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To: Kent Joint Chief Executives, 21st June 2011

Subject: Kent & Medway Investment Fund

Classification: Unrestricted

This report to Kent Joint Chief Executives provides a summary of the findings and key issues from a feasibility analysis undertaken to explore the potential for a Kent and Medway Investment Fund. It outlines how the model could operate and is seeking the support of Medway and Kent District and Borough Councils to take forward the development and set up of the KMIF.

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1. Recommendations

It is recommended that Kent Joint Chief Executives agree to proceed with the next stage of work to develop and set up the Kent and Medway Investment Fund, accepting that:

- Partners wishing to engage in the next stage jointly contribute the following amounts towards the development costs: KCC up to £500,000; Medway £50,000; Borough / District Councils £25,000, subject to each authority's own internal approval processes.

2. Introduction

The report is seeking Kent Joint Chief Executives' 'in principle' support for the proposal to create a Kent and Medway Investment Fund and approval to proceed to the next stage of work focused on the development and set up of the Fund.

CBRE has been appointed by KCC to develop proposals for a Kent and Medway Investment Fund. An initial Scoping Paper was produced in February which introduced the concept of an Investment Fund based on experience of setting up an 'Evergreen Fund' in the North West. A Feasibility Report has now been produced by CBRE setting out in more detail how a Kent and Medway Investment Fund could operate and is attached at Appendix 1. This paper to Kent Joint Chief Executives highlights the key issues and considerations for local authority partners and sets out the next steps for taking forward the development and set up of a Kent and Medway Investment Fund

Following circulation of the Scoping Paper, KCC and CBRE met with the Chief Executives of Medway and all Borough and District councils who expressed an initial interest. The purpose of these meetings was to introduce the KMIF concept and explore the extent to which it could deliver against a range of aspirations. The response from these meetings has been positive with ten of the twelve Districts indicating that they would like to be involved in working through the concept further.

This feasibility stage is intended to outline an investment fund model for Kent and also identify, and make recommendations on, specific issues that will need to be addressed in setting up the Fund. The next stage will be to establish formal project governance arrangements, involving Medway, Borough and District partners to take forward the development of the KMIF and agree the more detailed aspects of the structure and operation.

Objectives

3. The Kent and Medway Investment Fund aims to unlock regeneration and development by using local authority assets and funds to lever significant private sector investment. It will generate returns to be reinvested in a revolving fund in order to maximise benefits.

The KMIF is underpinned by three key objectives:
- To continue to deliver economic growth in a context of reduced central and local government funding streams;
- To maximise value towards this from local authority owned assets and support the delivery of asset management strategies that assist regeneration.
- To lever and unlock significant private sector investment across Kent.

The primary purpose of KMIF is to enable regeneration through shared resource commitments. It is not an asset management vehicle, nor is it focused on providing a source of income generation for the local authority partners.

Rationale and Approach

4. Finance markets have changed significantly in recent years with a severe contraction of bank lending following the global financial crisis. This has had a direct impact on national and local property markets which in turn is constraining private sector led development. KMIF will unlock development and optimise economic benefits by utilising local authority cash and assets to leverage private finance that would otherwise not be available. It provides a direct response to current constraints on public sector funding and offers an alternative approach to traditional grant funding streams by maximising the efficient and effective use of local authority owned assets.

KMIF will provide a commercial market return on investments and is not intended to provide gap funding. It is therefore targeting projects that are marginal to the market – in other words, it does not supplant existing private finance but instead offers an alternative source of finance to enable projects to become viable. It will provide finance for both public and private sector led projects that deliver against regeneration outputs.

The model outlined in the Feasibility Report proposes the creation of a local authority led partnership that will pool cash and assets to create a Fund. The partnership agrees an Investment Strategy that determines how the Fund will be invested, including output targets, level of risk, and rate of return on investment. Only projects that meet the criteria set out in the Investment Strategy will be supported by the Fund. The partnership appoints an independent, professional Fund Manager to deliver the Investment Strategy. Investments may be in the form of debt, equity or guarantee and returns will be recycled back into the Fund for reinvestment. The model also makes provision for the local authority partners to achieve economies of scale and lever investment against pooled assets through a Local Asset Backed Vehicle established within the KMIF structure.

