CITY OF YORK COUNCIL

Cabinet **4 March 2014**

Report of the Leader and Cabinet Member for Finance, Performance & Customer Services

Delivering Development Investment – Stage 2

Executive Summary

1. This report follows the Cabinet's approval of a more proactive approach to delivering development investment in November.

2. The report sets out the estimated overall scale of development – of sites and infrastructure – needed for the city to pursue its economic growth ambitions, as identified from early work to assemble a city-wide development pipeline.

3. In light of the investment priorities identified, the report sets out four broad funding options, which are explored at high level in the report – which range the spectrum from market-led approaches to more structured and proactive approaches which combine CYC and/or external investment.

4. The report recommends that Cabinet:

   (a) note the progress already being made across a range of development projects

   (b) agree to proactive development of the strategic investment pipeline ready for high level business case assessment against funding options;

   (c) develop a business case for the creation of a CYC commercial fund;

   (d) develop a business case for the creation of a joint venture investment vehicle ready for potential engagement with a strategic external investor;

(e) dedicate the necessary resource from Economic Development Unit to manage the development of this work, and delegation of responsibility to the Chief Executive and Director of CES to make changes to internal structures to provide the necessary resource to progressing this work;

(f) agree to the development of a project board to oversee development of this work.

Background

5. The city of York has set out an ambitious plan for growth – its economic ambition of Gross Value Added (GVA) and jobs growth clearly identified in the ***York Economic Strategy 2011-15*** *(YES),* created by the private sector-led York Economic Partnership (YEP), and the city's need for development of the appropriate commercial, residential and community spaces to accommodate that growth in the ***Local Plan Preferred Options, June 2013***.

6. As the YES identifies, the city of York has **significant economic growth potential** on the basis of one of the most highly skilled workforces in the country, significant research and enterprise expertise in key growth sectors including industrial biotechnology, insurance and rail, as well as a quality of life that regularly outranks competitor cities.

7. In order to capitalise on this growth potential, the YEP has identified an urgent need to **unlock sufficient growth infrastructure** (i.e. the sites, premises, and transport, energy and digital infrastructure) **to enable the city's economy to grow in line with its economic ambitions.** This environment is required to meet the significant demand which includes 4,000 social housing, 5,000 private sector housing, and 124,000 m2 business space.

8. It was on this basis members were advised in a report to November 2013 Cabinet that to take no action in response would be to place a significant constraint on the ability of the city to grow and achieve its ultimate economic potential. It was resolved that a solution be created to achieve the following objectives in response to the constraints on development:

    - **Critical mass of investment:** the model will need to provide the city a means to assembling sufficient levels of investment to make progress in providing the infrastructure and making viable market-led development of the city's key sites.

- **Pace:** the model will need to accelerate the pace of the natural rate of market development that the city has seen to date if it is to meet its economic growth ambitions and indeed if it is to ensure that the city remains “open for business” and for residents to find a home.
- **Return on investment:** most importantly, in order to make development work from a public and private sector perspective, the model needs to be able to make development in the city provide sufficient return on investment – both from a financial perspective, but also from a socioeconomic perspective.

9. This report sets out the scale of the challenge and identifies high level options for resolving the challenge, with a way forward recommended.

The story so far and the challenge

10. The city’s **Local Plan Preferred Options** (June 2013) sets out the sites required for accommodating the city’s economic ambitions – including proposals for 61 housing and 21 employment sites across the city. Work already undertaken to develop the York package of projects to be funded (either all or in part) through the West Yorkshire Transport Fund (WYTF) has identified a priority list of infrastructure required to support the city’s growth; further work being undertaken by Brinkoff Associates is set to confirm the infrastructure requirements to support the local plan sites.[1]

11. Between the emerging Local Plan and supporting infrastructure work, and existing development sites, the city has an overall plan for development which is required to support the economic growth to which the city aspires.

12. Within this context, there is currently **positive progress in the development of the city**. The first phase of the development of the Terry’s site is underway, and the development of the Network Rail Operating Centre next to the Rail Station suggesting that the market for development is improving. The development at Monks Cross, welcoming John Lewis and Primark to the city, with a second Primark set to locate in Piccadilly, has shown an increase in confidence from retail end users in the city’s offer, which has unlocked further development both out of town and in the centre.

