, interest will be earned until they are deposited with UDFs for investment. This income can be used to contribute towards national investment or as payment to the Holding Fund Manager. For example, on a total Fund of £62.5m, this would provide an additional income of £1.875m per annum at an interest rate of 3%.
Attracting private sector investment	The creation of a Holding Fund demonstrates a national commitment to the programme that may attract other investors, maximising the leverage of the initial investment. In a turbulent economic climate, investor confidence is an important factor.
Managing Authority value for money	Although the Managing Authority currently appraise regeneration business cases and grant applications, the internal resource required to support a large investment fund without a Holding Fund Manager is likely to incur additional cost for personnel and technical back office loan systems. These costs are likely to be fixed for a period of time or require long term contracts. The Holding Fund offers a flexible pricing mechanism dependant on the level of support required and clear exit provisions for the future.

**Table 8.3: Non financial benefits**

Single LUPS Fund	The Holding Fund would create a single fund responsible for long term investment dedicated to sustainable urban development. This is currently not available in Scotland. A fund could be added to or scaled up over time if it proved successful.
Speed project delivery	The set up of a Holding Fund enables draw down of JESSICA funding to a national level before a UDF is identified. This will reduce the time taken to direct money into the UDFs once it is approved, speeding project delivery.
Available expertise	The appointment of an experienced Fund Manager dedicated to the LUPS will provide the Holding Fund with private sector expertise. In addition, where a Holding Fund institution is procured that has previous JESSICA experience, this will be a benefit to the programme through their understanding of the process and "lessons learned".
Limited structural change to MA	The Holding Fund requires no change to existing Managing Authority Structure, except for the appointment of an Investment Board. If a Holding Fund was not put in place and the Managing Authority undertook the due diligence and investment appraisal alone, it is likely that additional resource teams and associated processes would need to be set up.

### 8.3.2 Disadvantages

The challenges of setting up and governing any new structure should not be underestimated as they may add considerable time or cost to the delivery of regeneration objectives. The potential disadvantages of the Holding Fund are summarised below.

**Table 8.4: Financial disadvantages**

Running costs	<p>The cost of running the Holding Fund is governed by the Regulations and may not exceed, on a yearly average, any of the thresholds below for the duration of the assistance, unless a higher percentage proves necessary after a competitive tender:</p> <ol style="list-style-type: none"> <li>2% of the capital contributed from the operational programme to holding funds, or of the capital contributed from the operational programme or holding fund to the guarantee funds;</li> <li>3% of the capital contributed from the operational programme or the holding fund to the financial engineering instrument in all other cases, with the exception of micro-credit instruments directed at micro-enterprises;</li> <li>4% of the capital contributed from the operational programme or the holding fund to micro-credit instruments directed at micro-enterprises.<sup>13</sup></li> </ol> <p>These rates are applicable to contributions from the operational programme to holding fund. If Priority 3 is expressed in total cost within the funding agreement, this will include the EC and national public funds, as well to private funds.</p> <p>The actual thresholds for Scotland will depend on the timing of contributions into the Holding Fund and then onto the UDFs. Assuming an initial £25m JESSICA contribution into the Holding Fund, this would result in a threshold of £500,000 for that year.</p> <p>The funding agreement may be structured to front-load payment of management costs for future years which exceeds the limits set out above. This is acceptable as long as the thresholds are not exceeded on an average yearly basis.</p> <p>The Commission expects the Managing Authority or Holding Fund to negotiate management costs in accordance with the principles of sound financial management. It recommends that the Funding Agreements link the remuneration to the amounts which will finally be actually invested, loaned or committed as guarantees to enterprises. Linking eligible management costs to the volume of finance contributed from operational programmes and finally disbursed to or committed for guarantees to enterprises, would create an incentive for holding funds and UDFs to be active in promoting development and expansion of enterprises and in particular SMEs.</p> <p>The Commission does not state what costs may constitute eligible costs, however the following have been granted previously:<sup>14</sup></p> <ol style="list-style-type: none"> <li>Staff costs, including travel and subsistence expenses, the cost of offices, equipment, IT systems, consumables and supplies, directly linked to the management and investment of contributions from operational programmes to financial engineering instruments and holding funds; such costs being incurred in carrying out activities such as selection and tendering procedures, controls, monitoring and reporting, consultancy, information and publicity.</li> <li>Overheads of the financial institution acting as a financial engineering instrument or holding fund in the management and investment of the contribution from the</li> </ol>
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<sup>13</sup> Council regulation EC No 1083/2006 of 11 July

<sup>14</sup> Commission services replies to the questions submitted by the JESSICA expert working group of the Council Question 9

operational programme.

As detailed in the benefits section, this cost may be covered by the interest earned on the fund.

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Co-Financing at Holding Fund level	In order to draw down the JESSICA funding, match funding must be demonstrated. Therefore, in order to maximise the benefits of a Holding Fund, it would be required to demonstrate co-financing at a Holding Fund level. This would require approximately £37.5m of cash or other assets on inception, based on a £25m JESSICA contribution and a 60/40 co-financing rate. This is likely to be a challenge. Alternative options are discussed in section 8.
Exchange rate risk	It will be the job of the Holding Fund Manager to manage foreign exchange risk, for example by hedging.

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**Table 8.5: Non financial disadvantages**

Set up requirements	Holding Funds must be set up as independent legal entities governed by agreements between the co-financing partners or shareholders, or as a separate block of finance within a financial institution governed by the Funding Agreement. Where the Holding Fund is established within a financial institution, it must be set up as a separate block of finance and kept in a separate account from those initially available in the institution. The documents required to be set up between the parties are detailed in section 4. It is likely that this be time consuming projects and a potentially costly process for the Managing Authority.
Selection of Holding Fund organisation and Holding Fund Manager	The selection of a Holding Fund is potentially time consuming and costly for the Managing Authority. However, as detailed in section 8, the appointment of the EIB may be done without a public procurement process.
Preparation of Funding Agreement & other associated documents	The preparation of necessary agreements is likely to add additional time into the programme. This cost will be borne by the Managing Authority. However, the content of the documentation is governed by the Regulations and the Holding Fund Manager may be willing to share best practice from other countries. Therefore it is anticipated that there would be limited negotiation required. Where negotiations are required with stakeholders, for example Ministerial approval on the agreement of investment criteria or winding up provisions, it is likely that the Managing Authority would be required to go through a similar internal process if it were to take ownership of the fund itself and appraise UDF business plans directly.
Perceived loss of control by the Managing Authority	The role of the Holding Fund Manager is to provide an arms length appraisal of potential projects. This appraisal is based on criteria contained within the Funding Agreement with the Managing Authority. The Holding Fund would report its assessment findings to the Investment Board, containing Managing Authority representatives with the power to veto its recommendations. Therefore, it can be concluded that the Managing Authority would retain control over any investment decisions as if it were making them itself.

The conclusion of the benefits appraisal is that provided it can be capitalised on inception, a Holding Fund should be set up to deliver JESSICA in Scotland.

### 8.3.3 Holding Fund Manager candidate options appraisal

A range of financial institutions were consulted and appraised on their ability and appetite to act as Holding Fund Manager or invest in a Scotland JESSICA structure:

- ▶ EIB
- ▶ Four Clearing Banks
- ▶ West of Scotland Loans Fund

Interest in the role was low from the West of Scotland Loans Fund who stated that JESSICA was on a larger scale than their current business lending to SMEs. They would not wish to take on the role of Holding Fund Manager as this would remove the focus from their core business. Three of the clearing banks, HBOS, Clydesdale and Royal Bank of Scotland did not have the resources nor the appetite to act as Holding Fund Manager or invest in the scheme at the current time. They considered the scheme would be too small to fit with their current strategy. Interest in acting as Holding Fund Manager was high from EIB and Barclays who have provided expressions of interest in writing. Barclay expressed a wish to have further discussions in relation to the role following the initial decisions by the Steering Group.

A summary of this appraisal is shown in the table below:

**Table 8.6: Options appraisal summary of potential Holding Fund Managers**

		Option		
		European Investment Bank	International Clearing Bank	National Loans Fund
Appraisal Criteria	Interest in taking the role as Fund Manager	High	Medium	Low
	Cost associated with the role	Medium (c£2m)	Medium (c£2m)	N/A
	Understanding of JESSICA	High	Medium	N/A
	Relationship with EC	High	Low	N/A
	Local knowledge	Low	High	N/A
	Procurement process	N/A	EC Rules (likely OJEU)	N/A

Whilst Barclays have a high local knowledge of Scotland, with offices in Edinburgh and Glasgow, their experience in JESSICA and with the Commission is limited.

By contrast, EIB have a high level of experience in JESSICA and in dealings with the Commission. They are currently preparing Funding Agreements with other countries and it would be assumed that this best practice could be shared with Scotland. They have no current local presence, but have acknowledged a possibility for personnel to be based in Scotland. Through their increased knowledge of Scotland and its regeneration projects, the potential for EIB to invest in these projects may also increase. EIB have informed ESEP that they would undertake the Holding Fund Manager role on a not for profit basis and due to the recent change in regulations, the cost of appointment would be minimal as no OJEU process is required.

The conclusion of the candidate options appraisal is that assuming the necessary documentation can be negotiated effectively with EIB and the pricing structure is confirmed in writing, EIB should be appointed as Holding Fund Manager.

### 8.3.4 Investment Board

EU Guidance does not set out any requirements of any role other than a Holding Fund Manager within the JESSICA structure. However, it is recommended that an Investment Board is set up to provide support to the Holding Fund Manager and review any investment decisions.

The Investment Board should be made up of technically competent members with a strong that have an understanding of the LUPS area, the ERDF programme objectives and current economic development projects in Scotland, including property. The members should have a strong commercial and financial understanding of project appraisal and should not be limited to public sector bodies.

The role of the Investment Board will be detailed in the Funding Agreement with the Holding Fund and negotiated with the Holding Fund Manager to ensure that it provides the necessary skill level and ability to compliment the investment process. The following responsibilities should be considered:

- ▶ Assistance in the preparation of the investment strategy and policies contained within the Funding Agreement
- ▶ Technical expertise and support to the Holding Fund Manager
- ▶ Business case preparation assistance to the UDFs as necessary
- ▶ Review of the Holding Fund Manager investment decisions

## 8.4 The Urban Development Funds

### 8.4.1 Structure of the UDF

The structure of the UDFs will differ in terms of their size, diversification, availability of funding sources and integration with existing structures. UDFs are required to be independent legal entities governed by agreements between the co-financing partners or shareholders or as a separate block of finance within a financial institution. The requirement of the UDF to be an 'independent legal entity' has been interpreted by the EIB to mean that it is not possible for a Local Authority to be a UDF, but that a URC would meet this criterion. The UDF must be legally mandated to receive and onward invest funds. Dependent on the structure of the UDF and the type of investment that it makes into a project, if it is deemed to be acting as an investment fund under FSA regulations the UDF may be subject to FSA monitoring. It would be expected that the detailed agreements could be drawn up in such a way as to avoid the necessity of FSA regulation.

There are two options for the Managing Authority when considering the use of the UDFs within a JESSICA structure:

1. Managing Authorities request bids from projects and allow the Holding Fund Manager to create appropriate UDFs – i.e. the Holding Fund Manager procures a project
2. Managing Authority request open bids from pre formed UDFs – i.e. the Holding Fund Manager procures a UDF

Scottish regeneration and development is delivered through a wide range of legal structures – URCs, limited companies and Local Authorities.

How the UDFs should be organised is dependant on the characteristics and the level of risk of the project investments being financed. The UDF structure may be dictated by the Managing Authority on a number of bases, including:

- ▶ Geographical – restricted to a certain area within the Operational Programme, for example within Local Authority boundaries
- ▶ Thematic – restricted to complimentary project types, for example transport or renewable energy
- ▶ Legal Form - restricted to a specific organisation type, for example Urban Regeneration Company or subsidiary of a Local Authority

In Scotland, an existing structure of long term regeneration and development vehicles is already in place. As can be seen in the case studies, the potential projects into which the Holding Fund may invest are varied and cross sectors. Therefore, it is likely that the option to create multiple UDFs would be the preferred option in Scotland and these could be aligned to fit with the existing regeneration structures, reducing cost and duplicity of work.

The bundling of projects into some configuration other than that currently in place is not only likely to require increased set up costs and complex governance arrangements, but may also impact on the accounting policies of the stakeholder organisations. A thematic UDF may be

possible for complimentary projects such as renewable energy or transport, however these would require further consideration. At the time of writing, discussions are ongoing with transport stakeholders to assess the feasibility of a transport-specific UDF which might bid into the Holding Fund. The case study organisations confirmed that while in principle they would be willing to discuss a thematic UDF or a wider geographical UDF across local borders, this would be more complex and require further due diligence to assess implications.

The preference for supporting existing structures was reflected within the case studies, where it was noted that the necessary governance and reporting procedures are already in place. Most existing organisations also have previous experience in preparing business cases and applying for European investment from the Structural Funds.

It is therefore recommended that based, on the information available, the Managing Authority does not procure projects or dictate the UDF structure, but invites bids from UDFs. This will allow the use of existing structures and partnerships as well as the potential to create new ones that will form UDFs to fit with known integrated urban development plans. This should not prevent the sharing of best practice across UDFs, or the bundling of sector specific projects within that area, but builds upon existing structures and experience.

Where the Scottish Government or other relevant bodies consider a strong case can be made for one or more thematic UDFs, these could also be developed over the coming months and bids submitted to the Holding Fund Manager for assessment. Examples may include a railway station improvement UDF or renewable energy UDF which invest in similar projects across Scotland. These bids would, however, be competing with geographical UDFs. The requirement for a UDF to be an independent legal entity with a robust governance system and its own administration adds bureaucracy to the process.

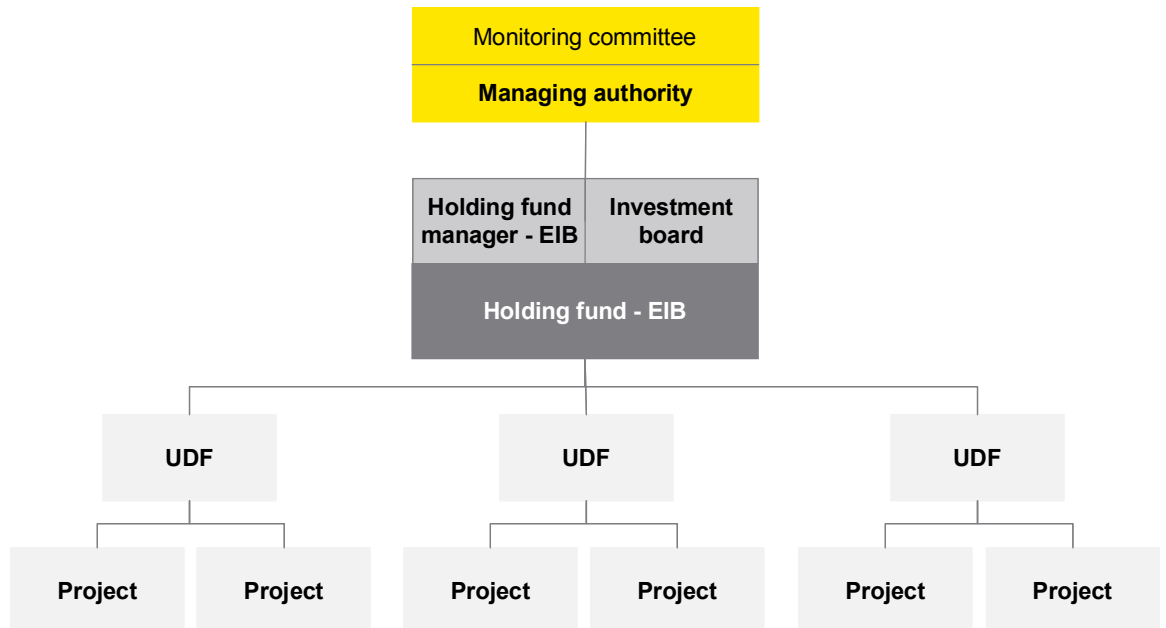
Most geographical based programmes include transport and renewables projects already led by local partners. Any cross-cutting sectoral UDF would need to align its investment plans and timescales with those of local partner bodies which could be a complex exercise. For example, a national station development UDF would need to ensure its investment plans in Dundee support and complement those of adjacent schemes on the waterfront, the phasing and sequencing of which are the subject of detailed plans and management processes controlled by the local partners. For this reason the expectation is that it is likely in practice to be more efficient for local delivery bodies to manage local projects. These bodies generally already have well-developed governance processes and administration systems in place.

It is believed that by procuring UDFs, existing regeneration and development delivery vehicles within Scotland could be used. In most eligible local authority areas, one or more potentially appropriate vehicles already exist. Where they do not, the steps required to create such a vehicle should not be onerous for local partners. Using existing structures minimises set up costs and utilises governance processes already in place. By restricting the UDF to the particular areas in which they have accountability for the delivery of their urban development plan, accountability for the JESSICA investment will be at the core of their organisation. As shown in our case studies, the existing urban development plans contain many projects that could deliver early actions for JESSICA, with many having identified local partners that could assist in the delivery of their vision. With the necessary guidance, they are prepared for a fast response to the JESSICA call, speeding delivery and therefore benefits of the projects.

## **8.5 Recommended structure of JESSICA in Scotland**

Based on the appraisals undertaken within this study, and assuming that the Holding Fund can be capitalised, the following structure is recommended for LUPS with EIB as Holding Fund Manager, appraising UDFs that are developed locally and not dictated by the Managing Authority to make use of existing regeneration delivery vehicles in Scotland.

**Diagram 8.7: Recommended JESSICA structure in Scotland**



This structure is based on strengthening and supporting the existing regeneration models in place in Scotland; some of which are still relatively new and in the early stages of their work. Allowing these organisations – which would include the URCs and other local delivery vehicles – to bid to become UDFs is the most practical response to the Commission’s guidelines on JESSICA structure and will avoid the creation of a new tier of beaurocracy.

## 9. Capitalisation of the Holding Fund

### 9.1 Highlights

- ▶ In order to draw JESSICA funding from the Commission, match funding must be demonstrated. This match funding may occur at two levels where a Holding Fund is formed – at Holding Fund level or at UDF level.
- ▶ Match funding at Holding Fund level provides many benefits, including increased speed of delivery, simplicity for the UDFs and enabling a strategic investment process rather than introducing bias based on supporting only those UDFs that can provide match funding.
- ▶ If match funding cannot be found to capitalise the Holding Fund, then the most obvious alternative would be to introduce match funding as a criterion which bidding UDFs would have to satisfy. The outcome of this process would not be known until a bid round was completed, leaving the risk that insufficient match funding might be raised nationally to access the full ERDF amount. During this time, interest on the potential £25m ERDF would be lost as it could not be drawn into the Holding Fund in the interim. This lost interest could amount to several hundred thousand pounds.
- ▶ Co-financing at Holding Fund level may be provided by cash or assets from either the public or private sector. Using the current co-financing rate within Priority 3 of 60/40 and an assumed JESSICA contribution of £25m, this would require cash or assets to the value of £37.5m. Under the rules of ERDF, an advance of the £25m will also be needed from the Scottish Government or other public body. This can then immediately be reclaimed from the Commission.
- ▶ No appetite among those private investors (several financial institutions) met with over the course of the study was found for match funding at Holding Fund level. It is therefore recommended that forms of match funding be explored by the Scottish Government in order to set up a Holding Fund.
- ▶ Assets put into the Holding Fund may be substituted for other assets or cash in future years, or used within the UDFs as a contribution in kind. They must be valued appropriately and restrictions may be placed on them while they are in the Fund. There was some interest from the public sector in providing these assets, with the possibility of substituting for cash proceeds on disposal or alternative cash funds. However, the low value of land and property assets in most regeneration area makes this approach problematic in practice.
- ▶ We therefore conclude that, while assets can be used as match funding, this is an unsatisfactory alternative to cash unless these assets can be turned quickly into cash or have a significant value and happen to coincide with the UDFs being funded. Introducing bias in the selection of UDFs based on those which have land assets undermines the independent ability of the Holding Fund Manager to act strategically in selection of UDFs.
- ▶ Capitalising the Holding Fund with cash would be the preferred option, but Scottish Government regeneration budget cash within this spending round is allocated and there appears to be minimal private sector interest. The Big Lottery Fund has expressed an interest in contributing some level of cash contribution and discussions are ongoing in this regard.

