

European Investment Bank
Interim Evaluation of SPRUCE
Final Report, February 2018

indigo**h**ouse

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The Collaborative Consultancy

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Glossary/Abbreviations

Abbreviation	Name
EIB	European Investment Bank
ERDF	European Regional Development Fund
EU	European Union
JESSICA	Joint European Support for Sustainable Investment in City Areas
LUPS	Lowlands and Uplands Scotland
NPF	National Planning Framework
SPFM	Scottish Public Finance Manual
SPRUCE	Scottish Partnership for Regeneration in Urban Centres
UDF	Urban Development Fund
URC	Urban Regeneration Company
VFM	Value for Money

Executive Summary

This report sets out the findings of the interim evaluation of the Scottish Partnership for Regeneration in Urban Centres ("SPRUCE") fund, undertaken by the Indigo House Group ("Indigo House") on behalf of the European Investment Bank ("EIB") and the Scottish Government.

The purpose of the interim evaluation was to assess the economic, social and environmental impact of the fund within the context of the policies and strategy initially established, and to consider the value for money ("VFM") offered by SPRUCE in contrast to traditional grant funding and other ways to address market failure.

The 10-year investment period for SPRUCE is ending on 28 November 2021 and the report contains a series of conclusions and recommendations which could influence the future of the fund post 2021.

Overall the interim evaluation found:

- ✓ SPRUCE has been **successful in supporting the economic growth strategy** of the Scottish Government at a very challenging time. Over £48m was invested in five urban developments and two energy efficiency projects by December 2015.
- ✓ The first seven projects funded by **SPRUCE delivered a range of social, economic and environmental benefits in Scotland** (including land remediation, business space, jobs, carbon savings and some additional community benefits) which would not have occurred in that timeframe or in those priority areas had SPRUCE funding not been available.
- ✓ SPRUCE offers **considerable value for money** to the public purse when compared against alternative pricing interventions including non-repayable grant and/or other structured financing alternatives. SPRUCE achieved strong leverage in the first tranche and represents the **most economically advantageous** option for achieving a set of desired impacts compared to other funding options in the short, medium and long term;
- ✓ The additional value for money created by SPRUCE is powered by the **combination of the investment led approach and the recycling of funds**. Both the investment led approach and the recycling aspects improve VFM for the public pound in their own right, but value is accelerated and optimised when they are combined, and **this is the distinguishing feature of SPRUCE**.
- ✓ The business space projects are supported by significant demand/market need and the SPRUCE funding is **justified by market failure**. The energy projects address **wider socio-economic (including fuel poverty) and environmental concerns**. The rationale for the early investments was therefore found to be consistent with the investment strategy;
- ✓ More development work is required to bring forward opportunities to **apply the investment led approach** which is a distinguishing feature of SPRUCE in more deprived areas (and beyond City Centre Areas like Glasgow) and where there is wider socioeconomic and market failure. This would allow SPRUCE to contribute more fully to the **regeneration challenge in Scotland**, perhaps as one strand of a wider policy or by following earlier pump-priming grant interventions in priority areas.

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- ✓ The additional value for money and **potential additional benefits** available from the recycling phase(s) are **so considerable** that the Scottish Government should consider the broader **application of the investment led approach to other areas of public policy and finance**. This could represent a **significant public policy funding mechanism** in Scotland enabling scarce public finances to go significantly further.

We also found:

