**Cheshire and Warrington Local Enterprise Partnership Board Meeting**

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| **Agenda Item:** | 7 (i) |
| **Subject:** | Enterprise Zone Investment – Quadrant Phase 2, Birchwood Park |
| **Author:** | John Adlen |
| **Date:** | 18 March 2020 |

# Executive summary

WBC Birchwood Park Trustee Limited (as Trustee of the WBC Birchwood Park Unit Trust) has applied for an investment of up a maximum of £3,618,000 to deliver a £15.2m project to develop five industrial units totalling 15,773 sq m (169,785 sq ft) at Birchwood Park, Warrington. The scheme could generate c.£436k per annum in retained business rates, providing a payback of up to 8.3 years and potentially generating up to £9.1m in retained business rates over the lifetime of the EZ. The applicant is seeking grant funding on the basis of a gap in the overall financial viability of the scheme on the basis of an undeliverable return on investment owing to risk without EZ support.

The Quadrant Phase 2 investment was approved by the Enterprise Zone Board at its meeting of 24 January 2019 and was approved by the Performance & Investment Committee at its meeting of 21March 2019. As the investment could potentially be over the £2.5m delegation limit to the EZ Board, it is being presented to the LEP Board for final approval.

A copy of the term sheet is attached at Appendix A of this report. In order to cut down on the level of paperwork distributed, copies of the full business case and the Cushman & Wakefield appraisal report are available to Board Members on request.

# Recommendations/actions/decisions required

It is recommended that the LEP Board ratifies the decision of the Enterprise Zone Board and the Performance & Investment Committee to approve the investment in the Quadrant Phase 2 scheme at Birchwood Park and delegates authority to the Chair of the LEP Board and the Chair of the Enterprise Zone Board to sign off the legal agreement with the applicant, subject to the EZ loan facility being in place.

1. **Background**

Warrington Borough Council bought Birchwood Park from Patrizia in September 2017. Birchwood Park is held in a trust with Warrington Borough Council as the sole shareholder. Patrizia have been retained as Asset Manager for the site. In 2016, Patrizia developed phase 1 of the Quadrant scheme, comprising three industrial units 711 (13,911 sq ft), 713 (21,750 sq ft) and 720 (37,500 sq ft) Cavendish Avenue, all of which let within one year of practical completion.

1. **Scheme proposal**

Patrizia is proposing to develop a phase 2 scheme of five industrial units totalling 15,773 sq m (169,785 sq ft). The development will comprise the following units:

* Unit 717 – 1,699 sq m (18,290 sq ft)
* Unit 718 – 1,699 sq m (18,290 sq ft)
* Unit 719 – 2,236 sq m (24,072 sq ft)
* Unit 720 – 5,467 sq m (58,850 sq ft)
* Unit 721 – 4,671 sq m (50,283 sq ft)

1. **Financial summary**

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| **Project Item** | **(£)** |
| **Costs** |  |
| Construction Costs | 13,883,961 |
| Professional Fees | 1,634,865 |
| Finance Costs | 1,406,152 |
| Developer’s Profit | 2,911,275 |
| **Total Costs** | **19,836,253** |
| **Revenue** |  |
| Net Development Value | **18,530,254** |
| **Surplus/Gap** |  |
| **Gap** | **-1,305,999** |

The table above sets out the financial summary of the project as set out in the business case, which shows a gap of **£1,306,000**.

The EZ contribution is made up of three broad elements:

1. **Access road infrastructure** – a contribution of £650,000 towards the costs of providing an access road into the site, which are considered abnormal infrastructure costs that are impacting on scheme viability.
2. **Void and interest cover** – cover for void costs (including service charges and void rates) and finance costs for up to a maximum of 3-years on a reducing basis as each unit is let, which reduces the risk for the developer/landowner in the event of a market slowdown and gives them the confidence to develop this scheme speculatively.
3. **Electricity infrastructure** – a contribution of up to a maximum of £1m if required to cover reinforcement works to the local electrical infrastructure network to serve all development sites. This contribution will provide sufficient capital to enhance the network to enable additional capacity to be provided should this be required by a prospective high energy occupier.

As such, the scale of the investment from the EZ into the Quadrant Phase 2 scheme is between a minimum of **£650,000** and a maximum of **£3,618,000** dependent upon the pace of lettings on the new scheme and whether the electrical infrastructure works are required. The table below shows the estimated cost and payback period to the EZ depending on the scale of the ask.