### 9.2 Match funding at Holding Fund level

Where the Holding Fund is capitalised on inception of the programme, the whole programme will benefit due to:

- ▶ Creation of a cost neutral Holding Fund – the interest earned on the unutilised monies in the fund can be used to contribute towards Holding Fund management costs
- ▶ A strategic approach to investment – as the most worthy investments can be made without introducing distortions based on who has access to match funding
- ▶ Increase in the number of eligible projects – as projects that do not have the required match funding will become eligible
- ▶ Creation of a ringfenced investment fund within Scotland for regeneration
- ▶ Simplification of the process for UDFs – as UDFs not required to demonstrate match funding or raise additional finance and can leverage additional investment from the private sector
- ▶ Accelerated project delivery – as the money is available for immediate investment in UDFs

### 9.3 Holding Fund capitalisation requirements

Assuming a co-financing rate of 60% and an anticipated JESSICA contribution of £25m, the Holding Fund would require to demonstrate £37.5m in match funding. The £25m would initially also need to be contributed by the Managing Authority or other national body but can be reclaimed almost immediately from the Commission. This timing difference will require an advance of £25m from the Scottish Government or other public source, which will be repayable, typically within around three months.

The match funding was initially understood to be a cash requirement. However, in November 2008 the Commission confirmed that in the case of the UK, as set out by BERR, that land and premises may be contributed to a UDF or Holding Fund as national co-financing. This was then included within the April 2009 update to the Regulations.

The regulations permit in-kind contributions to operations, however while it may be declared as eligible expenditure, it is only payments from UDFs for investment into projects that will be eligible at closure.

Article 46 of Regulation (EC) No 1828/2006 states what can be considered a 'payment by an urban development fund', namely that 'urban development funds shall invest by means of equity, loans or guarantees'. Therefore a contribution in kind must be used as an investment if it is to satisfy as eligible expenditure at the end of the programme.

The Regulations do not specify how land or premises contributed to a UDF can be 'turned into' investments by means of equity, loans or guarantees, and the Commission have stated that this is a matter for Managing Authorities and UDFs to decide. This may be done through the Holding Fund using land as collateral to raise cash to pass onto the UDFs in an eligible way, to exchange land for shares of equivalent value in the UDF or through disposing of the land to raise funds.

It is not necessary to transfer title of the assets to the Holding Fund, but it is necessary for the Funding Agreement to contain detail on the agreed restrictions placed upon the assets while they remain within the Holding Fund as co-financing. These restrictions are likely to include development and disposal; that is, any activity that would adversely affect the potential value of the Fund.

The current use of the asset and the level of contribution made into the Holding Fund will be an important part of the valuation. For example, transfer of ownership and the transfer of short term right to use the land will require different valuation. Although all public sector organisations use formalised valuation methods, such as the Royal Institute of Chartered Surveyors Red Book, the value associated with many assets held for disposal or

regeneration is low and there are likely to be considerable challenges in raising the full match funding amount, even if there is a willingness to contribute assets. For example, the main land asset for use in the key project identified for JESSICA in the Clyde Gateway case study is valued at only £86,000. In many regeneration projects the value of land assets is negative, reflecting the need for subsidy to be provided before they can be developed.

The Commission have stated that the manner in which the portfolio is contributed should not prejudice the subsequent investment by the UDF. Therefore, the assets used to initially capitalise the fund may be substituted for more relevant assets as necessary. The deadline for eligible spend is the end of 2015, and it would be required to make these substitutions in a timely manner in order to meet this.

## 9.4 Availability of Match Funding

The study team met with the following organisations to review what contribution can be made to the Holding Fund as either cash or assets:

- ▶ Scottish Government – Estates
- ▶ Scottish Government – Regeneration
- ▶ Scottish Enterprise
- ▶ Clearing Banks

### 9.4.1 Capitalisation using cash

Capitalisation using public sector cash is the simplest option. It provides certainty and allows a top down strategic approach to investment without prejudice or pre selection of projects.

There are a range of current funding streams for regeneration projects from the Scottish Government and Scottish Enterprise, but these are currently sources of grant funding. A cash match for JESSICA is likely to be over and above this grant funding and there is currently no cash in this spending round that remains unallocated and could be diverted into a Holding Fund. However, there are possibilities that future spending could be diverted into the JESSICA Fund. The investment nature of JESSICA would benefit the government in future years by increasing the funding available for regeneration.

### 9.4.2 Capitalisation using assets

Discussions were held with the Property Advice Division of the Scottish Government and with Scottish Enterprise to update them on the JESSICA study and pursue any opportunities identified for them to contribute assets into the Holding Fund as co-capitalisation.

Three proposals were discussed:

- ▶ Option 1 – the assets put into the Holding Fund would be those assets held for disposal, with the sale proceeds remaining within the Holding Fund to be invested in the UDFs.
- ▶ Option 2 – the assets put into the Holding Fund would be substituted in the future with either cash or other assets.
- ▶ Option 3 – the assets put into the Holding Fund were used by the UDFs to invest in projects as a contribution in kind.

#### Option 1

It was noted that there is a duty for those parts of the Scottish Government which hold property to continually review their property holdings and to ensure that they hold only that

which is required for present or future planned needs. Property deemed to be surplus to requirements is to be disposed of. As this is a continual process, the Scottish Ministers do not have a substantial bank of surplus properties ready for disposal.

The challenge faced in Option 1 is that both organisations are governed by the Scottish Public Finance manual (“SPFM”), containing guidance on the sale and gifting of assets. The SPFM obligates all Public Sector bodies in Scotland to obtain at least market value for assets being sold. To the extent that an asset is sold at less than the market value, this is classed as a gift and there is a charge against the revenue budget.

Where Scottish Ministers dispose of assets at less than market value, the difference is deemed to be effectively a subsidy given to the purchaser by the vendor. It was noted that although a number of assets are legally those of the Scottish Ministers, they are held on different ‘accounts’ e.g., NHS, Scottish Water and it would be those bodies giving the subsidy. Those bodies may have no remit for subsidising the body which benefits and this would be to the detriment of their own business, for example in the NHS, reducing the sum it has available to re-circulate into the provision of healthcare.

Scottish Enterprise has an active acquisition and disposal strategy and were interested in discussing how these assets may be used to capitalise the Holding Fund in order to contribute towards their own regeneration objectives.

This option would require further discussions with both organisations to further understand the potential impact, and may require an amendment to the SPFM.

### **Option 2**

The challenge presented by Option 2 is the level of restrictions placed on the assets while they are temporarily in the Holding Fund, and the risk associated with not finding suitable alternatives with which to substitute them.

The Scottish Government did not feel that it had suitable assets available for this option, due to the low number of unused assets, or those upon which it would place restrictions.

Scottish Enterprise was interested in further discussions on this option and would may also look to contribute an element of their own regeneration fund in the future as a substitute for assets.

### **Option 3**

The Scottish Government do not believe they have appropriate assets available to be used within JESSICA eligible projects.

Scottish Enterprise is aware of a number of assets they currently hold that could be used for eligible JESSICA projects. Currently this land is sold into the regeneration projects at market price and therefore they would be interested in further discussions on this option.

## **9.5 Match funding at UDF level**

If match funding is not possible at Holding Fund level, it will be necessary to demonstrate that the co-financing amount is available at UDF level before the JESSICA contribution can be drawn. This is similar to the requirements to demonstrate match funding before traditional grant is applied for. It would also reduce the amount of repayment required to the JESSICA fund as the contribution would also reduce.

Based on the case studies, this option is likely to be hard for those UDFs without a significant cash/grant budget as the value of land held is minimal and there is a distinct lack of cash available to provide match without diverting it from other projects. The requirement of match funding at UDF level may lead to pre selection of projects, ie those with available match, or require an amendment to the eligibility criteria.

Where the UDF does not have assets and these assets are held within the Project Co, further complications arise. Eligible expenditure is considered to be the investment from the UDF into a project. Therefore, the Project Co would be required to invest in the UDF with its asset in order to provide the UDF with the asset to meet the eligible expenditure criteria. Project Co will then have two relationships with the UDF – one as investor and one as beneficiary. The investment into the UDF would be repaid to Project Co as investor when Project Co beneficiary repays.

Where the UDF has a single project this may be a complex method of achieving match at UDF level, but it poses limited additional risk to the Project Co as it is effectively investing in itself and the value of the asset washes through. However, where the UDF has multiple projects, the Project Co investment in the UDF is exposed to the risk of other Project Cos failing and not making a return. This would result in Project Co effectively paying for the asset twice – one through the JESSICA investment from the UDF and secondly as the initial investment into the UDF that received nil return.

Match funding at UDF level may be possible in some cases, but comes with several key drawbacks:

- ▶ Uncertainty that match funding can be raised at local level until the bidding process is run.
- ▶ Introduction of bias into project selection based on those projects which have match funding, rather than funding the best candidates.
- ▶ Complexity of restructuring transactions and funding agreements locally to align with JESSICA Holding Fund / UDF / Project Co tiers and structure.
- ▶ Reduced national impact due to smaller Holding Fund – project sponsors may conclude that the amounts available are too small to merit a time consuming application and may focus on securing grant instead.
- ▶ Management efficiency - the EIB has expressed some reservations about the efficiency of establishing a Holding Fund with no match funding. The inability to draw down ERDF in the interim would mean that interest income would be foregone and other resources would have to be identified to pay for the Holding Fund Manager.

## 9.6 Conclusion

It can be concluded that the benefits associated with capitalising at Holding Fund level outweigh those for demonstrating match funding at UDF level, and that an injection of cash would be the most effective solution.

Unfortunately, no clear source of public sector cash has been identified in the current year to take this option forward. However the provision of assets on a temporary basis to capitalise the fund and draw down the JESSICA contribution, followed by substitution of future public sector cash or assets to be used within the projects is a workable solution. This would be a decision for the Managing Authority and the Scottish Ministers in the context of future budget planning.

Match funding at UDF level has also been considered, and while it is not possible to rule this out as an approach, there are a significant number of drawbacks, in particular the reduction in scale of the fund. Establishing JESSICA requires a fund of scale to make the set up and ongoing administration costs worthwhile. The EIB has indicated that a fund of £50m - £60m is at the smaller end of the range in European terms. Reducing this further by failing to provide match would call into question the appropriateness of adopting JESSICA. The key benefits of JESSICA such as recycling receipts would be lost, although alternatives might involve allowing large-scale projects to access larger grant sums by widening ERDF criteria. There are questions, however, as to the EC's willingness to allow expanded eligibility criteria for regions which do not adopt JESSICA.

## 10. Project selection

### 10.1 Highlights

- ▶ The selection of UDFs and their projects within which the JESSICA fund should invest will be a defining factor in the success of the fund as a revolving facility. Consideration will be required of many variables to ensure that the fund manager is provided with viable opportunities for investment that appropriately spread the risk and returns across the programme.
- ▶ There will be two aspects to project selection – EU and national project eligibility as reviewed in section 8 and financial investment appraisal to assess the potential for repayment and returns.
- ▶ Three methodologies were reviewed that could be applied to assessing the projects with varying level of Holding Fund Manager support. The preferred option is an open call for bids being shortlisted based on eligibility criteria and then more detailed proposals being developed by bidding UDFs. This is similar to a Competitive Dialogue approach where a pre-qualification stage is followed by a shortlisting and more detailed proposal being developed.
- ▶ The evaluation criteria for the initial sift (or pre-qualification) stage should be confirmed by the Managing Authority in conjunction with co-funding partners. These will include the six core JESSICA criteria identified on page 24. However, additional criteria should be added at this stage tailored to the LUPS context. These are likely to include evidence of alignment with Regeneration Outcome Agreements, the Scottish Government Economic Strategy and partnership working at local level.
- ▶ At the second stage, the investment criteria for detailed business plans should be based on a number of factors that will be provided in the UDF submission to the Holding Fund Manager. These should reflect business plan best practice and cover issues such as strategic fit, outcomes delivered, financial profile, delivery method, timescales, risk management and governance. Guidance should be provided to shortlisted UDFs on the subjects to be addressed in detailed submissions. It is preferable that the measures and assessment weightings for these criteria are not set in stone, but a degree of flexibility is allowed to ensure a balanced judgement across the submissions.
- ▶ The types of organisations who are likely to bid for JESSICA as UDFs will include URCs and other regeneration vehicles. These bodies are accustomed to developing business plans. Any further support required to write these business plans should be resourced by these bodies. The Holding Fund Manager can provide support in the form of guidance and comments to ensure bids are as strong as possible; again parallels can be drawn with a Competitive Dialogue approach.

### 10.2 Defining the investment criteria

Assuming that a Holding Fund is set up and capitalised at the start of the programme, the Holding Fund Manager will assess all bids from the UDFs for JESSICA funding. These bids will be assessed using criteria agreed with the Holding Fund Manager and detailed in the Funding Agreement as described in section 4.

There will be two stages of project selection:

- ▶ Eligibility – assessing if the UDF and proposed project is eligible to receive JESSICA funding on the basis of European JESSICA criteria and national eligibility. These were reviewed in section 8, although further eligibility criteria based on fit with national policies are likely to be required as part of this stage of project selection.

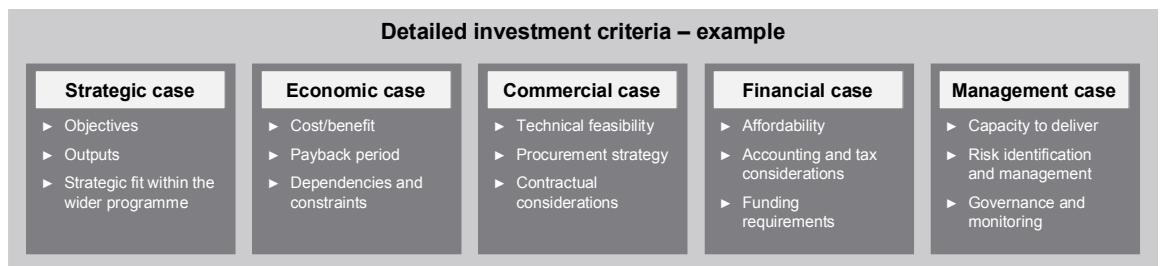
- ▶ Investment – assessing if the UDF and proposed project(s) will repay and / or provide returns, create the greatest regeneration impact and provide confidence over delivery.

The investment criteria should allow the Holding Fund Manager the necessary flexibility to appraise projects not only against static criteria, but against each other or projects that have already been approved.

There are a number of criteria that will be essential to the selection of a project, and those that would be preferred. Where there are criteria with varying importance, these should be ranked and weighted accordingly. These weightings may require to be updated at each call for bids, to represent the requirement of the fund and the projects that are underway. For example, if a call for bids is done in 2014 and Project A is submitted that has a potential high return, but a risk that the money cannot be spent by 2015, it may be more appropriate at that time to fund Project B that has a smaller return but scores highly on readiness to deliver. Project B may then be funded once the initial eligible spend date has passed.

It is likely that the UDFs and proposed projects will have very different characteristics. The type of characteristics that may be relevant to the investment decision, and should therefore form part of the investment criteria, should be available within the business plan submitted by the UDF. Some areas for consideration, based on standard practice guidance in the assessment of business cases are shown in the diagram below:

**Diagram 10.1: Potential investment criteria considerations**



While this is common good practice in business case preparation, our case studies indicate that the potential UDFs would benefit from knowing the final criteria clearly in advance to ensure that they prepare the most appropriate business plan and application.

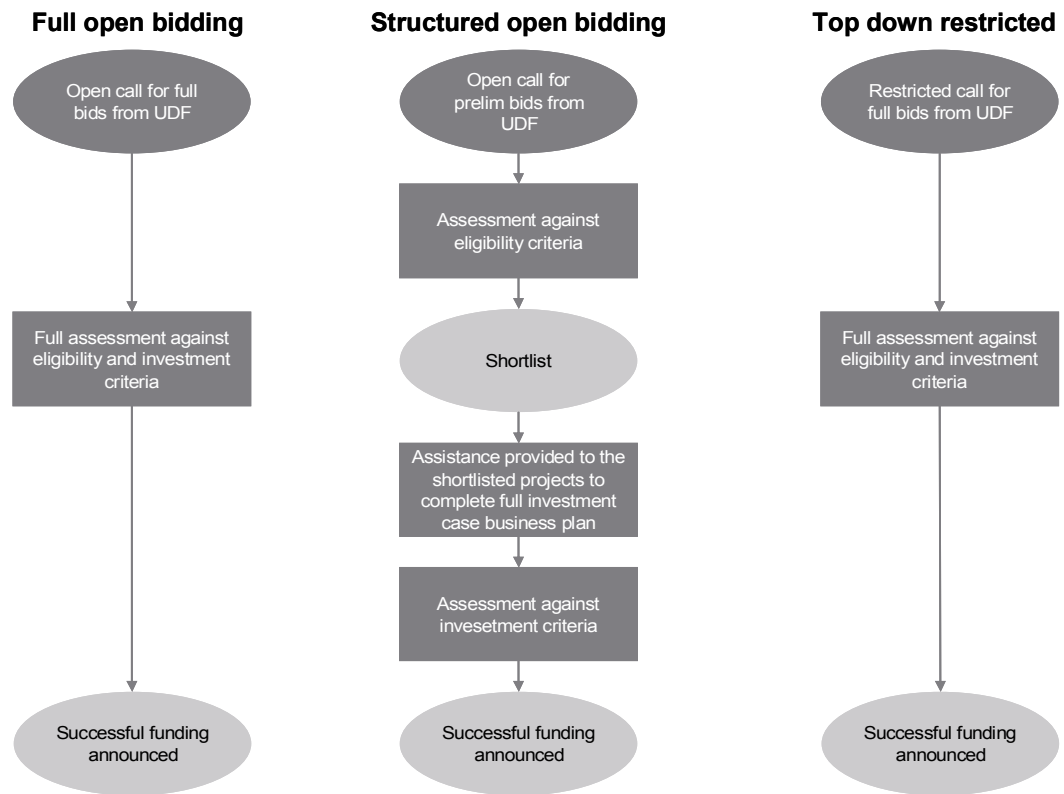
### 10.3 Methods of project selection

A transparent procedure for the selection of UDFs and for taking decisions on contributions from operational programmes to them should be applied. This selection procedure should be based on specific and appropriate selection criteria relating to the objectives of the operational programme, criteria which should be approved by the Monitoring Committee.

