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THE CITY OF EDINBURGH COUNCIL

Item no 9
Report no PS/87/09-10 CD

Edinburgh Waterfront Tax Incremental Financing (TIF) Project Business Case

Policy & Strategy Committee

23 February 2010

1 Purpose of Report

1.1 To seek approval of the Business Case for the Edinburgh Waterfront Tax Incremental Financing Project and the recommendations contained in Section 9 of this report.

2 Summary

2.1 A paper providing an update on the progress of a pilot Tax Incremental Financing (TIF) project in the Leith docks area was presented to the Policy and Strategy Committee on 1 December 2009 and approval given to proceed to a full Business Case for the project. This paper summarises the findings of the Business Case to adopt TIF as a means to fund infrastructure delivery in the area in order to bring about much needed economic growth and development. TIF provides an alternative means of funding which captures the "tax increment" – the locally generated incremental public sector revenues that would not have arisen were it not for the delivery of enabling infrastructure investment within a particular area – which is then used to meet debt repayments on the initial investment. The major advantage of TIF is that it enables the benefits of urban regeneration to be reinvested and avoids the need to raise taxes or divert public spending away from other projects. The basic assumption is that all upfront funding is met through prudential borrowing and that the uplift in non-domestic rates revenue generated as a consequence of the enabling infrastructure is used to meet debt repayments on the initial investment. Thus the funding of the TIF proposals will not impact on existing revenues of the Council.

2.2 Whilst the physical redevelopment of this area is largely the responsibility of Forth Ports plc, it has been recognised that the sheer scale, nature and complexity of the regeneration effort requires the support and cooperation of the public sector, particularly in the current market conditions. Over the past 12 to 18 months, the value of all sectors of property has fallen significantly and projects assessed as bankable two years ago are now perceived as high-risk. Generally speaking, regeneration of brownfield land, with major up-front infrastructure investment requirements, has always been viewed as marginal in terms of risk and return but is now unlikely to proceed without substantial public sector support. Whilst recognising that movements in property values tend to be cyclical, it is nevertheless by no means certain that values will return to the peaks of two years ago.

2.3 Initial feasibility work undertaken by PricewaterhouseCoopers (PwC) on behalf of the Council examined projects across the whole Waterfront area but funding these projects was considered too ambitious for a TIF project. A smaller portfolio of projects was therefore considered more realistic. As a consequence a number of key infrastructure projects have been identified which are considered most likely to unlock the greatest economic benefits in the short to medium term across the Waterfront, and to serve as a magnet for additional and complementary activity.

2.4 The attached Executive Summary summarises the findings of the appraisal undertaken by PwC and recommends using TIF to procure key infrastructure projects in Leith docks. Included are details of the economic analysis, the financial modelling results, potential revenue streams, sensitivity analyses, together with details of the recommended delivery structure and other procurement and governance issues.

3 Main Report

Strategic Issues

3.1 In terms of Scottish Government policy, TIF has the potential to meet a number of core deliverables. These are:

- TIF could assist in meeting a number of the Scottish Government's key policy objectives and assist in the delivery of a number of Scottish Government initiatives such as delivering and improving sustainability and increasing private and social housing supply.

- TIF is consistent with recent initiatives to move away from ring-fencing funding offered to local authorities, and towards greater local autonomy from the centre under the concordat between the Scottish Government, COSLA and local authorities.

- One of the key strengths of TIF is the discipline of considering the need for and prioritising infrastructure to ensure funding is being used in an efficient and effective way, and one which maximises the benefits and returns for the authority.

- TIF provides the platform for economic growth and delivery of the Scottish Government's five key strategic objectives which aim to make Scotland wealthier and fairer, smarter, healthier, safer, stronger and greener.

3.2 Scottish Futures Trust has indicated its support for a pilot project and confirmed that Ministers are generally supportive in principle of this TIF project.

Prioritisation of Assets

3.3 In looking at potential infrastructure projects which would most likely unlock economic development, consultation was held with senior Council officials and local developers. Of a range of investment opportunities across the whole of the Edinburgh Waterfront, projects in the Leith docks area were selected in view of the level of investment to date, the extent of existing commercial and retail development and the associated visitor numbers, its current and future connectivity with the City Centre and its potential to unlock private sector development. The proposed high-priority projects are:

(1) A new road link between Seafield Road and Constitution Street to provide improved access from East Edinburgh to the whole harbour development which includes land for commercial and residential development;

(2) A public esplanade outside the Ocean Terminal shopping centre for new commercial outlets at the water's edge which will allow a through connection to the future tram network;

(3) A new finger pier for the Britannia and visiting cruise liners to replace the existing berthing facility which will be part of the new esplanade; and

(4) New lock gates at the entrance to Leith Docks to facilitate the cross-Forth ferry and marina.

Revenue Streams

3.4 Whilst Council Tax, Stamp Duty and non domestic business rates were initially considered as potential sources of revenue, only non domestic rates revenue is seen as a viable source of income which could be hypothecated to meet the interest and loan repayments. Since Council Tax and Stamp Duty are either collected by HM Treasury or required for other services, capturing these revenue streams could be problematical and have therefore been discounted for the purpose of this appraisal.

3.5 Given that the economic benefits of the prioritised assets are expected to apply not only to Leith docks but also to extend to the wider waterfront area, the proposal is that the uplift in non-domestic rate revenue is collected from an area which extends beyond where the investment is actually being made. This area is referred to as the "Red Line Area" and plans showing the limits of these areas are attached at Annex B.

Economic Impact Appraisal

3.6 As part of the economic appraisal, consultation was undertaken with local developers and with a range of organisations, representing a diverse range of relevant backgrounds: local public and third-sector organisations, including some with particular relevant expertise such as transport, housing or tourism;

representatives of the Edinburgh-wide business community; and private sector organisations working in the investment and/ or property development sectors.

3.7 The analysis also examines 'what might happen anyway' in the absence of any intervention by the public sector, and, as a result, what benefits might be expected to arise in the absence of the TIF proposals. That consultation exercise confirmed the general view that without further intervention at the Waterfront there is a significant risk that development will stall in the short-medium term. As part of the analysis the effects of "displacement" have also been considered to establish the true impact of the proposed infrastructure, i.e. it aims to take account of the activities and benefits that may be diverted from elsewhere as a result of any intervention.

3.8 Key points arising from the analysis of the responses from both local developers, and the wider group of stakeholders, is that without further public sector intervention in the Waterfront area, there is a significant risk that private sector development will stall in the short-to-medium term.