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| **Scheme Element** | **Best Case Scenario**  **(£)** | **Assumed Business Case\* Minus Electricity Infrastructure (£)** | **Assumed Business Case\* (£)** | **Worst Case Scenario\*\***  **(£)** |
| Road infrastructure | 650,000 | 650,000 | 650,000 | 650,000 |
| Void Cover | - | 281,000 | 281,000 | 843,000 |
| Interest Cover | - | 375,000 | 375,000 | 1,125,000 |
| Electrical Infrastructure | - | - | 1,000,000 | 1,000,000 |
| **Total** | **650,000** | **1,306,000** | **2,306,000** | **3,618,000** |
| **Payback Period (years)** | **1.5** | **2.9** | **5.3** | **8.3** |

\* Assumes 1 year of void and interest cover as set out in the business case

\*\*3-years void and interest cover agreed with the applicant as the maximum contribution from the EZ

1. **Value for money**

The Quadrant Phase 2 project could generate c.£436k per annum in retained business rates and potentially generating up to £9.1m in retained business rates over the lifetime of the EZ. The investment could payback between 1.5 years to a maximum of 8.3 years against the worst case scenario. Negotiations on the legal agreement with the applicant has reduced the ask for rental cover from 5 to 3 years and has incentivised the applicant to accept tenants at the stated rental level in their development appraisal. Cushman & Wakefield’s appraisal notes that the project demonstrates good value for money on a cost per job basis relative to national benchmarks.

1. **Benefits**

The benefits associated with the investment case are set out in the table below.

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| **Benefit** | **Quantum** |
| New commercial floorspace (sq ft) | 169,785 |
| Brownfield land reclaimed (ha) | 5.62 |
| Number of new businesses attracted to the EZ | 5 |
| Number of gross new permanent jobs created | 480 |
| Number of net new permanent jobs created | 223 |
| Number of temporary construction jobs created | 100 |
| Gross Value Added (£) | 7.0m |
| Annual Retained Business Rated (£) | 436,000 |
| Total Retained Business Rates (£) | 9.1m |
| Public/Private Sector Leverage (£) | 13.9m |

1. **Risk analysis**

The following key risks are associated with this proposal:

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| **Risk** | | **Impact** | **Likelihood** | **Mitigation** |
| 1. | Uncertainty about level of investment from EZ required | Increased funding from EZ required | Low | The LEP has negotiated a finite investment envelope which caps the level of investment at £3.61m. |
| 2. | Estimated level of retained business rates not achieved | Would impact on the ability of the LEP to repay funding. | Low | Cushman & Wakefield have assessed the estimates provided by Patrizia as reasonable and benchmarked them against available VOA data on comparable properties at Birchwood Park. |
| 3. | Developers do not deliver projects on time or on budget | Delays in completion of schemes would impact on level of retained business rates, whilst budget overruns would further increase the viability gap on schemes. | Moderate | Patrizia UK is an established and pro-active international Asset and Development Manager that has delivered new development in excess of £180m in Gross Development Value, including 135,000 sq ft of industrial and office development at Winnersh Triangle, Berkshire; 175,000 sq ft office building at First Street, Manchester; and 85,000 sq ft of industrial in Glasgow. They have a good track record of refurbishing and developing new property at Birchwood Park, including Quadrant Phase 1. Warrington Borough Council as the landowner/funder is generally considered to be well resourced and WBC’s accounts indicate a Balance Sheet of £239.5m as at 31st March 2018. |
| 4. | Schemes do not achieve practical completion, which does not trigger the payment of business rates | Would impact on the ability of the LEP to repay funding. | Low | Track record of the developer and a longstop completion date set within the legal agreement, with clawback penalties for under-performance. |
| 5. | Developers deploy rate mitigation schemes to avoid empty rates | Could reduce empty rates payable to 25%, would impact on the ability of the LEP to repay funding. | Low | A ‘no rate mitigation’ clause built into the EZ investment legal agreement. |
| 6. | Schemes do not attract occupiers | Limited impact as developers still have to pay empty rates | Moderate | Applicant has evidenced market demand through a market report provided by a B8 property agents as well as being able to demonstrate strong enquires for this type of property and even lost enquires which they have been unable to satisfy due to lack of suitable premises. |
| 7. | Investments are not deemed to be State Aid compliant | Limited impact as the risk on State Aid sits with the developer | Low | Provision of a State Aid opinion as part of the legal agreement and by the LEP’s legal advisers. Clawback provisions in the EZ investment legal agreement are triggered by any State Aid breach. |

1. **Independent appraisal**

Cushman & Wakefield have undertaken a technical appraisal of the proposed investment which concludes that overall the project provides a good case for EZ investment in terms of:

* Strategic fit with the EZ Development Strategy
* Clear demand for the project given the evidenced scale of business enquiries received and lack of available supply of high-quality industrial units of this mid-scale within Warrington and the wider sub-region.
* The need and rationale for public sector support as demonstrated by the unwillingness of the market to risk speculative development and for occupiers requiring space for immediate occupation
* Good value for money in terms of cost per job and level of retained business rates
* Deliverability of the scheme including freehold ownership of the site, necessary planning consents and track record of the developer.