KMIF will harness the benefits of scale that can be realised through local authorities working in partnership. It is hoped that KMIF will be joined by most authorities within Kent to create a critical mass of projects and access to finance which makes it a size that becomes of interest to the private sector. Based on the experience of setting up the North West Evergreen Fund, the KMIF will need to be seeded with cash and assets totalling £20m to £30m in value from the local authority partners.

Key issues

5.i Governance

In order to remain attractive to the market it is important that the structure of KMIF is as simple and transparent as possible, whilst protecting the interests of the public sector partners. The Feasibility Report recommends that the KMIF is established through a Limited Partnership as the simplest and most tax efficient structure that is also widely recognised by the market and would therefore be attractive to potential investors. An analysis of the alternative options considered is provided within the Feasibility Report.

In order to operate KMIF through a Limited Partnership structure (within which partners have limited liability) a General Partner (with unlimited liability) will also need to be established. To retain their limited liability status, the Limited Partners cannot be involved in the day to day management and operation of the Fund, and this is delegated to the General Partner. The Fund is then managed in accordance with the Investment Strategy defined by the local authority partners.

There are two main options (within a LP structure) in respect of the General Partner arrangement:

1. the partners form a special purpose vehicle to act as the General Partner. A separate Fund Manager is then appointed and managed by the General Partner. This option offers the partners greater involvement in the operation of Fund by creating an additional layer of governance. The General Partner can then determine the extent to which it delegates responsibilities to the Fund Manager.

2. A General Partner is appointed by the Limited Partnership to also be the Fund Manager. Although this is a more arms length option for the partners (as the partners would not be involved in the General Partner decision making), they retain control over the General Partner/ Fund Manager through the Partnership Agreement and Investment Strategy. A review panel could be established to give the partners additional visibility over the performance of the General Partner.

The founding partners will need to consider and agree the extent to which they want to be involved in the day to day management of the fund; balancing the need for appropriate scrutiny and control to protect their interest whilst ensuring structures do not become unnecessarily complex and remain attractive to the market. In practice the approach could be a combination of the two options above. KMIF could initially be established with a SPV General Manager (option 1) and then transition to option 2 at a later date. This decision will need to be taken jointly with the local authority partners as part of the fund development stage.

The objective is for all local authority participants to join KMIF at set up. The more local authority partners involved at the outset then the greater the initial financial resource that the Fund can call upon. Entry will be allowed at a later stage although penalties will need to apply to reflect: the initial setup costs; any increase in the value of the Fund; the reduced risk associated with late entry. All partners will be required to invest a minimum sum to secure equal voting rights. Partners may choose to increase their investment either at Fund or project level and returns will be on a pro-rata basis. Any additional investment will not impact on voting rights, which remain equal.

5.ii Seeding the fund

In order to make finance available for projects, the Fund must be seeded with a mix of local authority cash and assets. It is not, however, intended to be a vehicle for holding local authority owned assets and partners will need to be selective in identifying the most appropriate assets to invest in the Fund. The Fund will complement existing local authority asset management strategies by providing a mechanism for extracting value from key sites/ premises at Fund level (through a Local Asset Backed Vehicle) as well as making funding available for development projects.

Although some local authorities have been successful in establishing Local Asset Backed Vehicles (LABVs), there may be insufficient scale in many areas for each District to take this approach individually. Moreover, the KMIF structure builds upon the LABV arrangement by being capable of leveraging a much broader mix of institutional finance at the Fund and project levels.

5iii Project Pipeline

In developing proposals for the KMIF an initial potential project list has been drawn up. These are exclusively public sector led projects. Private sector led projects will equally be eligible to access the Fund providing they fulfil the investment criteria. Further projects will be identified through an open call.