[1] For full list of projects prioritised for inclusion in WYTF, please see Item 132a in the 7 May 2013 Cabinet report (link: http://democracy.york.gov.uk/ieListDocuments.aspx?CId=733&MId=6884&Ver=4)

13. Other developments such as the work underway on the White Swan Hotel, with its conversion of upper floors to residential and retail ground floor, and Hiscox's move to Hungate, have seen long-stalled prime city centre sites moving into development.

14. In other cases, the local authority is working with landowners and stakeholders on a site-specific basis to move forward delivery. For example, the Council is working in partnership with Network Rail following the December Cabinet decision to earmark £10m of Economic Infrastructure Fund (EIF) monies into making the site viable for development, and the next phase of masterplanning is now being commissioned for the site. The Council is also underway with progress to develop the Guildhall into a Digital Media Arts Centre, using EIF funding to catalyse the development.

15. In large part, these positive news stories in the development of key sites around the city reflect the **recent upturn in the market for development** – which has created a window of opportunity for generating development returns.

16. However, challenges remain if the city is to realise fully its economic growth ambitions – challenges which centre on the need for a need for proactive investment. First, there are a **number of key strategic sites which the market will not readily develop in the immediate future, and in some cases, not at all without intervention** – whether for a lack of suitable infrastructure, inability to obtain sufficient development finance, or an inability to generate sufficient returns for a defined investment opportunity.

17. Further, the **volume and pace of development currently being delivered is not sufficient** to meet the city's growing demand. With a backlog of 4,000 affordable homes, and 5,000 new homes, and a severe undersupply of Grade A office stock, the market or public sector alone cannot create the critical mass of investment and development to meet the quantum of need even in the medium term at current rates of development.

18. Equally, whilst some infrastructure will be delivered through investment by the West Yorkshire Transport Fund and Single Local Growth Fund process, **there are certain key infrastructure investments that without further intervention or investment, will not be delivered in a timescale required to support the pace of economic development** sought by the city.

19. Finally, even where developments are moving forward with market forces, most require proactive support from the Council's planning, economic development, and regeneration related activities/teams – resource which is at risk of public sector budget reductions in 2015/16. Without an innovative solution that puts this resource into a greater capacity to become more self-sustaining (i.e. generating revenue from the work undertaken on a more commercial basis which is reinvested in maintaining this resource to support further investment), there is a danger of the city losing such resource in future.

20. As such, there is a need for a more **proactive approach to the city's development opportunities and infrastructure**, which will ensure the city is able to accommodate the growth to which it aspires – which ultimately will in itself create a virtuous circle of increasing Council Tax, business rates, and planning gain income, which in turn will provide resource within the city to facilitating future development.

The investment pipeline

21. To understand the scale of the investment required to facilitate the required development, officers and partners have begun to map the pipeline of the critical development opportunities that would need to be delivered if the city is to achieve its growth potential of 1000 jobs per annum and an increase in GVA by 63% by 2030. These development priorities range several categories including:

    - Provision of critical infrastructure to support growth
    - Creation of centres of excellence in key growth sectors
    - Step change in provision of Grade A office space
    - Development of residential offer to address severe shortfall in supply

22. When viewed together, these projects form a "pipeline" of development priorities, along with the associated investment needs to deliver each project.

23. Early estimates suggest that the **total development pipeline requires investment of up to approximately £700m to £1bn.**

24. The investment required to deliver this pipeline will come from a variety of sources, from across both public and private sector. These include planning gain (CIL and S106), LEP funding (SLGF and WYTF), and other opportunities to secure Government funding. In addition there has been interest expressed by capital market investors, which could form part of an overall solution.

25. The remainder of this report explores options for delivering these critical development priorities, as well as the governance arrangements and interim pump-priming resource required to assemble the necessary package of funding.

Options identification

26. Based on soft market testing undertaken by Council officers at MIPIM and York's Investors Week in Autumn 2013, the potential options have been identified as those set out below.

27. **Option 1: Market-led approach**

28. As has been seen in the early progress on sites like Terry's, the market is capable of delivering a number of the key sites identified as investment priorities.

29. The market-led approach requires little direct intervention from the Council in capital terms; however, from a market-led approach, it is critical that the Council has sufficient effective development resource in place to support schemes through planning and ensuring the right infrastructure is in place to support delivery of schemes.