Three methods of project selection have been reviewed with all assuming that a Holding Fund Manager is instructed to start the call to procure UDFs, evaluate in accordance with the agreed criteria and present recommendations to the Investment Board. Each option reflects a varied involvement from the Holding Fund Manager, with corresponding support for the UDFs.

The options are summarised in the diagram below.

**Diagram 10.2: Delivery options of project selection**



It should also be noted that the Holding Fund Manager is required to examine whether the contributions from operational programmes to the UDF would correspond to public procurement of services governed by the EC or national public procurement law. Where this is deemed to be the case, the Holding Fund Manager should act in accordance with applicable Community and national rules which may require a procurement process to be followed outside of these options.

Top down restricted bidding allows the Managing Authority to pre select particular projects, UDFs or geographic areas. This does not meet with the Steering Group requirements and was therefore discounted.

Full open bidding requires the UDFs to produce full business cases for evaluation without any input from the Holding Fund or opportunities for modification. The evaluation of multiple, large documents will present an intense resource requirement from the Holding Fund Manager. Past experience of similar processes indicates the quality of submissions will be variable and some applications may not even be eligible. It is likely that the extra costs associated with an assessment on this basis will be passed onto the Managing Authority. The creation of a business case is a large undertaking on the part of the UDF and preparing one without guidance or support may result in unnecessary work being undertaken, taking focus away from their existing regeneration projects.

Structured open bidding is similar to the process that many regeneration delivery vehicles currently go through when bidding for funding, for example the URC business cases or the town centre regeneration bidding process. The shortlisting process allows the organisations to present a short summary of the UDF and project structure to confirm if they have an eligible project before undertaking a full business case exercise. Due to the higher level of details, it also reduces the time taken to evaluate the submissions by the Holding Fund Manager.

At this stage, which is similar to a pre-qualification stage under EU procurement rules, the Managing Authority can add further “sift” criteria to the six core JESSICA requirements. These additional criteria are likely to include fit with key government policies such as the Economic Strategy and Single Outcome Agreements. Evidence of partnership working at local level may also be an important aspect of the assessment. It is expected that any co-funding partners would wish to be involved in discussions about these criteria. Following resolution of match funding issues, the pre-qualification criteria should be incorporated into the drafting of the Funding Agreement / Memorandum of Understanding to ensure clarity at the outset for the EIB.

Following the announcement of the shortlisted projects, this process provides a level of guidance to the UDFs, but utilises their experience and resource in developing detailed plans. The process is anticipated to be similar to the current Competitive Dialogue process for major projects, providing the UDFs and Holding Fund Manager an opportunity to discuss the proposal and structure the business case to meet with the investment criteria. It is expected that the Holding Fund Manager remains independent, with the UDFs engaging specialist advisors where necessary.

#### **10.4 Preferred project selection option**

Based on the analysis above, structured open bidding was deemed to be the preferred option, aligning with existing process and Managing Authority objectives.

## 11. The next steps

### 11.1 Highlights

- ▶ As part of the ERDF Structural Fund, many of the roles and responsibilities required for JESSICA are similar to those already in place.
- ▶ The next stage of the process is to approve this feasibility study and sign a Memorandum of Understanding (MoU) with the preferred Holding Fund Manager. The preferred Holding Fund Manager is the EIB.
- ▶ A key next step is the assessment of whether match funding can be secured at Holding Fund level.
- ▶ The implementation of JESSICA in Scotland and the appropriate application or bidding process should be clearly communicated to all interested parties, for example hosting a workshop pre launch.

### 11.2 Implementation requirements

This report has concluded that where co-financing can be secured at Holding Fund level, a Holding Fund should be appointed to procure UDFs through a structured process that will assist them in finalising a business plan for evaluation. However, it has also made a number of recommendations for further investigation surrounding the securing of co-financing and amendments to the eligibility criteria.

In setting up a JESSICA structure in the LUPS area of Scotland, there are therefore a number of necessary steps that are required including: approval of concept, implementing recommendations and procurement of the Holding Fund Manager. These are addressed in turn below.

#### 11.2.1 Approval of concept

This report has examined the feasibility of a JESSICA structure in the LUPS area and concluded that it has the possibility to provide many benefits. This report is now required to be approved by the JESSICA Steering Group, the LUPS Monitoring Committee and the Managing Authority. Prior to approving this report, these groups may require further review of the recommendations, or to consult with the Highlands and Islands Monitoring Committee to ensure maximisation of synergies and consistency across Scotland.

#### 11.2.2 Appointment of the Investment Board

There is no formal requirement to have an Investment Board, however where the Managing Authority do choose to appoint a board, it will be required to follow national guidelines. The process requires advertising the position and is overseen by the Office of the Commissioner for Public Appointments in Scotland (OCPAS).

#### 11.2.3 Procurement of the Holding Fund Manager

The Commission recognises that the need for a Managing Authority to select a suitable Holding Fund is an important step in using JESSICA. The April 2009 update to the Regulations have strengthened the ability of the EIB and EIF to provide assistance to Managing Authorities in order to directly award them a contract without a tendering process.

The Regulations therefore set out the methods by which a Holding Fund may be appointed as:<sup>15</sup>

- a. the award of a public contract in accordance with applicable public procurement law
- b. the award of a grant, defined for this purpose as a direct financial contribution by way of a donation to a financial institution without a call for proposals where this is in accordance with national law
- c. the award of a contract directly to the EIB or EIF

As EIB are the preferred Holding Fund Manager, negotiations may begin immediately.

The first step in mandating EIB is the completion of a Memorandum of Understanding (MoU). It is understood that the Managing Authority are in receipt of a draft MoU and have begun discussions on proposed amendments. This has not been reviewed within this study.

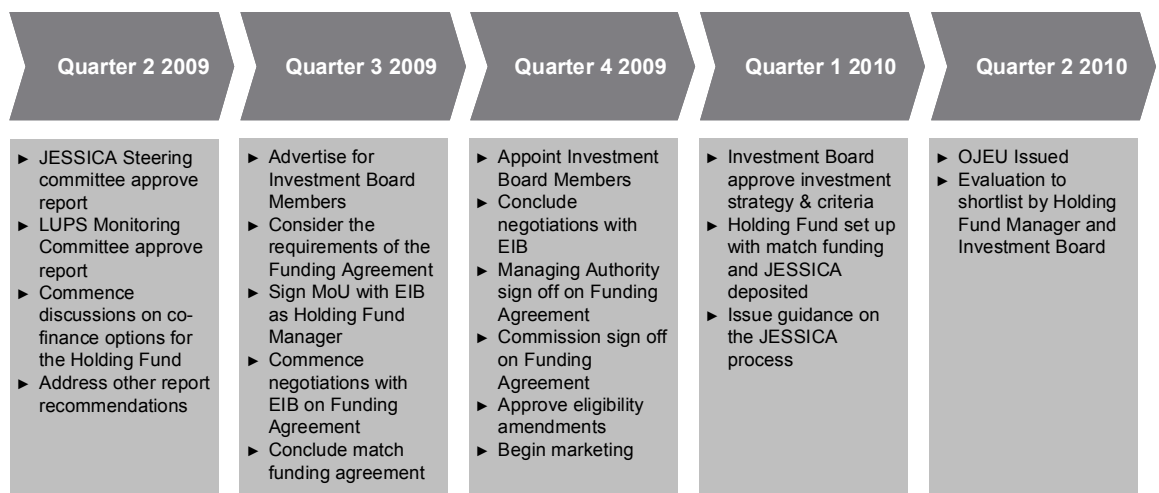
Following the MoU, a Funding Agreement will be drawn up between the parties. The content of this is detailed in section 4. It is understood that EIB have provided the Managing Authority with an exemplar Funding Agreement and have confirmed that, were they to be selected, they would assist the Managing Authority in meeting its requirements. The timetable to complete this document would be dependant on the Managing Authority's requirements and the time required to gain stakeholder approval from the necessary departments, particularly in relation to the selection criteria and investment strategy. Other studies have indicated that this process would take three to six months.

It is not necessary to have obtained all of the co-financing on inception of the Holding Fund, however if the intention remains to capitalise at Holding Fund level before any investment into the UDFs, it is logical to resolve this issue before signing the Funding Agreement with the Holding Fund. This will prevent unnecessary amendments to the Funding Agreement if further challenges arise in the capitalisation process.

## 11.2.4 Timeline

The timeline below summarises the key activities required prior to a call for bids.

**Figure 11.2 : Indicative Timeline to OJEU**



The key unresolved issue is the approach to match funding, specifically whether this can be found to capitalise the Holding Fund, or whether UDFs will need to raise this locally. While this is a policy decision for Scottish Ministers, other elements of the process are relatively straightforward and can proceed in parallel. This includes signing a Memorandum of

<sup>15</sup> Council regulation EC No 284/2009

Understanding with the EIB and appointing the Investment Board. The timescale set out above shows that the first call for proposals would be made early/mid 2010, with the first JESSICA investments potentially being made later in the year. A common theme from all consulted as part of this study was that there is a demand for JESSICA now, and driving to meet or better these timescales would be welcomed by regeneration projects around Scotland hoping to benefit from the new approach JESSICA brings.

## Appendix A Case study: Dundee Waterfront

### Introduction

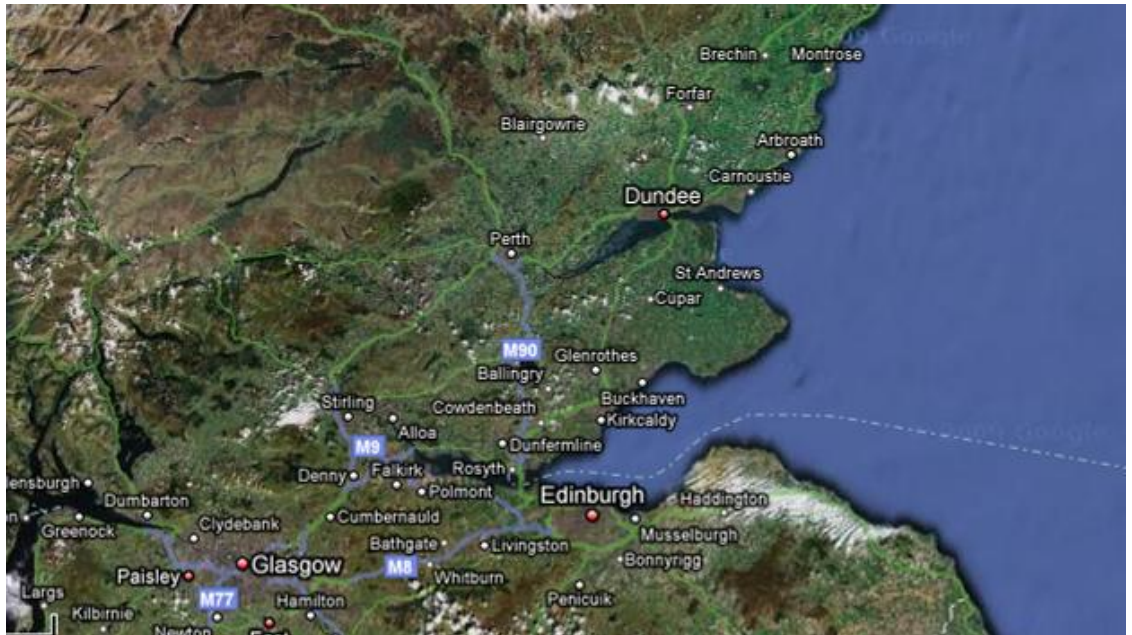
The development of a JESSICA holding fund in Scotland is an opportunity to increase the speed of delivery and impact of regeneration across the country. In undertaking the case studies, meetings were held with the case study teams where the concept of JESSICA was discussed.

This section summarises the inception of the case study vehicle, its strategic objectives and the current financial position.

### Background

Dundee is Scotland's fourth largest city, lying on the north bank of the Firth of Tay which feeds into the North Sea on the east coast of Scotland.

**Figure 1 – Dundee location**



Dundee's port first grew through the wool trade, which was replaced by linen and subsequently the weaving of imported jute. The weaving industry lay behind the city's rapidly growth with many migrant workers arriving through the 19th and early 20th centuries. In this period, Dundee also gained a reputation for its marmalade industry and its journalism, and Dundee is often known as the city of 'jam, jute and journalism'.

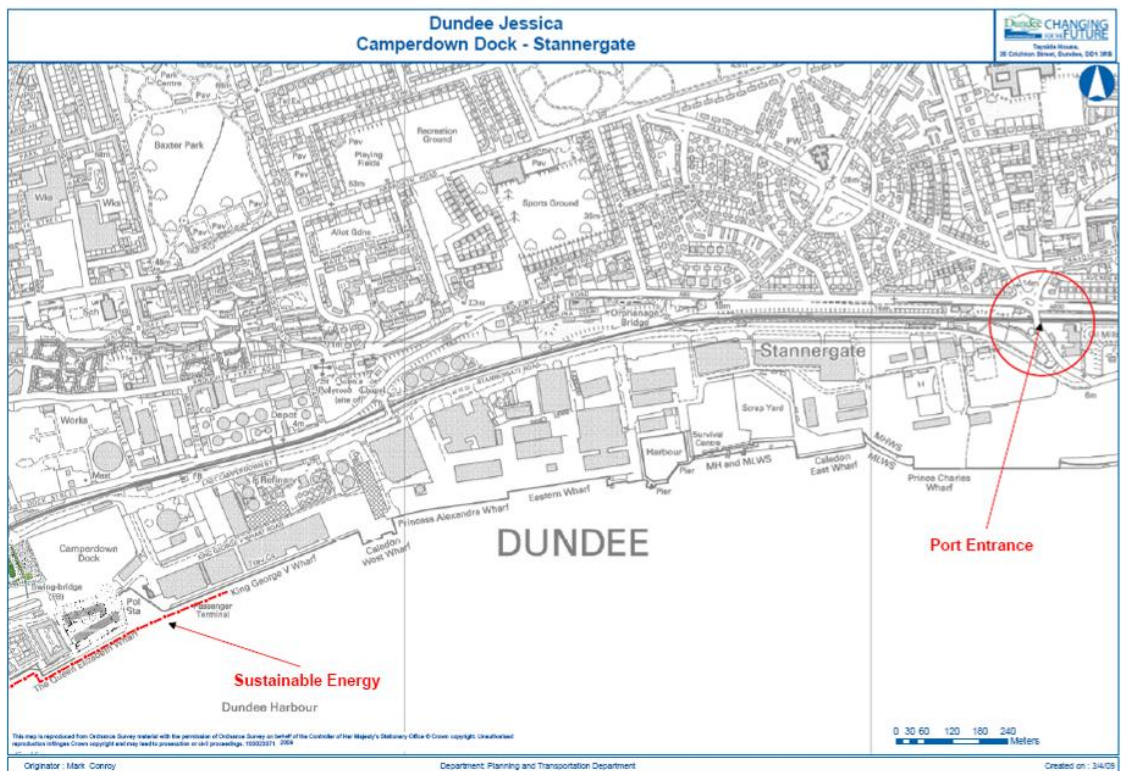
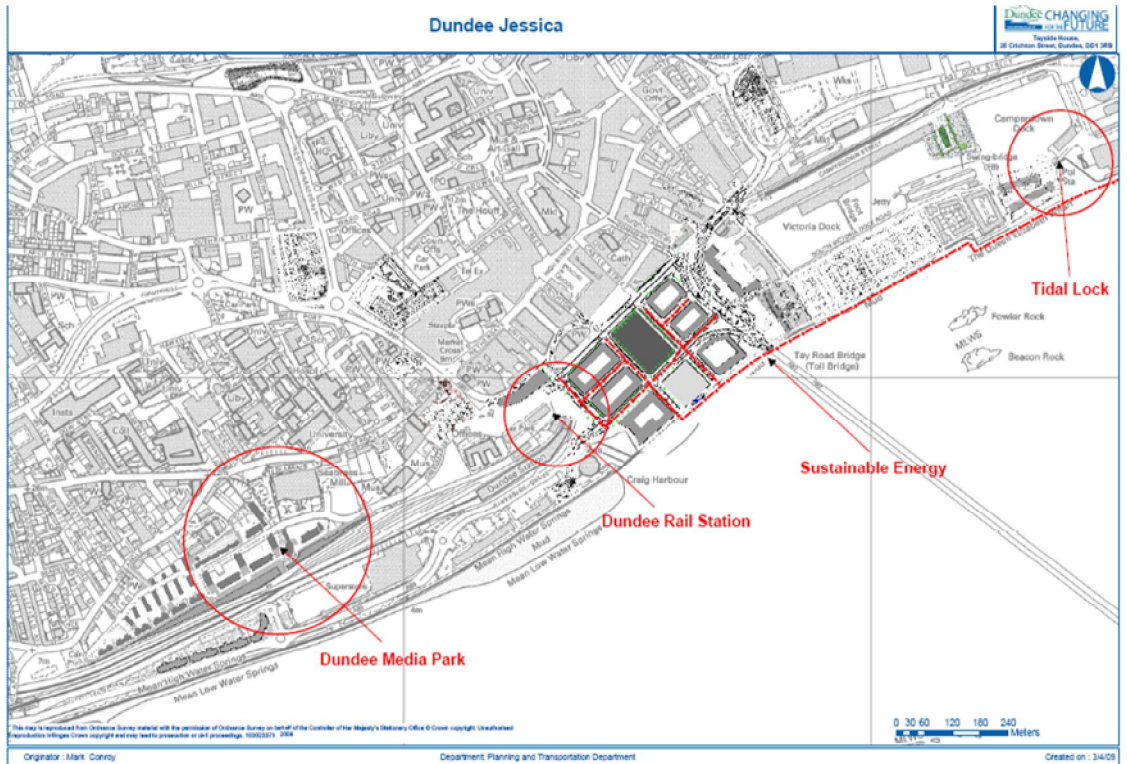
Estimates from 2006 record the population of Dundee City at around 141,930. Dundee's recorded population reached a peak of 182,204 in the 1971 census, but has since declined due to outward migration.

Today, Dundee is promoted as the City of Discovery, in honour of Dundee's history of scientific activities and of the RRS Discovery, Robert Falcon Scott's Antarctic exploration vessel, which was built in Dundee and is now berthed in the city harbour. Biomedical and technological industries have been a major success in renewing the city's economy since the 1980s, and the city now accounts for 10% of the United Kingdom's digital-entertainment industry. Dundee has two universities – the University of Abertay Dundee and the University of Dundee. However, Dundee still suffers from significant deprivation in some areas, and the



The programme known as the 'wider waterfront' is comprised of four areas. These are highlighted on the maps below.

**Figure 3 – Dundee Wider Waterfront Development Plan**



The key features of each area are summarised below.

### **Central Waterfront**

- ▶ Mixed use development sites to be created for offices, housing and leisure, together with a proposed new Victoria and Albert 'outpost' museum.
- ▶ This area is the core area of focus for the waterfront and in particular Dundee City Council, who own a significant area of land. The central waterfront will provide the key connections from the existing city centre to the River Tay.
- ▶ Infrastructure investment on the next phase of the road network and services is due to start in Spring 2009. Two phases are already complete at a cost of £11m - Western Road and Dock St Rail Tunnel Strengthening.