In contrast, if the proposed infrastructure projects were taken forward:

- Stakeholder consultation indicated that although there would be potential displacement effects, a significant proportion of the demand could still be additional, and would therefore generate incremental non domestic rate revenues consistent with the rationale for using TIF;

- Developer responses indicated that the proposed infrastructure investment could successfully unlock private sector development in the area, in housing, retail, business, hotels and tourism;

- Levels of anticipated displacement could be minimised according to the nature of the commercial development in each sector, and how this fits into the existing market offer in the City Region;

- Gross Value Added could be in the range between £72 million and £206 million per annum and the number of FTEs created between 2,630 and 7,172 which would more than justify the initial investment on economic impact grounds; and

- There are also wider social and economic benefits which could result from the investment.

3.9 In summary, the following outputs are predicted as a consequence of taking forward the prioritised assets:

Element	Economic Impact	
	Low	High
Projected capital spend on upfront infrastructure	£84.1m[1]	£84.1m[1]
Impact on development: Net additional housing (no. of units)	583	1241
Impact on development: Net additional business space (sq.ft)	175,500	540,000
Net additional retail space (sq.ft)	94,770	270,000
Hotels (beds)	541	1188
Tourism (visitors)	5,827	10,800

Notes: 1. Construction cost of £84.1m includes fees, contingencies, risks, construction inflation, project management costs and optimism bias.
2. Economic impact: **High** – this represents best possible outcome.
3. Economic impact: **Low** - this represents least optimistic outcome

4 Financial Implications

4.1 The projected cost of the prioritised assets including fees, contingencies, risk, optimism bias and inflation over the construction period is £84.1m. Project management costs as identified in Section 4.10 have been capitalised within the overall costs.

4.2 The proposal is that the Council use the Public Works Loan Board ("PWLB") as the source of prudential borrowing to fund the initial infrastructure costs. The interest rate assumed in the base case, 5% per annum, is in line with December 2009 25-year PWLB rates, with a small buffer. This is considered a reasonable rate to assume for the base case financial modelling, but changes to this rate have been considered as part of a sensitivity analysis.

4.3 The financial analysis was initially run on four main scenarios, the first ("100%") assuming that all the predicted non domestic rate revenues are available for debt servicing, and a further three ("High-", "Mid-" and "Low Additionality") scenarios factoring in displacement based on the results of the economic impact analysis discussed above. It is proposed that the Mid Additionality scenario be treated as the base case for the purpose of the analysis. It represents a point in between the high and low additionality scenarios, which takes into account a slightly higher probability of the high scenario occurring than the low scenario (60% - 40% likelihood). This reflects the stated approach for the project which is to seek to minimise the levels of displacement which occur across all forms of development. The results are shown in Table 4.1 below.

Table 4.1: Financial results

	100%	High Additionality	Mid Additionality[1]	Low Additionality
'Steady state' annual revenue in real terms, £m	10.8	8.0	6.7	4.8
Nominal revenue 2025-6, £m	14.8	11.0	9.2	6.6
Maximum upfront borrowing enabled over 25 years, £m	144.3	110.7	93.7	68.2
Borrowing enabled as a % of requirement	172%	132%	111%	81%
Earliest date full infrastructure cost could be repaid	31/3/2026 (17.5 years)	31/3/2032 (20.5 years)	30/9/2033 (23 years)	30/9/2035 (25 years)

4.4 As discussed earlier, some allowance needs to be made to take account of the displacement that is likely to occur and that a proportion of the economic growth and resultant incremental taxation revenues that will be generated will be at the expense of demand elsewhere. That being the case, it is assumed for the purpose of this appraisal that the Mid Additionality scenario highlighted above reflects a sensible and conservative base case for the project. These results confirm that the borrowing requirement would be repaid within 23 years, or that 111% of the borrowing requirement is likely to be financed within 25 years.

4.5 Under PWLB borrowing there is no formal scope for interest to be rolled up into the principal under these TIF proposals. It is, however, inherent in the nature of the proposed project that construction costs for the upfront infrastructure will be incurred before the resultant incremental non domestic rate revenues are generated. Therefore there is an early-years interest gap, during which debt service costs cannot yet be met from project revenues. The indicative size of this early-years gap for the base case (Mid Additionality) scenario is £1.31m in total interest costs between 1st April 2010 and 31st March 2016.

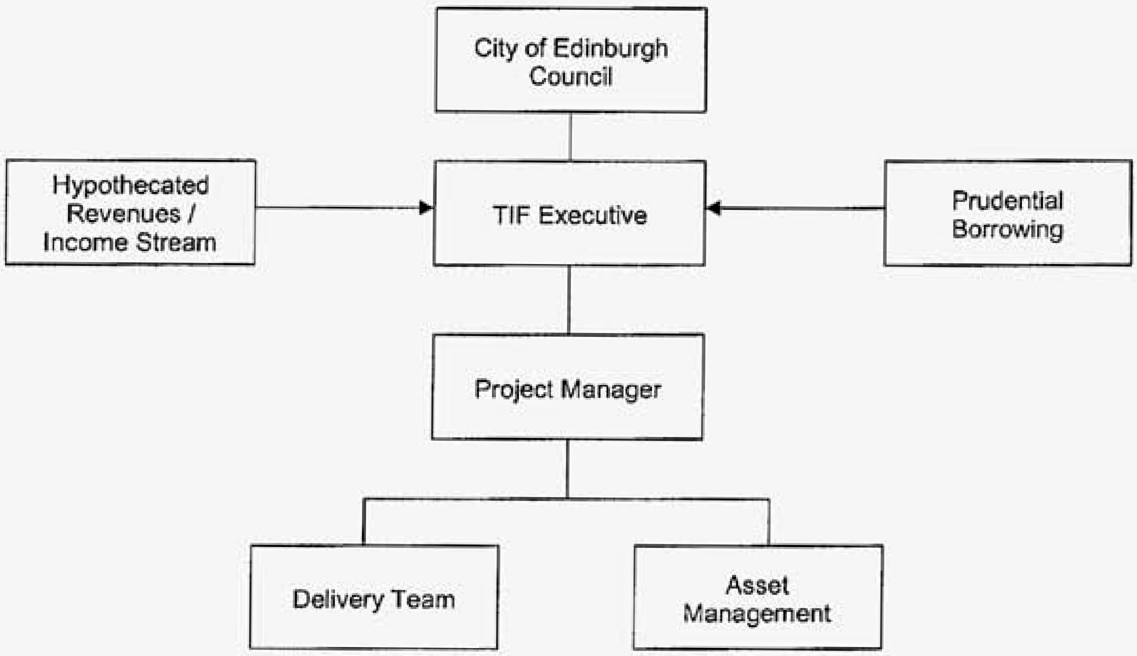
4.6 The above results were then subject to sensitivity tests which looked at no inflation increases on non domestic rates revenue, increases in interest rates of 1% and 2%, possible delays in the commercial development, reductions in rate revenues of 10% and 20 % and increases in infrastructure costs of 10% and 20%. Full details of these sensitivity tests are provided within the attached Executive Summary. A key finding of these tests is that the early years interest gap, when rate revenues are not sufficient to cover interest costs, is particularly sensitive to certain changes in assumptions, notably interest rate increases and delays in the rate revenue build-up. To some extent this is a function of the relationship between the particular profiles of capital expenditure and debt drawdown, and rate revenue build-up over time. In view of the above it is recommended that an approach be made to the Scottish Government to secure their agreement to underwrite 50% of the early year's interest gap until such time as the rates revenue meets the interest charges.

