

East Midlands 2007-13 ERDF Programme – JESSICA Urban Development Fund

Purpose of the Paper

This paper aims to provide LMC members with background on the East Midlands JESSICA Urban Development Fund which utilises £10m ERDF from Priority Axis 1 (PA1) and is focused on premises and facilities to support innovation, research and development activities in urban areas.

A presentation on the Fund and an update on the latest investment position will be given at the meeting by the Fund Operator, Jones Lang LaSalle.

Recommendation

Members of the LMC are invited to:

- Note the paper as background for the East Midlands JESSICA Urban Development Fund.
- Provide any comments on the approach and the investment opportunities

1. Introduction to JESSICA

JESSICA (Joint European Support for Sustainable Investment in City Areas) is a financial engineering instrument that has been developed by the European Commission and the European Investment Bank (EIB). Article 44 of EU Regulation 1083/2006 makes provision for ERDF funds to support financial engineering instruments for Urban Development Funds (UDFs). The format of UDFs is not prescribed by the Regulations, but it is anticipated that they will consist of public-private partnerships that invest in an integrated plan for sustainable urban development. Under the initiative, ERDF Programmes can allocate resources to make repayable investments in projects – these investments, which can take the form of equity, loans or guarantees (alone or in any combination), need to be delivered through Holding Funds¹ or UDFs². The JESSICA mechanism provides the opportunity to allow long term investment, and importantly recycling of that investment, in order to bring lasting improvements.

With JESSICA financial engineering instruments, the public sector is expected to maintain its role as an aggregator of partners creating the conditions for the development of urban projects instead of being the single or main investor/risk taker.

The JESSICA initiative provides an opportunity to:

- Make ERDF funding in the region more efficient and effective by using non-grant financial instruments and therefore creating stronger incentives for project implementation;

¹ Holding Funds can invest in several UDFs.

² Urban Development Funds invest in a Public Private Partnership (PPP) or projects in an Integrated Urban Development Plan.

- Attract financial resources for public-private partnerships and urban development projects with a focus on sustainability;
- Utilise financial and managerial expertise from relevant European Financial Institutions (such as EIB); and
- Ensure long term sustainability and a legacy for ERDF due to the recyclable nature of any investments.

The JESSICA initiative provides an innovative way of securing private and banking sector contributions at a time when public match funds are being stretched.

2. Strategic Fit

The economic climate in 2008 and 2009 was having a significant impact on the availability of funding to support regeneration and development activity required to achieve the region's objectives. With the availability of grant funding diminishing, it was considered important that investment was set aside and made in capital development activities to build the infrastructure required to aid the region's long term recovery and future growth. The region recognised that a JESSICA fund could provide an investment mechanism that would facilitate a move away from traditional public sector economic development grant funding towards enabling and recycling investment over the long term.

Regeneration can be defined as a set of activities that seek to reverse economic, social and physical decline in areas where market forces alone will not do this. The East Midlands JESSICA fund was established to address this issue of market failure by providing appropriate financing to make projects commercially viable. The fund is intended to utilise the financial development and expertise of the private sector, and help unblock development activity that has stalled as a result of the credit crisis and ensuing recession.

The rationale for the fund is therefore to invest in regional projects which would not be deliverable by the private sector in isolation due to the commercial risks, particularly in terms of covenant risk associated with SMEs in high value added sectors and in the light of impacts of the wider banking crisis which has reduced the availability of development finance.

Provision for the use of the JESSICA initiative is identified under both Priority Axes of the Operational Programme - to support investment in innovation infrastructure under Priority Axis 1 and to support the sustainable urban development theme under Priority Axis 2.

Priority Axis 1 seeks to increase business competitiveness by accelerating the rate and level of innovation and improving resource efficiency by enabling businesses to develop and exploit new products, processes, technologies, services and markets. It sets out a need to create an effective environment for innovation and to have the physical infrastructure assets in place to maximise the potential growth and continued development of innovative businesses.