### **Seabraes Yard**

- ▶ Majority of land owned by Scottish Enterprise on the site of a former British Rail yard.
- ▶ Designated by the planning authority for Digital Media development with masterplan in place.
- ▶ One office developed so far, with financial assistance from Scottish Enterprise.
- ▶ £1.6m of ERDF grant has been spent on infrastructure predicated on a Digital Media use.
- ▶ Development interest is currently low and consideration is being given to the appropriateness of Digital Media use and/or whether the quality of development specified by the masterplan is too onerous for the type of Digital Media occupiers who may be attracted to the location.

### **City Quay**

- ▶ Originally wholly owned by Forth Ports but large areas developed / sold with some speculatively built offices, residential, retail and commercial uses.
- ▶ A marina development has been identified as potentially adding significant value to the area. Feasibility work has been undertaken with Forth Ports and Dundee Marina Ltd interested in the concept, although significant infrastructure costs would be required.

### **Port**

- ▶ Currently an operational port owned by Forth Ports.
- ▶ Infrastructure / access issues with parts of the wider site impair development potential, although road / bridge improvements and clearance and remediation of the developable area of the site may not be prohibitively expensive.
- ▶ Some interest from more than one private sector entity in a major inward investment for the manufacture of marine wind farm equipment. Dundee is likely to be a very suitable location on the coast for building and transporting these large structures out to sea.
- ▶ Further work is required to develop this opportunity and ensure Forth Ports are comfortable with the financial implications of this development on their land. However, major economic benefits and skilled jobs would be expected from such an investment.
- ▶ Forth Ports and Scottish and Southern Energy have formed a joint venture (Forth Energy) to explore energy generation opportunities. In Dundee, there is public and private sector interest in the possibility of a Combined Heat and Power (CHP) plant being situated on the port and piping heat (steam) to the development sites due to be created on the rest of the waterfront.

## Objectives

The objectives of the Partnership Agreement between Dundee City Council and Scottish Enterprise are to:

- ▶ Undertake marketing and promotion of the Dundee Waterfront on a national and international basis
- ▶ Maximise, coordinate and mobilise support from public sector bodies (including the Partners) where required to secure private sector investment
- ▶ Work with relevant Stakeholders to create the policy and planning environment best suited to the implementation of the Core Project<sup>16</sup>
- ▶ Consider all major investment and development opportunities relating to the Core Project and use best endeavours to direct resources within the appropriate timescales towards securing these
- ▶ Align their respective policies and strategies so as to ensure a favourable context for the delivery of the Core Project

## Outputs

An Economic Impact Assessment undertaken in June 2008 indicated anticipated quantifiable benefits for the Central Waterfront of:

- ▶ Increase in productivity to Scottish level by 2020 (and to 95% by 2015)
- ▶ Increase in net GVA by £68M at 2018, by £268M at 2028 and £513M by 2048.
- ▶ 1065 FTE net jobs created by 2020 (400 FTE by 2015)
- ▶ Enhanced offer for business and financial services sectors (representing 50% of all new office floorspace within Dundee Central Waterfront by 2015);
- ▶ Increased inward investment (min. 20% of office floorspace will be businesses new to Dundee by 2015)
- ▶ 710,000sqft of high quality office space by 2020
- ▶ Increased awareness and perception of Dundee (targets to be set after 2009 baseline study)
- ▶ Increase in average rental levels to £15psf by 2010

<sup>16</sup> The Core Project is the Central Waterfront, defined as the area along the River Tay between Discovery Point and the Tay Road Bridge

## JESSICA challenges and opportunities for Dundee

The development of a JESSICA holding fund in Scotland is an opportunity to increase the speed of delivery and impact of regeneration across the country. In undertaking the case studies, meetings were held with the case study teams where the concept of JESSICA was discussed.

This section summarises the thoughts of the case study teams in implementing JESSICA in Scotland.

### Value of fund

- ▶ **Prioritisation:** the case study identified a range of projects totally around £20m in potential JESSICA funding. There are clear issues with this in relation to national prioritisation in the context of a £25m initial ERDF allocation into a national fund.

### Application and bidding

- ▶ **Eligibility Criteria:** The proposed changes to eligibility criteria will allow a far greater range of regeneration and business support activity to be delivered with ERDF funding in the Dundee Waterfront. Queries were raised in relation to eligibility for tourism related projects, for example the proposed Marina, and how well the railway station redevelopment fits with the proposed revised wording of the criteria.
- ▶ **Application Process:** ideally Dundee would be given an appropriate indicative allocation for a range of key projects and time to develop/fine tune this in order to maximise benefit to the programme. However, it was recognised that the size of the national 'pot' is relatively small and this may be difficult to achieve.
- ▶ **Number of Bid Rounds:** If the JESSICA fund is administered through bidding rounds, there is a tactical consideration of the order in which projects are put forward, in order to ensure large projects secure funding from a limited national fund first and do not miss out following a heavily subscribed first bidding round.
- ▶ **Timing:** It was recognised that absolute clarity on application process and information required to support this was needed so that proposals could work towards this as soon as possible.

### Repayment

- ▶ **Repayment Return:** JESSICA funding in almost all cases would need to accept nil expected return beyond payback of the initial investment. However, overage-type clauses could be added to capture upside gains.
- ▶ **Risk Profile:** Private sector funding is hardest to secure for projects where the risk profile is uncertain or deemed as high risk. JESSICA should invest in regeneration projects that may be of higher risk where private investment is not available. In most of the projects this would involve JESSICA providing the full estimated investment value of the end use – not just an equity tranche – since the projects are likely to be too risky for bank lending.
- ▶ **Timing:** in most projects, repayment is not likely to occur for many years due to the long term nature of the programme. JESSICA should be able to support projects of this nature in order to have maximum impact.

### Recycling of income

- ▶ **Benefit of recycling:** The local partners expressed a view that it would be preferable for the recycled investment proceeds to be retained locally. However it was acknowledged that this might not occur for many years and national pressures would be against this.

### **Land and property assets**

- ▶ Potential availability: Scottish Enterprise noted a willingness to consider the use of assets both within and outwith the Waterfront as part of a JESSICA arrangement should match funding need to be identified at UDF level. The use of assets may not however be necessary due to the potential availability of cash as matching resource.

## Potential JESSICA Projects

Seven possible projects within the wider Waterfront programme were identified as candidates for JESSICA investment. These projects were felt by the partners to be deliverable by 2015 and might fall within the proposed revised eligibility criteria. The projects are described below.

### 1. Central Waterfront infrastructure

A JESSICA investment of £10m in up-front infrastructure, likely to include provision of the main services i.e., gas, water, electricity, sewerage and digital cabling could be made in any of the next few years of the project. This would contribute to the overall investment requirement of £73m. When the plots are sold for development for business use, the expected £10m receipt would repay the JESSICA investment.

The value of £10m is based on development appraisals prepared for the partners by a surveying practice. It assumes some uplift in current land values for the regeneration benefits of surrounding development. A key issue is the required return on any JESSICA investment. If a return was to be required by JESSICA, then if values are as expected the only possible source for this would be additional grant from the public sector partners.

However, in the event that land receipts were in excess of £10m, JESSICA could claim a priority return of, say 15%. This would mean that the first £1.5m (15% x £10m) of any 'overage' beyond the expected land value could be paid to a Holding Fund as return. Clearly there is a corresponding risk that values are below the expected £10m. In this case the JESSICA investment would not be repaid in full.

The important finding from this example is therefore that JESSICA should be prepared to invest on a nil assumed return basis; otherwise public sector funding would merely be recycling into JESSICA to pay a return. This does not, however, prevent the use of an overage mechanism to allow upside value to be captured. The partners believed JESSICA funding would be most useful if it could be provided in the form of equity/risk capital to challenging long term projects which would be too risky for conventional private investment.

### 2. Provision of heat energy to Central Waterfront

Discussions are ongoing between the partners, led by Dundee City Council, and Forth Ports/Scottish & Southern Energy (whose joint venture is known as Forth Energy) in relation to the construction of a Combined Heat and Power (CHP) plant on the port estate.

This would involve the creation of a large scale biomass power station, close enough to the central waterfront to allow servicing of new developments using the waste heat generated. Some feasibility work has been carried out, and there is believed to be substantial demand capacity due to the range of users in the area, such as the refinery based nearby and continuing development along the Waterfront. Significant basic electricity infrastructure already exists on the site, including a large substation.

Electricity generated in the power station would be sold to the National Grid. The steam generated from the waste could be piped at high pressure to potential nearby users and converted to heat in a heat exchange. Initial work undertaken by Dundee City Council indicates that the most efficient form of piping this steam to the Central Waterfront area would be in pipes laid along a short distance of the River Tay.

It would be most efficient to lay any such pipe infrastructure at the same time as other service cables and pipes are being laid to service the new development plots in the Central Waterfront. This will be taking place over the next 3 to 4 years. It will be costly and inefficient to retro-fit such large pipes to a completed development and would involve digging up of the newly laid road network.

However, no pre-lets have been secured for the Central Waterfront, and it is currently a speculative scheme. It would be a significant cost risk for Forth Energy to pay for the necessary pipe infrastructure to service the Central Waterfront with no guarantee of end users. Further work is being undertaken by the public sector partners and Forth Energy to explore costs and options, for example, whether Forth Energy could provide the main supply pipe with JESSICA paying for service connections into development plots. High level estimates of potential pipe costs on this basis are in the region of £2m.

If JESSICA funding could be used to fund this £2m cost, probably through Dundee City Council, there are different options for how a return might be received. A capital payment of this £2m (with or without a return element) could be made, either in a lump sum or stages, by Forth Energy once income from the sale of heat starts to be received. Alternatively, a fee based on a percentage of tariff income could be agreed. The latter model is similar to a tried and tested model for kerosene pipelines at airports (used for example at Gatwick and Manchester). This would also have the benefit of generating an ongoing income stream to the Holding Fund.

### 3. Rental guarantees on Central Waterfront

As noted in the previous project examples, the Central Waterfront scheme aims to create serviced development plots, with the expectation that commercial developers will buy these sites and build offices. It is likely that, at least in some of the early years, this development will be largely speculative in nature. Current city centre office rents are around £13 per square foot. The target for the new premises at the Central Waterfront is £15 per square foot.

JESSICA could be used to provide a rental guarantee to speculative developers on the difference between these, i.e., £2 per square foot. This may reduce the risk of speculative build for the private sector. However, from the purposes of accounting for such a guarantee at the Holding Fund level, it may be necessary to provide in full for the maximum liability. Furthermore, this liability could exist in perpetuity unless a time limit was agreed with the developer. For this reason, the partners are cautious about the potential for using rental guarantees, either using their own funding or alternative approaches such as JESSICA. There are also significant timescale issues, since rental may not commence on large parts of the site until after 2015.

Were a rental guarantee called, repayment might be expected to come through either charging a fee to the landlord or establishing a clawback mechanism where repayment starts if rents move above, say, £15 per square foot.

### 4. Enabling infrastructure to service major development on the port

The partners have been in ongoing dialogue with potential Foreign Direct Investors in relation to the possibility of siting a major facility for the manufacture of marine wind farm equipment on the east end of the port site in Dundee. Once built in very large assembly buildings, these wind turbine towers are taken out to sea in an upright position. It is considered that Dundee is very suitable for this purpose due to the depth of the Tay and its sheltered position on the coast. A development of this nature would be prestigious for the area and would be expected to bring hundreds of high quality engineering jobs.

However, the potential site contains a range of old buildings to be demolished, requires a fish dock to be filled in, roads cleared and a new road access to be constructed – at present there is only one small access road over a level crossing. There is also an inadequate bridge over the railway on another part of the site which would require upgrading. A further amount would need to be spent on electricity connections to allow the site to connect to the national grid. The total cost of these works is estimated in high level terms to be around £5m.

The partners consider that JESSICA investment could fund this £5m infrastructure requirement. In addition, discussions to date indicate that the cost of constructing the assembly buildings may be uneconomic for the manufacturer, and that public sector assistance may be required. This could take the form of a contribution to the cost of the

buildings or a reduced rent. Forth Ports, as current site owner, would need to be comfortable with the financial arrangements. It is assumed for the purposes of the case study that this project would not create any issues in relation to EU policy prohibiting certain subsidies of port infrastructure which might distort trade patterns between Member States.

Assuming that the JESSICA investment is limited to the £5m enabling infrastructure cost, an obligation could be agreed for the manufacturer to repay this over the long term. Repayment could also come in the form of a share in ground rent received by Forth Ports.

## 5. Marina infrastructure

The public sector partners together with land owner Forth Ports have investigated the potential for a marina development in the City Quay area. Initial feasibility work indicates there is around £4m - £5m of work to be carried out in the creation of a lock to enable boats to navigate in and out of a potential marina. The capital value of a marina may be in the region of £1m to an operator who would receive income from rental of berths.

Given the speculative nature of this development, commercial funding would be difficult to secure and the scheme clearly has a funding gap. However, it may be possible to use JESSICA investment equivalent to the £1m value of the marina and contribute this to the lock infrastructure works.

When the rights to operate the marina are sold to an operator, the expected value of £1m would be used to repay the JESSICA investment. This type of investment would be similar in financial terms to project 1, being based on a nil assumed return beyond payback of the initial investment, but potentially with an overage agreement to capture upside value.

Eligibility is a key issue with this project; previous feedback from the EC has been that projects of this nature with a tourism focus are unlikely to be eligible under Priority 3. However, the partners wished the issue to be revisited as part of the case study.

## 6. Railway Station redevelopment

Dundee station is in poor condition and the partners, in conjunction with owner Network Rail, are considering a redevelopment to include greater commercial uses. This project may be the most challenging from an eligibility viewpoint under Priority 3, although it could be argued that, in conjunction with using the CHP heat sources providing a sustainability benefit, improving the station would increase the flow of public transport commuters to and from Dundee.

The costs of infrastructure improvements and upgrading of bridges) may be in the region of £2m. The overall cost of demolition and rebuilding of appropriate parts is £11m. If JESSICA funding was used to pay for this work, then the receipts from increased commercial activity in the station (such as retail rents) could be used to repay the investment over the long term.

There will be no increase in platform capacity, this is not needed. Making the station brighter and more appealing with new facilities will increase usage.

### **Summary of JESSICA investment**

It is clear that further work would be required on most of these projects to develop a firm investment proposition. Only project 1 is sufficiently developed with the detailed supporting calculations necessary to underpin a bid to a Holding Fund Manager for JESSICA investment. The other projects will take different timescales to develop to this level. However when considered as a package, the investments would be mutually reinforcing and support the overall success of the Wider Waterfront as an integrated urban development plan.

In the event that the investment requirements from the projects described above were packaged into a Dundee Waterfront UDF, the overall JESSICA investment, based on the high level assumptions made in this case study, would be:

Project	Potential JESSICA investment
Central Waterfront site infrastructure	£10m
Heat pipes to Central Waterfront	£2m
Port enabling infrastructure	£5m
Marina infrastructure	£1m
Station redevelopment	£2m
<b>TOTAL</b>	<b>£20m</b>

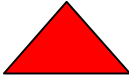
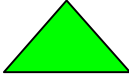
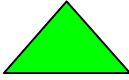
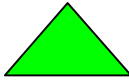
## Assessment against JESSICA criteria

All ERDF and JESSICA projects will be subject to individual scrutiny to ensure that the required eligibility and investment criteria are met. Further detail on the proposed wording amendments are available in section 7. Due to the high level information available at this time, the assessment may be subject to change as further information comes available.

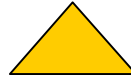
For illustrative purposes, this section reviews the proposed project against the ERDF eligibility criteria and contribution to targets.

### Assessment against Eligibility Criteria

The projects were assessed against current and proposed eligibility criteria for ERDF P3 projects considered to be improving the potential capacity of urban areas to develop. Rather than six separate assessments, the projects have been considered in overall terms below.

Improving the potential capacity of urban areas to develop	Assessment	Rationale
<p>Support for <i>development</i>, refurbishment and enhancement of locally based training/learning and e-skills centres</p> <p><i>(NB the development of training/learning &amp; e-skills will only be allowed if it forms a component part of an integrated urban development plan)</i></p>		No projects specifically include training or e-skills centres.
<p>Support for <i>development and</i> refurbishment of <i>existing</i> facilities and workspace to make them suitable for new or established SMEs (especially those that employ “green design” principles)</p> <p><i>(NB the development of workspace will only be allowed if it forms a component part of an integrated urban development plan)</i></p>		The Central Waterfront will include workspace for new and established SMEs. Green design is likely to be a key feature of development agreements for sale of development plots. In addition, the proposed heat source of a local CHP plant would complement green design of the buildings.
<p>Support for <i>small-scale</i> conversion and adaption to industrial sites and business centres/facilities that offer employment or training opportunities to people living in targeted areas (especially those that employ “green design” principles)</p>		The port projects – in particular the marina and marine wind farm operation would involve adaption of an industrial site to offer employment opportunities to local people. Again, the use of heat from a CHP plant would augment the sustainability of these schemes.
<p>Support for <i>small-scale</i> energy production from renewable energy technologies in response to local energy needs</p>		The CHP pipes is the key sustainability project with potential benefits for the whole waterfront.

*Support for measures that stimulate energy efficiency in multi-family social housing (priority will be given to projects that form part of and integrated urban development plan). Further justification to follow*



Residential property is part of the Central Waterfront scheme; this could include heat sourced from the local CHP plant. However, the level of social housing expected on the waterfront is still to be confirmed.

*Support for projects that invest in the rehabilitation of the physical environment (specifically work around the decontamination and servicing of brownfield land and gap sites but only if it can be demonstrated that the end use of the land is linked to ERDF eligible activity. This activity is eligible only as a component part of an integrated urban development plan and excludes development of public realm unless a reasonable and direct physical link is made with ERDF eligible activity)*



The majority of projects identified involve rehabilitation of the waterfront environment, including servicing of new plots designed for business uses linked to Priority 3.

**Linking urban areas of need with areas of opportunity**

**Assessment**

**Rationale**

Support for locally based job brokerage schemes that aim to match disadvantaged individuals with employment opportunities



The partners would include job brokerage schemes in the projects through use of a Community Benefits in Procurement approach as recommended by the Scottish Government.

Supporting safe transport hubs to link areas of need with those of opportunity



The Dundee station redevelopment project could be eligible under this criterion, depending on the final specification of the scheme. It may be beneficial to adjust this wording to be more explicit in terms of fitting the redevelopment of safe, efficient transport facilities.

Support for investment in increased local access to ICT facilities within communities with the intention of improving skills of local people seeking to re-enter the labour market and increasing access to web based public services



ICT facilities for training may be incorporated into some developments on the Waterfront, although the precise configuration of these is yet to be determined.

*Support for projects that promote clean and sustainable public transport to link areas of need with areas of opportunity.*



The Dundee station redevelopment project could be eligible under this criterion, depending on the final specification of the scheme.

*(NB this activity will only be allowed if it forms a component part of an integrated urban development plan).*

**Assessment against Indicators**

For this case study project, further work would be required by the partners as part of any application for JESSICA funding in order to quantify in detail the benefits against ERDF indicators. Much of the initial economic scoping work has been carried out but this would need to be developed to the next level of detail to address the specific indicators required.

