

## **AGENDA ITEM 6**

### **REPORT TO THE TEES VALLEY COMBINED AUTHORITY CABINET**

**21 DECEMBER 2017**

### **REPORT OF THE INVESTMENT DIRECTOR**

### **PORTFOLIO: INVESTMENT**

## **INVESTMENT UPDATE AND PROJECT APPROVAL(S)**

### **SUMMARY**

The purpose of this Report is:-

- to update Cabinet on progress with delivery of the Investment Plan;
- to inform Cabinet of Middlesbrough Borough Council's proposal to bring forward the development of new advanced manufacturing accommodation at Tees Advanced Manufacturing Park (TAMP) in Middlesbrough, designated as an Enterprise Zone; and
- to seek approval for an additional £6.15 million of Combined Authority investment in the £21.84 million TAMP project (on top of £1.5 million of grant funding previously approved), to fund site acquisition, ground remediation and infrastructure works to enable the TAMP site to be brought forward for such development.

### **RECOMMENDATIONS**

It is recommended that the Combined Authority Cabinet:-

- i. notes progress to date with the delivery of the Investment Plan, including levels of funding currently committed and in the pipeline;
- ii. notes MBC's proposal to bring forward the speculative development of approximately 180,000 sq.ft. of new advanced manufacturing accommodation at TAMP;
- iii. subject to the formal approval by MBC's Executive of MBC's funding for the project (scheduled for its meeting on 19<sup>th</sup> December 2017) and to the satisfactory completion of due diligence under our Assurance Framework, approves the allocation of up to £6.15 million of additional Combined Authority investment funding in respect of site acquisition, ground remediation and infrastructure works at the TAMP site. £1.5

million of grant funding has previously been approved in the Investment Programme, as announced in the original Growth Deal with Government;

- iv. approves the use of the Combined Authority's prudential borrowing powers, once they are in place, to fund the TAMP project with the repayments to be financed from the additional Enterprise Zone business rate income to be received as a result of the investment; and
- v. delegates the finalisation of the funding and associated contractual arrangements for the TAMP project to the Managing Director and the Finance Director.

## PROGRESS WITH DELIVERY OF THE INVESTMENT PLAN

1. The Combined Authority continues to make good progress in delivering the Investment Plan that was agreed in April of this year, now covering the delivery of over £477 million of investment up to 2021.
2. By way of update a number of commitments have been made since the launch of the Investment Plan in April including:-
  - Great Places Programme;
  - Culture Programme;
  - New Apprentice Grant;
  - Routes to Work Pilot Project;
  - Salters Lane Ingenium Park Infrastructure;
  - Port Clarence Logistics Site Improvements; and
  - Kirkleatham Catering Academy & Walled Garden and Teesside University National Horizons Centre completed due diligence and moved to delivery.

### 3. Investment Plan Summary Table

	2016/17	2017/18	2018/19	2019/20	2020/21	TOTAL
OPENING BALANCE	78,643,488	81,806,269	58,277,173	42,007,069	44,521,330	305,255,329
COMMITMENTS	31,501,275	65,481,296	57,640,075	31,513,628	20,339,000	206,475,274
PIPELINE	0	2,440,862	54,312,680	73,567,202	68,812,656	199,133,400
<b>BALANCE AT YEAR END</b>	<b>47,142,213</b>	<b>13,884,111</b>	<b>-53,675,582</b>	<b>-63,073,761</b>	<b>-44,630,326</b>	<b>-100,353,345</b>
<b>CUMULATIVE BALANCE</b>	<b>47,142,213</b>	<b>61,026,324</b>	<b>7,350,742</b>	<b>-55,723,018</b>	<b>-100,353,345</b>	

#### Assumptions:-

- That all requested funding is approved;
- That costs are correct, these will be tested through the Business Case;
- No borrowing included;
- No alternative funding sources are secured such as National funding for example NPIF transport schemes or HCA infrastructure funds etc.;
- Includes known pipeline only;
- Does not represent the direct match or leverage from investments. This will be tested through the business case; and

