

DERBY CITY COUNCIL REGENERATION FUND

INVESTMENT STRATEGY

12th NOVEMBER 2010

1. Introduction

Derby City Council recently approved the creation of a £10 million Regeneration Fund to support the private sector delivery of new high quality commercial development within the City and seek to perpetuate the progress made within the City on major regeneration schemes.

This Investment Strategy sets out;

- The rationale for the creation of the new Regeneration Fund.
- The identified goals and objectives of the Regeneration Fund.
- The preferred alternative funding mechanisms which will be considered to support projects, though this will not be an exhaustive list.
- The various stages of the investment appraisal process.
- The programme for the operation of the Regeneration Fund.
- Governance of the Fund.

It is set out as follows;

2. Derby City Council Regeneration Fund

In accordance with Council Cabinet approvals dated 16th February 2010 and 28th September 2010, Derby City Council approved revenue and capital funding for the establishment of a Regeneration Fund subject to the approval of an Investment Strategy. It is proposed that the Regeneration Fund will be formally launched in November 2010.

Key elements in relation to the operation of the Fund are summarised as follows;

2.1 Requirement For Regeneration Funding

Derby has been successful over the past decade in developing a significant advanced engineering sector within the city based upon the success of major employers such as Rolls-Royce (aerospace) and Bombardier (railway engineering) which has resulted in average wages considerably in excess of the regional and national average. Virtually all of the new private sector development activity has been on sites outside the city centre such as Pride Park and Wyvern Business Park which have taken advantage of enhanced accessibility and car parking in attracting new occupiers. It is noted that Pride Park and Wyvern Business Park have been able to meet occupier's needs particularly in terms of car parking, which has not been available at similar levels within the City Centre. It is estimated that some 90% of take-up of offices in 2008 was in relation to accommodation outside the city centre.

Annual office take-up in Derby is estimated at 200,000 sq.ft. per annum over the past year with a peak of 280,000 sq.ft. in 2008, although this included a single letting of 93,000 sq.ft. The Derby office market competes particularly with East Midlands centres in Nottingham and Leicestershire which have both historically performed better in terms of take-up and values and offer a range of high quality office accommodation to potential inward investors. Part of their success is through having an established office market together with speculative developments, neither of which have been experienced in Derby.

The city centre has seen major investment over recent years with the opening of the Westfield Shopping Centre and new public sector projects such as the new Magistrates Court, Jury's Inn and the proposed refurbishment of the Council House building. There are also a number of new hotel developments such as within the Derby Riverlights scheme around the new bus station. Other recent projects include Connecting Derby which will complete the construction of the inner ring road in February 2011 and the LightSpeed Derby project to create high speed broadband throughout the city centre.

Despite these major developments being undertaken the city centre has not seen new office development for over 20 years and consequently the existing stock is of medium or moderate quality. A number of sites anticipated to come forward for development remain in the pipeline and accordingly, there is no stock of existing offices under construction within the City capable of meeting the requirements of businesses seeking Grade A accommodation.

A number of developers in recognition of the above have been seeking to bring forward major new office schemes in areas such as within the Cathedral Quarter and other opportunities around the city centre core area. However with existing city centre office rentals estimated to be around £16.00 per sq.ft. for new build space and based on current development costs, funding costs and rentals at this level do not make speculative development viable without grant funding or significant pre-lets in place.

Alternative sources of grant funding or financial support for projects through the Regional Development Agency (emda) or the European Funding Programme are now extremely limited.

A supply of high quality new speculative office space is considered a key requirement in attracting new occupiers to the city centre including financial and professional services companies of which there is a notable lack of presence. Derby City Centre is currently unable to compete with other city centres in the East Midlands such as Nottingham and Leicester due to a lack of good quality supply of available accommodation, despite the benefits of a occupational cost advantage, good accessibility and the attractive cultural and retail offer available.

Derby City Council have therefore recognised the benefits of identifying funding as a catalyst to support the private sector in bringing forward the early provision of new high quality speculative office development within the City Centre.