Although several projects have been identified for investment by the Fund, development of the project pipeline will be a key element of the next stage of work. The level of return achieved by the Fund is dependent upon the quality and spread of the investment portfolio and therefore the range of projects coming forward. The Feasibility Report highlights the need for appropriate capacity to support and develop pipeline projects to ensure they are investment-ready. Each partner authority will be able to promote or 'sponsor' projects for inclusion in the Fund pipeline, however whether they also retain individual responsibility for project development or whether this is resourced collectively will need to be determined at the next stage of work.

5.iv Regional Growth Fund

A programme based bid to the Regional Growth Fund (RGF), Round 2 is currently being prepared for the KMIF. An Expression of Interest has been submitted and the full bid will need to be prepared by the end of June. If successful, RGF funds will be used to complement KMIF investment and bring forward additional projects that otherwise would not meet KMIF criteria. The KMIF can only invest in commercially viable projects. RGF will therefore be used to bridge any viability gap enabling projects to access KMIF.

Due to the RGF qualifying criteria it will not be possible to bid for additional funds to be used Kent wide. Instead, the RGF funding will be geographically targeted towards those Districts with lower employment levels and higher dependency on public sector employment. Typically projects in these areas are often less likely to be economically viable for KMIF support without additional funding due to the nature of the property markets. RGF will therefore augment KMIF and help balance the portfolio of investment in regeneration across Kent.

It is important to recognise that the prospect of a successful bid for KMIF may however be limited. RGF is a highly competitive process with criteria which clearly favours northern regions with greater employment dependency on the public sector. This is evidenced from the experience of Round 1 and the fact that only one bid was awarded in the South East. Although RGF would increase the investment capacity of KMIF, the proposed model is not dependant on RGF.

Financial Implications

6 If there is commitment to take forward the KMIF there are three funding streams required to develop and implement KMIF with financial implications for local authority partners:

i. KMIF development costs (including setting up the governance structure)
ii. Seeding the Fund
iii. Running costs

i. KMIF Development Costs
Funding will be required to take forward the development and set up of the KMIF at a cost of around £650,000. It is proposed that the Borough and District partners are asked to contribute £25,000 each towards these costs, Medway contribute £50,000 and KCC fund the remainder, up to £500,000. Contributions will be subject to partners' internal approval processes.

ii. Local Authority contribution to Seeding the Fund
KCC will need to determine how it will make its contribution to seeding the fund based on its availability of cash and appropriate assets. Local authority partners can either commit assets as a contribution to seeding the Fund or derive the value themselves and release cash to the Fund. The latter is more tax efficient and allows authorities to retain control of their assets. It is expected that local authority partners' investment in the Fund will be informed by existing asset management and collaboration strategies.

The financial commitment to seeding the Fund will not need to be made until the Fund is ready to be established, following further development work at the next stage. The level of investment required will be dependant upon the number of local authority partners. Assuming a minimum of ten partners commit to setting up the Fund it is anticipated that each partner will be asked to make a contribution in the region of £2m - £3m. Although the financial commitments will need to be in place, funds will only be drawn down from the partners to the Fund as projects are brought forward for investment.

It is intended that in order to maximise the value and return on the Fund there will be a financial lock in period for the lifetime of the Fund, expected to be for a 10 year period. The founding partners may want to consider making provision for dividend payouts, subject to the performance of the Fund. At this stage it is not possible to estimate the level of return that could be achieved by the Fund. The return is entirely dependent on the risk profile partners choose to invest in which will be defined in the Investment Strategy. It is also subject to the development of the pipeline and timing of investments. There are no benchmarks available from the North West Evergreen Fund as this has only recently been established.

iii. Running Costs
Running costs, based on the North West Evergreen Fund, will be in the region of £500,000 per annum including legal fees, administration and fund management costs. This figure could vary depending on the precise structure and approach adopted in Kent. It could also be considerably less in the initial years as the Fund Manager costs could be charged as a percentage of the value of the Fund. These costs could be met from a combinations of sources: contributions from partners; fees charged to the projects (through the loan); and returns to the fund (once these become available).

