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Cabinet

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Report Title: Loan Facility to Cheshire & Warrington Local Enterprise Partnership

Portfolio Holder: Cllr Amanda Stott, Finance, IT and Communications

Senior Officer: Jane Burns, Executive Director for Corporate Services

1. Report Summary

1.1. The Council, with Cheshire West & Chester (CWAC) and Warrington (WBC) Borough Councils, is seeking to stimulate and accelerate economic growth by entering into a £10m Facility Agreement with Cheshire & Warrington Local Enterprise Partnership (LEP).

1.2. The three aforementioned authorities will act independently to each provide the LEP with a £10m facility which will enable the LEP to provide total grants to developments of £30m in the Cheshire Science Corridor Enterprise Zone (EZ).

1.3. It is intended that the LEP will repay the loan using accelerated retained business rates generated from the supported developments in the EZ. Consequently, it is not on typical commercial or standard terms and full repayment is dependant upon the ongoing existence of the EZ and the rates system. These risks are considered in the relevant section below.

1.4. It aligns to the Investment Strategy within the Medium Term Financial Strategy (MTFS) as approved by full Council in February 2020.

2. Recommendations

2.1. Approval be given to enter into a £10m Facility Agreement with the Cheshire & Warrington Local Enterprise Partnership.

2.2. Delegated authority be given to the S151 Officer, in consultation with the Portfolio Holder for Finance, IT & Communications and Director of Governance & Compliance, to finalise the terms and conditions of the legal agreement between the Council and the LEP in respect of the loan and the associated governance processes.

2.3. Delegated authority be given to the S151 Officer and the Director of Governance & Compliance for the preparation, negotiation and completion of all ancillary legal documents required to give effect to the loan, and make arrangements to provide loan advances in accordance with the initiative as necessary.

2.4. Authorise Finance and Legal Officers to take all necessary actions to implement the proposals.

3. Reasons for Recommendations

3.1. To stimulate economic growth in the EZ by providing loan funding for the LEP to then use as grant funding to accelerate development of the EZ and grow the business rate base within the EZ quicker than would be possible without the intervention. Additionally there is an expectation that the Council will be repaid and will receive interest on the loan, which can be used to support other Council services.

3.2. There is a strong and shared strategic rationale between the Council, the LEP and other local authority partners working together to unlock and accelerate new development in the EZ, even out with the current economic landscape caused by Covid-19. Not only does it attract new businesses, create new jobs and boost economic activity, it also generates a stronger, accelerated flow of retained business rates for reinvestment into other economic development projects within the EZ and across the wider sub-region.

3.3. The LEP Executive Team and senior Finance Officers from the three local authorities have explored a range of options for how a borrowing facility could operate, including the creation of a single sub-regional facility and individual facilities with each local authority. The consensus was for individual facilities with the LEP supporting developments in the funding authority's locality.

3.4. An indicative pipeline of projects, requiring £30m funding and spanning the three Authorities, is expected to generate in excess of £90m of additional business rates, a multiplier of three. Recognising that developers will face competing offers across the country, it is important that the LEP positions itself to be able to provide support for schemes to incentivise early development.

3.5. Each local authority will provide the funds to enable the LEP to finance EZ investment projects in their own areas. In the event that a local authority is unwilling or unable to finance an EZ project in their area, the funding opportunity will be made available to the other two local authorities.

3.6. Approval of grants is through the LEPs existing EZ investment approval process, which includes EZ Board approval, Performance & Investment Committee approval and LEP Board approval for investments over £2.5m. The Council has Members and officers who attend these Boards/ Committees, as appropriate. In addition, a credit committee made up of senior Finance representatives from the three local authorities is to be established to provide oversight and assurance for the Councils as lenders, and to determine if individual loans to particular schemes can proceed. This would be distinct and separate from the Authority's normal representation on LEP Boards (where fiduciary duty is owed to the LEP).

3.7. It is the intention that the loan and associated interest will be repaid from the additional retained business rates generated by the new developments and the wider EZ.

3.8. There will be the ability to generate a return over and above the cost of providing the loan facility which can be used to support other Council objectives. A margin of 2.05% above prevailing PWLB rates has been agreed which could generate interest repayments of up to £300,000 per annum.