4.7 Notwithstanding the above, on the basis of the financial review, the base case assumption demonstrates an outcome whereby the incremental non domestic rate revenue generated by the proposed development would be sufficient to service the borrowings required for the proposed infrastructure assets.

Delivery & Governance

4.8 Having considered a number of options, the proposal is that the project be local authority led, rather than establish a separate dedicated delivery vehicle. Given that there is no anticipation that the Council would wish to sell on the assets or refinance the project and that all upfront funding is being met by prudential borrowing, this approach is considered to offer the most pragmatic and effective management structure for the project.

4.9 The following organisational structure is proposed to lead and manage the key elements of the project.



4.10 A robust project governance and reporting structure will be established to ensure quality assurance, accountability and clear decision making. This will take the form of the TIF Executive, which will comprise representatives from the Council and Forth Ports plc and could have co-opted members from other organisations, whose role will be to act as a Steering Group for the project. Subject to a future decision of the Council, the TIF Executive could retain delegated powers to approve the procurement of the various assets. Also proposed is a full time Project Manager, the cost of whom has been capitalised within the project costs, a Delivery Team comprising Forth Ports staff and an Asset Management team whose remit will be to manage the operational aspects of the various assets and to ensure compliance with all legal agreements entered into between the parties. The precise roles and responsibilities of the individuals need to agreed, as do the terms of reference and responsibilities of the delivery team and those managing the assets, but these are matters that can be decided at a later date.

5 Environmental Impact

5.1 Environmental Statements will be required for each of the prioritised assets. In the case of the lock gates, it is anticipated that an Appropriate Assessment will be required given the potential impacts on the Imperial Dock Lock Special Protection Area which is located just outside the development area. However, any impacts are likely to be short term.

5.2 In respect of the esplanade and pier, an Environmental Statement has already been prepared to accompany the existing outline planning application for the Harbour which is expected to be determined in early 2010. No significant environmental impacts are anticipated and appropriate mitigation measures are to be incorporated.

5.3 The proposed link road is located on former industrial land and given the history of the site some contamination is anticipated. However, it is not anticipated that there should be any residual risk to human health or the wider environment.

6 Risk Management

6.1 As part of the process of testing the feasibility of this TIF project, a risk workshop was held with stakeholders and Council officials to examine the level of risks within the project. Given the current stage of the project, the risks identified represented high level project risks, the main risks being seen as cost and time over runs during the approval and construction phases, variations in the expected revenue stream and other wider political/economic impacts. Each of the identified risks were assigned a weighting and mitigants then identified for each. Where appropriate, these are taken into account within the financial analysis.

6.2 It should, however, be noted that there remains a residual risk to all parties that due to continuing market failure, the expected economic benefits and non domestic rate revenues may not materialise. In those circumstances, Forth Ports plc has agreed to mitigate the risk by transferring the proposed development sites to the ownership of the Council. The transfer of some 10 acres of land will take place at the point at which non-domestic rate revenues are projected to cover interest costs. These sites are zoned for mixed use development and include office, retail and hotel development as part of a new office district at Waterfront Plaza. Approval of these proposals is the subject of the current outline planning application by Forth Ports PLC which is expected to be determined in the next few months. Security over these sites will be vested in the Council as part of the side agreements to be entered into between the parties such that Forth Ports Plc will forfeit the land if development does not proceed as envisaged once all enabling infrastructure has been completed.

7 Planning

7.1 All of the proposed infrastructure will require planning consent prior to implementation. At the present time the esplanade and pier are included within the current planning application for the Harbour which is currently under consideration by the Council and which is expected to be approved in the next few months. Future applications will be required in respect of the link road and new lock gates and the project phasing programme reflects the time required to obtain these approvals.

7.2 As with all planning applications, developer contributions under Section 75 of the Town & Country Planning (Scotland) Act 1997 will be required as part of the consent process. Agreement on the precise terms of those agreements will be a precursor to taking the individual projects forward.

8 Conclusions

8.1 In summary, the economic impact of investment in the four prioritised assets; new Dock Gates; an extension to Ocean Drive; a new Esplanade around Ocean Terminal; and a new finger pier for the Britannia and visiting cruise liners; could, in a best case scenario, service £110.7m of up front investment over a 25 year time frame against an investment of £84.1m. Taking a more conservative approach the analysis suggests that up to £93.7m of investment could be serviced over the same period which is 111% of the required investment. This Business Case also shows that the potential economic impact of an investment of £84.1m could create up to 540,000 sq ft of additional business space, 270,000 sq ft of retail space and up to 1240 housing units.

8.2 Based on the above analysis there is a clear case for adopting Tax Incremental Financing as a means to fund specific infrastructure projects within the Leith docks area, all of which are expected to act as a catalyst for development within the wider community. Such a strategy is expected to be viewed by the private sector as a positive response to the present difficult economic conditions and a much needed stimulus to the market both within Edinburgh's Waterfront and across the City.

9 Recommendations

9.1 It is recommended that Policy & Strategy Committee:

a) Approve the Business Case for the Waterfront Edinburgh TIF project, including the proposed Delivery Structure, as described in the attached Executive Summary;
b) Approve the Red Line Area as described in the Executive Summary;

c) Agree to seek the approval of the Scottish Government / Scottish Futures Trust to the Business case for the prioritised assets;
d) Agree to approach the Scottish Government to secure their agreement to underwrite 50% of the early year's interest gap until such time as revenue meets the interest charges; and
e) Agree to pursue the Next Steps as described in the attached Executive Summary.