Legal Implications

7. Pinsent Masons were appointed by KCC to work alongside CBRE and provide legal advice on the emerging proposals, with a specific focus on the Fund governance structure, Vires and State Aid implications. A full analysis of these issues is provided in the appended report.

7.i Vires

The legal analysis concludes that Well-Being Powers under the Local Government Act allow local authority partners to establish and participate in the proposed KMIF based on the current model and concept. Well Being Powers apply providing the primary purpose of the fund is to deliver regeneration outcomes and not to raise money (except possibly as a beneficial side effect). These powers will be replaced by a general power of competence under the Localism Bill, which is expected to be enacted in late autumn, and which may serve to limit tax exemptions currently in place. The provisions currently proposed under the Localism Bill will require authorities to trade through a company structure, ruling out the use of a Limited Partnership for the purpose of the KMIF. Tax exemptions under the LP structure will no longer be available, therefore increasing the operating costs of the KMIF and impacting on its financial viability. In order to guard against this and create flexibility for the future operation of the KMIF, it is possible to create a shell KMIF partnership by October in advance of the Localism Bill.

7.ii State Aid

KMIF is based on the principle that it will invest according to market rates and therefore will not contravene state aid rules. There may be circumstances where it would be beneficial to invest on less commercial terms to achieve regeneration outcomes and this will be possible in geographic areas where exemptions apply (specifically the East Kent Assisted Area)

Next steps , Phasing & Procurement

8. The feasibility stage of work has focused on the fund concept, how it could operate and the key decisions that will need to be made in setting up the KMIF. This report asks Chief Executives whether they support the concept in principle and whether they want to jointly take forward the development and set up of KMIF. Providing sufficient Districts signal an interest, they will be asked to contribute to the financial cost of the next stage of work (as outlined under section 4).

The next stage will comprise three main work streams:

- Development of the Investment Strategy
- Development of the Project Pipeline
- Development of the Governance Structure

Due to the inter-dependencies between the different elements and to also achieve better value for money, it is proposed that the KMIF development stage will therefore be openly procured as a single package. Breakpoints will be built into the work programme around key decision gateways in order to manage the potential risk and exposure to KCC and partners. It is important to note that CBRE and Pinsent Masons are not advising on the specification for this second stage of work to prevent a conflict of interest arising should they wish to submit a tender. The tender brief and specification will be developed by KCC Regeneration and Economy working with the local authority partners. The local authority partners jointly taking forward this next stage of work will collectively agree the procurement process, specification and phasing of work.

An indicative timetable is attached at Appendix 2. This is intended to outline the principle work-streams for the next stage of work. This will be developed in more detail following the appointment of consultancy support.

Procurement of the KMIF development will need to include specialist fund management advice. This could possibly be the same Fund Manager who will run the Fund on behalf of the KMIF partnership once it is established. This single appointment would ensure continuity of advice from development stage through to implementation and the partners could still retain the right not to proceed with the Fund by inserting an appropriate breakpoint after the development stage. Alternatively, the Fund Manager that will take forward delivery of the KMIF could be procured separately at the Fund set up stage. The appointment of the Fund Manager in both scenarios could be limited to an initial two year fixed period to allow partners to retain flexibility while the Fund is being established. The partners will in any case have the power to remove the Fund Manager in the event that performance targets are not achieved.

Based on the experience and timescales for setting up the North West Evergreen Fund, it is anticipated that the development stage will take a minimum of nine months to complete. An interim project governance structure, involving the District partners interested in taking forward the Fund, will be established to oversee the procurement and delivery of the development stage. This governance structure will comprise a Steering Group (with senior representation) to oversee strategic decisions, and a Working Group reporting into it. A key output from the development stage could be the creation of a shell Limited Partnership by October in anticipation of the Localism Bill (as noted in section 7) and to ensure flexibility is retained in determining the most appropriate delivery structures.