Cushman & Wakefield identified three areas that required additional clarification:

* A satisfactory State Aid opinion from the applicant’s legal advisors;
* Further evidence to support the applicant’s claim that they are exempt from public procurement regulations; and
* Further evidence from the Applicant that the assumptions in their financial appraisal represent the minimum cost in terms of the public sector investment required, in particular in relation to yields and profit margin.

These final points of clarification have been addressed during the drafting of the Investment Agreement.

# Investment agreement

An Investment Agreement has been drawn up by DWF acting for the LEP and Addleshaw Goddard acting for the applicant and a Term Sheet setting out the key commercial terms in the legal agreement is set out in **Appendix A**. Of note, is the fact that the applicant will only draw down the investment from the LEP at Practical Completion (PC) of the scheme, which removes the risk of non-completion or underperformance to the LEP and negates the requirement for a company guarantee as business rates liability are triggered at PC.

# Funding

The investment will be funded through the EZ Borrowing Facility established with Warrington Borough Council which will be repaid through the retained business rates generated.

# Conclusions and recommendations

The Quadrant Phase 2 scheme approved by the EZ Board and the Performance & Investment Committee represents a good investment for the Enterprise Zone. It provides a clear fit with the vision, strategic objectives and investment priorities set out in the EZ Development and Investment Strategy and provides a good ROI in terms of retained business rates and wider economic benefits to the Cheshire Science Corridor and sub-region.

On this basis, it is recommended that the LEP Board ratifies the decision of the Enterprise Zone Board and the Performance & Investment Committee to approve the investment in the Quadrant Phase 2 scheme at Birchwood Park and delegates authority to the Chair of the Enterprise Zone Board to sign the legal agreement with the applicant, subject to the EZ loan facility being in place.

**Appendix A: Investment Term Sheet**

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| **Recipient:** | WBC Birchwood Trustee Limited |
| **Project Name:** | Quadrant Phase 2 |
| **Amount of Investment:** | £3,618,000 |
| **Purpose:** | Development of £15.2m project to develop five industrial units totalling 15,773 sq m (169,785 sq ft) at Birchwood Park, Warrington. |
| **Funding:** | Local Authority Borrowing |
| **Repayment:** | From Enterprise Zone Retained Business Rates in connection with the Project, with a restriction on the Recipient utilising any rate mitigation schemes. |
| **Length of time site must be maintained to Approved Use:** | 10 years |
| **Key Milestones:** | The Recipient is obliged to adhere to the following key milestones within the project:   1. Longstop start date within 12 months (i.e. drawdown of first claim) 2. Practical Completion within 3 years of start date |
| **Draw Down of the Claim:** | Investment will only be drawn down on Practical Completion of the scheme and subject to the following:   1. Funder satisfaction that the Works to which the investment relates have been carried out to the approved project specifications 2. Funder satisfaction of the State Aid position 3. Funder satisfaction with any third party funding 4. Recipient has obtained the necessary consents |
| **Overage:** | An overage payment is payable by the Recipient, which is calculated on the sale price or an independent valuation at an agreed calculation date as follows:   1. Parties agreed project costs 2. Parties agreed priority return to investor of 25% 3. The Funder then achieves 50% of the Overall Surplus after those deductions. 4. Overage is payable on the earlier of Disposal at the end of the investment period. |
| **Permitted Changes:** | Any and all changes must be approved by the Funder via a Project Change Form. |
| **Permitted Disposal:** | The Recipient the right to dispose of part of/the site without triggering the overage clause for leases under 35 years |
| **Security:** | No guarantee is required as the Recipient will only draw down the investment on Practical Completion of the scheme. |
| **Events of Default/Clawback:** | The Recipient will be required to repay the monies in the following events:  (a) Any finding of State Aid breach  (b) Lack of progress towards Milestones and Targets  (c) Material Changes to the Project  (d) Usual insolvency provisions |
| **State Aid:** | The Recipient is responsible for ensuring that the Project is provided in accordance with State Aid Law. |
| **Monitoring:** | Monitoring reports to accompany any investment claims, plus an annual monitoring return for the remaining Project Duration (10-years). |
| **Boilerplate:** | The document contains the usual provisions and protections regarding Freedom of Information, Bribery Act and Confidentiality for this form of transaction. |