- ✓ There is good potential to develop SPRUCE as a market brand funder of regeneration and energy schemes in Scotland, **but work is still to be done to achieve this**. The feedback from the structured interviews indicates that the brand is underdeveloped and has doubtful or confused positioning currently. There is good awareness and recognition of SPRUCE in the property market but less experience of SPRUCE within the Local Authority market, at this stage, and this will have to be addressed. The approach adopted by North Lanarkshire Council to use Fusion Assets which is a special purpose vehicle is perhaps a useful case study for other Local Authorities to consider, not necessarily for industrial business space but as an alternative funding mechanism capable of leveraging private sector funding and delivering significant additional economic benefits in local communities. More information on Fusion Assets can be found in Appendix I.
- ✓ Feedback around the relatively modest scale of the fund and the limits on individual projects suggest these may be preventing otherwise eligible projects coming forward. However, special investor consent is available for SPRUCE to consider higher value projects and SPRUCE funding can be combined with grant and other funds. Some of the perceived constraints could therefore be addressed in some cases through appropriate project funding expertise including use of grant to address potential viability gaps on relevant projects. It is not the role of SPRUCE to fund non-viable projects.
- ✓ Other challenges experienced with SPRUCE in the initial period, based on feedback received, included the requirement in some cases for longer terms, a wider remit on the eligibility criteria and that the process was found to be longer and more onerous than they may have expected. Some of the project sponsors also commented on the level of fees involved. That said, project sponsors found Amber, the fund manager, easy to work with post financial close. SPRUCE involves a considerable amount of public money (Scottish and European funds), and the investors may consider some of these observations to reflect good governance of the fund, including satisfying European regulation that would not form part of a standard commercial funding agreement.
- ✓ A fund that tends towards shorter term lending will maximise the financial performance of the fund, and so there may be a tendency towards funding projects where the payback period is relatively short (Grade A office accommodation being an example). However, the investment strategy makes it very clear that the overarching policy aim of SPRUCE is to achieve wider social, economic and environmental impacts and so it is important that the **spread of projects is sufficiently balanced**. This points to the requirement for a portfolio approach and appropriate monitoring arrangements within the governance framework for any new SPRUCE fund, or where the current SPRUCE fund to be increased in size or extended in term.
- ✓ The assessment set out in the main report illustrates the impact of the SPRUCE fund in the initial investing period and over the longer term. It highlights the importance of the output

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targets in directing SPRUCE resources to deliver the desired impacts, and that the output targets take on increased significance with each 'recycle' and the longer the intervention runs. Consequently, it is important that the output targets have sufficient attention and play an **active not passive role in the resource allocation deliberations**. Again, the importance of this point increases relative to the size of the fund and the impact it can have at the national level.

- ✓ Management of the pipeline for **SPRUCE projects from the public sector** requires some development. It is fair to say that the early projects have been proactively sourced by the fund manager from their knowledge of the Scottish market. Whilst this has been successful for SPRUCE to date and will continue, it highlights that SPRUCE has not yet assumed the required position in the Scottish market, which feedback from consultees corroborates. A plan to develop a sustainable pipeline of SPRUCE projects from public sector partners is required and we have previously mentioned the need to increase engagement with the Local Authorities on this. There is also a large footprint of social enterprise and regeneration focussed organisations active in the Scottish market who are likely to have eligible projects, perhaps not directly, but through special purpose vehicles established for the purpose.

In terms of the **structure of the SPRUCE fund**:

- ✓ The original intention was to increase the Total Fund through co-funding from other partners and the Royal Bank of Scotland (RBS) was initially expected to provide an additional lending facility of £25m. However, to date, RBS has not co-invested in any of the projects which SPRUCE has funded, and no other co-partner has been established as yet. However, that said, significant leverage has been secured at the project rather than the fund level and this is an **appropriate financing mechanism**.
- ✓ Some further consideration on the scale of the fund, and the term of the fund is set out in the report. Our analysis has found that SPRUCE can deliver greater VFM over the longer term, and £50m is modest relative to the need in Scotland. The 10-year term is too short to optimise the impact of the recycling, as a proportion of the fund is unlikely to be reinvested as originally intended because it is not being repaid until 2023. We acknowledge these timeframes were well understood at the outset.

Our analysis also found that **the investment led approach** of SPRUCE is potentially **applicable in a much broader public policy context** as follows:

- ✓ In addition to funding core urban projects such as land remediation, business space and energy efficiency which the initial tranche projects have demonstrated, our analysis suggests SPRUCE may well be an appropriate funding mechanism for other areas of public policy. This could include mixed use site development (where it is sometimes difficult to extract commercial and residential uses); offices; industrial, warehousing and distribution facilities; research and development facilities; site remediation and access; other physical development that supports economic growth; energy efficiency, energy storage; and energy generation from solar, wind, hydro and waste to energy projects. Last year, the Northern Ireland Executive announced a new £100million Northern Ireland Investment Fund to target investment in these areas.

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- ✓ The investment led approach could be usefully targeted to address market failure in other sectors of the Scottish economy. Examples would include the creation of mainstream affordable credit programme to tackle market failure in the financial services industry, and creation of an affordable fuel programme to tackle market failure in the energy markets. These examples would be directly aligned to the regeneration aims of the Scottish Government but would perhaps be beyond the eligibility criteria of the current SPRUCE fund.
- ✓ SPRUCE is operating in the 'social investment' part of the financial market where capital is being used to create long term sustainable value for communities. However, part of the challenge in engaging with potential project sponsors including local authorities, is that the **project financing and capital structuring skills used to create sustainable investment led projects** are not available and many organisations have no recent experience of this type of work. As a consequence, there are likely to be eligible projects not being taken forward because there is no change agent on the project side with the essential project financing expertise.