Dave Anderson

Dave Anderson
Director of City Development

Appendices	Annex A: Edinburgh Waterfront TIF Project - Executive Summary Annex B: Red Line Area
Contact/tel/Email	Colin Hunter
Wards affected	
Single Outcome Agreement	
Background Papers	Waterfront Edinburgh TIF Project - Business Case dated January 2010

Annex A: Waterfront Edinburgh TIF Project – Executive Summary

EDINBURGH WATERFRONT TAX INCREMENTAL FINANCING (TIF) PROJECT

BUSINESS CASE

EXECUTIVE SUMMARY

January 2010

Executive Summary

Introduction

The City of Edinburgh Council has a stated policy to support physical regeneration and has set up arms length companies to facilitate the redevelopment of a number of sites within the City, including the Edinburgh Waterfront at Granton and Leith. In the current recessionary market where redevelopment has all but come to a standstill finding funding solutions to facilitate the regeneration, which in turn could drive economic growth and development, is critical to the future success of these areas. This paper sets out a Business Case for using Tax Incremental Financing (TIF) to fund a number of key projects within the Edinburgh Waterfront as a driver for much needed economic activity.

At the present time the projected public infrastructure investment required in the Edinburgh Waterfront is estimated to be of the order of £500 million. Allowing for normal funding sources from within the City of Edinburgh Council a funding gap of circa £475 million is expected and finding alternative funding sources for that level of investment is therefore a key consideration. Tax Incremental Financing offers the potential to accelerate and fund infrastructure delivery across Scotland, driving growth and development by capturing the "tax increment" – the locally generated incremental public sector revenues that would not have arisen were it not for the delivery of enabling infrastructure investment within a particular area – which is then used to meet debt repayments on the initial investment. The major advantage of TIF is that it enables the benefits of urban regeneration to be reinvested and avoids the need to raise taxes or divert public spending away from other projects.

In early 2009 PricewaterhouseCoopers (PwC) completed a study for the City of Edinburgh Council to investigate the feasibility of a pilot TIF project in the Edinburgh Waterfront area. In looking at what projects were most likely to unlock the greatest economic benefits in the short to medium term across the Waterfront it became clear that financing the projected gross infrastructure costs across the whole area was unrealistic and too ambitious. As a result, the analysis focused on the development of a number of key infrastructure projects which were considered most likely to act as a catalyst for further economic development.

This report recommends taking forward a pilot scheme which is made up of a number of key infrastructure projects within the Leith docks area, each of which is expected to serve as a magnet for additional and complementary activity in the wider area. Piloting this TIF model is expected to be viewed by the private sector as a much needed stimulus to the market.

The paper assesses the economic impact of the proposed scheme, sets out the funding arrangements and includes a financial analysis of the potential revenue stream, together with a sensitivity analysis to test the overall viability of the project. The paper also identifies the next steps leading to delivery of the scheme.

The Scheme

The vision for the Edinburgh Waterfront is to create a world class waterfront development as an extension to the City, one which regenerates and
integrates old and new in a mixed, vibrant and inclusive community, including

- A string of mixed use urban villages;
- A vibrant mix of uses to create places to live, work, learn, invest and enjoy;
- A high quality waterfront with a clear focus on the public realm and contemporary interpretations of traditional Edinburgh architecture; and
- Sustainable communities with ambitious environmental targets.

The key landowners and developers in the area are the City of Edinburgh Council, Waterfront Edinburgh Limited (a CEC owned Company), Forth Ports PLC, and National Grid Property Ltd, each of whom is working to the Local & Structure Plans for the area. In addition, each developer has an approved Masterplan which reflects the common desire to create a new 21st century urban quarter within Edinburgh.

However, initiation of much of this development is constrained by a lack of enabling infrastructure. In addition, the scale of conventional funding available for housing and growth related infrastructure means that Edinburgh can only meet a proportion of the projected cost from its traditional and existing sources of funding, i.e. developer contributions, land sales and existing budgets. In the current recessionary climate, those funds are significantly reduced because of the lack of economic activity.

However, TIF offers the opportunity to bring forward a number of projects which could bring about economic activity in the wider area. In addition, TIF provides a revenue stream which will reduce the original principal without the need for separate government funding. In terms of Scottish Government policy, TIF also has the potential to meet a number of core deliverables. These are:

- TIF could assist in meeting a number of the Scottish Government's key policy objectives such as delivering and improving sustainability and increasing housing supply, both private and social.

- TIF is consistent with recent initiatives to move away from ring-fencing funding offered to local authorities, and towards greater local autonomy from the centre under the concordat between the Scottish Government, COSLA and local authorities.

- Encouraging the discipline of considering the need for and prioritising infrastructure requirements to ensure funding is being used in an efficient and effective way, and one which maximises the benefits and returns for the authority.

- TIF provides the platform for economic growth and delivery of the Scottish Government's 5 key strategic objectives which aim to make Scotland wealthier and fairer, smarter, healthier, safer, stronger and greener.

Following a critical review by representatives of the Council and other key stakeholders of a range of investment opportunities across the whole of the Granton and Leith waterfronts, development of a number of key infrastructure projects in the Leith docks area is considered to offer the best opportunity as a catalyst for further development and to serve as a magnet for additional and complementary activity. This recognises the existing attraction of the many leisure and retail facilities and the expected benefits that will come about as a consequence of the new tram line. The prioritised assets are:

(1) a new road link between Seafield Road and Constitution Street to provide improved access from east Edinburgh to the whole Harbour development which includes land for commercial and residential development;
(2) a public esplanade outside the Ocean Terminal shopping centre for new commercial outlets at the water's edge which will include a through connection from the centre to the future tram network;
(3) a new finger pier for the Britannia and visiting cruise liners to replace the existing berthing facility which will become part of the new esplanade; and
(4) new lock gates at the entrance to Leith Docks to facilitate the cross-Forth ferry and marina.

The overall estimated cost of the above assets including allowances for risk, project contingencies, design and construction fees, inflation and an allowance for optimism bias as required by HM Treasury Green Book guidance (the tendency for project appraisers to be overly optimistic and to overstate the benefits, and understate timings and costs, both capital and operational) is £84.1 million. Based on the economic appraisal undertaken these projects are expected to bring additional vitality to the area around Ocean Terminal and are projected to unlock some 800,000 sq.ft of commercial space (up to 540,000sq ft of office space and up to 270,000sq ft of retail space), up to 1,100 hotel beds and potentially up to 1,240 residential units.