4. Other Options Considered

4.1. Senior Finance Officers from the Council, along with the other Cheshire Councils, have agreed on the merits of utilising Council borrowing facilities to pump-prime development in the EZ to maximise and accelerate business rate retention.

4.2. Other options were considered but discounted for various reasons.

4.2.1. **Do not lend and use other LEP funds to make the grants**

4.2.1.1. The LEP is not cash rich and all of its funding is tied to specific purposes and criteria; e.g. Government funding for capital investment in Local Growth Fund projects; and for operational funding of the LEP itself.

4.2.1.2. To date, the LEP has committed £7.6m in investments in the EZ utilising its existing Growing Places Fund (GPF). However, there are insufficient funds remaining in the GPF to fund the proposed level of grants in the EZ. This would also have the effect of tying up GPF funds and impacting the ability to invest further across the sub-region.

4.2.1.3. Other funds such as the Cheshire and Warrington Development Fund come with strict criteria such as eligibility, building standards and security, as is typical when utilising monies from the European Regional Development Fund.

4.2.2. **Pooling resources into a single fund**

4.2.2.1. Advancing funds by way of a loan gives the Council the ability to ensure the grants are made to projects within the EZ. The option of pooling financial resources into a single fund controlled by the LEP was discounted, so each local authority will provide the funds to enable the LEP to grant-fund EZ investment projects in their own areas; effectively they will operate as three separate loan facilities.

4.2.3. **Council lend directly to or invest in developers**

4.2.3.1. The lack of customary security for the Council is an area of concern. Because the LEP has few genuine assets there is nothing tangible to secure the loan against, other than future retained business rates. Thus, direct lending to, or investment in, developers has been considered.

4.2.3.2. Loans to developers could have the benefit of being secured against an identifiable asset. However, with EZ status, an expectation of developers is that they would benefit from the EZ-retained business rates of the LEP, and obtain gap-funding to make projects viable. They are not expecting to be offered loans, and having charges placed on their properties may not be desirable or deliverable for them, in light of other borrowings they may have.

4.2.3.3. The attractiveness of the scheme proposed is that developers benefit from a grant whilst the Council gains what would be a quality development in its geographical area, and still has the potential to recover its loan to the LEP via retained business rates.

4.2.3.4. In general it is possible that in this period of likely quantitative easing the access to relatively cheap credit may not be a problem for businesses and therefore a loan provided by the Council, subject to State Aid rules, may not be economically advantageous to developers. Faced with a potential geographical choice between investment opportunities, developers may choose to go elsewhere and/ or delay investments in Cheshire East.

4.2.3.5. The Council could also invest directly in developers. The Council is already an investor in Alderley Park Holdings Limited where the Cheshire East EZ is located and where the LEP would grant the borrowed money. Whilst increasing an equity stake may be desirable, it would not provide the Council with additional security or a liquid exit route and repayment. Most assets will be secured against loans from higher-ranked banks and financial institutions.

4.2.4. **Tripartite arrangement with LEP and developer**

4.2.4.1. A three-way arrangement whereby the Council lends funds direct to the developer, but repayment is via retained business rates from the LEP, has been considered but rejected, partly due to State Aid complexities.

4.2.4.2. Lending direct to the developer could have the advantage of being able to secure a charge on the asset. However, as noted above, where this charge would rank against other charges would have to be considered. There is currently no such arrangement on offer.

4.2.4.3. However, for State Aid purposes the loan would need to be on commercial terms. Having a scenario where there was no expectation on the part of the loanee to repay the loan, as this would be repaid from retained business rates by the LEP, could be subject to State Aid challenge.

4.2.5. **Do nothing**

4.2.5.1. The business case for the Cheshire Science Corridor EZ predicted total retained business rates of approximately £200m by 2041, of which £90m is in respect of the 13 schemes being supported by the initiative outlined in this report. Therefore, it would be entirely possible to do nothing and let the amounts accrue over time.

4.2.5.2. However, this proposal seeks to accelerate economic development and maximise the ability to retain business rates and re-invest across the sub-region.

