Working for a brighter future together

Cabinet

Date of Meeting: 11 June 2019

Report Title: Formation of a Cheshire and Warrington LEP Urban Development Fund

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

Senior Officer: Frank Jordan, Executive Director Place

1. Report Summary

1.1. The Authority has been approached by Cheshire and Warrington Local Enterprise Partnership (the LEP) to act as Entrusted Entity (EE) for a new Urban Development Fund (UDF) and to act as the main applicant for £20m of European Regional Development Fund (ERDF) funding.

1.2. The Fund will provide loans or investment capital (via equity share) to companies in the Cheshire & Warrington Sub Region in respect of schemes focussing on research and innovation excellence; entrepreneurship and the creation of new firms; and the production and distribution of energy derived from renewable sources. The Fund is expected to run for 10 years as regards making investments in ERDF priorities, after which the monies will be available for reinvestment in the Sub Region.

1.3. The Ministry of Housing, Communities and Local Government (MHCLG) require a Local Authority to act as Entrusted Entity in this regard (there is no precedent for a LEP acting that capacity).

1.4. As the main applicant there will be ongoing reporting and sign off requirements for the Authority though the intention is that the LEP will carry out most of the day-to-day work and will ensure that the Authority's exposure to risk is minimised.

1.5. The Authority will ultimately be required to act as guarantor for the ERDF funds and therefore it is important to ensure that the vehicles set up to manage and report on the fund are done so in such as a way that the risk to the Authority is minimised.

1.6. Having received approval to establish the UDF and apply for and enter into a legally binding funding agreement for ERDF funding, Cabinet approval is now sought for the key structures and governance required to enable the UDF to commence operations.

2. Recommendations

Following on from the Cabinet recommendation on 5 February 2019, and decisions of Council on 21 February 2019, and the Portfolio Holder for Finance and Communication on 5 April 2019 approving the creation of an Urban Development Fund, it is recommended that Cabinet:

2.1. approves the creation of a Special Purpose Vehicle (SPV) to act as General Partner for the proposed Urban Development Fund;

2.2. delegates authority to the Executive Director - Place in consultation with the Section 151 Officer and Monitoring Officer to approve a Limited Partnership agreement between the Council and the General Partner and a Management Agreement between the General Partner and the Fund Manager and any ancillary legal agreements required to ensure the Urban Development Fund is correctly constituted;

2.3. delegates authority to the Executive Director - Place in consultation with the Section 151 Officer and Monitoring Officer to approve the creation of a Board of Directors of the Urban Development Fund SPV, made up of representatives as deemed appropriate;

2.4. delegates authority to the Board of the Urban Development Fund SPV to act as the Investment Committee and approve investments, drawdowns and all matters relating to the Fund, and all steps necessary to comply with the Funding Agreement entered into with MHCLG;

2.5. approves entering into a Service Level Agreement with the LEP as the Council's delivery partner under the terms of the Funding Agreement, with regard to procurement of the Fund Manager and the management and operation of the Fund, to ensure appropriate input and oversight from the Council;

2.6. approves undertaking the procurement of a Fund Manager;

2.7. authorises the Executive Director - Place in consultation with the Portfolio Holder for Finance, IT and Communication to approve the award of the contract to the Fund Manager; and

2.8. authorises the Executive Director – Corporate Services to take all necessary actions to implement these proposals.

3. Reasons for Recommendations

3.1. The Authority already acts as Accountable Body for the LEP. It is identified that there are difficulties in local firms accessing financing which can prevent projects from taking place. The benefits to the Authority and the wider sub region from the initial investment are considerable.

4. Other Options Considered

4.1. The LEP may have been able to contract with MHCLG (Ministry of Housing Communities and Local Government) and create the Fund in their name. However, whilst this was considered technically possible it has not been tested and so there is no legal precedent to support it. The length of time it would have taken Government lawyers to consider and approve the scheme under this approach could have put the funding in jeopardy. The matter of the UK's exit from the EU was considered; and in order to move forward with the proposal it was felt that having a Local Authority body act as Entrusted Entity would provide the comfort and confidence that MHCLG were seeking.

5. Background

5.1. An Evergreen Fund covering Cheshire and Warrington, Greater Manchester and Lancashire was developed under the 2007-13 European Regional Development Fund (ERDF) programme. The fund had an initial value of £60m, and was fully committed by December 2015.

5.2. Greater Manchester LEP committed £50m of ERDF funds to a successor fund along with £15m for a low carbon fund, both confined to its geographical area. There is now a desire for Cheshire and Warrington LEP to establish a successor fund for this sub-region.