Conclusion and Recommendations

SPRUCE has successfully contributed to the economic growth strategy in Scotland. It has delivered a number of significant benefits to the Scottish economy in a relatively short intervention period and at a very difficult time. It demonstrates significant additional value compared to traditional grant or other funding interventions and offers considerable potential to deliver impacts of scale across Scotland as part of a long term strategic plan. Whilst it has performed well, it has not yet reached its full potential and some attention is required particularly in respect of regeneration aims.

Based on our analysis we recommend consideration is given to the following:

- ✓ For the **current SPRUCE fund**: An extension of the current investing period beyond 2021 to enable the fund to be fully reinvested in the Scottish economy; and,
- ✓ Creation of a **more significant and longer-term, possibly Evergreen, SPRUCE 2 fund** to support delivery of the Scottish Governments economic aims. Consideration should be given to whether a single SPRUCE programme, or multiple programme approach is required; for example, supporting interventions in broader areas of public policy which are relevant to the domestic agenda in Scotland but may extend beyond the remit of the European funding. This should include **investor ready support** to help generate a sustainable pipeline of projects from the public sector and see these through to successful financial close.

Further detailed conclusions and recommendations are included in the main report.

1. INTRODUCTION & BACKGROUND

1.1 Purpose of report

This report sets out the findings of the interim evaluation of the Scottish Partnership for Regeneration in Urban Centres ("SPRUCE") fund, undertaken by the Indigo House Group ("Indigo House") on behalf of the European Investment Bank ("EIB") and the Scottish Government.

The purpose of the interim evaluation was to assess the economic, social and environmental impact of the fund within the context of the policies and strategy initially established and to consider the value for money ("VFM") offered by SPRUCE in contrast to traditional grant funding and other ways to address market failure.

The 10-year investment period for SPRUCE is ending on 28 November 2021 and the report contains a series of conclusions and recommendations which could influence the future of the fund post 2021.

1.2 Our methodology

In undertaking the interim evaluation, Indigo House met with officers from EIB, Scottish Government and Amber and undertook fieldwork including structured interviews with projects sponsors. This included site visits where possible. We also interviewed a range of stakeholders including property agents, Local Authorities and the Managing Authority within the Scottish Government.

We also reviewed a comprehensive range of documents including the investment strategy for SPRUCE, previous SPRUCE studies where these were made available, the IPSUD and other project information and various strategy and policy documents.

The quantitative and qualitative data collated enabled an evaluation of the financial and broader impact of SPRUCE as well as some comparative analysis to assess the Value for Money offered by SPRUCE relative to alternative approaches to addressing market failure.

1.3 Limitations

The report has been prepared on the specific instructions of EIB and Scottish Government for the sole purposes set out in our contract and for the sole use of EIB and Scottish Government. In carrying out our work and preparing our report we have worked solely on the instructions of our client.

Third parties may choose to make of this report entirely at their own risk and Indigo House, EIB and Scottish Government shall have no responsibility in relation to any such use and we assume no responsibility or liability to any third party in respect of the contents of the report.

Other than general reasonableness checks the Indigo House Group has not sought to verify the accuracy of the data, information and explanations provided as part of the evaluation as would be the case during an audit or due diligence exercise. Reliance has therefore been placed on the information supplied and which has been used to inform our analysis.

2. STRATEGIC INVESTMENT CONTEXT

2.1 Introduction

SPRUCE is a regulated investment fund and can provide loans, mezzanine debt and equity investments to revenue generating, infrastructure and energy efficiency projects supporting regeneration in Scotland.