4.2.5.3. Furthermore, in the light of the Covid-19 pandemic, the Council needs to consider how it is best placed to provide stimulus, such as via this proposal, so that the sub-region is positioned to maximise the benefit from any future upturn.

5. Background

5.1. The Cheshire Science Corridor, which includes Alderley Park, obtained Enterprise Zone status in April 2016. Enterprise Zones are specially designated areas identified for regeneration and development for business use.

5.2. Under an agreement between the Ministry of Housing, Communities & Local Government and the Local Authorities any additional business rates generated, until 2041, from investments in the Enterprise Zones can be retained by the LEP to fund further development to promote economic growth.

5.3. This important benefit from Enterprise Zone (EZ) status, the ability to retain any additional business rates generated for up to 25 years in the sub-region, is the driving factor behind this decision. The Cheshire Science Corridor EZ could generate approximately £200m in retained business rates by 2041, to be reinvested into economic development projects across the sub-region.

5.4. The LEP has identified a pipeline of 13 projects which, subject to funding, could accelerate the development of the EZ and are expected to generate in excess of £90m of additional business rates, which will be retained by the LEP and used to service the loans and for further investment in the sub-region.

5.5. Loans provided by Cheshire East, Cheshire West & Chester, and Warrington Councils to the LEP will enable the LEP to provide grants to developers to progress schemes – and the local authority loans will be repaid, with interest, from the additional business rates income generated and retained by the LEP under the assumed ongoing EZ rules.

5.6. Following consideration of the matter by S151 Officers of the three local authorities and Executive officers from the LEP, it was proposed that a single interest rate and uniform set of terms and conditions for the loan facility be developed. WBC have led the preparation of the loan terms, latterly in consultation with CEC and CWAC, and these are close to finalisation.

6. Implications of the Recommendations

6.1. Legal Implications

6.1.1. The Council has the power to make the proposed loan by using the General Power of Competence, introduced in the Localism Act 2011, which gives the Council the power to do anything that an individual may do (unless specifically prohibited). This provides the Council with the power to make reasonable accountable decisions which support innovative approaches.

6.1.2. The proposed loan in its current form is a highly bespoke arrangement. A £10m unsecured loan is to be made to the LEP who will then grant fund projects within the Cheshire Science Corridor Enterprise Zone. The LEP will repay the loan using business rate income from this Enterprise Zone (less the LEP's costs). The use of the Council's loan as a grant and the loan's repayment via business rate income is unconnected to the funded projects and unsecured. The LEP's liability to pay the interest and/ or repay the loan is limited to the amount of Retained Business Rates paid over to the LEP.

6.1.3. The proposed Facility Agreement contains bespoke drafting to capture the LEP's use of the loan as grant funding and the repayment of the loan from business rates. In particular, as drafted, the LEP can be insolvent but not be in default as a standard insolvency definition has been removed and the need for financial and a legal due diligence prior to making the loan (e.g. on the legality, validity and enforceability of the loan) have been removed.

6.1.4. The Facility Agreement defines Retained Business Rate Income as received business rates in respect of the properties within the Cheshire Science Corridor Enterprise Zone less any such income, which is approved by the LEP Board. This drafting gives the LEP the unilateral ability to reduce the Retained Business Rate Income to zero if it so wishes and so it is imperative to ensure that this is addressed in the loan documentation in order to ensure that this sole source of repayment under the Facility Agreement cannot be unilaterally reduced. Repayment is reliant on the receipt of Business Rates. It is understood that the need for the EZ model to be revisited by the LEP is accepted, to assess the impact of current economic circumstances.

6.1.5. The LEP is proposing to enter into grant agreements with recipients of the funding. The LEP has provided a Heads of Terms document which is to be used as the basis for negotiation of bespoke grant agreements with each proposed recipient. The proposed Heads of Terms include mechanisms such as overage, charges and parent company guarantees. Such mechanisms are not usually used in grant agreements (which are a gift of funds for a specific purpose whereby the funder retains some power of clawback in the event the grant is misapplied or not used) and may prove difficult to legally enforce.