2.2 Target Programme Outputs

It is proposed that the £10 million Regeneration Fund will secure the following range of outputs;

- Secure the delivery of 20,000 sq.m. (215,285 sq.ft.) of new quality office accommodation within Derby City Centre.
- Secure £75 million of private sector investment within the City Centre.

- To secure the beginning of the establishment of a new office core area within Derby City Centre.
- To create or safeguard 500 new jobs.
- To seek to secure BREEAM 'excellent' standards where possible to increase the environmental sustainability of buildings within the city centre.
- To promote sustainable mixed use developments with linkages to the city centre area.
- Bringing redundant or underutilised existing buildings back into economic beneficial use
- To secure returns from projects receiving support under the Fund to enable investment to be made in other future projects over the longer term.
- Conserving and protecting heritage assets and public realm.

Any proposals for funding contributions shall be considered in relation to securing the above range of outputs and value for money benchmarks.

2.3 Potential Funding Mechanisms

Proposals will be considered for a range of alternative funding mechanisms to support private sector companies in the delivery of high quality accommodation contributing to the above range of outputs. Funding for individual projects will be considered on the basis that the investment is the minimum net contribution required to secure the delivery of the project and that the form of investment is the most appropriate required within the circumstances. Any investment proposed is to also take into account the fact that the City Council would seek to endeavour to secure longer term returns for recycling into future projects within the Regeneration Fund.

It is anticipated that funding mechanisms which may be considered will include equity investment into various forms of joint venture arrangements, which may reflect alternative priorities of return, debt finance arrangements and short term rental guarantees at realistic market rental levels. As a last resort the use of gap funding to address viability issues may be considered due to the impact on the ability to recycle receipts within the fund.

Any proposed investment will require to be compliant with all relevant legislation and guidance including OJEU, State Aid and procurement.

With regard to criteria for investment relating to each of the funding mechanisms and associated governance with legislation and state aid, these are identified (though not in order of preference) as follows;

i. Equity Investment/Joint Ventures

- The City Council may vest land (at market value) or funds to contribute to costs of reclamation, infrastructure provision and built development. Public funding may also be used to fund professional fees associated with the works but not internal (revenue) developer costs such as personnel time.
- Investment made by the public sector to sit side by side with the private sector with all receipts/profits apportioned between the parties in accordance with level of investment made.

- The project must demonstrate the ability to repay the investment made by the public sector along with an acceptable/appropriate level of return in accordance with risk.

ii. Debt Finance

- Investment made must be demonstrated to be recoverable by the Council in an appropriate period of time along with an acceptable level of return in accordance with market (commercial) terms.
- Ability for the Council to step in/recover their investment in the event of any default by the developer. Investment may be secured by way of a legal charge over the property.

iii. Rental Guarantees

- To be available on a short term basis (typically a maximum three years) and at a maximum of market rental levels.
- Consideration to be given to stepped arrangements i.e. 75% in year one, 50% in year two and 25% in year three (if required).
- Consideration also to be given to offering rental guarantees on a proportion of available floor space within a building which may provide sufficient confidence and financial cushion to enable development to commence.
- Projects to demonstrate how any funding drawn down as a rental guarantee to be repaid including timescales for repayment.

iv. Direct Acquisitions/Development by Derby City Council

- The City Council may acquire at market value, land or property considered key for the delivery of the Regeneration Fund and identified target outputs.
- The City Council may undertake the direct development of land and property assets it owns in accordance with securing target outputs identified by the Regeneration Fund. Any projects will be undertaken in accordance with public procurement and OJEU regulations.

v. Gap Funding

- Derby is not within the definition of Assisted Areas for the EU Assisted Areas Map and therefore funding is only available to small enterprises at 10% and medium enterprises at 20% intervention levels (in accordance with advice received from emda's internal state aid expert in July 2007). A clear definition for SMEs will therefore require to be provided.
- Projects to be considered/appraised in accordance with eligibility criteria including eligible uses, market value, eligible works, costs in accordance with market rates, deliverability and relevant outputs generated.
- Any funding to be invested by way of a gap funding agreement in accordance with EU regulations.