Priority Axis 2 (PA2) is concerned with increasing sustainable economic and enterprise activity in disadvantaged communities. It is spatially targeted to focus resources on the most disadvantaged areas whilst exploiting the potential linkages to adjacent areas of economic growth.

At both the European and National level, the importance of investment in innovation continues to be highlighted as critical to economic recovery and future growth.

Reflecting on these issues, and following consideration by the PA1 sub-group, the PMC recommended in May 2009 that a regional Urban Development Fund using the JESSICA principles be established to focus on the development of premises and facilities to support innovation, research and development activities. That is, to limit its scope to Priority Axis 1 activity. An invitation to apply for £10m ERDF grant funding to support the establishment of the fund was published on 12 June 2009 and following a formal selection process King Sturge Financial Services (now called Jones Lang LaSalle) were appointed as the Fund Operator.

The fund has been specifically established to bring forward relevant activity and deliver outcomes as defined in Priority Axis 1. PA1 is intended to create a high value added economy and to support specific actions that will increase innovation activity in the regions' key sectors and high growth businesses. The fund's focus of activity is on the development of new premises and activities to support innovation and the upgrading or extension of the existing employment agenda. It is considered that appropriate development projects are likely to include a significant proportion of the following activity:

- Research and development
- Innovation
- Workspace for small to medium sized enterprises (SMEs) and high technology operators

4. Target Outputs and results

As illustrated by the table below, The Fund has identified the following target outputs and results, which align with ERDF policy and indicators:

Input	Activity	Outputs	Outcome	Impact
JESSICA	Develop land, property and facilities	Brownfield land reclaimed, Floorspace developed Businesses assisted	Jobs created Businesses improving performance Leverage	Employment rate Improved productivity GVA

The amount achievable and deliverability of these outputs and results is to be assessed for projects as part of the investment appraisal and selection process.

5. Size of Fund

The PA1 investment into JESSICA is £10m ERDF matched by £5m Single Programme funding from the East Midlands Development Agency. At the Funds outset there was an expectation that this would be further matched with £5m private sector funding to bring the fund to a total value of £20m.

6. Investment return objectives

The primary measure of success will be the Fund's performance against the non-financial factors, priorities and target outputs identified above. However, the Fund will be required to preserve the real purchasing power of its initial capital base so that investment in projects can continue over the expected life of the Fund. The Fund is therefore expected to recover its investment and seek to recover the following in order of priority;

- inflation adjustments to capital invested
- associated Fund costs
- appropriate level of risk adjusted return to reflect risks of the project
- profit in the event of better than expected project returns

Investments are to be made in a State Aid compliant manner although it should be noted that no UK wide State Aid notification exists for JESSICA. However, specialist advice has been taken to ensure the Fund is compliant and this would be revisited before any specific project investments are made.

7. Permitted Capital Instruments

The Fund is able to invest via Equity, Debt or Rental guarantees. The form of investment by the Fund depends on the attributes of each project, its individual merits and risk profile.

8. Investment period

The Fund is required to have invested (i.e to have defrayed) its initial funding comprising £15m by June 2015. The intention for JESSICA funds is for the investment to be recycled i.e the invested capital to be recovered and the returns reinvested into subsequent projects. There is no fixed termination date for the fund, although the Fund's Board are required to review the position in 2015, in addition to on-going reviews.

9. Recommendation

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Annex A



Transforming the East Midlands

- £15 million available to invest in Commercial Property Developments
- Providing Equity and Debt project finance of up to £5 million
- Focus on Innovation, Science, R&D, Technology and Growth sectors in Urban Areas
- Working with Public and Private Sector partners
- Recycling investment to ensure a long term legacy for the region
- Established via JESSICA - Joint European Support for Sustainable Investment in City Areas

www.eastmidlandsurbandevelopmentfund.co.uk



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