## **UDF Structure**

### **Dundee UDF**

The partners would envisage a series of projects being consolidated into a Dundee UDF. As the Partnership is an unincorporated structure between Dundee City Council and Scottish Enterprise, a Dundee UDF would need to be administered through a body corporate. Dundee Development Ltd, a wholly-owned subsidiary of Dundee City Council, has been initially earmarked for this purpose. This would then invest JESSICA funds into the projects, as administered by Dundee City Council or Scottish Enterprise.

### **Match funding**

If match funding for the national JESSICA programme is identified nationally at holding fund level, then no specific arrangements would need to be made locally upon creation of the UDF in relation to assets or cash as match funding. However, it would need to be shown that cash disbursed to projects were, by 2015, matched by the value of other resources. The national resources contributed to the Holding Fund upon its inception need not, in the end, be the same as those used in projects as matching resources, as substitution of these for other matching resources is permitted. However, if the national resources are not to be used, the UDF must be clear on where the eventual matching resources will come from.

If co-capitalisation at UDF level is required, then the principal source of these matching resources is likely to be the cash allocation agreed by partners recently for the Central Waterfront.

Scottish Enterprise indicated it may be able to allocate some land assets as matching resources. We understand that title to these land assets need not be transferred from partners to the UDF or Holding Fund, and that a 'notional' allocation of rights could be made to the Holding Fund. This would involve a restriction in the land registry on transfers of title without the Holding Fund Manager's consent. The ability to arrange this 'notional' allocation of land may require further confirmation from the European Commission; in the event that a transfer is required this would be possible but would involve a Stamp Duty Land Tax charge and a legal conveyancing process.

With the alternative scenario of match resources being provided in the form of cash no such complications occur. If this cash was provided at Holding Fund level then the JESSICA money drawn down to the UDF would already contain a 40/60 split and could therefore be invested in its entirety in the projects.

## Impact of JESSICA on identified projects

The possibility of JESSICA funding will have an impact on the identified projects, creating new opportunities to deliver an improved development with private sector partners. However, the projects may be subject to challenges throughout the process..

This section reviews some of the potential impacts of JESSICA on the identified project.

### Benefits

It is envisaged that JESSICA will bring the following benefits to the projects:

- ▶ JESSICA funding will be used to fund the 'investment' elements of projects. This could allow projects to proceed which otherwise would be considered too risky for conventional private investment.
- ▶ JESSICA funding frees up grant monies to be used on true 'gap funding' elements of the programme.
- ▶ Augments and complements the overall funding package identified under the Partnership Agreement between Dundee City Council and Scottish Enterprise.
- ▶ The EIB have advised that eventual cross subsidy is possible between projects. For example, if one project does not repay the investment but another generated extra surplus, this extra surplus could be applied to repay the investment gap on the first project.

### Challenges

Key challenges of using JESSICA funding in these projects that require further investigation include:

- ▶ Most projects would generate nil return, i.e. payback of initial JESSICA investment only.
- ▶ Could the required level of technical information to support due diligence by a Holding Fund Manager be developed in time for any bidding/application process? This is likely to vary between projects so a fixed deadline, say early/mid 2010, might mean some important components of the overall "package" miss out.
- ▶ The requirement for 60% match funding is a key issue for the partners. While public sector land assets may be available in some cases, a number of attractive projects with strong outcomes and repayment potential may not be able to secure match funding under the framework required by the UDF structure.
- ▶ The JESSICA funding would be true risk capital in most cases and would suffer first loss in the event that predicted values do not materialise. Project end values would therefore need to be supported by robust business cases with professional valuation advice taken. This will then provide comfort to the Holding Fund Manager assessing the investment-worthiness of proposals.
- ▶ Repayment of JESSICA investment is unlikely to occur in most of these projects before 2015. The ability to recycle funds quickly is therefore relatively low, as would be expected of a challenging long term regeneration programme.

## Appendix B Case study: Clyde Gateway

### Introduction

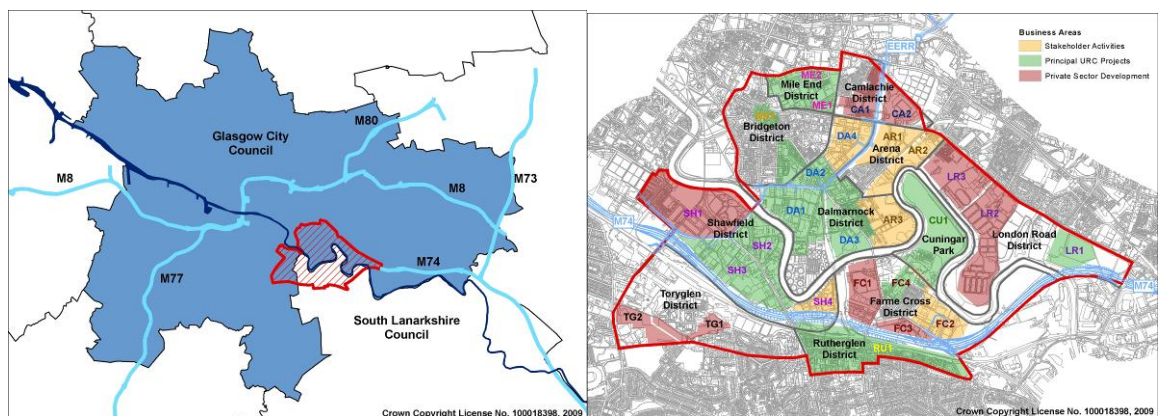
The development of a JESSICA holding fund in Scotland is an opportunity to increase the speed of delivery and impact of regeneration across the country. In undertaking the case studies, meetings were held with the case study teams where the concept of JESSICA was discussed.

This section summarises the inception of the case study vehicle, its strategic objectives and the current financial position.

Clyde Gateway Urban Regeneration Company (URC) was established in December 2007 for the East End of Glasgow with a vision to provide 'a dynamic and sought after city location with a strong community, which will attract major investment and establish itself as one of the foremost places in the West of Scotland to live and work, supporting Glasgow's ambition to be a world class city region'. The URC is a partnership between Glasgow City Council, South Lanarkshire Council, Scottish Enterprise and the Scottish Government.

The creation of the Clyde Gateway URC is a major opportunity for the public and private sector to work together to deliver sustained change and transformation of the Clyde Gateway area. The URC will contribute towards the wider development of the Clyde Gateway, including development for the 2014 Commonwealth Games to be held in Glasgow and major investment in infrastructure such as the M74 Completion and the East End Regeneration Route.

There are 26 projects included in the 3 year Operating Plan within 5 geographic areas, covering business, strategic land, urban centre and tourism and leisure categories of physical investment. The operating plan is structured such that returns from early action projects are reinvested into later projects as the programme progresses. The Clyde Gateway area is pictured below:



A key objective of the URC is to remove the barriers to private sector investment into the local projects. This requires a long term approach, building on cycles of investment to deliver sustained change and economic transformation.

### Objectives

The strategic objectives of the URC, set out in the Business Plan May 2007 and Operating Plan 2008-2011 are:

- ▶ Sustainable place transformation
- ▶ Increase economic activity

► Develop community capacity

### Outputs

Over 25 years, the URC aim to achieve the following outputs in the Clyde Gateway area:

Output	Measure
Remediation of derelict & contaminated land	350ha
Regional income	£380million increase
Employment space	400,000 sqm
Retail and related space	46,000 sqm
New jobs	21,000 (gross)
New homes	10,000
Population	20,000 increase

The target outputs for 2008-2011 aim to achieve a balance between delivery of early economic benefits and the acquisition or development of key assets that will realise longer term project objectives. A key focus for the early stages is on land assembly and the relocation of businesses and showpeople to facilitate the delivery of early action projects. It is envisaged that this will lead to new job opportunities and construction opportunities, particularly for the local unemployed. The early action outputs for the period 2008-2011 are summarised below:

#### Strategic goal one: sustainable place transformation

Activity	Indicator	Target
Strategic site assembly programme	Land acquired	36 ha
Deliver construction works	Job & training opportunities created	131 jobs, 26 places
Deliver greenspace projects	Number of projects	4 projects

#### Strategic Goal Two: Increase Economic Activity

Activity	Indicator	Target
Relocate businesses occupying strategic land	Businesses relocated	82 Companies
	Existing jobs retained locally	1500 jobs
Secure new investment projects	Land sales	£10.6m
	Investment secured	£45.2m
	Jobs attracted	691 jobs
	Training places creates	138 places

#### Strategic Goal Three: Develop Community Capacity

Activity	Indicator	Target
Work with local unemployed on skills development	Training places	164 places
	Trainees securing employment	82 jobs
Support showpeople communities	Pitches relocated	220 pitches

### Financial planning

[Excluded at the request of Clyde Gateway for publication]

## JESSICA Challenges and Opportunities for the Clyde Gateway Area

The development of a JESSICA holding fund in Scotland is an opportunity to increase the speed of delivery and impact of regeneration across the country. In undertaking the case studies, meetings were held with the case study teams where the concept of JESSICA was discussed.

This section summarises the thoughts of the case study teams in implementing JESSICA in Scotland.

### Application and bidding

- ▶ *Eligibility criteria:* The proposed changes to eligibility criteria fit very well with the URC's business plan to focus on areas such as SME's and remediation work, providing an incentive to apply for funding.
- ▶ *Application process:* Guidance should be provided on the application process to provide transparency and manage expectations, for example the standard of business case required and the diligence UDF / HF manager will undertake in appraising applications.
- ▶ *Number of bid rounds:* Guidance should be provided on the number of bid rounds anticipated, in order to allow development of more complex projects.
- ▶ *Timing:* A key objective for the URC is the delivery of projects within the community. Where projects have been identified as having potential for JESSICA funding, the impact of the JESSICA process on delivery should be reviewed. For example, the project used in this case study has a proposed start date of January 2010 and delay to this may impact the wider programme.

### Repayment

- ▶ *Relationship with ERDF grant:* Whilst JESSICA offers more flexibility in its investment criteria and uses than ERDF grant or other grant funding provided to the URC, JESSICA is required to be repaid. Therefore grant funding may be seen as preferable in some projects.
- ▶ *Repayment return:* JESSICA would be deemed more attractive where the return on investment and payback period is more flexible or at a lower rate than available with private sector funding. This would make JESSICA a viable option for projects of a long term nature, eg remediation and infrastructure, or where there is not a clear date for onward sale of assets.
- ▶ *Risk profile:* Private sector funding is hardest to secure for projects where the risk profile is uncertain or deemed as high risk. JESSICA should invest in regeneration projects that may be of higher risk, but would offer a greater impact to the programme without incurring higher risk premiums than the private sector.

### Recycling of income

- ▶ *Benefit of recycling:* The opportunity for recycling JESSICA receipts was agreed to be an attractive feature, especially if returns could remain in Gateway area.

### UDF Structure

- ▶ *Transparency:* The URC were attracted to UDF concept for Gateway, but there was concern over transparency for reporting purposes to the Board if sites, assets and funding from different projects were mixed into a single UDF. Consideration would be given to either single UDF per project, or thematic UDF within the URC for similar projects.

- ▶ *Asset title:* The URC would be interested in using assets to capitalise the holding fund or at UDF level, but acknowledged that this may be dependant on other factors including loss of asset control and taxation matters associated with transfer of title.
- ▶ *National thematic UDF's:* Scotland wide thematic UDF's may be problematic as transparency would be lost. The URC would be unlikely to put assets into a national UDF due to potential loss of control that the Board would be unlikely to approve.
- ▶ *URC status:* The URC is set up as a charity. This prevents it providing loans at non commercial rates. Where JESSICA is deemed to have a return lower than a market loan, this would not be acceptable. It is therefore necessary for the URC to utilize its trading subsidiary to receive JESSICA funding and pass it onto the project.

## Potential JESSICA project

Projects currently included within the Operating Plan were reviewed with Case Study team for their suitability to utilize JESSICA funding to maximise financial and non financial outputs. Due to the opportunities and flexibility provided by JESSICA as a financial instrument, the project scope and therefore financial analysis may require further review as part of an application process. Information included within this section was provided by the case study project teams.

This section includes detail on the project scope and the forecast financial data, including returns.

### Site 1 – London Road L3

#### *Introduction*

Information for this case study has been taken from Board papers previously submitted and technical reports provided by Clyde Gateway, currently in draft.

Clyde Gateway URC is currently implementing its first operating plan, covering the period from 2008-11. The focus of the plan is to assemble strategic land to enable large scale transformational initiatives to be developed, while delivering key early action projects. The early action projects include greenspace, public realm and delivery of sites for business and residential relocations.

A key early action is delivery of new business, inward investment and relocation projects at Site 1 on London Road. The site is in Clyde Gateway's ownership, has planning consent for Business, General Industrial and Storage and distribution uses, and is attracting interest from a number of business projects. The URC Operating Plan includes budget costs for delivery for the site preparation, infrastructure and landscaping works. Unfortunately the company withdrew interest in March 2009 and the masterplan, market appraisal, cost plan and programme are required to be reworked.

In light of the necessary redesign of the masterplan and the potential for JESSICA funding for appropriate projects, the opportunity has been taken by Clyde Gateway to explore alternative structures for the site that remain appropriate to the wider programme and meet with the initial project objectives.

#### *The site*

The London Road site lies within the Clyde Gateway boundary to the South of London Rd and to the North of the River Clyde. The site is well defined with the sites eastern boundary being the M74 Completion and an associated bridge over the river. There are no existing buildings or occupiers, presenting a unique opportunity to create a new business location within Glasgow City.

The site has a gross size of 12.14ha, or 11.2ha net developable size once physical constraints are factored. The site may accommodate up to 40,000m<sup>2</sup> of business space.

### ***The case study project***

Market appraisal studies undertaken by Clyde Gateway URC have identified low levels of speculative industrial development, and that larger units of over 4,645 sq m of constitute almost 50% of availability. This older, larger stock does not satisfy occupiers requiring either modern or small scale accommodation. This market failure has resulted in a shortage of industrial units of less than 930 sq m.

The proposed JESSICA project on the London Road site is focused on providing a specific area within a larger business park for SME occupancy; comprising both office and workshop space of approximately 10,000m<sup>2</sup>. The buildings would be high specification design and energy efficient, built to deliver sustainability for the long term.

Despite the ongoing economic situation, there is still considered to be a strong demand for smaller industrial units in the city for SMEs where larger sites, financial incentives, available buildings and proximity to motorways have driven demand.

The development pipeline has recently slowed due to lack of demand and difficulties with the availability of funding. However, the Clyde Gateway URC Property Group have identified a number of local companies with property requirements as a result of recent growth or involuntary relocation. Due to the activity in the area, there are a number of compulsory purchases arising from the M74 Completion, the Commonwealth Games 2014 Athletes Village, the East End Regeneration Route and Clyde Gateway projects.

Demand for new business space on the site can be therefore categorised as:-

- ▶ Local company interest
- ▶ Indigenous Clyde Gateway demand
- ▶ Mobile industrial and office demand
- ▶ Formal employment trends and forecasts

## UDF structure

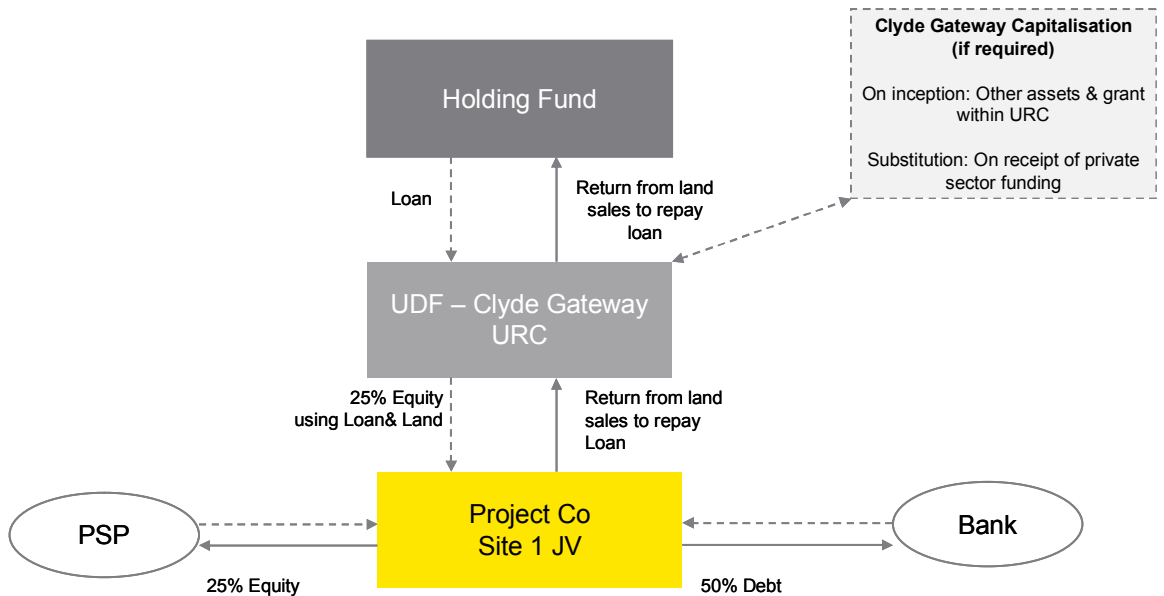
In the current economic climate it is considered unlikely that a bank would finance more than 50% loan to value and that a private sector partner would be unlikely to provide the full 50% equity required due to either the risk profile of a regeneration site, or the lack of necessary working capital. Therefore, JESSICA funding would be used to create a Joint Venture with a private sector developer, in conjunction with land provided by Clyde Gateway and debt finance from a banking institution. It is believed that this will make the project more attractive to developers and support the construction industry in the area. This joint venture may also be used to provide facilities management and development management services for the site, delivering affordable services to SME's to assist in their long term development.

There has been no soft market testing with developers or funders and an estimated 50% loan to value ratio has been used based on experience with similar projects in the current market. If private sector finance is not available, there would be the possibility of JESSICA funding up to 40% of the joint venture or Clyde Gateway providing additional grant funding to be used in the delivery of the project.

As already provided for within the Operating Plan, grant funding would be used for groundworks, with JESSICA funding used to speed delivery of the project through the provision of equity. This would further decrease the risk profile for a private sector investor.

Clyde Gateway URC is a separate legal entity from the Local Authority and has a clear governance structure therefore, it is understood to fit the requirements of a UDF vehicle. Using the URC as a UDF would minimize the additional set up costs of using JESSICA funding and further expedite delivery.

Potential structure of the JV is shown in the diagram below:



In order to draw down JESSICA funding from the EC, there is a requirement to demonstrate match funded at Holding Fund and Project Co level. National guidelines for Scotland are a maximum JESSICA contribution of 40% into the holding fund. It is currently understood that the UDF is not required to demonstrate this matching. However, should the UDF be required to match the JESSICA funding drawn down from the holding fund, it is possible to use other assets (eg land or cash) from within the Clyde Gateway programme. This would then be substituted for the private sector debt and equity once the JV is incorporated. This concept is currently under discussion with EIB and may result in additional risks to the project including restrictions on assets prior to substitution and challenges in the set up of funding arrangements with the private sector.