The Regeneration Fund will seek to work with other funding sources such as ERDF or the East Midlands Urban Development Fund JESSICA vehicle to seek to maximise the impact of the Fund, although it is recognised that this will be subject to an apportionment of project outputs between different funding sources.

3. Marketing of Derby City Council Regeneration Fund

A marketing campaign will be undertaken to promote the availability of the Regeneration Fund and that any decision with regard to funding is undertaken in the light of the fullest range of projects for consideration.

It is proposed that the creation of the £10 million Regeneration Fund would be advertised in the Commercial Property Section of the Derby Telegraph and the Estates Gazette providing national exposure to the property development and agency markets.

A specific website will be created which will be utilised to hold all relevant information including background and target outputs and enable interested parties to draw down application forms and other relevant documents.

A launch event proposed on the 23rd November 2010 will seek to raise the profile of the fund with local business leaders, developers, property owners and agents and a promotional leaflet prepared and circulated which would refer interested parties to the website for the Fund as well as providing contact details for parties wishing to discuss specific opportunities.

4. Project Appraisal Process

Derby City Council have now appointed Chartered Surveyors and legal consultants to support the project appraisal process and provide additional resources to enable all enquiries to be dealt with within identified timeframes and to provide an independent professional opinion as to the suitability of projects coming forward. It is recognised that the Fund would be unable to support all of the potential proposals which have been previously identified as well as new projects which may come forward. Thomas Lister Ltd have been appointed to undertake project appraisal and supporting valuation work as well as taking overall responsibility for the management of the Fund on a day to day basis. Anthony Collins Solicitors have been appointed to advise on legal matters including procurement, state aid as well as the legal mechanisms for any agreements for investment undertaken by the Fund.

In accordance with advice received from the consultant team, it is proposed that appraisals shall be undertaken in a three stage process and would identify each of the relevant stages as follows;

4.1 Preliminary Project Assessment (PPA)

The first stage would provide a preliminary assessment of the project with the overriding objective that only projects meeting the objectives of the fund are taken forward to the appraisal stage and that the applicant would not be required to spend significant time and money on pursuing projects with no chance of success. A PPA may be undertaken on the basis of limited project information but would require site plan, indicative development appraisal including basic scheme details and confirmation of site ownership or how the site may be subject to the control of the applicant.

A PPA would be undertaken by Thomas Lister (with input from Anthony Collins Solicitors where appropriate) for review by the client group and this would include a scoring of each of the projects against the following criteria;

- *Deliverability* – this would provide an assessment as to the ability of the applicant to deliver the scheme against criteria such as planning status, site ownership and any site constraints identified such as vacant possession or ground conditions.
- *Value for Money* – the ability of the project to contribute to the generation of the identified outputs against the level of investment proposed (both gross and net of the identified future returns)
- *Alignment to Strategic Objectives* – an assessment as to the extent to which the proposed project meets with the objectives of the Fund – such as the delivery of new high quality office accommodation within the City Centre and key strategies of the City Council, including the Local Plan and Derby City Centre Framework.
- *Design & Sustainability* – the design and sustainability standards achieved and how these contribute to enhancing the existing stock of accommodation within Derby City Centre.
- *Track Record and Financial Standing of Developer* – an assessment of the capability of the applicant to deliver the scheme including experience in the undertaking of similar projects.

Based upon the project scoring achieving an agreed minimum threshold, then interested parties would be invited to submit an outline application for investment. It is anticipated that this will require the developer to address any issues identified within the PPA process.

Thomas Lister will complete the PPA for client review within one week of receipt of project information.

4.2 Outline Application and Assessment

Where invited to do so, the applicant will draw down the application form together with guidance notes available to support the completion of the form which will include a schedule of all of the information which is required to support the outline application. It is anticipated that this will enable a full understanding of the developer's proposals to be obtained including costs, values, identification of a series of project options and any additionality, also potentially including the use of different forms of investment.