- *Does not include any further allocations to regional projects or further commissioning of activity by the Cabinet.*
4. The total requests for TVCA investment currently stand at £199 million, £100 million over the level of currently available funds, excluding borrowing.
  5. TVCA are working hard on accelerating delivery and are currently forecasting to spend over 100% more than in 2016/17. This has been the result of:-
    - Increased development funding;
    - Flexibility and security of multi-year funding;
    - Increased in-house legal and commercial expertise; and
    - Direct and supportive programme management arrangements.
  6. This was discussed in our recent 'Annual Conversation' with Government on the Local Growth Fund, and provided Government with the assurance the programme was picking up speed.
  7. We continue to review and streamline our processes and address capacity constraints where possible to accelerate delivery, project development and decision making to bring the pipeline forward.
  8. Annexe A sets out a summary of progress, business cases received and those in development.
  9. The current pipeline for European funding is £34.5 million with a minimum requirement for c£14 million match from these proposals. £101 million of European Funds is also potentially available to the Tees Valley. DCLG notified us that the next call window will open on 8th December to account for the Autumn statement. The calls will still close on 26th January 2018. Two calls will be launched:-
    - SME Competitiveness – revenue activity only £10m indicative allocation
    - Low Carbon – capital & revenue activity £5m indicative allocation

We expressed concern at the shortened period of time for applications but this is a national position. To allow as much time as possible for partners to develop applications an Information Event was held on Friday 24th November. There are a number of potential projects in the pipeline and one to one sessions have been made available for anyone wanting to discuss their project idea in more detail.

## **TAMP**

### Site History

10. TAMP is one of eight sites forming the Tees Valley Enterprise Zone and is an important development site for the Tees valley as a whole. The site extends to 11 hectares (32.12 acres) and is located at South West Ironmasters, less than a mile from Middlesbrough town centre and between the A66 Trunk Road and Riverside Park. An indicative map of the site is at Annexe 2.
11. Having been designated as an Enterprise Zone in 2012, development to date has been limited with only around 1 hectare (2.47 acres) having been developed to accommodate the current TWI facility, which is located on the north-eastern border of the site. Various schemes have been discussed by MBC with developers in recent years but have not come to fruition, largely due to the inability to demonstrate the

viability of prospective development due to the large costs of developing such schemes on a speculative build basis and the need for significant remediation work on a former industrial site.

### Project Description

12. The TAMP project aims to address the market demand in Tees Valley for business/manufacturing premises in the light manufacturing sector, which is not being met by private sector development. Local manufacturing businesses are currently restricted in terms of their growth options and ability to derive efficiency gains from modern accommodation.
13. This Project offers the Combined Authority and Middlesbrough Council, working in partnership, the opportunity to:-
  - (a) bring forward a key site that will enable potential inward investment and skilled employment opportunities for the Tees Valley;
  - (b) address market failure in the manufacturing accommodation/speculative investment market in the Tees Valley;
  - (c) directly contribute to the delivery of the Combined Authority's Strategic Economic Plan in terms of the supply of sites and premises for business growth, and by addressing brownfield land; and
  - (d) each recover their investment over time, through the receipt of business rates and rent arising from the development and occupation of the site.
14. The Project overall aims to deliver:-
  - (a) the remediation of 11 hectares of brownfield land and delivery of associated site infrastructure – by end 2018;
  - (b) Phase 1 development – approximately 180,000 sq.ft. of advanced manufacturing space (to be funded by Middlesbrough Council at its risk) on a speculative basis by 2020. Future phases can create approximately 100,000 additional floorspace, subject to demand;
  - (c) the hosting of up to 500 -1,000 direct skilled jobs in advanced manufacturing – assuming employment density of 1 job per 33 - 17 sqm, upon full occupation, by 2022;
  - (d) potentially an additional 100 - 200 indirect and supply chain jobs by 2025;
  - (e) an anaerobic digestion plant/gas turbine plant, both privately funded (these additional business rates are not included in current financial modelling); and
  - (f) the hosting of around 10 manufacturing/advanced manufacturing companies by 2022.
15. The Combined Authority has been requested to provide up to £7.65 million of grant funding to pay for site acquisition, remediation and infrastructure work on the TAMP site, to enable the development of high-quality, commercial accommodation which will be funded by MBC). £1.5 million of this sum was already approved in the

Investment Programme as announced in the original Growth Deal with Government, so this approval covers the additional £6.15 million.