5.3. At present there is limited funding available to gap-fund schemes in the sub-region. The investment programme developed by the current Enterprise Zone has shown that there is plenty of demand for gap funding, but the Enterprise Zone only covers a relatively small part of Cheshire and Warrington.

5.4. The LEP has a £12.1m Growing Places Fund which has made 6 loans to date. Four of these loans have been fully repaid; so whilst the funding is available for reinvestment, there are a number of loan applications being developed which means there is currently only £1.7m available for other investment.

5.5. It was therefore proposed to apply for £20m of ERDF (2014-20) monies and establish a Cheshire and Warrington Urban Development Fund. The funding would be split by ERDF priorities 1,3 and 4 as follows:

ERDF Priority	Description	Amount (£)
1	Enhancing research and innovation (R&I) infrastructure and capacities to develop R&I excellence, and promoting centres of competence.	7,000,000
3	Promoting entrepreneurship, in particular by facilitating the economic exploitation of new ideas and fostering the creation of new firms, including through business incubators.	5,000,000
4	Promoting the production and distribution of energy derived from renewable sources.	8,000,000

5.6. To apply for and subsequently draw down and account for ERDF funds, the monies have to be paid to an Entrusted Entity (EE) such as a Local Authority. Therefore the LEP has approached Cheshire East, as existing Accountable Body for the LEP, to take on the role of Entrusted Entity and apply for ERDF funding.

5.7. The ERDF funding would be passed from the Entrusted Entity to the Urban Development Fund, managed by an experienced Fund Manager. The Urban Development Fund Manager will have to be procured as part of a full OJEU and ERDF compliant process.

5.8. The Urban Development Fund will operate via a Special Purpose Vehicle (SPV), incorporated and owned by Cheshire East Council. This will have no staffing implications and will simply act as a holding company through which the Fund Manager can be procured and the ERDF funds distributed.

5.9. An Entrusted Entity is the Accountable Body for the programme. According to ERDF rules, this has to be a public sector body such as a Local Authority. The role of the Entrusted Entity is:

- To ultimately be accountable for the ERDF investment;
- Signatory to the ERDF Funding Agreement and responsible for compliance with terms and conditions;
- To submit ERDF claims to MHCLG as the Managing Authority (MA);
- Establishment and reconciliation of bank accounts;

- Disbursement of payments for third party fees;
- Treasury management of the ERDF investment including disbursements to the Fund Manager, paying Fund Manager fees, processing repayments and managing interest and other gains;
- To undertake the procurement of the Fund Manager;
- To manage the performance of the Fund Manager;
- To provide management information and updates to the Managing Authority (i.e. MHCLG);
- To facilitate audits by the Managing Authority and others.

5.10. It is proposed that much of the work will be done by the LEP, with authority, scrutiny and sign-off being provided as and when required by the Council. For example, the LEP would prepare the claims, and send to the Authority for review and sign-off just as it currently does with other funding claims. A Service Level Agreement will be agreed between the Authority and the LEP with regard to respective responsibitilies for the management and operation of the Fund.

5.11. The Authority would still need to check the accuracy of what was being submitted; and would need to carry out significant due diligence in advance of the Fund Manager being appointed; ERDF applications being submitted; and funding agreements being entered into. It is agreed with the LEP that CEC resource input will be reimbursed over the life of the Fund to cover the officer and external advisor time and costs. Other costs such as Fund Manager, audit and any other fees will be met initially via LEP resources (for 3 years), with subsequent costs being met out of the Fund proceeds and interest generated on Fund balances.

5.12. The Entrusted Entity is the Accountable Body so would need to ensure that the UDF was set up and run in compliance with ERDF regulations and company regulations.

5.13. However, as the investments will be made by the UDF on the recommendation of the appointed Fund Manager any investment risk will lie with them and would be covered by their professional indemnity cover. This would be subject to the Investment Operating Guidelines being drafted correctly (which MHCLG should be asked to approve and which the LEP will be requested to indemnify CEC against).

5.14. The main areas of risk for the Entrusted Entity are: not procuring the Fund Manager in a compliant way; and not contracting with the Fund Manager to provide cover for ineligible investments.

5.15. To minimise this risk it is proposed that the LEP buy in procurement and external legal support to manage the procurement and ERDF bidding processes. This will be supplemented by CEC reviewing all documents and obtaining its own legal opinion to ensure that all necessary steps (e.g. SLAs) have been taken to minimise the risk to the Authority and that the LEP is fully aware of their responsibilities.