### Current estimated financials

Based on information provided by the Clyde Gateway Team, the forecast financials of the project are estimated as:

#### Development Value

Net floor area	100,000ft <sup>2</sup>
Net income p.a.	£700,000
Gross Development Value (GDV)	£8,750,000
Less sale costs	£350,000
<b>Net Development Value</b>	<b>£8,400,000</b>

#### Development costs

Building costs; 100,000 ft <sup>2</sup> @ £60/ft <sup>2</sup>	£6,000,000
Fees	
Design team @10%	£600,000
Planning @ Building warrant	£25,000
Contingencies @ 3%	£331,250
Finance charges during construction	
Costs x 6% over 6 months	£198,750
Letting time (allow 6 months @ 6%)	£198,750
Marketing /agent fees / legals @ 2%	£132,500
Developers profit @ 10% of GDV	£827,500
<b>Development Costs</b>	<b>£8,313,750</b>

#### Residual Land value

Net Development Value	£8,400,000
Less Development costs of	£8,313,750
<b>Residual land Value</b>	<b>£86,250</b>

### Return on investment

Returns on the investment are likely to be derived from sale of the asset either as a portfolio across the whole site or on a piecemeal basis to the occupiers, or through rental and management fee income.

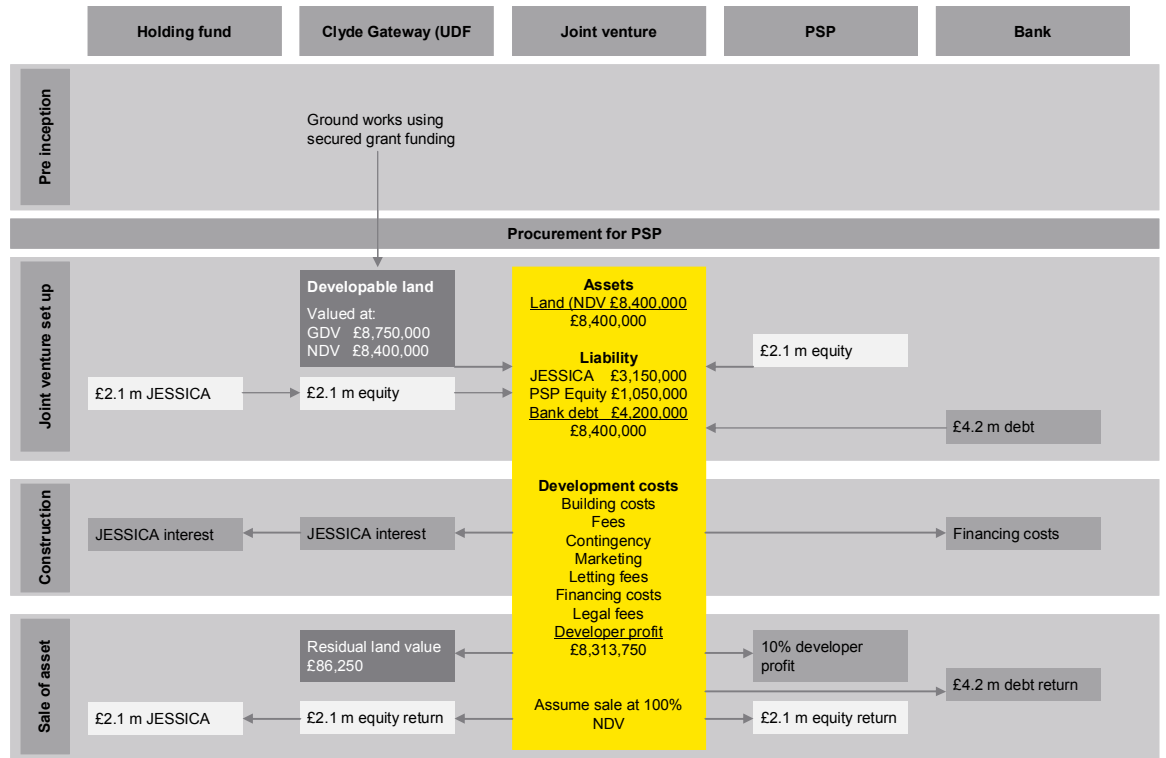
Assuming a joint venture structure using bank debt, repayments would be made to all investors on a ranked basis. This would result in equity being paid out after senior debt and present the risk of JESSICA not being repaid if the sale price was inadequate.

Throughout the procurement process, the repayment profile would be negotiated, however it may be possible to take measures to further protect the JESSICA investment, or return to Clyde Gateway. It may, for example, be possible to rank JESSICA before the private sector equity or to fix a residual land value within the JV agreement.

The structure currently assumes no return on JESSICA equity as this would only serve to reduce the residual land value amount payable to Clyde Gateway. Using the forecast figures provided, a required return on JESSICA funding would potentially require a greater initial investment or a greater sales figure.

### Summary of transactions

Using the financials provided by Clyde Gateway, the project transactions may be represented as:-



### Other potential projects

Whilst Site 1, detailed above, is clearly a suitable use of JESSICA funding due to its eligibility and readiness to deliver, a number of other project within the programme have been identified. These projects are summarised below:-

#### Dalmarnock Road Business Centre

Assembly of various vacant commercial properties between 23-53 Dalmarnock Road. Upper floors and selected ground floor units to be refurbished to form local business centre.

Eligibility assumed due to provision of support for development and refurbishment of facilities and workspace to make them suitable for new or established SMEs.

Repayment of JESSICA investment would be through rental income on the developed units.

Total capital costs £1.8M;  
 Acquisition £0.5M,  
 Refurbishment £1.3M

JESSICA Loan: £0.6m

#### Dalmarnock Station Redevelopment;

Transport hub and central area at the proposed refurbished Dalmarnock station, accessing the business and mixed use areas in Dalmarnock and Shawfield. JESSICA investment could either be used to compliment existing grant or through the creation of an SPV with a private sector investor such as Network Rail through their RAB or a retail provider.

A STAG assessment is currently being undertaken and the URC are in discussions with Transport Scotland. The station will be a major transport hub for 2014 Commonwealth Games athletes and spectators travelling between the athletes village and venues.

Eligibility is assumed under supporting safe transport hubs to link areas of need with those of opportunity and support for projects that promote clean and sustainable public transport to link areas of need with areas of opportunity.

JESSICA repayment would be repaid through a mixture of retail rental income and the sale of assets within the area, assumed to rise in price with the development in the area.

Total capital costs £8m

JESSICA Loan: £4 m

### **Multiple Occupancy Development**

Development of multi-occupancy serviced office development aimed at SME's. The site is 6000m<sup>2</sup> development with a JESSICA investment to be input into an SPV with a private sector developer.

Eligibility is assumed under Support for development and refurbishment of facilities and workspace to make them suitable for new or established SMEs

JESSICA repayment would be through the sale of assets post development.

Total capital costs £16m

JESSICA Loan: £8 m

### **Clyde Gateway Skills Centre**

Acquisition and conversion of property on Fordneuk Street to form a local skills centre.

Eligibility is assumed under support for development, refurbishment and enhancement of locally based training/learning and e-skills centres

The JESSICA repayment method is currently unknown

Total capital costs £3.7m

JESSICA Loan: £1.5 m

### **Summary of JESSICA investment**

It is clear that further work would be required on most of these projects to develop a firm investment proposition. Only Site 1 is currently sufficiently developed with the detailed supporting calculations necessary to underpin a bid to a Holding Fund Manager for JESSICA investment. The other projects will take different timescales to develop to this level. However when considered as a package, the investments would be mutually reinforcing and support the overall success of the Clyde Gateway Operating Plan.

In the event that the projects above were demonstrated to meet the eligibility criteria, the overall JESSICA investment for Clyde Gateway, based on the high level assumptions made in this case study, would be:

Project	Potential JESSICA investment
London Road Site 1	£2.1m
Dalmarnock Road Business Centre	£0.6m
Dalmarnock Station Redevelopment	£4m

Multiple Occupancy Development	£8m
Clyde Gateway Skills Centre	£1.5m
<b>TOTAL</b>	<b>£16.2m</b>

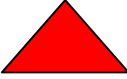
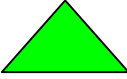
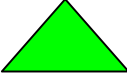

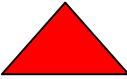

## Assessment against JESSICA criteria

All ERDF and JESSICA projects will be subject to individual scrutiny to ensure that the required eligibility and investment criteria are met. Further detail on the proposed wording amendments are available in section 7.. Due to the high level information available at this time, the assessment may be subject to change as further information comes available.

For illustrative purposes, this section reviews the proposed project against the ERDF eligibility criteria and contribution to targets.

### Assessment against Eligibility Criteria

The London Road Site 1 project was assessed against current and proposed eligibility criteria for ERDF P3 projects considered to be improving the potential capacity of urban areas to develop.

Improving the Potential Capacity of Urban Areas to Develop	Assessment	Rationale
Support for <i>development</i> , refurbishment and enhancement of locally based training/learning and e-skills centres <i>(NB the development of training/learning &amp; e-skills will only be allowed if it forms a component part of an integrated urban development plan)</i>		Learning and skills centres are proposed for other projects within the Clyde Gateway area
Support for <i>development and</i> refurbishment of <i>existing</i> facilities and workspace to make them suitable for new or established SMEs (especially those that employ "green design" principles) <i>(NB the development of workspace will only be allowed if it forms a component part of an integrated urban development plan)</i>		Project scope is for [xx] units specifically for SMEs, designed and constructed in an environmentally sustainable way
Support for <i>small-scale</i> conversion and adaption to industrial sites and business centres/facilities that offer employment or training opportunities to people living in targeted areas (especially those that employ "green design" principles)		Project scope will offer employment opportunities through the design and construction phase with the private sector partner with the possibility of future jobs within SMEs or as part of the maintenance contracts
Support for <i>small-scale</i> energy production from renewable energy technologies in response to local energy needs <i>Support for measures that stimulate energy efficiency in multi-family social housing (priority will be given to projects that form part of and integrated urban development plan). Further justification to follow</i>	 	Possibility to use heat pumps in the road to regulate temperature across the site No social housing within the project scope
<i>Support for projects that invest in the rehabilitation of the physical environment (specifically work around the decontamination and servicing of brownfield land and gap sites but only if it can be demonstrated that the end use of the land is linked to ERDF eligible activity. This activity is eligible only as a component part of an integrated urban development plan and excludes development of public realm unless a reasonable and direct physical link is made with ERDF eligible activity).</i>		Possibility for JESSICA funding to be used as part of the groundworks to free up government grant.

### Assessment against Indicators

Having provided evidence that the project meets ERDF3 eligible activity criteria, the project was assessed against the indicators and targets contained within the LUPS Operating Plan for projects considered to be improving the potential capacity of urban areas to develop.

This assessment is summarized below:

Indicator	Type	Target	Clyde Gateway Site 1 Target
Number of e-learning/childcare and other community facilities supported	Output	350	0
Area of business space created or modified (m <sup>2</sup> )	Output	7,500	[15,000]
Number of renewable energy projects supported	Output	180	[1 heat pump]
Number of enterprises supported	Result	1,100	[ TBC ]
Increase in the number of individuals gaining employment through supported e-learning/childcare/community facilities	Result		No
Increase in share of energy for renewable resources in supported areas	Result		Yes
<b>Priority as a whole</b>			
Number of gross jobs created	Result	4,500	20,000 CGW 600 Site 1 SME
Number of gross jobs safeguarded	Result	3,600	[relocations]
Number of net jobs created	Impact		

Due to the potential for commercial returns to repay the funding, as required by EU JESSICA criteria and demonstrated above, it may be concluded that the projects are suitable for JESSICA funding under the proposed ERDF P3 amended wording.

## Impact of JESSICA on Identified Project

The possibility of JESSICA funding will have an impact on the identified project, creating new and exciting opportunities to deliver an improved development with a local private sector partner. However, the project may be subject to challenges throughout the process and new additions to the risk register.

This section reviews some of the potential impacts of JESSICA on the identified project.

The development of Site 1 is currently documented within the Operating Plan and despite the withdrawal of the proposed major occupier of the site; the objective remains to deliver regeneration outputs with the funding available.

### Benefits

It is envisaged that JESSICA will bring the following benefits to the project:

- ▶ *Dedication to SME development:* Projects for workshop and office development space has tended to focus on large national or international companies due to their higher level of financial security and defined long term requirements. The flexibility offered to the URC by JESSICA with regards to return on investment and financial covenants etc will allow the URC to pass these onto SME's to create an environment where SME's can flourish.
- ▶ *Improved design capability:* Securing JESSICA funding would enable the design of the development to be enhanced to offer environmentally sound and sustainable accommodation at a lower cost for SME's than is available currently. This would also allow for a more holistic development than providing simply buildings for re-sale.
- ▶ *Repayment arrangements:* The flexibility of JESSICA to allow repayments over a longer period of time may allow the repayment methods to change, for example using.
- ▶ *Early action outputs:* Where JESSICA can be used to expedite activity on site this would be beneficial to provision of outputs, but also as a positive impact on the wider Clyde Gateway programme
- ▶ *Attracting private sector development:* The use of JESSICA funding as equity or debt into the JV would attract private sector development. This would in turn provide many benefits, including:
  - ▶ Provision of liquidity into the project, assisting developers in the current climate. If this was a local company, this would also contribute to the wider economic rescue plan for the country.
  - ▶ Private sector expertise and experience to deliver a state of the art development

### Challenges

Key challenges of using JESSICA funding in this project that require further investigation include:

- ▶ Detrimental impact on timetable where setting up a JESSICA holding fund would take longer than the indicative procurement schedule.
- ▶ Implications of adopting a new structure in order to benefit from JESSICA funding, for example accounting requirements, tax considerations and change in procurement process.
- ▶ Increased risks associated with involvement of a private sector partner.

- ▶ Ability of the URC to provide funding into a project company due to its Charitable status

**Alternative options**

There are currently three alternative options if JESSICA funding is not utilised on this project:

- ▶ No development due to lack of funding
- ▶ Change in scope as a result of lack of funding available
- ▶ 100% funding provided by Clyde Gateway URC

It is clear that all of these options would impact on the wider regeneration programme as they would result in a lack of development or a diversion of grant funding away from use in other projects as gap funding.

## Appendix C Case study: Ravenscraig Ltd

### Introduction

The development of a JESSICA holding fund in Scotland is an opportunity to increase the speed of delivery and impact of regeneration across the country. In undertaking the case studies, meetings were held with the case study teams where the concept of JESSICA was discussed.

This section summarises the inception of the case study vehicle, its strategic objectives and the current financial position.

#### North Lanarkshire

Based in the heart of Scotland, North Lanarkshire has a population of around 324,680 and covers one of the largest local council areas in the country, encompassing Airdrie, Belshill, Cumbernauld, Coatbridge, Kilsyth, Motherwell and Wishaw town centres. As the fourth largest unitary authority in Scotland, North Lanarkshire covers 47,358 hectares including 18,066 hectares of agricultural land.

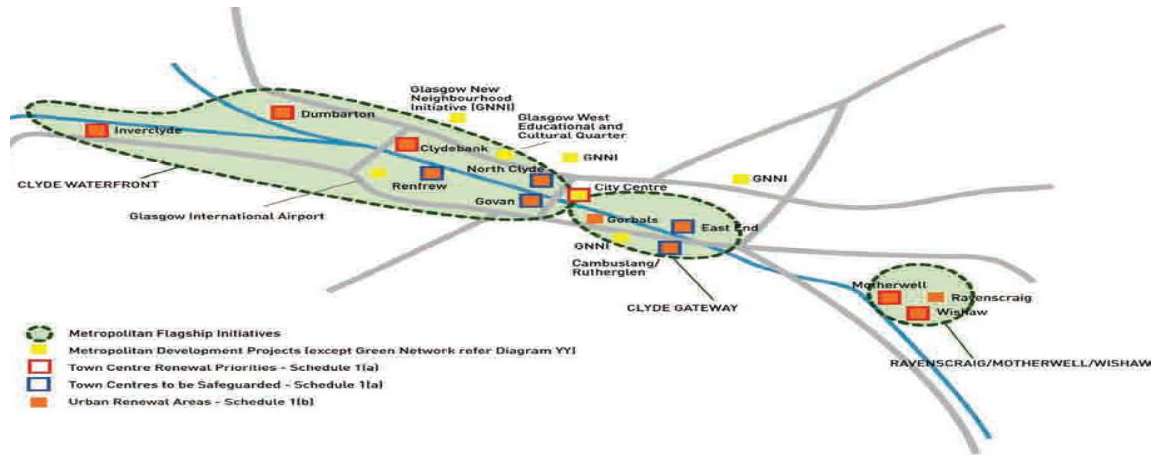
In the Scottish Economy Report 2005-08 North Lanarkshire emerged as the fastest growing economy in Scotland at 8%, beating the Scottish average of 7.2%. Although manufacturing has steadily decreased, the service sector's growth has risen by 30% since 1997, with the finance and business sector now employing 23,000 people – an increase of 50%. Joint ventures have led to the creation of modern business parks increasing the business base and employment opportunities. Economic activity has increased in the last eight years and now stands at 77%, up from 69% in 1999.

However, the North Lanarkshire economy has been particularly affected by the recent economic downturn due to the areas reliance on the manufacturing sector. The recession in the UK has had a profound impact on North Lanarkshire's town centres with the number of redundancies doubling in recent years. As a result the number of individuals claiming out of work unemployment benefit over the past year has increased by 99% in the year to February 2009 with the National Statistics of April 2009;. This is well above the national average for Scotland (64%) and other comparable areas of Fife (58%), Glasgow City (48%) and Dundee City (64%). This trend is expected to continue well into 2009.

North Lanarkshire has relatively higher numbers employed in construction and manufacturing than many other Scottish local authorities, and these sectors have severely suffered as house building and major capital projects have slowed, and global demand for manufacturing has declined rapidly. While reliable statistical evidence is not yet available, anecdotal evidence provided by the Case Study team suggests that the business base and rate of business start ups in North Lanarkshire will have slowed markedly over the past year. Again, this trend is expected to continue into late 2009 and early 2010 before markets and global demand begin to pick up again.

#### Ravenscraig Corridor

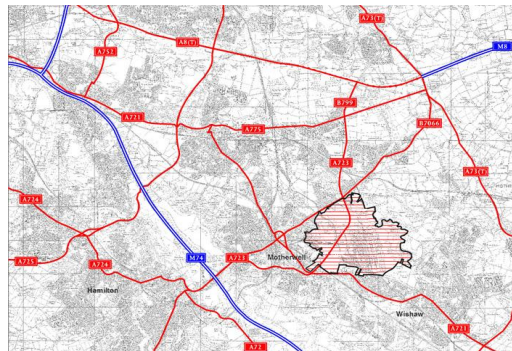
In the Glasgow and Clyde Valley Joint Structure Plan 2006, the towns of Motherwell, Ravenscraig and Wishaw were identified as one of the Metropolitan Flagship Initiatives due to their importance and scale of joint action required in the regeneration of the area. These three towns are collectively known as the "Ravenscraig Corridor". Along with Clyde Waterfront and Clyde Gateway the Ravenscraig Corridor was deemed to have particular significance for the implementation of the Metropolitan Development Strategy, being the main focus for the longer term development of the Structure Plan area. The National Planning Framework recognizes these three areas as national spine priorities being central to the restructuring of the metropolitan area and to the competitiveness of Scotland. The location of these Metropolitan Flagship Initiatives is shown in the diagram below:



The development priorities for the Structure Plan were reaffirmed in the Scottish Governments National Planning Framework (2004) and the Regeneration Policy Statement (2006) which identified Lanarkshire as one of the key economic development zones for Scotland.