6.1.6. The proposed mechanism relies heavily on due diligence by the LEP, a third party. Due diligence will need to be carried out on the actual terms of each grant agreement to determine who would bear the liability if the grant funding was, for example, misapplied, constituted illegal State aid or breached. Each grant agreement will need to be considered in terms of the risk to the Council (as the original provider of the funds).

6.1.7. Consideration needs to be given to any impact resulting from the loan being made to the LEP's company and the Framework Agreement needs to be examined and advice provided.

6.1.8. One of the considerations in relation to signing off the proposals is the creation of a Credit Committee. This Committee is be made up of representatives of the three Councils. It will have a right of veto over individual proposed grant agreements. In doing so the Councils would be fettering the LEPs independence and so could be viewed as using the LEP as a mechanism to lend money in a manner not otherwise available to a Local Authority (and as a means to avoid state aid).

6.1.9. The circumstances around the making of the Facility Agreement and EZ grants that flow from it carry with it a number of risks as identified within the body of this report. As such it cannot be said that to proceed is without risk; however it is understood that organisationally the benefit of proceeding on balance outweighs the risks. Therefore, any decision to proceed is on the basis that the risks and concerns must be acknowledged and accepted by decision makers in an informed manner.

6.2. **Finance Implications**

6.2.1. The proposal would require a capital cost of providing a loan facility of up to £10m, with the stated aim of this being repaid by the LEP through retained business rates. It is entirely possible that there may not be a requirement for the full £10m based upon the pipeline of LEP projects within the Cheshire East EZ area.

6.2.2. Providing a loan facility is referred to in the Council's Investment Strategy, as agreed as part of the Medium Term Financial Strategy 2020-24 approved in February 2020. This provided approval of the headroom available for different investment types, of which loans is but one.

6.2.3. A local authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth, even though those loans may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

6.2.4. Within the existing Capital Programme for Corporate there is a £36m agreed budget for Strategic Capital Projects. It is envisaged that subject to necessary approvals the loan would be advanced from this budget line. This is consistent with how Local Authority loans are accounted for within the Capital Account.

6.2.5. The terms of the loan agreed with the LEP stipulate an arrangement fee of £25,000 and an interest rate of the agreed Public Works Loan Board (PWLB) rate at the time the loan is taken out plus a margin of 2.05%. The relatively low rate of return reinforces the fact that economic growth is driving this investment proposition, rather than financial return.

6.2.6. If the actual cost of borrowing for the Authority was less than the PWLB rate – e.g. if the Council has borrowed from elsewhere - this would in effect increase the margin on the loan. Assuming full recovery of the loan and associated interest it is estimated that this could generate an additional amount of up to approximately £300,000 per annum based upon the current borrowing cost within CEC.

6.2.7. There is an existing pipeline of 13 projects identified by the LEP across the EZs in the three local authority areas. These are envisaged to cost approximately £30m (in gap-funding requirement) and generate £90m of additional retained business rates. Based upon the pipeline of projects they range from under construction to speculative. Of the 13 projects, two are currently in the Cheshire East EZ area and would cost £8m (in grant-aided gap-funding), and are anticipated to generate £24m in retained business rates. There is the potential for further projects to utilise the remaining £2m of the proposed facility.

6.2.8. The projects within CEC are well advanced, which gives added assurance, as they will start to generate retained business rates sooner and thus commence loan repayment. Additionally, Finance has visibility of what retained business rates are currently received in respect of the EZ and that provides added comfort, that there will continue to be a flow of retained business rates from these and other projects to service the debt.

6.2.9. It should be noted that there is currently no recourse to other LEP funding should retained business rates be insufficient to pay back the loan. Thus there is a risk that some or all of the loan is not repaid. Such a scenario may occur if legislation around LEPs, enterprise zones or business rates change. We do not anticipate this at present. Finance will continue to monitor and mitigate where possible the risks as identified in Section 6.6 below. We will do this through regular meetings with the LEP, active debt management through our Treasury function and monitoring of the receipt of retained business rates by the Council.