Consultation and Communication

9. KCC Regeneration and Economy has led the development of KMIF proposals but has been supported by a working group involving representation from SEEDA, Medway and KCC cross directorate expertise from Legal, Finance and Property. Meetings have also been held with ten Districts who expressed an interest in the KMIF concept to explore how the proposed model could deliver against their aspirations.

KCC colleagues in Legal , Finance and Property have provided some initial comments on the Feasibility Report and raised a number of points that will need to be addressed during the next stage of work. These comments are listed in the table below and are intended to provide an indication of some of the issues and the relevant work stream. This list is by no means exhaustive and it is expected that local authority partners will have other concerns that need to be addressed through the development work. An outline timetable for progressing the work-streams is attached at appendix 2.

	Issue	Stage / work-stream at which it will be addressed
Governance	Voting and control rights. Mechanisms to prevent viable proposals from being blocked	Legal review Investment Strategy
	Level of control afforded by the General Partner. Whether it is more difficult to remove the Fund Manager if they are also the General Partner.	Legal review
Outcomes	How market return is balanced against regeneration priorities	Investment Strategy
Procurement	Whether Fund Manager is procured at Fund development stage or whether FM is appointed after Investment Strategy is written and fund is ready to be implemented	Establish interim governance and procure advisors.
Seeding the Fund	Approach and basis for valuing assets.	Agree partner contributions
Financial Implications	How the annual running costs will be met.	Legal review and governance
	Financial modelling to determine anticipated level of return and sensitivity analysis	Financial modelling
Project Pipeline	Process for identifying new projects and private sector input	Call for projects

Discussions with SEEDA and HCA are ongoing regarding the future of the Kent and Medway portfolio of assets and liabilities. At this stage it is anticipated that the proposed HCA Stewardship arrangements and KMIF could operate in parallel, with KMIF providing the finance for projects brought forward under the Stewardship portfolio.

Initial soft market testing suggests there is private sector interest for KMIF. Skanska, Denne and Aviva have all expressed an interest and invited further discussions. The Kent Pension Fund has also indicated that they could be willing to invest between £10m - £20m and has requested that the proposals be presented to the Superannuation Fund Committee.

It is accepted that any commitment to the development of KMIF by local authority partners may need to go through internal sign off arrangements. The Kent Joint Chief Executives may want to advise whether they would like the Feasibility Report, findings and recommendations to be presented to Kent Forum.

Risk Management

10. In committing to the next stage of developing the KMIF, local authority partners are making financial commitments towards the cost of this work (as outlined in section 6). These would be abortive costs if it was decided not to proceed with the set up stage.

It is important to note that agreement to proceed with the development and set up stage does not equate to a ten year financial commitment to the KMIF. The precise level of investment required from each partner to seed the fund will need to be determined through the next stage of work.

The limited partnership structure ensures that the risk to the local authorities is limited to their investment as KMIF would not in itself be raising debt. The proposals make provision for partners to exit from KMIF providing they sell their stake (which admittedly may not be easy in the early years). All partners can collectively agree to close KMIF at any time.

There is potential risk that the proposed call for projects could raise expectation and this would need to be carefully managed in terms of how this was presented to the market.

Conclusion

11. The KMIF concept offers an innovative alternative to delivering strategic and large scale regeneration in a way that is attractive to the market and capable of levering significant investment. It complements and builds upon existing local authority asset management strategies. It provides a means of unlocking development and delivering against regeneration targets against a backdrop of reduced public sector spending.

The Feasibility Report outlines how the KMIF could operate and identifies the specific issues that will need to be agreed by partners in order for it to be set up. The Kent Joint Chief Executives are asked whether they are supportive of taking forward the fund concept. Providing there is sufficient support, a project governance structure will then be established along with a project budget to progress the development and set up stage.