30. This approach will work most effectively for those sites where the commercial return is clear, and where pace is not a critical issue for the authority strategically.

31. This option is less applicable where barriers such as major infrastructure investment or pace are critical to making the development stack up financially or strategically, where public sector intervention or a wider investment portfolio approach may be required to bring forward a project.

32. ***Advantages***: This option requires the least capital investment from the public purse, although some schemes will require infrastructure investment likely to come from public sector sources.

33. The market-led approach also requires the least risk taken by the authority, and as such, is attractive from the perspective of the public purse.

34. ***Disadvantages***: Although at no immediate cost to the authority, this market-led option has its limitations. In some cases, it does carry the implicit cost of business rates and Council tax income that otherwise might have been achieved within a shorter timeframe, which in itself would have enabled potentially greater public sector investment in bringing forward further investment.

35. Without proactive intervention, the pace of development will be dictated purely by the profit margins of individual housebuilders, developers and investors. Further, although partnerships between city partners and developers and investors may happen on an ad hoc basis, the likelihood of partners identifying the most suitable opportunities for partnering and matching appetite for risk and return is the lowest of the options presented to members in this report.

36. **Option 2: Joint venture approach – Project by Project**

37. Whilst the authority may be able to pursue Option 2 for some projects, and indeed this option has been shown to work with EIF investments earmarked for the Guildhall and York Central providing catalysts for the development of these key sites, it is unlikely that the Council will be in a position to prudently fund the full pipeline through this option alone.

38. Instead, a third option would be to explore partnering CYC investment with other forms of funding, including principally private sector investment – either through the capital markets or through a third party investor of another sort.

39. In option 2, this joint venture style of approach enables the authority to work on a project by project basis to facilitate development in key sites. This approach is already being explored for York Central, and may be pursued in other cases across the city.

40. ***Advantages***: The advantage of a joint venture approach generally is that it enables the city to package an overall project, assess the financial implications, and bring in private sector investment. (this approach could be combined with Option 3 – i.e. the council investing some funds, but then seeking private sector investment to cover some of the additional risk)

41. ***Disadvantages***: The principal disadvantage to this approach is that it is complex in terms of establishing the relevant vehicles to take forward investment, and can take time.

42. **Option 3: Council-led approach: Creating a council Commercial Investment Fund**

43. The second option would be for the Council to assemble a fund to assist with taking forward major infrastructure. This would be focused upon the creation of a commercial investment fund, which would be a CYC controlled mechanism which seeks to deliver the key Council objective of securing economic growth in the future.

44. This would build on the current capital projects, and other schemes (including the EIF) already happening, and create an internal fund which would be focused upon both commercial investment, for financial gain, together with the capacity to invest in non commercial schemes where the overall economic benefit was such that the investment could be supported.

45. At its simplest, commercial gains from profitable elements would grow the overall capital value (including revenue income streams), with specific non commercial drawdown of the fund for selected schemes.

46. Potential funding sources into the fund would consist of the following – new homes bonus, venture funding, additional capital receipts, council revenue funding, additional council tax, and increased business rates. It would be possible to create a fund that has flexibility in terms of capital and revenue funding, alongside revenue income streams which fund potential borrowing.

47. ***Advantages***: This option enables the greatest level of control over investment priorities, enabling the authority to have greatest say over the ultimate delivery of development. Each investment would be subject to detailed appraisal of impact, and would be focussed upon both commercial return and economic impact.

48. ***Disadvantages***: This option has its own limitations in terms of overall scale of investment. Whilst a significant fund could be created, it will not be possible to create the scale of funding that might be needed for some of the largest investments (e.g. the outer ring road), though a contribution to such schemes might be possible.

49. Also, clearly any investments would need to pass the Council's risk assessment, and it is inevitable that the Council's risk exposure is likely to be less than a private investor.

50. **Option 4: Joint venture with strategic city partner(s)**

51. Whilst the above options will work for a number of the projects identified in the investment pipeline, there are several major projects that would remain unfunded without a more innovative solution. In particular, investments with a high up-front cost and indirect return – such as transport infrastructure improvements – are likely to require an approach that mixes the longer time horizon of the public sector sources of finance with the critical mass and expertise that private sector sources bring with them.