6.3. **Policy Implications**

6.3.1. This is aligned to Council policies in respect of economic development.

6.4. **Equality Implications**

6.4.1. The proposal relates to enabling development in the Enterprise Zone to create jobs and support economic growth. There are no implications of the proposal that would be considered to have any negative effects on people with protected characteristics under the Public Sector Equality Duty.

6.5. **Human Resources Implications**

6.5.1. There are marginal human resource implications as a result of the recommendations herein. Some existing Finance and Legal resources will be utilised in order to manage the process of preparing the facility agreement, preparing and authorising drawdowns and managing the repayment of the loans as and when they fall due.

6.6. **Risk Management Implications**

6.6.1. The key risks associated with advancing a loan to the LEP are:

6.6.2. **LEP ceases to exist**

6.6.2.1. There is a risk that government policy leads to the dissolution of the LEP and that there is no obligation to repay the loan. We assess this as having a low probability but high impact and overall is currently deemed to be low risk.

6.6.2.2. There is no indication that government policy is likely to change in the medium term, in this regard. There is currently a stable government, with a strong mandate that appears committed to devolving power to the regions. In addition, the loans will be recorded on the LEP’s balance sheet so should the LEP be dissolved then there would be an expectation that existing liabilities are met or taken forward by any successor organisation.

6.6.2.3. The pipeline of projects within the CEC geographical area should also work to the advantage of the Council and minimise risk. Because one project is near completion and has a relatively short payback period this means repayment will commence sooner and reduce the exposure of potential default from the later projects with longer paybacks.

6.6.3. **Changes to regulatory framework of LEPs, business rates or EZs**

6.6.3.1. The Cheshire Science Corridor, which includes Alderley Park, obtained Enterprise Zone status in April 2016. Enterprise Zones are specially designated areas identified for regeneration and development for business use that are established through specific government statute.

6.6.3.2. Under an agreement between MHCLG and the Local Authorities any additional business rates generated, until 2041, from investments in the Enterprise Zones can be retained by the Local Authorities and LEP to fund further projects to promote economic growth.

6.6.3.3. Given the central pillar that business rates represents in the UK taxation and local authority financing system some reliance has been placed on this as a significant risk mitigator rather than a cause of risk.

6.6.3.4. There is no indication of or historic precedent for government abolishing EZs early. Therefore we have to assume that the EZ will continue to exist until 2041.

6.6.3.5. Similarly with business rates. They are intertwined with the organisation and management of EZs. It is likely that if business rates were to be abolished they would be replaced with an alternative form of taxation on businesses. We have no indication that there are any plans to replace or diminish the role that business rates play in UK taxation policy. As a mitigation it may be prudent to have the loan agreement reference business rates or any replacement for the rates system.

6.6.3.6. The application of reliefs could impact the value of retained business rates. The Covid-19 response has seen business rates temporarily suspended or reduced for a number of sectors. The Council and LEP need to continually monitor this for early indicators that the Science Corridor EZ is affected. Some mitigation is offered by how far advanced individual projects that the LEP might invest in within the Alderley Park EZ are, in relation to others. There is the potential for CEC to be repaid quicker, say, when compared with investing in other EZ projects, thus reducing the exposure to losses.

6.6.4. **Schemes do not achieve practical completion**

6.6.4.1. This could occur because the developer gets into financial trouble or because they deliberately delay the completion of the scheme. Not reaching practical completion means that the payment of business rates is not triggered, which in turn means that the LEP would be unable to repay the debt finance provided by the local authorities.

6.6.4.2. The intention is that this risk is to be actively mitigated by the LEP through a rigorous due diligence process on grant applicants; through the application of legal charges and company/ personal guarantees and through the provision of a longstop completion date within the legal agreement, with clawback penalties for under-performance.

6.6.4.3. Additional assurance is provided from the stipulation that the LEP would be able to make its loan repayments from income from other EZ investments, not just the specific project supported.

6.6.4.4. For CEC in particular, as noted above some comfort is afforded by the fact that the first scheme the LEP is seeking CEC funds to support is the Glasshouse, and this is nearing practical completion so will start to generate retained business rates almost immediately.