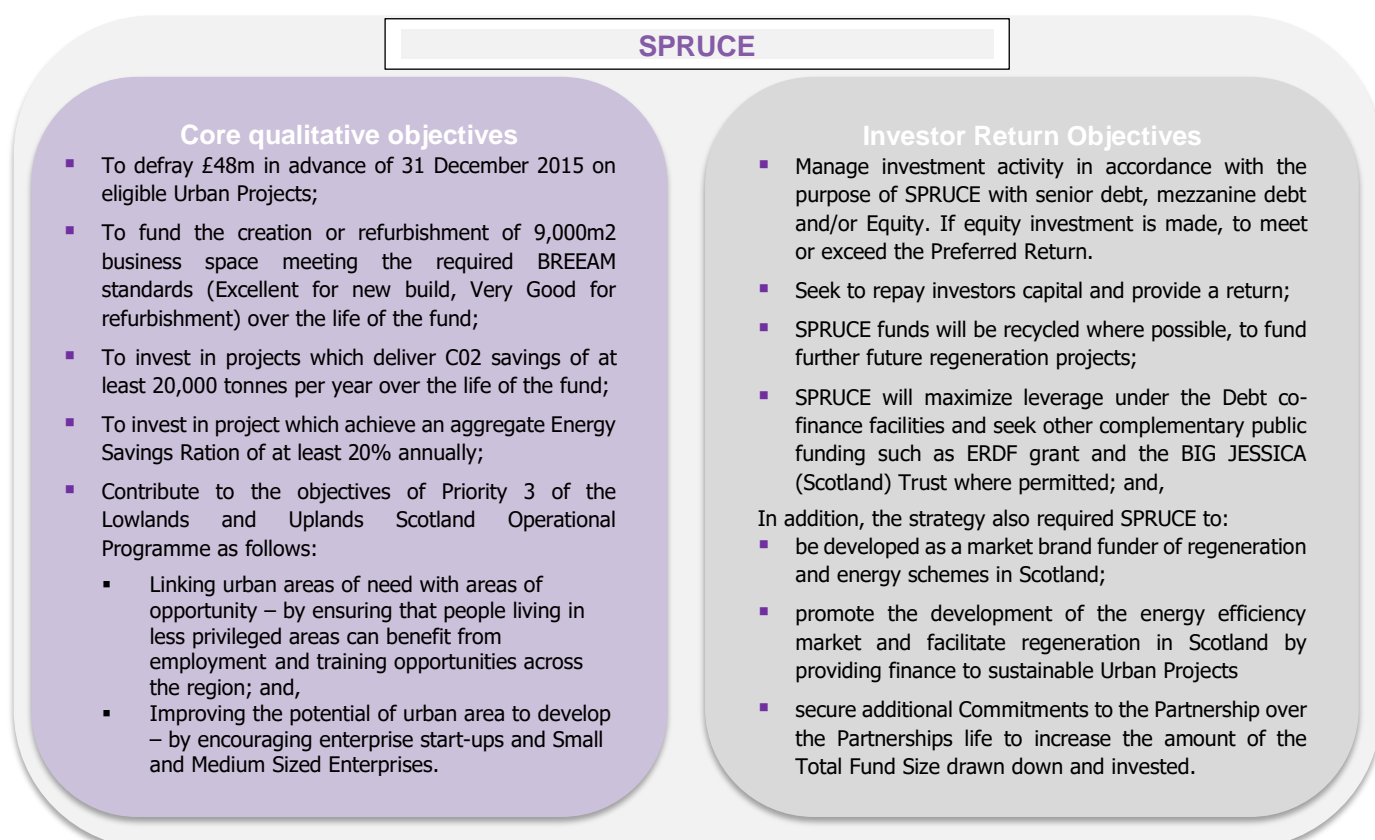
It was established by the Scottish Government in 2011 using ERDF funds from the 2007-13 Lowlands and Uplands Scotland ("LUPS") operational programme as part of the Joint European Support for Sustainable Investment in City Areas Holding Fund initiative ("JESSICA" or "JHF"). The JHF was initially capitalised with £50m, with SPRUCE involving £48m. SPRUCE is now a £64m fund having received further funding more recently from the Scottish Government.

2.2 SPRUCE Objectives

SPRUCE is based on the premise that sustainable urban development is a key factor in the long term social, economic and environmental success of our cities areas and that the investment approach (rather than grant) delivers improved longer-term outcomes through creating value in the built environment and the communities the fund serves.

The overarching policy aim of SPRUCE is to achieve wider social, economic and environmental impacts and so SPRUCE may not necessarily seek to maximize financial return. However, it is managed independently and on commercial principles. Consequently, there are a number of investment return objectives to deliver alongside the five core strategy objectives and these are summarised below.

Diagram 1: SPRUCE investment objectives



2. STRATEGIC INVESTMENT CONTEXT

2.3 Governance Structure

The Scottish Government commissioned EIB as the holding fund manager for SPRUCE in 2010. Amber was appointed as the independent investment manager in 2011 following a successful procurement exercise. Amber administer SPRUCE from their Scottish base in Edinburgh. SPRUCE is governed by:

- i. The **Investment Board** who ensure implementation of the investment strategy and funding agreement with EIB. These are core documents and provide much of the framework for the effective governance of SPRUCE. The objectives for SPRUCE (see diagram 1) are detailed in the investment policy and these have informed an important aspect of the impact and VFM assessment. The investment strategy was approved by the Investment Board in 2011 and later revised in 2015. Membership includes the Scottish Government and three independents. EIB participate as observers to the Investment Board;
- ii. The **Advisory Committee** who are consulted on policies, guidelines, sectors for investment, capital raising, appointment of external advisors including auditors and replacement of key executives. The Advisory Committee approves the risk management policy, measurement and verification policy and operator's costs approval process. Membership includes two investor representative places, two independents and the operator;
- iii. The **Investment Committee** approve investment decisions and request drawdown of Loan Commitments from investors. The Investment Committee provide independent decision making on a commercial basis without political influence and comprise of the Amber Executive.