**Ravenscraig**

Ravenscraig is located on the former Ravenscraig steelworks site in Lanarkshire. It lies between Motherwell and Wishaw. A new transport network will link the M74 and M8 and the potential for a new railway station linking to Glasgow and Edinburgh is currently being investigated. Ravenscraig is shown in the map below:



The objective of the Ravenscraig project is to transform Scotland’s largest underperforming land asset into a new development which will act as a catalyst to attract further investment in the region. The overall project will be taken forward by Ravenscraig Limited on the basis of a series of stand alone phases over a 20 year period.

Ravenscraig Ltd was established informally in 1999 and legally determined a partnership in 2006 to deliver one of the largest regeneration projects in Europe. Ravenscraig Ltd, is the Special Purpose Vehicle (SPV) set-up set-up between Scottish Enterprise, Wilson Bowden (now Barratt Developments) and Corus to deal with the redevelopment of the Ravenscraig site. The Joint Venture agreement entered into is complex with an obligation on Scottish Enterprise, to administer, but not necessarily fund applications by Ravenscraig Ltd for public sector contributions to the project towards gap funding. The partners in the SPV, along with North Lanarkshire Council, have over the last 10 years developed plans for the site which will ensure that the site will contribute to the growth of the Glasgow Metropolitan Region.

Ravenscraig Ltd is funded through loans from its private sector shareholders and funding from European and national sources. Income is generated through land sales post development at open market value and through development agreements between the parties whereby any surpluses generated by development above the developer’s cost plus

20% profit is distributed. Income is distributed via a waterfall agreement that reflects the respective inputs of the parties into the project.

### Ravenscraig Ltd objectives and outputs

The Ravenscraig project masterplan was approved by the Council in 2005 and the House of Lords in 2006. Its aims were to:

- ▶ Generate £1.215 billion private sector investment on completion
- ▶ Enhance, build and grow the business base with the provision of 216,000 sq m of commercial floor space
- ▶ Create new employment opportunities through 11,952 fte jobs
- ▶ Provide skills and employment opportunities through 446 training places and 397 vocational qualifications
- ▶ Attract and retain residents through the provision of 3,500 houses for up to 10,000 people
- ▶ Promote sustainable land use through the remediation of 455ha of mixed use development
- ▶ Enhance and improve the external image of the region

### Financial planning

Prior to inception, a demolition and decontamination programme was undertaken by Corus and two pre development phases were completed by Scottish Enterprise with assistance from EU Funding. The first Scottish Enterprise programme in 1998 was the construction of a spine road through the site and the second programme in 2003 was the remediation, decontamination and platforming of 40ha of land for commercial use.

Phase 1 of the project is to be delivered over 8 years at a total cost of £62.802m. Investment committed to date totals £32.96m made up of:

Investment (£m)	Corus	SE	EU	WBD	Total £m
Decontamination & Demolition	20.00				20.00
1st Pre Development Programme		7.03	3.37		10.40
2nd Pre Development Programme		4.11	4.00		8.11
Planning & Design Fees (historic)				1.30	1.30
Planning & Design Fees (Phase 1)				TBA	
Phase 1		12.86		20.10	32.96
Total	20.00	24.01	7.37	21.40	72.78

EU funding was provided within the 2000-2006 Programme under priority 2.1.

Phase 2 of the project is currently under review, however the proposed development is represented in the diagram below.



## JESSICA challenges and opportunities for Ravenscraig Ltd

The development of a JESSICA holding fund in Scotland is an opportunity to increase the speed of delivery and impact of regeneration across the country. In undertaking the case studies, meetings were held with the case study teams where the concept of JESSICA was discussed.

This section summarises the thoughts of the case study teams in implementing JESSICA in Scotland.

### Application and bidding

- ▶ *Eligibility criteria* – Clarification was requested on the inclusion of tourism and retail as an eligible activity. The retail aspect of the proposed project could create 3,500 jobs which is very significant although does not appear to be eligible under the revised priority 3 wording.
- ▶ *Size of fund* – A £25m Jessica contribution was felt to be far too small nationally. Note: this is the JESSICA element of the fund and with match funding of 60% the size of the overall fund would increase.
- ▶ *Capitalisation of the fund* – It was felt that the Scottish Government could seek to increase cash based match funding contributions at Holding Fund level, thus creating a larger loan fund.
- ▶ *Capitalisation of the fund* – SE have assets which could be part of a UDF, or potentially a national Holding Fund in order to demonstrate match funding at Gartcosh and Carrickstone Woods, although this is not specific to Ravenscraig Ltd.
- ▶ *Allocation of funding* – It was agreed that investment should be needs driven and not spread too thinly across the country. Prioritisation should be given to key urban development projects.

### Recycling of income

- ▶ *Recycling of receipts* – The views of the Case study team varied. NLC felt that it would be important to allow the receipts to recycle within NLC area. Scottish Enterprise took a slightly different view and noted the potential need for other areas of the country to re-bid into the fund.

### UDF structure

- ▶ *Type of UDF* – NLC have a wide range of potential projects that may be eligible for JESSICA funding and it will be important to ensure that the UDF covers the most appropriate areas to achieve maximum benefits.
- ▶ *Impact on other capital programmes* – There are projects currently within the geographical area that could utilise JESSICA instead of grant or capital funding. This would free up investment for other projects increasing the impact and speed of delivery of regeneration in the area.

### Ravenscraig Ltd Specific

- ▶ *Funding gap* – The key issue for the project is a funding gap on public sector infrastructure where projected land receipts are no longer sufficient to cover the cost of this.
- ▶ *Private sector partners* - At the start of the JV arrangement (the then developer) Wilson Bowden was cash rich and could augment this with bank debt to fund infrastructure, the cost of which was then recouped from land sales with a priority return. The private

sectors will have an obligation to continue to provide projects, however their ability and appetite to do this is as yet untested.

- ▶ *Amendment to existing Joint Venture Agreement* – Any change in the current project structure may require an amendment to the existing joint venture agreement.

## Potential JESSICA Projects

This case study was intended to explore the possibility of using JESSICA funding for projects within the Ravenscraig Ltd masterplan. Following discussions with the project team, it became evident that there were limited projects within Ravenscraig Ltd that met with the JESSICA eligibility criteria. The Case Study project team consisted of people from Scottish Enterprise and North Lanarkshire Council that are also involved in the projects within the Ravenscraig Corridor. Therefore, projects have been included within this case study that are out side Ravenscraig Ltd, but are within the Ravenscraig Corridor as evidence that there are viable projects in the area. If JESSICA was used in these projects, it would indirectly release substitution money that could be used in the case study project and benefit the wider area.

### Ravenscraig Ltd

The Ravenscraig masterplan includes £140m of infrastructure required to create serviced sites including roads, decontamination and utility preparation.

The public sector contribution to the infrastructure was estimated to be in the region of £70m, however this is currently under review. In addition, the current economic climate and recent acquisition of the previously cash rich private sector investor, has resulted in a detrimental effect on the cash flow of the company. This has the potential to impact planned developments and delay delivery of the project. A number of projects within Ravenscraig have been reviewed within this case study.

### Equity into Ravenscraig Ltd

One option raised by the partners was whether JESSICA funding could be used to invest equity into Ravenscraig Ltd either as a repayable contribution towards the public sector funding requirement or as a substitute for private sector equity. The income distribution waterfall would be amended to reflect this, which on sale of the land post development would enable repayment.

The availability of JESSICA funding relies on meeting eligibility criteria. Where support for projects investing in the rehabilitation of the physical environment, specifically work around the decontamination and servicing of brownfield land, is provided it must be demonstrated that the end use of the land is directly linked to ERDF eligible activity. Currently the serviced sites identified are for mixed use including housing, retail and business space. In order to secure JESSICA funding it may be required to demonstrate that the funding will only be used to service sites that more clearly meeting the ERDF criteria.

There are likely to be a number of challenges in meeting the eligibility criteria for this investment. Where the development is to be made suitable for new or existing SME's, it will be necessary to demonstrate the demand for SME space within Ravenscraig. This may present a challenge to the project due to the abundance of SME space in the locality. Where the development is to be used for housing, it will be required to demonstrate that there is investment stimulating energy efficiency in multi family social housing.

### BRE Innovation Park

Ravenscraig Ltd are in discussions with BRE to rent out a plot of land for the construction of Up to 6 full scale demonstration buildings and a visitor centre using energy efficient technology. These homes will be multi family social housing and the promotion is similar to that undertaken in Garston, Watford that opened in 2005. Scottish Enterprise are considering their position due to the nature of the investment.

It was deemed that there was no opportunity for JESSICA funding due to the lack of repayment ability and difficulty meeting the eligibility criteria as the houses are due to be demolished after the promotion period.

### ***CHP Plant***

Discussions have taken place with the Board on the potential to create a CHP plant within Ravenscraig to provide district heating. The proposal has not been through a feasibility study and is not currently part of the masterplan.

In principle a CHP plant may meet the JESSICA eligibility criteria, however due to the lack of information available it was not considered further within this case study.

### ***Ravenscraig Train Station***

Ravenscraig Ltd are currently in discussions with Network Rail regarding the creation of a new station connecting Ravenscraig with Glasgow and other Lanarkshire towns. The proposal is currently undergoing Scottish Transport Appraisal Guidance stage 1 (STAG 1). The proposed track will join the Wishaw Deviation Line and is currently estimated to cost £10m.

The station has the potential to provide retail or commercial space and will be connected to the town using a Park and Ride system, with appropriate car parking facilities provided. Acting as a safe transport hub, the station area will provide public transport to the area, connecting it with areas of opportunity for employment, as well as inwards travel.

The construction of a safe transport hub does meet the eligibility criteria and there are a number of options for the use of JESSICA funding within the project. Where the station is to be funded in full through public sector funding, JESSICA could be used to contribute towards this cost with repayments made through the rental income from retail space, car parking or park and ride charges. Alternatively, where the station is financed using Network Rail's Regulated Asset Base (RAB), JESSICA may be used as an up front capital contribution, reducing future repayment requirements.

### ***Ravenscraig Corridor***

#### ***Wishaw Business Centre***

The development of Wishaw is an integral part of the urban development plan for the Ravenscraig Corridor. This project is the creation of a business centre aimed at SME's in the service sector as an incubator and for those relocating from facilities that are not currently fit for purpose or are constraining growth. JESSICA repayments would be made through ongoing rental received, or through sale of the units.

The project has received approval by the Council to be taken forward with outline plans indicating planning approval may be obtained within 9 to 12 months. The land is currently owned by NLC, with indicative costs provided by a quantity surveyor and summarised below.

Net floorspace = 754m <sup>2</sup>	
Total Construction Cost	£1,735,000
Available Funding (NLC or Partner)	£1,000,000
JESSICA Loan	£ 735,000

Note: Costs shown are based on construction costs not residual capital value of the buildings

#### ***Wishaw Hub Facility***

This project is the creation of a 'hub' that would house a range of accommodation for business and services for both the commercial and public sector. This would provide a central "One Stop Shop" for the town, housing a public library, e-learning centre, employability and careers services as well as office space for SMEs. The space would be occupied by

SMEs relocated from facilities that are not currently fit for purpose or are constraining growth. JESSICA repayments would be through ongoing rental payments.

The project is currently under review by the Council, with acquisition of the site yet to be completed. It is assumed that grant would be used to fund the acquisition and that public sector tenants would take out a head lease on the building. The project is estimated to be two years away from a start on site, with indicative costs provided by a quantity surveyor and summarised below.

Net floorspace = 4300m <sup>2</sup>	
Total Construction Cost	£8,690,000
Available Funding (NLC or Partner)	£2,000,000
JESSICA Loan	£6,690,000

Note: Costs shown are based on construction costs not residual capital value of the buildings

In order to maintain a balance of projects across the Motherwell-Ravenscraig-Wishaw corridor projects for Motherwell have been included. The projects however do not have costs in the detailed way the Wishaw projects have but they are included in a variety of strategy and action plans, approved by the Council, for delivery.

#### ***Park Street Corridor, Motherwell***

The area between the western edge of Ravenscraig and Motherwell Town Centre has been identified in the current local plan as a significant corridor link between the areas required to be developed if Motherwell is to achieve benefit from the new development. In the short term it is seen as a possible link between Motherwell college, the regional sports facility and Motherwell Railway station, until such time as more permanent infrastructure is in place in Ravenscraig. The Council has started development of the area through development of the Dalziel Building, a 5 storey office block. Ownership of land within the corridor rests almost entirely with the private sector with the exception of another 2 plots of council land. The area caters for a mixture of business uses at present, small and medium scale, and a proportion of this would continue.

A masterplan is in place and is currently being revised Work on estimated costs and a repayment plan have not been considered at this stage and therefore it is not clear how JESSICA could be used within the project.

#### ***Motherwell Railway Station***

Discussions have been taking place, initiated by SPT, over the refurbishment and redevelopment of the station area. The project includes new car parking, office accommodation and better communication links to the town centre of Motherwell and onwards to Ravenscraig. The project could bring a number of new business opportunities, be sustainable in terms of transportation, and would increase connectivity to the metropolitan area and within the corridor.

The construction of a safe transport hub does meet the eligibility criteria and there are a number of options for the use of JESSICA funding within the project. Where the station is to be funded in full through public sector funding, JESSICA could be used to contribute towards this cost with repayments made through the rental income from retail space, car parking or park and ride charges. Alternatively, where the station is financed using Network Rail's Regulated Asset Base (RAB), JESSICA may be used as an up front capital contribution, reducing future repayment requirements.

This project is included within a variety of strategy and action plans, approved by the Council, for delivery.

### **Drumpellier Business Park, Coatbridge**

Fusion Assets is the local a regeneration company in North Lanarkshire. It is a strategic development vehicle, owned by North Lanarkshire Council. The focus of the company is to deliver commercial development projects in areas of market failure that will create sustainable regeneration and long-term economic benefits by helping to regenerate, diversify and sustain town centres and brownfield sites. Priority has initially been given to the Airdrie & Coatbridge and Motherwell, Ravenscraig & Wishaw corridors.

Fusion Assets are currently working on the development of owner-occupied offices at Drumpellier Business Park. Planning consent is in place and a property development partner, Ogilvie Construction, have been appointed. The 3-acre serviced site is situated west of Coatbridge, close to the M8 and a five-minute walk from Kirkwood rail station. JESSICA funding would be repaid through the sale of assets post construction.

Whilst there is not a clearly defined integrated urban development plan document in place for Fusion Assets there have been a number of studies undertaken by advisers identifying market failure that could come together as an urban development plan. The project has received ERDF funding for decontamination of the land under the 2000-06 ERDF Objective 2 programme. Indicative costs are summarised below:

Net floor space = 5,000 sqm <sup>2</sup>	
Total Construction Cost	£9,000,000
Available Funding	£4,000,000
JESSICA Loan	£5,000,000

Costs shown are based on construction costs not residual capital value of the buildings

### **Summary of JESSICA investment**

It is clear that further work would be required on most of these projects to develop a firm investment proposition. At this stage, no projects have been developed with the detailed supporting calculations necessary to underpin a bid to a Holding Fund Manager for JESSICA investment. The projects will take different timescales to develop to this level and will require negotiation with existing shareholders in the case of Ravenscraig Ltd. Using the information available, it is not certain that the projects meet the eligibility criteria, especially that within the case study. However, it is clear that there are other projects in the area that may benefit from JESSICA, freeing up capital for contribution into Ravenscraig which would result in JESSICA indirectly supporting the overall success of the North Lanarkshire area.

In the event that the investment requirements from the projects described above were packaged into a North Lanarkshire UDF, the overall JESSICA investment, based on the high level assumptions made in this case study and the assumption that Ravenscraig Ltd investment could be demonstrated to meet the eligibility criteria, would be:

Project	Potential JESSICA investment
Ravenscraig Ltd – Station Development	£10.0m
Wishaw Business Centre	£0.73m
Wishaw Public Service Hub	£6.69m
Motherwell	[TBC]
Drumpellier Business Park	£5.00m
<b>TOTAL</b>	<b>£22.42m</b>













## Assessment against JESSICA criteria









All ERDF and JESSICA projects will be subject to individual scrutiny to ensure that the required eligibility and investment criteria are met. Further detail on the proposed wording amendments are available in section 7. Due to the high level information available at this time, the assessment may be subject to change as further information comes available.

For illustrative purposes, this section reviews the proposed project against the ERDF eligibility criteria and contribution to targets.

### Assessment against eligibility criteria

The project was assessed against current and proposed eligibility criteria for ERDF P3 projects considered to be improving the potential capacity of urban areas to develop and linking urban areas of need with areas of opportunity.

Improving the potential capacity of urban areas to develop	Ravenscraig Ltd		North Lanarkshire Wide	
	Assessment	Rationale	Assessment	Rationale
Support for <i>development</i> , refurbishment and enhancement of locally based training/learning and e-skills centres <i>(NB the development of training/learning &amp; e-skills will only be allowed if it forms a component part of an integrated urban development plan)</i>		no projects identified which meet this criteria		The Wishaw HUB would provide careers and e-learning services
Support for <i>development and</i> refurbishment of <i>existing</i> facilities and workspace to make them suitable for new or established SMEs (especially those that employ "green design" principles) <i>(NB development of workspace will only be allowed if it forms a component part of an integrated urban development plan)</i>		no projects identified which meet this criteria		All projects provide accommodation for SMEs
Support for <i>small-scale</i> conversion and adaption to industrial sites and business centres/facilities that offer employment or training opportunities to people living in targeted areas (especially those that employ "green design" principles)		no projects identified which meet this criteria		no projects identified which meet this criteria
Support for <i>small-scale</i> energy production from renewable energy technologies in response to local energy needs		no projects identified which meet this criteria		no projects identified which meet this criteria
<i>Support for measures that stimulate energy efficiency in multi-family social housing (priority will be given to projects that form part of an integrated urban development plan). Further justification to follow</i>		The CHP project scope may meet this criteria once developed		no projects identified which meet this criteria
<i>Support for projects that invest in the rehabilitation of the physical environment (specifically work around the decontamination and servicing of brownfield land and gap sites but only if it can be demonstrated that the end use of the land is linked to ERDF eligible activity. This activity is eligible only as a component part of an integrated urban development plan and excludes development of public realm unless a reasonable and direct physical link is made with ERDF eligible activity).</i>		The CHP project scope may meet with this criteria once developed		The Wishaw HUB site is partly gap

Linking Urban Areas of Need with Areas of Opportunity	Ravenscraig Ltd - Station		North Lanarkshire	
	Assessment	Rationale	Assessment	Rationale
Support for locally based job brokerage schemes that aim to match disadvantaged individuals with employment opportunities		no projects identified which meet this criteria		Wishaw HUB will provide a base for the local job brokerage scheme
Supporting safe transport hubs to link areas of need with those of opportunity		Ravenscraig station & transport hub will link Ravenscraig to opportunities in Glasgow and Lanarkshire		Motherwell station will link Ravenscraig to opportunities in Glasgow and Lanarkshire
Support for investment in increased local access to ICT facilities within communities with the intention of improving skills of local people seeking to re-enter the labour market and increasing access to web based public services		no projects identified which meet this criteria		Wishaw HUB will provide ICT facilities for local people
Support for projects that promote clean and sustainable public transport to link areas of need with areas of opportunity.  (NB this activity will only be allowed if it forms a component part of an integrated urban development plan).		Ravenscraig station & transport hub will promote public transport		Motherwell station will promote public transport

### Assessment against Indicators

Having provided evidence that the project meets ERDF3 eligible activity criteria, the project was assessed against the indicators and targets contained within the LUPS Operating Plan. This assessment is summarized below. Please note that the Motherwell projects have not been included within this assessment due to the early stage of the project scope.