It is anticipated that Thomas Lister will work closely with the applicant in both supporting them in the completion of the application, identification of project options and any issues to be addressed. The Outline Assessment report will review information and identify a preferred way forward whether by way of a joint venture, rent guarantee or other identified form of funding. The level of funding required would also be estimated along with commentary as to whether this represents value for money.

The outline assessment would be reviewed by a group including senior officers of Derby City Council. Where appropriate, the applicant would be invited to submit a detailed application for investment.

Thomas Lister will complete the assessment within two weeks of receipt of completed and signed outline application and all of the necessary supporting information.

4.3 Detailed Application and Assessment

The detailed application form and guidance would be available on the programme website and would require full information to be provided. This stage of the appraisal process will require the provision of full project information and the appraisers will be required to

provide a red book valuation and a cost appraisal report prepared by quantity surveyors to support any recommendations for the type and level of investment proposed.

It is anticipated that this stage would involve detailed negotiations between applicants and appraisers as to the level and form of proposed investment including issues such as cashflow, security for investment, and distribution of returns and proposed levels of developers profit. Any detailed assessment report will require the completion of a full Heads of Terms for the proposed investment – potentially including input from Anthony Collins Solicitors. This will include a detailed recommendation to officers including the timescale for funding as it is regarded as a key element of the programme that this achieves early site activity as opposed to improving the profitability of pre-let schemes. Therefore any offer of funding would require to be time limited with regard to commencement on site.

Any applicant will require to confirm that they will enter into the Derby City Council Recruitment and Training Agreement.

Any offer of funding would be subject to the completion of an appropriate funding agreement.

Thomas Lister will complete the detailed appraisal within two weeks of receipt of completed and signed detailed application and all of the necessary supporting information.

The detailed assessment and supporting reports will be presented to Derby City Council for Cabinet Approval to the proposed investment. Cabinet meets on a monthly basis.

5. Programme

The Regeneration Fund will operate from the 1st December 2010 until such time as all of the resources within the Fund are fully committed. Regular updates as to the availability of funding shall be provided through the Fund website. An indicative programme for implementing and administering the Fund is detailed as follows:

- Launch event to be held on 23rd November.
- Enquiries received following the launch event until funds under the programme are fully committed.
- Cabinet approval to the Investment Strategy obtained by the end of November.
- Appraisals of initial schemes submitted and seeking funding completed by December 2010.
- Heads of Terms for approved projects completed by the end of February 2011.

DCC have indicated that subject to the success of the Fund they may consider the making of further investments within the Fund. In addition, it is anticipated that as projects mature and equity investments are realised there will be the opportunity for the re-cycling of funding to support further projects.

A full update will be provided as to the progress of the Fund on a quarterly basis indicating the number of projects within each stage of the fund application process.

6. Governance

As previously noted, the formation of the Derby City Council Regeneration Fund has received all necessary approvals within the Council subject to the preparation and approval

of the Investment Strategy. Capital and revenue funding have been allocated within the Council's budget for 2011/2012 and future years.

Each individual investment by the Fund will be subject to Cabinet Approval by Derby City Council and any investment sought will be subject to a recommendation by the City Council's appointed property consultant. Approval documentation will include the Full Appraisal report, red book valuation and cost report together with legal due diligence report and will confirm that the proposed project is in compliance with all relevant legislation and guidance including state aid and procurement matters.

7. Conclusions

The Derby City Council Regeneration Fund is set up with a specific goal of sustaining the ongoing regeneration of Derby and is specifically targeted at projects which will deliver maximum impacts to the City centre.. The Fund is created in the limitations of other available public sector funding sources to seek to address the shortage of Grade A office accommodation within the City centre which is identified as being required to meet the requirements of high added value businesses which are sought to be attracted to the City.

The Investment Strategy sets out the objectives, prioritisation and the appraisal process to be undertaken in order to evaluate the most appropriate projects and forms of funding necessary to deliver these within current market conditions in accordance with legislation and state regulations.