2.4 Scotland's domestic framework for SPRUCE

The Scottish Government has a **single overarching purpose** "to create a more successful country where all of Scotland can flourish through increasing sustainable economic growth". Delivery is encapsulated in five strategic objectives that map a Scotland that is wealthier and fairer, smarter, healthier, safe and stronger and greener. The Government's Economic Strategy is supported by 16 national outcomes and the Agreement of June 2010 between EIB and SG lists the following **six outcomes** which are most relevant to SPRUCE:

1. We realise our full economic potential with more and better employment opportunities for our people
2. We have tackled the significant inequalities in Scottish society
3. We live in well-designed, sustainable places where we are able to access the amenities and services we need
4. We have strong, resilient and supportive communities where people take responsibility for their own actions and how they affect others
5. We value and enjoy our built and natural environment and protect it and enhance it for future generations
6. We reduce the local and global environmental impact of our consumption and production

An important feature of SPRUCE is that the investments should be made in Urban Projects which are defined as projects that form part of an integrated plan for sustainable urban development (IPSUD) which are themselves influenced by the National Planning Framework ("NPF"). NPF is a

2. STRATEGIC INVESTMENT CONTEXT

strategic plan setting out an integrated social, economic and environmental framework for the future development of Scotland, looking forward 15-20 years.

2.5 Timelines

In accordance with the brief, the interim evaluation covers the period from commencement of the investment period in 2011 to the end of 2016 with a particular focus on the projects signed prior to the commencement of the recycling period. Some of the key milestones for SPRUCE are detailed below.

Diagram 2: SPRUCE milestones



3. IMPACT ASSESSMENT

3.1 Introduction

The impact assessment of SPRUCE is based on the material provided to Indigo House for the purposes of the interim evaluation and structured interviews with a number of consultees, including the sponsor for each of the first seven projects. It is not intended to be an audit of the impacts or a fresh analysis of them, rather it works from the information provided and considers whether SPRUCE has delivered the impacts expected.

3.2 Summary findings

Overall our impact assessment found:

- ✓ SPRUCE has been **successful in supporting the economic growth strategy** of the Scottish Government at a very challenging time (2011 to 2016). It has delivered a number of significant projects and benefits in Scotland which otherwise would not have occurred either in that timeframe or in those priority areas.
- ✓ The business space projects are supported by significant demand/market need and the SPRUCE funding is **justified by market failure**. The energy projects address **wider socio-economic (including fuel poverty) and environmental concerns**. The rationale for the early investments was therefore found to be consistent with the investment strategy.
- ✓ More development work is required to bring forward opportunities to **apply the investment led approach** which is a distinguishing feature of SPRUCE in more deprived areas (and beyond City Centre Areas like Glasgow), and where there is wider socioeconomic and market failure. This would allow SPRUCE to contribute more fully to the **regeneration challenge in Scotland**, perhaps as one strand of a wider policy or by following earlier pump-priming grant interventions in priority areas.
- ✓ The additional value for money and **potential additional benefits** available from the recycling phase(s) are **so considerable** that the Scottish Government should consider the broader **application of the investment led approach to other areas of public policy and finance**. This could represent a **significant public policy funding mechanism** in Scotland enabling scarce public finances to go significantly further.
- ✓ Our evaluation suggests that whilst the SPRUCE fund has performed well, it has not yet reached its full potential. This is explored later, particularly in the value for money section.

In terms of the **core qualitative objectives**, we found:

- ✓ More than £48.7m was invested in initial tranche projects by 31st December 2015 thereby meeting the first core objective to defray £48m in that period.
- ✓ This included investment in five urban development projects and two sustainable energy projects including:
 - Grade A office accommodation in Glasgow City Centre at 110 Queen Street and St Vincent Plaza and Industrial business units at Dundyvan and Strathclyde Business Park in North Lanarkshire resulting in 29,190 square metres of business space created to BREEAM standards (Excellence for new build, Very Good for refurbishment) and meaning the investment strategy objective to fund the creation or refurbishment of 9,000m² to those standards has been more than met.