16. The contractual arrangements will be structured so that:-
  - (a) The Combined Authority will enter into a funding agreement with MBC for the payment of the overall £7.65 million investment;
  - (b) MBC will enter into an agreement with the developer for design work and remediation and infrastructure work;
  - (c) MBC will enter into a separate construction agreement with the developer for the construction of the business accommodation on the site;
  - (d) After completion of the site and construction works, the ownership of the site will transfer from the developer to MBC;
  - (e) MBC will then enter into leases with occupiers;
  - (f) MBC will also set up arrangements for the marketing and management of the site.
17. As the TAMP site is within an Enterprise Zone, business rate income paid on the site is received by the Combined Authority, up to 2037. This allows the funding provided by the Combined Authority to be repaid from the collection of business rates from tenancies created as a result of the project (see below for further details). This is a good example of the benefits of Enterprise Zone status, allowing up-front investment to unlock business growth, and ensuring the rates paid by those businesses to recoup the initial investment over time. This would be the first example of the Combined Authority using new borrowing powers in this way, and is a model that is also being explored on other Enterprise Zone sites where a strong business case for investment can be developed.
18. The Combined Authority's investment funding will pay for site acquisition, site remediation and infrastructure. MBC is entering into a development agreement for the construction of the speculative business accommodation, at its sole cost (£12.5 million), and will take the risk on the letting and occupancy of that space.
19. Although the scope of Phase 1 of the construction development by MBC only covers a proportion of the site, the Combined Authority's funding will secure the remediation of the entire site. The potential second phase of site development can create further business accommodation and therefore additional business rates income for the future, which is not currently factored into the Combined Authority's business model for the investment.

#### Ambition and Potential Benefits

20. The aim is to create long term, high quality employment opportunities and boost economic growth through the provision of new manufacturing accommodation in a modern setting, building on Tees Valley's excellent connectivity and skills base to make a significant contribution to growth and exports. The high quality construction and site specification for TAMP aims to provide the conditions which support the retention and growth of existing businesses and the attraction of inward investment, with their associated supply chains.

21. The project objectives align with the Strategic Economic Plan, MBC's Investment Prospectus and the common goal of supporting the attraction of inward investment in strategic growth sectors such as advanced manufacturing and other sectors such as logistics.
22. Potential benefits arising from this development will also include:-
  - (a) the retention of businesses which might otherwise leave Tees Valley to seek better growth opportunities elsewhere;
  - (b) improved access to skilled employment opportunities - employment in advanced manufacturing is also more likely to require the skills transferable from legacy sectors such as steel making;
  - (c) increased economic outputs and improved efficiency in the local economy;
  - (d) encouraging investment in sectors with high growth potential which helps to diversify the local economic mix and increase economic resilience; and
  - (e) a catalytic effect on the speculative development market, proving the concept here and increasing the potential for further market investment in the area.