Having looked at potential public sector revenues that would be generated as a consequence of the enabling infrastructure, the proposal is that the uplift in non-domestic tax revenues from within the areas shown on the plans at Annex A are used to meet the debt repayments on the initial investment. Whilst alternative revenue sources are potentially available (Council Tax & Stamp Duty), these are either collected by HM Treasury or required for other services and have therefore been discounted for the purpose of this appraisal. The area to be included, hereinafter referred to as the "Red Line Area", encompasses areas outside the immediate environs of Leith as it is widely expected that the impact of the enabling infrastructure will extend to the wider community.

It is fair to say that over the past 12 to 18 months, the value of all sectors of property has fallen, putting most new development projects on hold. Projects assessed as bankable two years ago are now perceived as high-risk and generally speaking, regeneration of brownfield land, with major up-front infrastructure investment requirements, has always been viewed as marginal in terms of risk and return. This acknowledges the higher cost of infrastructure and decontamination required compared to other greenfield sites.

Although movements in property values tend to be cyclical, it is by no means certain that values will return to the peaks of two years ago which are required to meet the increased infrastructure costs. It is quite possible that we are witnessing a fundamental re-basing of property values, risk perception and associated debt levels. It seems reasonable to assume therefore, that but for the infrastructure investment support provided by this TIF scheme, development would be deferred for a considerable period and perhaps indefinitely, or significantly scaled down.

Economic Analysis

The aim of the economic impact analysis has been to assess whether any new intervention delivers real results, over and above what would have happened anyway, and to establish whether the proposed intervention offers good value for money. (Additionality and Economic Impact Assessment Guidance Note, Scottish Enterprise, 2008).

As part of the appraisal a "counterfactual scenario" was examined which considers, in the absence of any intervention by the public sector, 'what might happen anyway' and, as a result, what benefits might be expected to arise in the absence of the TIF proposals. It represents the baseline from which additional benefits must be measured and is thus the 'deadweight' to be subtracted from the gross benefits anticipated to arise from the proposed intervention. In relation to the Waterfront, the deadweight is the level of development that may be able to proceed without any of the proposed public sector interventions (i.e. the prioritised assets) being delivered. In order to ascertain what this profile might be consultation has been held with a number of developers and other stakeholders to understand their views on the level of development, if any, which could proceed without intervention.

Based on respondents views the projected worst case scenario if the assets are not delivered is that none of the planned developments take place. This view is based on a number of factors:

- A slow and uncertain economic recovery will reduce the potential returns from development and likelihood of (any) development being taken forward (irrespective of the enabling assets);

- The ultimate success and marketability of the entire Masterplan rests on creating a "sense of place" with the proposed mix of uses including residential, commercial, business and leisure. Failure to deliver the enabling assets will significantly compromise the ability to deliver this mix and undermine the viability of any given aspect of the planned developments; and,

- Forth Ports PLC and other developers, interested in the Waterfront, have a diverse portfolio of investment opportunities available to them and may, in the absence of the enabling assets, find higher returns from investment could be achieved elsewhere and outside of Scotland.

A best case scenario if the assets are not delivered is that up to 10% of the planned developments could take place. Again this view is based on a number of assumptions including:

- Economic recovery is better than currently anticipated which leads to an up-turn in both demand and potential returns; and

- The tram line to Ocean Terminal is successfully completed.

In summary, the consultation with developers and other stakeholders suggests that without further intervention at the Waterfront there is a significant risk that development will stall in the short-medium term.

Another key element of the economic appraisal is the assessment of displacement which seeks to take account of the activities and benefits that may be diverted from elsewhere as a result of any intervention. This is of particular importance for a TIF project as it allows one to consider what activity, and therefore business rate receipts, may be displaced from elsewhere in Edinburgh and, for national policy makers, to consider the potential impact on the rest of Scotland. In essence, if displacement is expected to range between 10% and 46% for retail space, then only 54% - 90% of the retail receipts could reasonably be considered to be additional.

On the basis of the analysis undertaken, a range of displacement percentages that reflect both a high additionality and a low additionality scenario have been derived in relation to each type of development anticipated and these are shown in the table below. Tourism and hotel's exhibit the lowest displacement effects whereas business space is anticipated to experience the greatest displacement impacts.

	Low Displacement (high additionality)	High Displacement (low additionality)
Retail	10%	46%
Business	40%	70%
Hotel	0%	23%
Housing	27%	46%
Tourism	0%	18%

In assessing the overall potential development that could be generated as a consequence of taking forward the proposed assets, a range of outputs have been derived which include the implications of the potential displacement figures shown above, as well as the low and high additionality scenarios described earlier. These are shown in Table 1.1 below:

Table 1.1: Economic Appraisal

Element	Economic Impact	
	Low	High
Projected capital spend on upfront infrastructure	£84.1m	£84.1m
Impact on development: Net additional housing (no. of units)	583	1241
Impact on development: Net additional business space (sq.ft)	175,500	540,000
Net additional retail space (sq.ft)	94,770	270,000
Hotels (beds)	541	1188
Tourism (visitors)	5,827	10,800

Notes:

1. Economic impact: **High** – this represents best possible outcome.
2. Economic impact: **Low** - this represents least optimistic outcome.
3. Construction cost of £84.1includes fees, contingencies, risks, construction inflation, project management costs and optimism bias.

In addition, Gross Value Added could be in the range between £72.2m and £206m, and the number of FTEs created between 2,630 and 7,147.

Financial Analysis

A key principle of TIF is that any taxation revenues hypothecated should be genuinely incremental, i.e. taxes from development which have been unlocked by the upfront infrastructure investment which would not otherwise have happened but for the intervention. The financial analysis has drawn on the results of the Economic Impact study, taken the range of potential displacement effects from that study and applied these percentages to the full forecast non domestic rate revenues as a proxy for the proportion of rate revenues which may not be truly incremental.

The Economic Impact Study results suggested that the following displacement effects could potentially apply to each type of commercial space developed:

Type of Development	Potential Displacement Effects
Retail	10% - 46%
Business	40% -70%
Hotels	0% - 23%

For the purposes of the financial modelling, three different additionality scenarios have been developed based on the results of the economic analysis, namely High Additionality, Mid Additionality, and Low Additionality. The displacement assumptions for each scenario are as follows:

Scenario	Retail Displacement	Business Displacement	Hotel Displacement
High Additionality	10%	40%	0%
Mid Additionality	24%	52%	9.2%
Low Additionality	46%	70%	23%

It is proposed that the Mid Additionality scenario be treated as the base case for the purpose of the analysis. It represents a point in between the high and low additionality scenarios, which takes into account a slightly higher probability of the high scenario occurring than the low scenario (60% - 40% likelihood). This reflects the stated approach for the project which is to seek to minimise the levels of displacement which occur across all forms of development.