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- Two energy efficiency projects funded in Glasgow and St Andrews which are contributing to the stated objectives of investing in projects which deliver CO² savings and aggregate Energy Savings Ratio of at least 20% annually. These objectives were partially met at the interim evaluation.
- Remediation of a large and strategically important site at Haymarket in Edinburgh which, in addition to the above projects has involved the remediation of 7.57 ha of brownfield land, making a valuable contribution to the first of the Priority 3 objectives.
- ✓ The extent to which the investments have contributed to the full range of Priority 3 output targets and a broader range of economic, social and environmental benefits for Scotland is considered in more detail at 3.3. A case study for each project is provided at Appendix I.

In terms of the **investor return objectives** we found:

- ✓ Initial tranche investments involved senior debt facilities in line with the expectations of the Investment Strategy. No mezzanine or equity investments were made in the first tranche, but it is expected these may form part of future investments.
- ✓ Repayment of SPRUCE funding commenced as early as 2013 and SPRUCE has been recycling its original capital since late 2015. Four of the seven projects were repaid in full by the end of 2017.
- ✓ A total of £14.3m is not expected to be repaid until 2023 and is therefore beyond the initial 10-year investment period for the fund. Unless the repayment is made early or the investing period of the fund is extended, or another revolving fund established, this sum will not be available for reinvesting. It is our understanding that the investing partners did not expect the fund to be fully recycled in the 10-year period, but rather it be maximised in the timescales available.
- ✓ SPRUCE funding achieved strong leverage of £2.51 for each SPRUCE pound invested. The total development cost of the initial tranche projects exceeded £122.2m with SPRUCE providing 35% of the total funding requirement. This leverage compares favourably to other areas of public finance.
- ✓ We have excluded the Haymarket project in the calculation of the leverage. The SPRUCE funding has been used at Haymarket to finance the land remediation works and is essentially pump priming for future as yet unrealised benefits and leverage.
- ✓ For the period under review to the end of 2016, earnings from interest and other charges applied (for example, commitment fees) have been used to meet the cost of administering SPRUCE. No return was made for investors in that period.
- ✓ Feedback around the relatively modest scale of the fund and the limits on individual projects suggests these may be preventing otherwise eligible projects coming forward. However, special investor consent is available for SPRUCE to consider higher value projects, and to combine SPRUCE funding with grant and other funds. Some of the perceived constraints could therefore be addressed in some cases through appropriate project funding expertise. It is also important to note that it is not the purpose of SPRUCE to address potential viability gaps on projects and that this remains the role of grant funding, where appropriate.

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- ✓ Other challenges experienced with SPRUCE in the initial period, based on feedback received, included the requirement in some cases for longer terms, a wider remit on the eligibility criteria, and that the process was found to be longer and more onerous than they might have expected. Some of the project sponsors also commented on the level of fees involved. That said, project sponsors found Amber, the fund manager, easy to work with post financial close. SPRUCE involves a considerable amount of public money (Scottish and European funds), and the investors may consider some of these observations to reflect good governance of the fund, including satisfying European regulation that would not form part of a standard commercial funding agreement.

For the **additional requirements** we found:

- ✓ There is good potential to develop SPRUCE as a market brand funder of regeneration and energy schemes in Scotland, **but work is still to be done to achieve this**. The feedback from the structured interviews indicates that the brand is underdeveloped and has doubtful or confused positioning currently. There is good awareness and recognition of SPRUCE in the property market but experience of SPRUCE within the Local Authority market will have to be addressed. The approach adopted by North Lanarkshire Council to use Fusion Assets which is a special purpose vehicle is perhaps a useful case study for other Local Authorities to consider, not necessarily for industrial business space but as an alternative funding mechanism capable of leveraging private sector funding and delivering significant additional economic benefits in local communities. More information on Fusion Assets can be found at Appendix I.
- ✓ There was some early success in promoting the development of the energy efficiency market and facilitating regeneration in Scotland by providing finance to sustainable Urban Projects with two of the first seven projects involving energy efficient district heating schemes in Glasgow and St Andrews. These provide energy efficient heating to social housing, student accommodation and St Andrews University.
- ✓ The original intention was to increase the Total Fund through co-funding from other partners and the Royal Bank of Scotland (RBS) was initially expected to contribute £25m. However, to date, RBS has not engaged in any of the projects which SPRUCE has funded, and no other co-partner has been established as yet. However, that said, significant leverage has been secured at the project rather than the fund level and this is an **appropriate financing mechanism**.