6. Implications of the Recommendations

6.1. Legal Implications

6.1.1. The LEP and the Council have received external legal advice on the structure of the investment fund. They have outlined that the main areas for consideration are :-

6.1.2. Compliance with the Common Provision Regulation (“CPR”), and the Guidance for Member States on the selection of bodies implementing financial instruments (the “Selection Guidance”)

6.1.3. When assessing the compliance of a financial instrument structure it is necessary to consider both the CPR and the Selection Guidance. The CPR and the Guidance place particular emphasis on complying with applicable law, particularly state aid and public procurement requirements. The selection of financial intermediaries must be made on the basis of open, transparent, proportionate and non-discriminatory procedures, avoiding conflicts of interest.

6.1.4. The Council is intending to utilise the In-House (or Entrusted Entity) model. The Council will therefore be the organisation receiving the ERDF funding and passing this down to its own special purpose vehicle (“SPV”).

6.1.5. Provided the three criteria for in-house award are met then a public body with contracting authority status is able to implement a fund through its SPV. These three criteria are:-

- Ownership

  No direct private capital participation in the controlled legal person can exist.

- Control

The contracting authority must exercise control over the legal person concerned which is similar to that which it exercises over its own departments

- Activity

  The controlled legal person must carry out more than 80% of its activities in the performance of tasks entrusted to it by the controlling contracting authority.

6.1.6. All three criteria relate to the “Teckal” exemption and it is proposed that the SPV would meet all three criteria.

6.1.7. The Council would be relying on its general power of competence as set out in the Localism Act 2011 in order to set up the SPV.

6.1.8. **State aid law**

State aid will arise whenever public funds are selectively directed towards organisations involved in delivering economic activities where this is capable of distorting the relevant business market and having an effect on trading conditions between Member States.

- Potential aid to the contracting authority and its SPV

Advice is that no aid arises as the transfer constitutes an agreement for the administration of public fund duties made between two public sector bodies. Similarly there is no aid to the SPV as the SPV is considered to be part of the public sector body.

- Potential aid to the LEP

The CWLEP will be a delivery partner to the fund providing its services at cost. It is not engaging in economic activities rather it is assisting in the proper administration of public funds.

- The recipients of loan and equity investments

In relation to this, loan and equity investments may be made on the basis of the Market Economy Investor Principle (“MEIP”) i.e. the transaction reflects an investment which a private sector market operator would reasonably be expected to make under the same or similar circumstances but care will need to be taken to ensure that an appropriate audit trail is in place which justifies viability either through Pari Passu or benchmarking. Pari Passu is defined as occurring when a transaction is carried out under the same terms and conditions (and therefore with the same level of risk and rewards) by public bodies and private operators who are in a comparable situation. Alternatively, suitable benchmarking is another method of proving compliance e.g. benchmarking of loans against the reference rate for interest. Benchmarking in equity investments involves a comparison demonstrating that the public body is operating in line with how a commercial operator would act in a similar situation.

- Potential aid to the Fund Manager

If the fund manager is selected through an open and competitive public procurement process the remuneration provided will be on terms established by the market. It is therefore assumed that there is no overcompensation and no aid arises, provided the procurement is properly carried out.

6.1.9. **Public procurement rules**

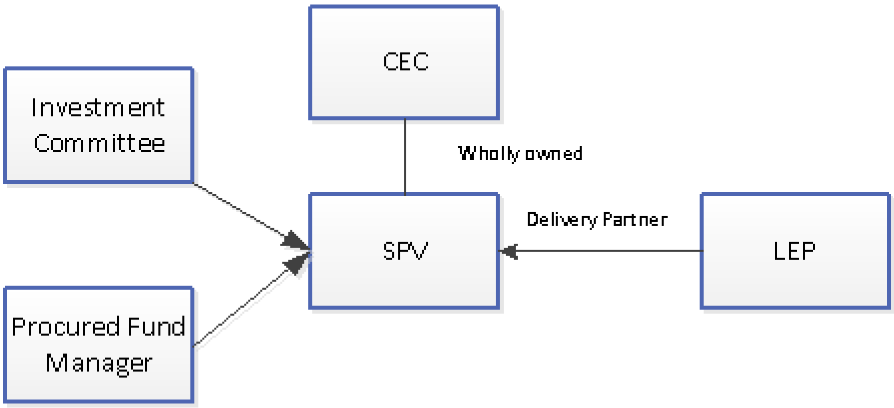
The fund manager will need to be procured in compliance with the Public Contracts Regulations 2015. The Council will need to ensure that the LEP and their consultants undertake the procurement in a compliant manner and in accordance with the requirements of Article 7 of the Delegated Regulation. The fund manager will need to have relevant capabilities, certifications and demonstrate its financial viability.