52. More importantly, it may be necessary to match the investment profile of these more challenging investment projects with other investment projects that are able to generate a more immediate and/or steady return on investment.

53. A version of Option 2 would be to establish a joint venture to a **portfolio of critical investment priorities** and revenue streams based on the full or subset of the investment pipeline.

54. This option would see the city working to package the pipeline of investment, and the business cases supporting that pipeline, with one or a few strategic investors making investments into key sites and infrastructure on a 25 to 50 year basis, with a modest return over that period.

55. The key difference between the first 3 options and Option 4 is that with the latter, there is an opportunity to generate investment for projects with a less immediate revenue return – i.e. the more challenging projects like investing in the Outer Ring Road, which otherwise might not be funded either at all or to the full extent required for a full solution – by matching them with other projects that do. By balancing the portfolio, the city is able to fund projects that otherwise might not be possible to fund.

56. With this option, the authority would develop a joint venture approach to investing in the city's targeted investment projects at a strategic and holistic level (as opposed to the project by project approach implied by Options 2 and 3).

57. The pipeline will generate a range of income streams:

- Council Tax;
- business rates;
- Community Infrastructure Levy (CIL);
- Section 106 (S106);
- social housing;
- private residential rents;
- sale of homes;
- commercial rents

58. This revenue thus creates the basis for leveraging private sector investment where necessary, although the **exact revenue streams which could be used to match against private sector investment will need careful consideration**, as there are certain income streams that are vital to providing public services, the demand for which is created by the growth stimulated by the investment, and some streams are subject to changes in the way that Government legislates for collection and distribution.

59. ***Advantages***: As with Option 2, the advantage of a joint venture approach generally is that it enables the city to package revenue-generating projects with those projects that require a large up front expenditure with little return other than indirect returns (i.e. Outer Ring Road). This approach would attract an "umbrella investor" but in this option, the opportunity for development of new commercial opportunities not identified on the investment pipeline currently would be available.

60. ***Disadvantages***: There are risks associated with the JV approach in the set up costs and some degree of financial risk. It should also be recognised that such an approach is likely to be complex to establish and take significant time. Ensuring the effective governance would be critical to this approach.

A way forward

61. Whilst all of the options identified above will be appropriate to certain projects within the pipeline, there is **a need for a more structured and strategic approach** which will enable the city to be proactive in engaging with external investors, whether public or private sector.

62. As such, it is proposed that the city dedicate resource to the development of the investment pipeline as identified in paras 21 to 23, and that members dedicate the necessary resource to move forward the development of outline business cases for projects identified in the pipeline and options for funding in a coordinated way.

63. In the meantime, the Council will continue to provide resource to proactively support market-led schemes, including through the creation of a development team approach/resource for supporting investors, developers and landowners.

64. The Council will also continue existing CYC capital investment where a business case stacks up, i.e. with schemes like the Guildhall project.

65. However, given that it is likely that the market and ad hoc support from the Council will not be able to deliver all of the projects in the pipeline, it is also necessary to develop the more proactive investment options identified above. In particular, it is proposed that Cabinet approve work by officers proactively developing business cases for **Options 3** (the CYC Commercial Fund approach) **and 4** (a joint venture vehicle for city-wide investment) to bring back to Cabinet for approval and agreement by September at the latest.

66. With the resulting proactive funding model in place to respond to the investment pipeline, the city will have the opportunity to match investment against a range of public and private sector investment sources including but not limited to:

- **Leeds City Region Revolving Investment Fund** – a Fund that is invested in by CYC and other city region partners to create a city region fund for economic infrastructure.

- **Local Growth Fund** – the city is engaged in two Local Enterprise Partnerships and is working with both to identify potential investment from the associated Local Growth Funds – which are pots of funding that will be devolved to LEPs to spend on projects which boost economic growth and jobs.

- **European Regional Development Funding – 2014-2020** – working through respective LEPs, the city will have the opportunity to match investments made in projects with European funding depending on the extent to which these projects align with European objectives and LEP priorities within those objectives.

- **Other European sources of funding** – European Investment Bank provides further finance options that may be considered for extending the reach of the initial investment made.