3.3 Wider impacts delivered

The relevant information for the impact assessment mainly exists in the various monitoring reports and integrated plan for sustainable developments (IPSUD) report for each project which formed part of the basis on which the funding was signed off. At the end of 2016, SPRUCE reported on the outputs achieved up to that point and this shows mixed performance for the period under review to the end of 2016 with:

- ✓ Significant overachievement on the area of business space created or modified to BREEAM standard (29,190 against a target of 7,500).
- ✓ Strong delivery on the land reclaimed or redeveloped with the anticipated 7.57 ha of brownfield land reclaimed or redeveloped met as all of the sites have been redeveloped or remediated, ready for redevelopment.

3. IMPACT ASSESSMENT

- ✓ Reasonable contribution on the number of jobs created (2399 against a target of 4500). The gross jobs were found to have been calculated using reasonable density assumptions at around one job per 12 sq ft for the commercial space. Over 6,300 such jobs are expected over the life of the fund for the first 7 projects with more than half (3,500) associated with Haymarket. This does not seem to include the construction impact, which would have lasted for a period.
- ✓ Twenty nine enterprises supported at the end of 2016, against an anticipated 54. There were lower than expected achievements on renewable projects and enterprises supported and many of the other impacts, do not appear to have been measured. These reflect the overall aims of ERDF Priority 3 but it was never likely that SPRUCE would or could deliver these.

It should be noted that the investment strategy confirms that the outputs are 'a non-binding indicative list of Output Targets' which the fund hopes to achieve. It is however clear that the initial tranche investment delivered good achievements in some but not all of the 12 outputs reported, and that the balance of impacts required from SPRUCE perhaps requires some further consideration. Our understanding is that the output targets are under review and may be revised based on discussions in June 2016.

In addition to the core outputs, Amber also monitors some additional indicators including total business space created or modified, number of start-ups supported and long-term occupancy. Other indicators which we would also expect to see (and focussed on tackling deprivation and regeneration) relate to income deprivation and fuel poverty, community benefits (e.g. apprenticeships), and some VFM metrics which do not appear to have been assessed, e.g. public funding cost per job, GVA per job created, Benefit Cost Ratios. This makes it difficult to assess the funding beyond a general level.

A number of the projects have secured additional community benefits. Amber agreed commitment to community benefits with each of the project sponsors during negotiations and this has generated additional wider impacts from the SPRUCE investments. For example, St Andrew's University has also set-up Guardbridge Guarantee as a means of delivering community benefits in the Guardbridge area through the scheme, including new equal opportunities, apprenticeships and employment. There will also be regeneration impacts from the development of a 3.6 acre derelict site, which is intended to act as the catalyst for the regeneration of a wider 36 acre site.

Figures provided on economic impacts are gross, with no assessment of additionality. It is therefore difficult to provide a view as to what the net impact of the overall fund or individual projects are. However, feedback from the structured interviews confirms the property industry view that the commercial space projects would not have happened without SPRUCE funding and therefore we can estimate additionality to be relatively high, at least for the construction impact.

However, as companies have re-located into the new office and industrial space there is likely to be a sizeable level of displacement in the operating impact. It is difficult to be precise on the size of this without consulting with the companies themselves, but there are still likely to be productivity impacts from operating in more modern and bespoke premises.

There is also multiplier effect to be considered from both the direct construction and operating expenditure. It has been calculated that the construction sector in Scotland has an output multiplier of 2.1, which indicates that £1 of spending generates £2.10 of economic output (from

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direct, indirect and induced effects). The real estate sector has an estimated employment multiplier of 1.51.

3.4 Overall impact assessment

Overall, we found that whilst delivering solid early performance, it is not yet maximised and there are some important issues to consider regarding future tranche investments and beyond 2021.

An evaluation study commissioned by Scottish Government in 2009 found that there was a strong case for using the JESSICA initiative to support Urban Development Fund investments in the Lowlands and Uplands region, based on a review of emerging opportunities, how they aligned to the LUPS OP objective and the prevailing landscape of public and private finance. The interim evaluation confirms this remains the case. However, it also suggests some more development work is required to ensure SPRUCE continues to deliver on national outcomes two and four, and that the scale of the fund, and the balance of investments requires more thought for future tranches.

¹ Jones, C & Trevillion, E (2015), *Commercial Real Estate and the Scottish Economy*. Scottish Property Federation.
<http://www.scottishpropertyfederation.org.uk/sites/default/files/resources/SPF-Research-Report-June-2015.pdf>

4. VFM AND FUTURE PROSPECTS FOR SPRUCE

4.1 Introduction

In accordance with the brief we have considered the value for money offered by SPRUCE and the investment led approach compared to traditional non-repayable grant, and against a longer term structured financing arrangement of 10 years.