#### Evidence of Need and Demand

23. Through this development the public sector can enable the delivery of a major accommodation cluster for the growth of advanced manufacturing. This is the second fastest growing sector in the UK economy and offers significant benefits in terms of skilled employment, including the potential to build on the presence of TWI as the current anchor tenant on the site.
24. Advice MBC have received from sector specialists Cushman & Wakefield highlights that there is demand for new industrial/manufacturing accommodation of the scale proposed by this development. In the absence of public sector pump-priming, the development of such advanced manufacturing space to this scale is very unlikely at present, whereas the demand profile for such facilities is seen as robust.
25. This specialist advice suggests that the units, and the price point to which they are pitched, will secure reasonably long and stable tenancies, reaching a high level of occupancy within a reasonable timescale. A consequential risk highlighted is that the space might fill at the expense of some of the local accommodation stock currently available. However, it is also suggested that the downstream demand for commercial and light industrial units is such that the displaced units should also secure secondary occupation in a reasonable timescale, therefore reducing the long-term risk of market distortion.
26. The proposed scheme will be marketed nationwide, to attract advanced manufacturing businesses by providing a premium environment and quality accommodation. The quality of the scheme, coupled with its location at the centre of the Tees Valley road network, is therefore key to attracting inward investment.
27. Initial enquiries from potential occupiers are already being received by MBC and the developer. These are in advance of the site being marketed which could lead to pre-lets, therefore de-risking the development from the public sector perspective, with rental and business rate income potentially being secured before construction begins.

## Funding

28. MBC is proposing to use its prudential borrowing powers to fund the cost of construction of the business premises. Once the units are built, MBC will carry the liability to pay business rates to TVCA even if the buildings are empty.
29. MBC are therefore bearing a significant proportion of the risk profile for this project but, fundamentally, the proposal cannot proceed without the financial support of the Combined Authority. Given the ability of the Combined Authority to recover its grant funding through the Enterprise Zone business rates collected, there is no feasible alternative funding source available for the balance of this project without the Combined Authority's input and the input of the long term projected business rates for the site.
30. Through retaining the business rates uplift on the TAMP site until March 2037, the Combined Authority stands to make a return on its investment which can then be recycled into other Tees Valley initiatives. MBC commissioned Cushman & Wakefield to produce a delivery options report included in which was an assessment of the potential business rate income for the site. The report provided an estimated income level of £9.4 million until the end of the Enterprise Zone agreement in March 2037.
31. The Combined Authority has scrutinised the business rate calculations provided and has carried out sensitivity analysis tests on the assumptions made by Cushman & Wakefield in the report. The impact of applying all the sensitivities to the revised base position, is to reduce the estimated rate income figure for the period by £1.48 million to £8.37 million. This lower value would only arise as a result of all of the sensitivity scenarios being applied, and is therefore seen as a downside return that can be expected through business rates over the Enterprise Zone period.
32. Government has committed to granting borrowing powers to Combined Authorities from 2018. As this project would generate a direct return to the Combined Authority through Enterprise Zone business rate receipt and retention, we are proposing that we use these borrowing powers to fund the £6.15 million additional funding required (and potentially also the £1.5 million grant funding already approved).
33. By way of illustration, at the current PWLB rates this borrowing would result in a total value of interest repayable of £1.46 million if £6.15 million funds were borrowed straight away, with repayments until the end of the Enterprise Zone period in 2037. This would produce a total amount repayable of £7.61 million which provides £760,000 (9%) headroom against the sensitised business rates income of £8.37 million, and £2.24 million (23%) headroom against the revised base figure of £9.85 million.
34. Initially we would look at utilising our current investment plan cash reserves to fund the project and only borrow when this would be required, and where doing so would release resources needed to fund other priorities. If we assume that the borrowing is not required until 2021, this would result in reduced interest repayable of £1.29 million (based on borrowing £6.15 million). This would increase the headroom to £930,000 (11%) against the sensitised income estimates and £2.41 million (24%) against the revised base estimate.

35. The business rates included within the calculations are based solely on Phase 1 of the project and on the premises to be constructed by MBC. This is seen as prudent, as construction of any additional Phase 2 premises is not certain at this point. Within the Cushman & Wakefield report it indicates the potential rates for the planned Anaerobic Digester Plant at approx. £24,000 annually based on the current rates multiplier. It also gives an indication of potential rates for Phase 2 of the site, and at current rates this could produce an additional annual return of £190,000. However there is no indication of when this phase of the construction would proceed.