6.6.4.5. Additionally, developments on Alderley Park, the EZ located in CEC, are led by Bruntwood, which is a significant regional developer. Alderley Park is a key strategic location for Bruntwood and its partners.

6.6.5. **Estimated level of retained business rates not achieved**

6.6.5.1. If the estimated level of retained business rates generated by a grant is not realised, then this would impact on the LEP's ability to repay the Council.

6.6.5.2. To mitigate this risk, the LEP requires developers to provide detailed and realistic estimates of Rateable Values for their schemes, which are assessed by the LEPs retained property advisers. Collectively, the LEP and Authorities have good Valuation Office Agency data on the rateable values on the sites in the EZ to benchmark against.

6.6.5.3. For each project there is an element of sensitivity analysis and business rate cover (rates expected /grant value). This suggests that there is adequate cover should an estimate be incorrect.

6.6.5.4. Where this would impact the ability of the LEP to repay the debt there is a stipulation that the LEP would be able to make its loan repayments from income from other EZ investments, not just the specific project supported, and including those in other Council areas.

6.6.5.5. Some further comfort can be taken from the fact that CEC is already paying retained business rates relating to the EZ over to the LEP, so there is an identifiable revenue source to support future repayment.

6.6.6. **Rate mitigation**

6.6.6.1. Landowners/ developers may deploy rate mitigation schemes in order to avoid paying empty rates, which would reduce the level of retained business rates generated and the ability of the LEP to repay the debt finance.

6.6.6.2. We are assured that the LEP has anticipated this tactic and has built in a 'no rate mitigation' clause into the LEP grant agreement, which prevents landowners/ developers from avoiding paying rates on empty properties. Assuming that these are utilised in the agreements then this would reduce both the likelihood and impact of any mitigation.

6.6.7. **Cost and time overruns**

6.6.7.1. Delays in completion of schemes would impact on level of retained business rates, whilst budget overruns would further increase the viability gap on schemes.

6.6.7.2. We are wholly reliant upon the LEP to manage this risk. They stress that this risk is mitigated by a rigorous pre-investment due diligence process which assesses the track record and financial standing of the applicant, key milestones and targets set within the grant agreement. Ongoing monitoring of construction progress against the drawdown of the EZ investment is also carried out.

6.6.7.3. Any LEP EZ grant will be capped at an agreed maximum level regardless of cost overruns so the risk of cost overruns is borne by the developer. We have to assume that it would be in developer's interests to complete and secure occupancy.

6.6.7.4. Ordinarily this would be assessed as low risk; however, in the current climate there is the increased risk that construction projects will not complete on time and that occupancy will take longer, thereby encouraging developers to withhold payment of rates.

6.6.8. **Other risks as identified**

6.6.8.1. A detailed risk register that considers these risks, along with other considerations, will be produced and maintained for the duration of the loan.

6.7. **Rural Communities Implications**

6.7.1. There are no direct implications for rural communities.

6.8. **Implications for Children & Young People/Cared for Children**

6.8.1. There are no direct implications for children and young people.

6.9. **Public Health Implications**

6.9.1. There are no direct implications for public health.

6.10. **Climate Change Implications**

6.10.1. Whilst not directly impacting the Council's carbon footprint there is a desire on the part of the LEP and the developers at Alderley Park to invest in schemes that have a positive impact upon the environment. It could be the case that some of the funding is used to deliver developments that are supportive low carbon initiatives and outcomes.

7. Ward Members Affected

7.1. The loan will be used to support investment on the Alderley Park site which impacts the Alderley Edge Ward. However the benefits in terms of returns will be Borough-wide.

8. Consultation & Engagement

8.1. The principle of the loan has been predominately negotiated between Warrington Borough Council and the LEP. Latterly there has been some discussion between the LEP, Warrington, Cheshire West and Chester and Cheshire East Councils.

9. Access to Information

9.1. There are no additional supporting documents relating to the report and its recommendations.

10. Contact Information

10.1. Any questions relating to this report should be directed to the following officer:

Name: Paul Goodwin

Job Title: Finance Manager (Commercial & Project Accounting) and Acting Deputy S151 Officer

Email: paul.goodwin@cheshireeast.gov.uk