The financial analysis has been run on the four main scenarios, the first ("100%") assuming that all the predicted business rate revenues are available for debt servicing, and a further three ("High-", "Mid-" and "Low Additionality") scenarios factoring in some displacement based on the results of the economic impact analysis. The results are set out in Table 1.2 below:

Table 1.2 – Financial Analysis

	100%	High Additionality	Mid Additionality[1]	Low Additionality
'Steady state' annual revenue in real terms, £m	10.8	8.0	6.7	4.8
Nominal revenue 2025-6, £m	14.8	11.0	9.2	6.6
Maximum upfront borrowing enabled over 25 years, £m	144.3	110.7	93.7	68.2
Borrowing enabled as a % of requirement	172%	132%	111%	81%
Earliest date full infrastructure cost could be repaid	31/3/2026 (17.5 years)	31/3/2032 (20.5 years)	30/9/2033 (23 years)	30/9/2035 (31 years)

Notes

1. Mid Additionality is the proposed Base Case.

The results of the financial modelling using the full 100% of the gross new rates show a case in which the proposed borrowing for upfront investment in infrastructure could relatively easily be serviced by the new business rate revenues generated by the resultant development. The full 'steady state' business rate revenues reach £10.80m in today's terms once all development is completed in 2025-6, or £14.80m in nominal terms with an assumed 2% per annum inflation rate. This level of revenue could service up to £144.30m of borrowing, or 172% of the £84.1m needed for the Esplanade, the Lock Gates, the Finger Pier, and the Road Link. Alternatively, the 100% case shows that the projected upfront borrowing could be fully repaid in 17.5 years if all the business rate revenue generated were to be used for TIF.

The following sensitivities have been modelled on the base case to test the robustness of the proposals, and how reactive they are to changes in the underlying assumptions.

Sensitivity Analysis: Scenarios

Scenario	Description
1	No revenue inflation
2a, b	Interest rate increases: (a) by 1% pa, (b) by 2% pa
3	Delay in commercial development – profile moves back 2 years
4a, b	Rate yield revenues down by (a) 10%, (b) 20%
5a, b	Infrastructure cost increases –by (a) 10%, (b) 20%

The results of running the different sensitivities are:

- Scenario 1: If no revenue inflation is assumed, there is a substantial impact on the ability to repay the necessary borrowing, with the timescale expanding from 23 to 32.5 years. The early years interest gap increases by just over a quarter, from £1.31m to £1.68m;
- Scenario 2: Interest rate increases from the 5% base case assumption appear to indicate that for every 1% increase in rates, the amount of upfront borrowing which could be serviced falls by c. 10%; or the time taken to service the full upfront cost increases by c. 10%. The early years interest gap increases notably under the 6% rate scenario, nearly doubling to £2.57m, but the increase is far steeper under the 7% scenario, where the gap is £6.91m.
- Scenario 3: A 2-year delay in the commercial development and rate revenue build-up timescales has a relatively low impact on overall debt serviceability, but has a severe effect on the early years interest gap, increasing it more than fivefold to £7.04m.
- Scenario 4: Reductions in the business rate yields of 10% are just manageable if all other assumptions remain equal, with repayment just achievable in 25 years; though a 20% fall would result in a requirement of 28 years of rate hypothecation to repay. The early years interest gap is also increased notably under the 20% reduction scenario, to £2.45m.
- Scenario 5: Increases of 10% or 20% in infrastructure costs have a similar, but slightly smaller, impact to the rate yield decreases examined under Scenario 4 – the case just remains viable if costs increase by 10%, but would require 27 years to repay and nearly twice the capacity to cover the early years interest gap if they increased by 20%.

The sensitivity testing shows a need for mitigation strategies if downside risks materialise and the borrowing cannot be repaid within the base case timescales. These will be considered in the broader context of the nature and time period of the rate hypothecation to be agreed with the Scottish Government.

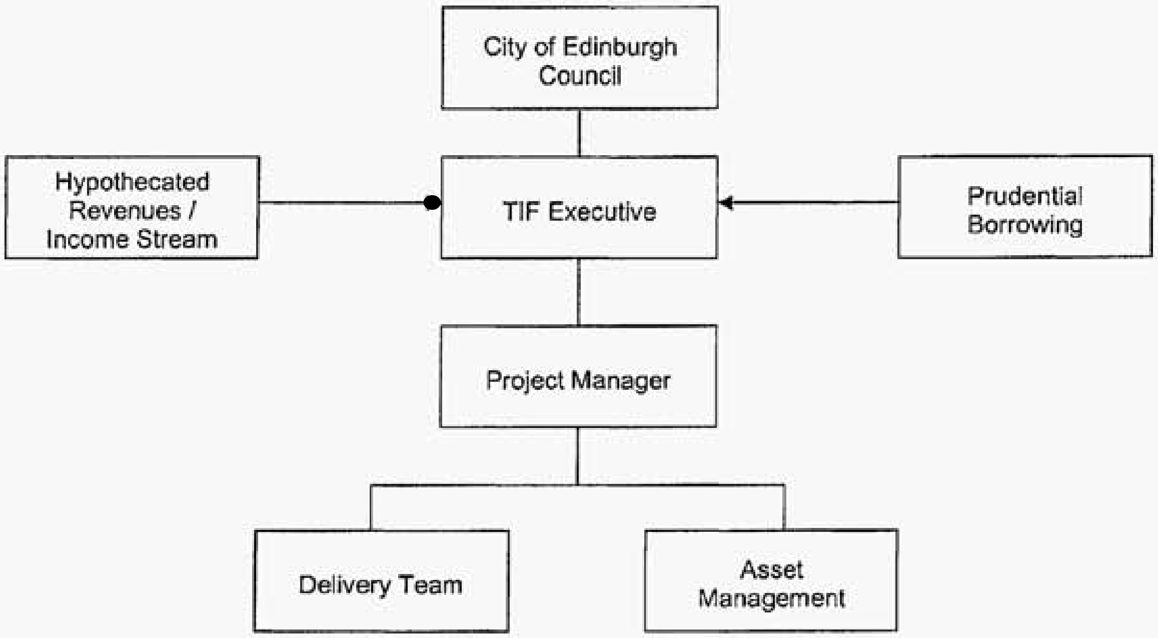
On the basis of the financial review the Mid Additionality base case demonstrates an outcome whereby the incremental non domestic rates revenue generated by the proposed development would be sufficient to service the borrowings required for the proposed infrastructure assets.