## **FINANCIAL IMPLICATIONS**

36. There are no financial issues arising from the Investment Plan update generally; any financial issues in respect of any of the projects arising from the Plan will be dealt with when considering the project specific funding arrangements in each case.
37. The TAMP proposal is to commit an additional £6.15 million to the TAMP project in the Combined Authority's Investment Plan, to be funded via Prudential Borrowing.
38. Investment Plan cash reserves will be utilised initially to fund the project, with borrowing powers to be utilised when the Investment Plan reserve needs to be replenished.

## **LEGAL IMPLICATIONS**

39. There are no legal issues arising from the Investment Plan update generally; any legal issues in respect of any of the projects arising from the Plan will be dealt with when considering the project specific funding arrangements in each case.
40. On TAMP, it is proposed that the Combined Authority carries out due diligence on the financial and legal aspects of the project proposal internally, although it will be also able to rely on the advice of Womble Bond Dickinson to MBC on procurement and state aid matters. In terms of technical due diligence, the Combined Authority will rely on advice from MBC's external technical consultants, who have agreed that their advice will be made available to the Combined Authority who will be able to rely on it.
41. Initial legal advice from Womble Bond Dickinson is that the overall transaction is permissible under the Public Contracts Regulations 2015 (PCR15) on the basis that there is only one possible provider of the works and services required for the development, due to the Developer's ownership of the TAMP site. Womble Bond Dickinson advise that this position has been successfully relied on elsewhere.
42. Confirmation of a satisfactory state aid position is currently awaited from Womble Bond Dickinson.
43. The Combined Authority will use its standard funding agreement for capital projects to govern the terms of its investment. The funding agreement will be tailored so as to minimise the risks identified in the risk section below as far as possible.

## **RISK ASSESSMENT**

44. The delivery of the Investment Plan more generally is categorised as low to medium risk. Existing management systems and daily routine activities are sufficient to control and reduce risk.

45. The key risks in relation to the Combined Authority's investment in the TAMP project are as follows:-
- (a) The Combined Authority's borrowing powers are not confirmed by Parliament – the timing of this confirmation is not critical to this project, as long as the powers are confirmed before the Combined Authority needs to borrow these funds, which may be more than a year away. However, if the Government decides not to confirm the powers at all, the risk is that the funding has been committed and defrayed, but it will take significantly longer to recover through Enterprise Zone business rate income. This is considered to be highly unlikely.
  - (b) The development stalling following the Combined Authority's investment but before the construction of the Phase 1 accommodation is complete. This will be managed through the Combined Authority's funding agreement with MBC, and through MBC incentivising the completion of the remediation and construction works through its contractual arrangements with the developer, including step-in rights;
  - (c) Where the development is completed, but the assessment of occupier demand proves inaccurate, the risk that rates actually paid are less than forecast. It should be noted that, once the buildings have been constructed, it would be the responsibility of MBC to pay the business rates to TVCA, even if the buildings are not occupied;
  - (d) The risk that in the future buildings are let to occupiers who do not pay full business rates (such as charities); this will be managed through a formal lettings policy agreed between MBC and TVCA, where TVCA would be required to consent in advance to any such occupation; and
  - (e) MBC sell the site at a future date – this will be addressed in the funding agreement with MBC.
46. Conversely, the risk of not delivering the development is a lack of quality accommodation to attract new inward investment or accommodate growing domestic companies. The risk is that, in the absence of this development, growth and inward investment opportunities may be lost to the Tees Valley, as businesses look farther afield to meet their accommodation requirements.

## **CONSULTATION**

47. MBC will be undertaking consultation on the development of the site through its normal consultation and planning processes.