67. Beyond the project-specific potential to match funding, there is the option of “thinking bigger” and considering the development of an Urban Development Fund either at regional or multi-authority level (perhaps along the East Coast Mainline partnership in which CYC has taken a leading role). Such a fund would see the city and other local authorities in the sub-region or region **pooling investment under JESSICA** (Joint European Support for Sustainable Investment in City Areas) – creating a kind of super-fund whereby the city’s bang for buck is larger than the original investment potential of a city-specific fund.

Governance

68. In order to pursue this approach, it is proposed that resource is dedicated to the development of the investment pipeline and these options. It is proposed that a business case for these options be brought to Cabinet by September at latest, at which point either or both options could be brought into operation to progress business cases to funding, across the range of options identified above.

69. In order to ensure robust governance of this work, it is proposed that a Project Board is created to oversee development of this work, operating as a sub-group of the **Creating Jobs Growing the Economy Board** will take lead responsibility for the development of the ultimate solution. The Council’s Capital Asset Board will be involved in the development of an understanding of the assets that could be considered as part of the pipeline of investment in order to attract/leverage further investment.

70. The **York Economic Partnership** will take a strategic role in supporting the development of the pipeline and exploration of options where appropriate.

Resource requirement

71. In addition, there is a need to commit sufficient Council officer resource and support. In order to develop the business case for a

mechanism through which the Council can facilitate development of the investment pipeline, an appropriate resource is required commensurate with the task and skills required. Thus, this report proposes a **commitment by Cabinet for the Economic Development Unit to manage the development of the pipeline and investment mechanism.**

72. It is also proposed that the **Chief Executive and Director for City and Environment Services be enabled to make whatever changes are required to internal organisation of officer time** to bring together suitable teams from across the Council into a more focused investment, economic development and regeneration team to deliver this work.

73. If the proposals in this report are accepted, the timeline for this programme of work is set out here:

- **Stage 1 – November 2013** – Principles of proactive approach to attracting development investment proposed and accepted by Cabinet– completed
- **Stage 2 – March 2014** – Resources and temporary reorganisation of resources agreed; approach to development of investment mechanism agreed; funding options identified– present report
- **Stage 3 – by September 2014**– Options appraisal, final recommendations, start the delivery of preferred option
- **Stage 4 - 2015** - Investors secured and delivery underway

Benefits

74. The benefits of the model extend across the full economic, social and environmental conditions of the city:

- The pipeline approach will enable the city to **increase the supply of Grade A office stock** – both for larger employers that seek quality premises as inward investors, and growing indigenous businesses that are currently constrained by the lack of grow-on space

- As a result, the pipeline approach should enable a **<u>significant</u> increase in the city's employment –** particularly initially at the high value end, but which through supply chain impacts, will help to generate further employment throughout the full range of skills opportunities. As a result, the pipeline approach will help create

new jobs at both the graduate end of the spectrum to the lower skilled end – including significant increases to the services industry resulting from the supply chain impacts of new employment in the city.

- In addition, the GVA generated from the investment made – initially from the simple investment in development, but indirectly from the employment created – will provide a further significant boost to the local economy and prosperity.

- The proposed investment in housing sites will provide a **major increase in the number, locations and range of housing options** available to residents. The increased supply should then lead to a decrease in average house prices in the city.

- The proposed pipeline model has the potential to enable a more sustainable approach to energy provision than otherwise would be possible from the more piecemeal approach to the development.

Recommendations

75. The report recommends that Cabinet members approve the following:

a) note the progress already being made across a range of development projects.

b) agree to proactive development of the strategic investment pipeline ready for high level business case assessment against funding options;

c) develop a business case for the creation of a CYC commercial fund;

d) develop a business case for the creation of a joint venture investment vehicle ready for potential engagement with a strategic external investor;

e) dedicate the necessary resource from Economic Development Unit to manage the development of this work, and delegation of responsibility to the Chief Executive and Director of City and Environmental Services to make changes to internal structures to provide the necessary resources to progressing this work;

f) agree to the development of a project board to oversee development of this work.

Reason: To allow officers to develop the business cases for a CYC commercial fund and a joint venture model, and to enable officers to engage landowners and potential investors in the process.

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<tr><td colspan="5">Specialist Implications Officer(s) None</td></tr>
<tr><td colspan="4">Wards Affected: All</td><td>√</td></tr>
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For further information please contact the author of the report

Background Papers: City of York Cabinet Report: Delivering Development Investment (November 2013)

Annexes: No additional papers