Indicator	Type	Target	Ravenscraig Ltd Target	North Lanarkshire Target
<b>Linking urban areas of need with areas of opportunity</b>				
Number of job brokerage initiatives supported	Output	210		HUB: 1
Number of ICT facilities supported	Output	350		HUB: 1
Number of transport hub projects supported	Output	25	1	
Increase in the number of individuals gaining employment through supported job brokerage schemes	Result			Result
Increase in the number of individuals gaining employment through supported ICT facilities	Result			Result
Time saved per journey	Result		Result	
<b>Improving the potential capacity of urban areas to develop</b>				
Number of e-learning/childcare and other community facilities supported	Output	350		HUB: 1
Area of business space created or modified (m <sup>2</sup> )	Output	7,500	TBC	WishawHUB:4,500m Wishaw BC: 754m Drumpellier: 5,000m Note: All net
Number of renewable energy projects	Output	180		

supported

Number of enterprises supported	Result	1,100	TBC	WishawHUB: 20 Wishaw BC: 8
Increase in the number of individuals gaining employment through supported e-learning/childcare/community facilities	Result			WishawHUB: Result
Increase in share of energy for renewable resources in supported areas	Result			
<b>Priority as a whole</b>				
Number of gross jobs created	Result	4,500	TBC	WishawHUB: 250 Wishaw BC: 60 Drumpellier: 700
Number of gross jobs safeguarded	Result	3,600	TBC	WishawHUB: 200 Wishaw BC: 40 Drumpellier: 310
Number of net jobs created	Impact		TBC	WishawHUB: 50 Wishaw BC: 20 Drumpellier: 390

## UDF structure

There are three options for UDF structure within this case study assuming all projects can be demonstrated to meet the eligibility criteria:

- ▶ A number of separate UDF's per project using existing set up of companies, eg Ravenscraig Ltd, Fusion Assets and a subsidiary of the Council investing into specific project companies.
- ▶ A North Lanarkshire wide UDF investing in individual project companies. A UDF may not be a local authority and therefore in the second option, a North Lanarkshire UDF would need to be incorporated as a new body corporate.

Use of an existing company, for example Fusion Assets as a UDF

### Match funding

There is a requirement to demonstrate match funding twice within the JESSICA programme. Firstly, match funding is required to be demonstrated in order to draw down JESSICA funds from the Commission. This can be done at Holding Fund or at Project Co level and may be in the form of cash, land or other assets. At the end of the Programme in 2015, the Project Companies are required to demonstrate that match funding has been spent.

If match funding for the national JESSICA programme is identified nationally at holding fund level, then no specific arrangements would need to be made locally upon creation of the UDF in relation to assets or cash as match funding. Monies passed from the Holding Fund to the Project Company, via the UDF will be deemed to have met the matched criteria and the Project Co will have satisfied the necessary criteria, assuming it is fully spent on eligible activities within the period.

The assets used to capitalize the fund at Holding Fund level may be substituted at any time throughout the programme. Therefore, they need not be those that are eventually used within the Project Company.

Where capitalization at Holding Fund level is not possible, or assets are put into the Holding Fund on a temporary basis in order to draw down the JESSICA contribution, the UDF or Project Company may be required to provide their own match funding. The process by which this would be done is still under review, however where land has been identified at Project Co level and could be used as match funding, the contribution to the Holding Fund by Project Co could be substituted by a contribution directly into the UDF in exchange for an investment in

that UDF. Project Co would then receive the net investment required from the UDF but on repayment would effectively get the value of the land back as an investor in that UDF.

## Impact of JESSICA on Identified Projects

The possibility of JESSICA funding will have an impact on the identified project, creating new and exciting opportunities to deliver an improved development with a local private sector partner. However, the project may be subject to challenges throughout the process and new additions to the risk register.

This section reviews some of the potential impacts of JESSICA on the identified project.

### Benefits

It is envisaged that JESSICA will bring the following benefits to the project:

- ▶ Due to the lack of cash available in Ravenscraig Ltd in the current climate, where JESSICA is used in Ravenscraig Ltd to substitute private sector contribution, this will enable delivery to continue on the project while providing time for the private sector partners to recover.
- ▶ Where JESSICA funding is used on projects in the wider North Lanarkshire area, this will free up funding to be used in Ravenscraig Ltd, allowing a greater number of projects to be completed.

### Challenges

Key challenges of using JESSICA funding in this project that require further investigation include:

- ▶ Ravenscraig Ltd may struggle to demonstrate meeting the eligibility criteria to qualify for JESSICA funding.
- ▶ The working assumption is that the identified projects would generate nil return in a most likely scenario, i.e., payback of initial JESSICA investment only. This would impact the potential for an evergreen fund at national level.
- ▶ Repayment of JESSICA investment is unlikely to occur in most of these projects before 2015. The ability to recycle funds quickly is therefore relatively low, as would be expected of a challenging long term regeneration programme.
- ▶ The requirement for 60% match funding at UDF may be an issue for the project. While land assets may be available in some cases, a number of attractive projects with strong outcomes and repayment potential may not be able to secure match funding under the framework required by the UDF structure.
- ▶ There would be a requirement for Ravenscraig to amend the existing waterfall agreement. This may contribute additional time and cost to the project.

## Appendix D References

### European regulations and guidance

EC 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999

COCOF/07/0018/01-EN Note on the Commission services on Financial Engineering in the 2007-13 programming period

COCOF 08/002/03-EN Guidance note on Financial Engineering. Final version of 22/12/08

Commission regulation EC No 1828/2006 of 8 December 2006 setting out the rules for implementation of Council regulation EC No 1083/2006

Commission services replies to the questions submitted by the JESSICA Expert Working Group of the Council, Final 12.09.08

Council Regulation EC 1083/2006

of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999

Council Regulation EC 284/2009 of 7 April 2009 amending Regulation EC No 1083/2006

### JESSICA presentations

Conclusions of the EU JESSICA Expert Working Group, JESSICA Networking Platform Brussels 2009

EU Funding for Urban Regeneration & JESSICA, EIB SocInvest 08

JESSICA in Implementation, EIB JESSICA Task Force, Brussels 2009

JESSICA Regior D3 Financial Engineering

### National documentation

Glasgow and the Clyde Valley Joint Structure Plan 2006

Letter to Mr Chris Kirby ref REGIO/E/2/KD D(2008) 750535

Lowlands & Uplands Scotland European Regional Development Fund 2007-2013 Structural Funds operational programme, Scottish Government

People and Place: Regeneration Policy Statement, Scottish Government

Information provided by the case study teams

## JESSICA in Scotland - Feasibility of a Railway Thematic UDF

### Introduction

The purpose of this paper is to provide an example of the way in which a railway thematic UDF may be created within the JESSICA structure in Scotland to deliver railway upgrades and enhancements.

The possibility of a railway thematic UDF was explored due to the number of railway projects contained within the case study projects and the advantage of a single owner of the assets across the county.

The paper summarises the current utilisation of the Network Rail Regulated Asset Base (RAB) for a single railway project and considers the possibility of utilising the RAB to compliment JESSICA investment within a single UDF for a number of railway projects. The example contained within this paper makes a number of high level assumptions that require further investigation and there has been no market testing with Network Rail, local authorities or the Commission.

### The Regulated Asset Base

An existing product that scheme funders can utilise to deliver rail enhancement projects is Network Rail's (NR's) Regulated Asset Base (RAB). Under the RAB financing option, NR finances the cost of construction through either third party borrowings or the utilisation of cash surpluses and is repaid by the Local Authority over a 30 year period. The vast majority of RAB financed infrastructure works are pre-approved by the Office of Rail Regulation (ORR), which sets an efficient delivery price.

Similar to a PPP contract NR is able to recover the value of the initial investment (straight line over a 30 year period) plus a financing charge. It is anticipated that from 1 April 2009 this financing charge will be as low as 4.75% (real) which makes the use of NR's RAB a competitive form of financing.

The efficient price will be added to the RAB at agreed milestones and differing pricing mechanisms can be agreed as set out below. The pricing mechanism adopted will to some degree depend upon the level of design and evaluation that has been carried out. It is recognised that project timetables may not allow sufficient time to enable NR to commit to a fixed price. The ORR has stated that it has a preference for a pricing structure consistent with one of the options set out below:

- **Fixed** - where the scheme promoter seeks a fixed price from NR, NR will usually take all risks associated with construction and management of the scheme. Schemes are generally treated on a fixed price basis as NR's large portfolio of schemes means that the company can diversify the risk of cost overruns across its portfolio. This is the ORR's preferred approach but recognises that this may not always be appropriate or acceptable.
- **Target** - where a target price estimate is agreed in advance between NR and the funder. Under this option there is a pre-defined allocation of risk in the event of variations from this estimated target price, often with a pain/gain share mechanism which shares both downside and upside risks between stakeholders;
- **Emerging Cost** - the costs incurred by NR on the scheme are remunerated, usually subject to a cap on costs and review of actual cost against estimates at defined stages, which may include an efficiency review; and
- **Cost reimbursable** - all costs incurred are reimbursed in full to NR by the funder.

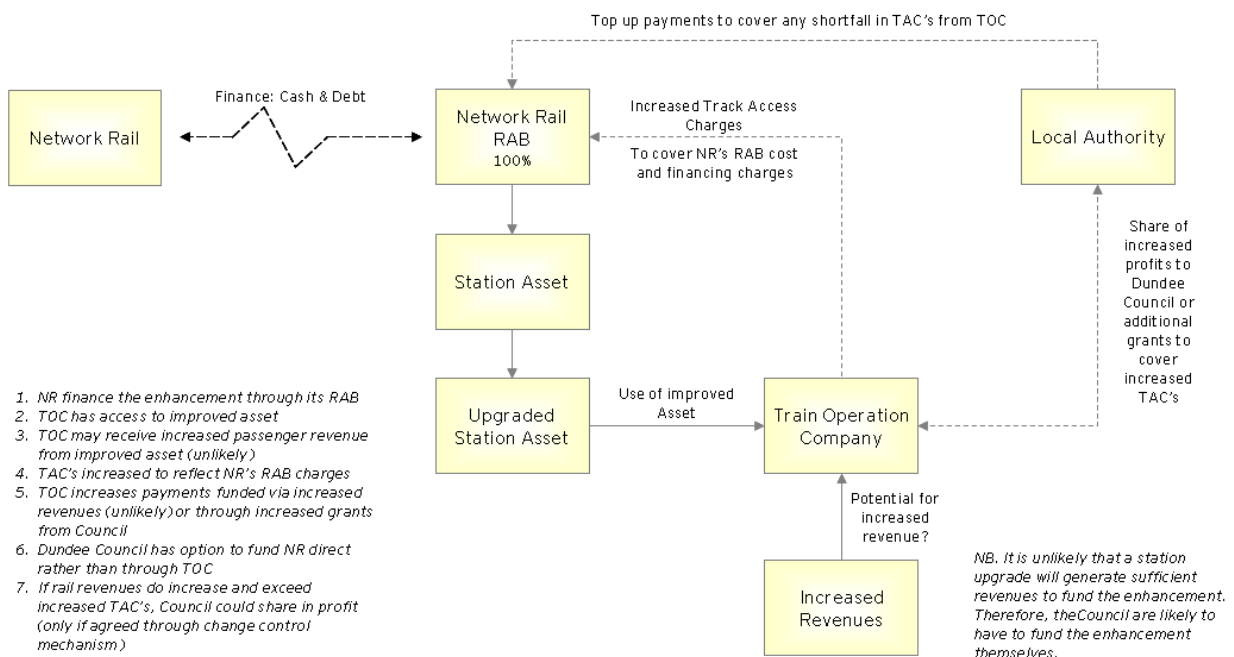
One of the roles of the ORR is to provide independent efficiency reviews of projects to ensure that NR is allowed sufficient funding to take on enhancement responsibilities. The ORR will use its powers to ensure NR meets its licence obligations and delivers 'Customers Reasonable Requirements' under license condition 7.

The table below summarises the main advantages and disadvantages of using RAB financing as it is currently used outside of the JESSICA structure:

RAB Financing	
Advantages	Disadvantages
<ul style="list-style-type: none"> <li>➤ Involvement of ORR helps to support efficient delivery through price review and enforcement</li> <li>➤ ORR involvement ensures greater risk transfer to NR</li> <li>➤ NR provides finance during construction</li> <li>➤ From an affordability perspective, funding commitments are spread over 30 years following completion and acceptance of asset</li> <li>➤ Return on RAB provides for NR taking delivery risk regarding outturn cost and provides for maintenance</li> <li>➤ Tried and tested method of funding within the Rail Industry</li> <li>➤ NR currently has capacity to borrow within Scotland.</li> </ul>	<ul style="list-style-type: none"> <li>➤ NR's RAB/debt ratio may act as a constraint to this option in the future</li> <li>➤ Additional interfaces when compared to traditional grant funded procurement due to involvement of ORR</li> <li>➤ Funding over 30 years may compromise ability to fund future projects</li> <li>➤ Capacity and/or appetite of NR to engage.</li> </ul>

### The Regulated Asset Base - Current Utilisation

A generic transaction for a local authority using the RAB to upgrade a station is summarised in the diagram below:

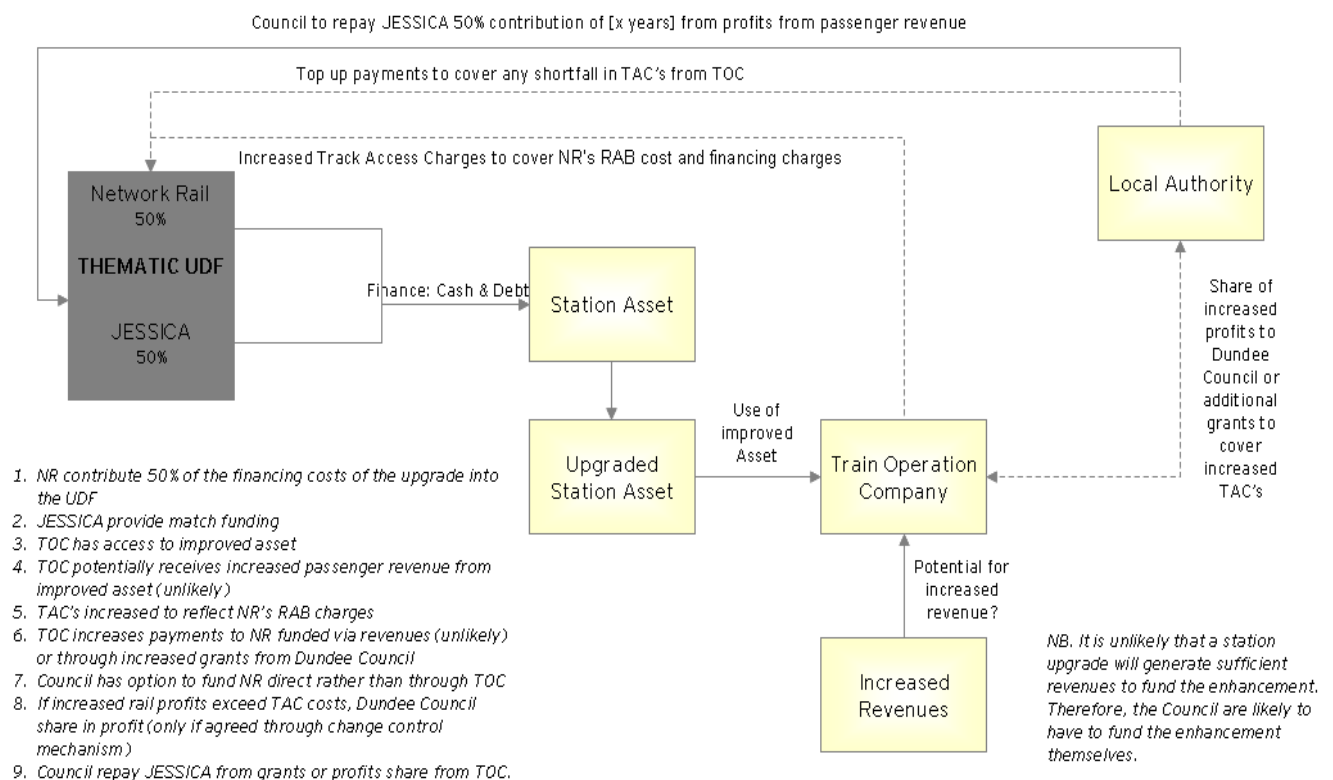


## The Regulated Asset Base - Utilisation within a JESSICA structure

In considering the potential for the RAB to be utilised within a UDF, a number of high level assumptions have been made. Key assumptions are:

- ▶ That the project is considered eligible under the ERDF priority 3 criteria
- ▶ That all parties are prepared to enter into the transaction

The diagram below summarises the transactions and the necessary steps:



There is the potential for the funding into the UDF to be further enhanced through contributions from local authorities requiring upgrades that contain economic rather than financial benefits or from the Scottish Government transport budget.

Whilst the solution presented above is feasible in theory, there are a number of challenges presented that would require further consideration, in addition to verification of the assumptions made above.

- ▶ Network Rail Return - The return required by Network Rail on the RAB is fixed and contains an element of interest and an element of profit. It would be likely to require a priority ranking over any JESSICA investment and confirmation that this set up would meet Network Rail internal procedures.
- ▶ UDF Costs - As discussed in the main report, there are likely to be set up costs for organisations that do not currently meet the JESSICA UDF criteria and for the ongoing monitoring and audit requirements associated with receiving a contribution from the Structural Funds. It is not certain that Network Rail would take on these costs or additional responsibilities.

- ▶ Commerciality - Station upgrades are rarely commercial and often rely on the Local Authority providing a contribution towards repayment. Whilst the level of repayment is likely to be lower using a combination of JESSICA and the RAB, a full appraisal would be required on a case by case basis.
- ▶ Level of Investment - The current assumption is that the JESSICA fund in Scotland will total approximately £50m. The costs of a railway station redevelopment vary, but have been up to £100m for a single station. Where there are a number of high specification projects that are of high capital value there is likely to be a limit to the number of projects that the UDF can undertake. This may decrease the attractiveness of setting up a UDF for Network Rail.

## **Conclusion & Recommendation**

This paper considers one option under which it may be feasible to use the Network Rail RAB to compliment JESSICA funding within a single UDF. In order to conclude if this is practical, further discussions are required with Network Rail with further considerations given to the assumptions and challenges noted above.