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## ANNEXE A – Investment Plan Progress Summary

	Current Commitments*				Approved Programmes	Pipeline			
	Complete	In Delivery	Funding Agreement	Due Diligence	Business Case Development	Assessment	Business Case Development	Pipeline	
Amount	£7,441,119	£127,606,685	£26,185,000	£33,924,469	£11,318,000	£26,927,000	£139,612,558	£32,593,842	
No. Projects	6	52	10	16	3	7	26	11	
<b>Total Amount</b>	<b>£195,157,274</b>				<b>£11,318,000</b>	<b>£199,133,400</b>			<b>£405,608,674</b>
<b>Total No. Projects</b>	<b>84</b>				<b>3</b>	<b>44</b>			<b>131</b>
<i>* Includes Development Funding, Projects, Programmes and Specific Ringfenced Grants</i>									

Since the Investment Plan was published in April 2017, Business Cases been received to date for the following projects:-

1. Salters Lane/Ingenium Park (see earlier in this Report). £2.2 million in the current Growth Deal programme as grant, request for an additional £1.7million Combined investment. Infrastructure and improvements on the road network. **FUNDING APPROVED**
2. Port Clarence Logistics Limited – £300,000 Combined Authority capital grant/£300,000 private sector match. Site infrastructure improvements through an access road and river dredging. **FUNDING APPROVED**
3. Teesside Advanced Manufacturing Park\* – £7.65 million Combined Authority investment, total investment £22.5 million, joint investment with Middlesbrough Council and developer. Remediation and development of proposed Advanced Manufacturing Park in Middlesbrough. Aim: December/January Cabinet decision. **FOR CONSIDERATION AT CABINET IN DECEMBER**
4. Centre of Excellence in Technical Training (Hartlepool, former Northern Lights Academy) £874,900 Combined Authority capital and revenue grant matched with £214,369 HBC match. Refurbishment and initial revenue support for a currently mothballed facility – funding approved. **DELEGATED DECISION TO BE SOUGHT IN DECEMBER**
5. Elwick Bypass - £17 million Combined Authority loan. The NPIF bid announcements have now been made and Elwick Bypass did not receive funds in this round. This business case cannot go to Cabinet for an investment decision until the outcome of the outstanding HCA Infrastructure Fund bid, as this will determine the level of TVCA investment required - currently awaiting the outcome of bid which (if successful) will reduce the Combined Authority's investment requirement significantly. Strategic road improvements to unlock further sites for development. Aim: December Cabinet decision (dependent on timing of HCA announcement). **UNDER REVIEW**
6. Teesside University Healthcare Innovation Research Centre - £945,000 Combined Authority Grant with £855,000 private sector match. Upgrade of both facilities and equipment needed to house a joint TU-TWI medical research activity based on TAMP. The funds will enable TU staff to co-locate with TWI on the site, and will be used to develop the facilities so that equipment from both TU and TWI to be clustered in one location, thereby developing a critical mass of medical device and prototyping equipment and provide a base from which new research activity will take place, supporting TU to win and deliver medical focused research in collaboration with industry and other stakeholders. **UNDER REVIEW**

## **Business Cases currently being developed:-**

- Billingham Bio-Pharmaceutical Campus – June 2018
- Boho Next Generation – March 2018\*
- Central Park Infrastructure – TBC
- Darlington Station – TBC
- DTVA Northside Phase 1 - November 2017
- Eaglescliffe Station Western Access – November 2018\*
- Energy Life Cycle Centre – December 2017
- Faverdale Phase 1 – TBC\*
- Feethams Grade A Office Accommodation – December 2017\*
- Hartlepool Innovation & Skills Quarter Phase 2 – June 2018\*
- Hartlepool Waterfront – November 2018\*
- Hemlington Grange Business Park – Expected January 2018
- Kirkleatham Estate Investment Programme – December 2017\*
- Middlesbrough Rail Station & Historic Quarter – March 2019\*\*
- Redcar Railway Station Business Quarter – TBC\*
- River Tees Development Plan – TBC\*
- Skippers Lane Industrial Estate – March 2018\*
- South Middlesbrough Transport Infrastructure – TBC
- Teesside University – Space for Innovation and Enterprise – December 2017
- Teesside Media Innovation Village – January 2019\*\*

\*Development funding committed

\*\*Development funding being considered