Delivery & Governance

Having considered a number of options which are detailed in the main Business Case report, the proposal is that the project be local authority lead, rather than establish a separate dedicated delivery vehicle. Given that there is no anticipation that the Council would wish to sell on the assets or refinance the project and that all upfront funding is being met by prudential borrowing, this approach is considered to offer the most pragmatic and effective management structure for the project.

Management responsibilities in terms of the operation and maintenance of the assets have also been agreed in principle between the Council and Forth Ports PLC.

The following organisational structure shows how it is intended that the local authority will lead and manage the key elements of the project.



A robust project governance and reporting structure will be established to ensure quality assurance, accountability and clear decision making. This will take the form of the TIF Executive, which will comprise of representatives from the Council and Forth Ports PLC and could have co-opted members from other organisations, whose role will be to act as a Steering Group for the project. Subject to a decision of the Council, the TIF Executive could retain delegated powers to approve the procurement of the various assets. Also proposed is a full time Project Manager, a Delivery Team and an Asset Management team whose remit will be to manage the operational aspects of the various assets and to ensure compliance with all legal agreements entered into between the parties. The precise roles and responsibilities of the individuals and the terms of reference and responsibilities of the delivery team and those managing the assets will be subject to agreement, but these are matters that can be decided at a later date.

The Delivery team will have responsibility for procurement and delivery of the various assets which is to be allocated to Forth Ports PLC who will be answerable to the Project Manager and ultimately the TIF Executive. Successful delivery of the overall project will be a key driver for Forth Ports PLC as they seek to achieve the maximum development impact from each infrastructure project. Procurement will follow normal public sector and European procurement rules to ensure best practice.

Where appropriate, risk will be managed or mitigated as far as possible. However, it should be noted that there remains a residual risk to all parties that due to continuing market failure, the expected economic benefits and business rate revenues may not materialise. In those circumstances, Forth Ports PLC has agreed to mitigate the risk by transferring the development sites to the ownership of the Council. The transfer of some 10 acres of land will take place at the point at which non-domestic rate revenues are projected to cover interest costs. These sites are zoned for mixed use development which will include office, retail and hotel development as part of a new office district at Waterfront Plaza. Approval of these proposals is the subject of the current outline planning application by Forth Ports PLC which is expected to be determined in the next few months. Security over these sites will be vested in the Council as part of the side agreements to be entered into between the parties.

In accordance with Office of Government Commerce (OGC) guidance Gateway Reviews are to be undertaken at each stage of the design/procurement process and prior to awarding contracts. In this way the Council's financial exposure will be measured and borrowing only sought having first demonstrated that there is a likelihood of success or, clear, tangible evidence of new development taking place.

Conclusions

In summary, the economic impact of investment in the 4 prioritised assets; new Dock Gates; an extension to Ocean Drive; a new Esplanade around Ocean Terminal; and a new finger pier for the Britannia and visiting cruise liners; could, in a best case additionality scenario, service £110.7m of up front investment over a 25 year time frame against an investment of £84.1m. Taking a more conservative approach the analysis suggests that up to £93.7m of investment could be serviced over the same period which is 111% of the required investment. This Business Case also shows that the potential economic impact of the proposed investment of £84.1 m could be between £72m and £206m per year in Gross Value Added to the local economy.

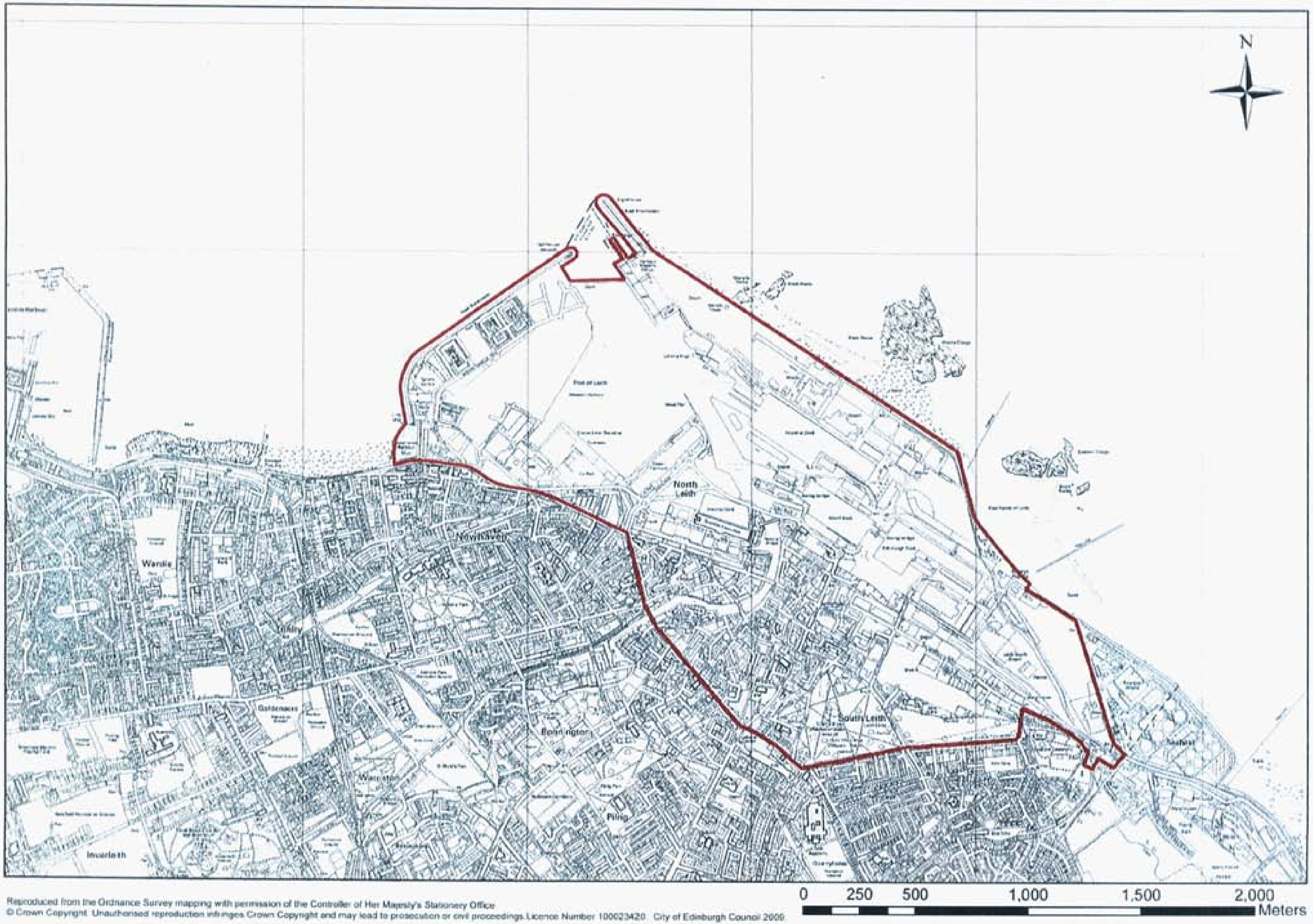
Based on the above analysis there is a clear case for adopting Tax Incremental Financing as a means to fund specific infrastructure projects within the Leith docks area, all of which are expected to act as a catalyst for development within the wider community. Such a strategy is expected to be viewed by the private sector as a positive response to the present difficult economic conditions and a much needed stimulus to the market both within Edinburgh's Waterfront and across the City.