All procurements which are included in an ERDF claim may be the subject of an ERDF audit.

By entering into the funding agreement, the Council has provided specific warranties as to the compliance of the procurement processes and will be responsible for any irregularities. Detailed records of each phase of the procurement process needs to be kept for the purposes of any audit.

The structure of the fund is as set out in the diagram below, with a limited partnership ("LP") being formed, this is a legal entity formed in accordance with the Limited Partnerships Act 1907. An LP broadly resembles an ordinary partnership save that it has two categories of partner, a general partner and a limited partner. The SPV would be the general partner.

CHESHIRE AND WARRINGTON UDF



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The terms of the funding agreement with MHCLG contains provisions and obligations on the Council in order to be able to receive the proposed maximum funding of £20 million. The main risks to the Council are

(i) that it must comply and secure compliance with the Structural and Investment Funds Regulations including compliance with State Aid Law and Procurement Requirements (as set out above);

(ii) risk of clawback or suspension of the funding should the Council not meet the terms of the agreement and default in some manner including not meeting any targets set out in the agreement;

(iii) the fact that it will be liable for the acts or omissions of any Delivery Partner i.e. the LEP or the Fund Manager.

6.1.10. These risks will need to be mitigated by allocating the proper resources in terms of legal, finance and procurement advice to review and validate the work undertaken by the LEP and to ensure that the terms of the Funding Agreement are adhered to throughout the life of the Fund. External legal advice will need to be sought on the various agreements required to ensure the limited partnership is properly set up and the Fund is correctly constituted.

6.2. **Finance Implications**

6.2.1. It is not envisaged that the Authority would be required to provide any funding (either revenue or capital) in order to submit an ERDF bid for £20m. The project is expected to last for 10 years.

6.2.2. Although much of the day-to-day work will be undertaken under the direction of and by the LEP, there will still be a requirement for the Authority to carry out review and validation of the work undertaken by the

LEP. This will involve professional legal, finance, audit (internal and external) and procurement advice and support, with costs reimbursed by the LEP, as described in the report.

6.2.3. The aim of the project is to bring forward the delivery of commercial development schemes which have either stalled or not proved viable due to a gap funding issue. The Fund will provide the gap-funding on the basis of a repayable loan or an equity stake in the investment.

6.2.4. The scope of the project is limited to investments in Cheshire and Warrington, that fit with priorities 1,3 and 4 of the ERDF programme. The total amount of funding initially being sought is £20m. It is envisaged that this amount could be increased if additional ERDF monies become available and/ or if other public funds become available, such as Shared Prosperity Funding.

6.2.5. The initial Fund is expected to run for a period of 10 years with all returns from investments paid back and available for reinvestment in the sub region.

6.3. **Policy Implications**

6.3.1. The decision is aligned to the Authority's role as Accountable Body for the LEP, and also Outcome 2 of the Council's Corporate Plan: Cheshire East has a strong and resilient economy.

6.4. **Equality Implications**

6.4.1. The nature of the Fund will not entail any staff being directly employed. Through introducing new capital to the sub region it is likely that positive benefits will be evident. The principal procurements will reflect the Authority's commitment to equality and diversity. Equally, whilst investment decisions will be based upon best fit and need there will be an awareness of the Authority's position on equality.

6.5. **Human Resources Implications**

6.5.1. The decision does not have any particular human resource implications. Officers from Finance, Legal, Procurement and Audit Services will be involved in the set-up and ongoing management and support with regard to the Fund, in order to fulfil our obligations as Entrusted Entity.

6.6. **Risk Management Implications**

6.6.1. The principal risks are noted in the report, in respect of the procurement of the Fund Manager and the recommendations made by them as regards investments made. These risks will need to be mitigated by allocating the proper resources in terms of Legal, Finance and

Procurement advice to review and validate the work undertaken by the LEP and to ensure that the terms of the Funding Agreement are adhered to throughout the life of the Fund. External legal advice will need to be sought on the various agreements required to ensure the limited partnership is properly set up and the Fund is correctly constituted.

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.

7. Ward Members Affected

7.1. The decision affects the sub region covered by the Cheshire & Warrington LEP. As such it has the potential to affect all wards. However, it is envisaged that the number of loans/investments entered into will be small over the life of the fund so is likely to affect a limited number of wards.

8. Contact Information

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

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