Next Steps

Assuming approval by the Policy & Strategy Committee, approval by the Scottish Government will be a precursor to any new TIF funded infrastructure, as will agreement on the hypothecation of the non-domestic tax revenues from within the proposed Red Line Area. The next steps will include:

- Agreement by the Scottish Government / Scottish Futures Trust of the Business Case for the four prioritised assets
- Approval by the Scottish Government of the hypothecation of the non domestic rates revenue from within the Red Line Area
- Submission to Scottish Government to secure their agreement to underwrite 50% of the early year's interest gap until such time as rate revenue meets the interest charges
- Agreement on the Heads of Terms between the City of Edinburgh Council and Forth Ports PLC on the ownership and maintenance of the various assets
- Agreement by the City of Edinburgh Council on the authority and composition of the TIF Executive
- Agreement between the City of Edinburgh Council and Forth Ports PLC on the procurement, management, maintenance and operation of the four assets
- Agreement on the role and authority of the post of Project Manager, Delivery Team Manager and Asset Manager
- Agreement on the existing level of non domestic rates revenue from within the Red Line Area with the City of Edinburgh Council for the purpose of identifying any uplift in rates revenue
- Step In Rights agreement between Forth Ports PLC and the City of Edinburgh Council.

Annex B: Red Line Areas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Port of Leith
North Leith
Newhaven
Wardie
Trinity
Goldenacre
Bonnington
South Leith
Seafield
Warriston
Pilrig
Inverleith
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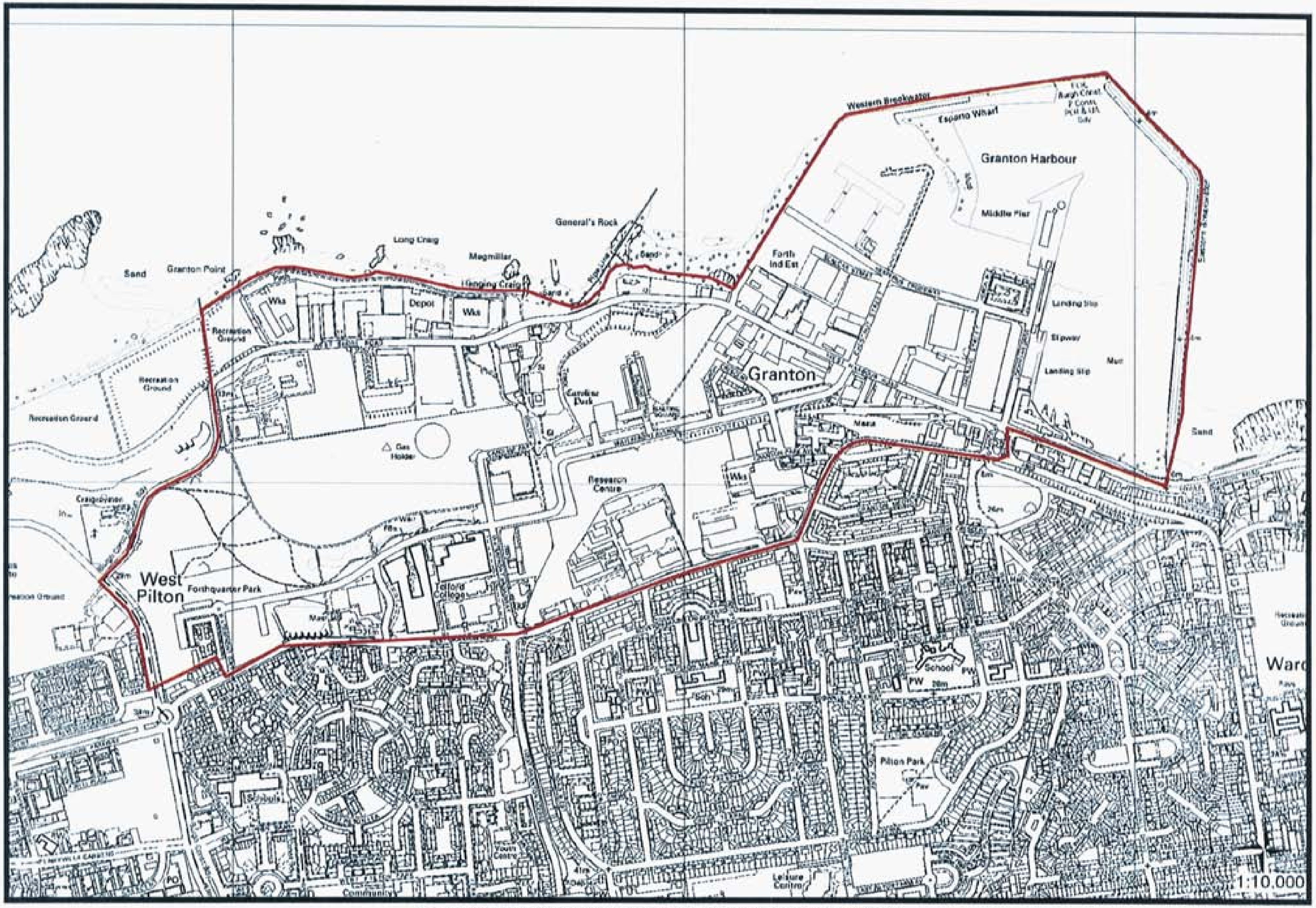
Meters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Western Breakwater
Esparto Wharf
Middle Pier
General's Rock
Long Craig
Magmillar
Sand
Granton Point
Recreation Ground
Gas Holder
Research Centre
Forth Ind Est
Granton
West Pilton
Forthquarter Park
Telford College
Pilton Park
School
Leisure Centre
Landing Slip
Slipway
Mud
Depot
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