The structured finance arrangement could be a social finance instrument similar to the charitable bond delivered on behalf of Scottish Government by Allia, or commercial finance similar to SPRUCE and involving senior debt, mezzanine or equity finance. The key difference to SPRUCE is the longer-term nature of the finance at 10 years on average.

We also considered the do-nothing option but rejected this on the basis that funding intervention is required to address long run and continuing market failure in Scotland regarding access to capital for urban development and regeneration projects. A do-nothing option would therefore undermine delivery of the Government's Economic Strategy including ERDF Priority 3 requirements.

4.2 Value for money assessment

The results of our comparison are summarized in Appendix II. It details the value for money offered by SPRUCE compared to non-repayable grant and a 10-year structured finance facility over various time frames and recycling activity. For example, it considers the performance of the current SPRUCE fund and the grant and structured finance facility options for the period of the interim evaluation only which is to the end of 2016, the performance expected to the end of 2023 when the final repayment on the initial tranche of SPRUCE investments will be fully repaid and also over the longer term (30-year period) with the funds available being fully recycled within that period (either once or three times). The VFM assessment is provided for illustrative purposes only. It assumes the same profile of projects, timing of investment, repayment periods and benefits achieved as per the initial phase of the current SPRUCE fund.

In summary, the **VFM assessment confirms:**

- ✓ SPRUCE offers **considerable value for money** to the public purse when compared against alternative pricing interventions including non-repayable grant and/or other structured financing alternatives. It represents the most economically advantageous option for achieving a set of desired impacts compared to these other options in the short, medium and longer term.
- ✓ The **additional value** created by SPRUCE is powered by the **combination** of the investment led approach and the recycling of funds. Both the investment led approach and the recycling aspects improve VFM for the public pound compared to traditional grant, but the maximum value is created when they are combined.
- ✓ The financial performance of the current SPRUCE fund has been **strengthened** by the relatively short payback period on the business space projects which repaid within three to five a half years. Dundyvan, Queen Street and St Vincent Plaza have all been sold on since completion. The post completion sale is a key part of the private developer's strategy. They do not wish to hold the asset long term but are keen to develop out, sell and move on. This has worked well for SPRUCE in the initial tranche. The two energy projects involve longer term loans.

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- ✓ There is the potential to recycle the fund quicker in future tranches by removing the fixed delineation between the initial investment phase and recycling phase. This means, other things remaining equal, the funds repaid could be reinvested as soon as they become available, subject to maintaining appropriate liquidity in the fund. The initial restriction was imposed to meet EU regulation of the funding and this would no longer apply.
- ✓ Table 1 and 2 provide a simple illustration of the potential value from SPRUCE and the leverage and impacts from a fully recycled fund. The potential additional benefits available from the recycling phase(s) are so considerable that the Scottish Government should consider the broader application of SPRUCE funding techniques across other mainstream programmes.

Table 1: Potential leverage from fully recycled SPRUCE funds

Leverage.	Total to 2016	Recycled *1	Recycled *3
SPRUCE investment	48.70	97.4	194.8
Other Funds (excludes Haymarket build out)	73.5	147	294
Total investment	122.20	244.40	488.80
Recycled funding	0.00	48.70	146.10
Original SPRUCE investment	48.70	48.70	48.70
Leverage achieved			
SPRUCE as %	40%	40%	40%
SPRUCE leverage per £1	£2.51	£5.02	£10.04

- ✓ This shows significant increase in the leverage gained from recycling the initial investment (increasing from £2.51 to £10.04) and this is very significant compared to other options.
- ✓ A portfolio that tends towards shorter term lending will maximise the financial performance of the fund, but as the investment strategy makes clear the overarching policy aim of SPRUCE is to achieve wider social, economic and environmental impacts and so it is important to note that SPRUCE may not necessarily seek to maximize financial return. This will have to be balanced therefore with the requirements of individual projects to be funded and points to the requirement for a portfolio approach for the Fund. Feedback also suggests a need for longer term money in some cases.

Table 2: Potential impacts from fully recycled SPRUCE funds

Impacts	Total to 2016	Recycled 1	Recycled 3
Brownfield land reclaimed or redeveloped	7.57	15.14	30.28
Area of business space created or modified under BREEAM classification	29190	58380	116760
Renewable energy and resource/energy efficiency projects supported	2	4	8
Enterprises supported	29	58	116
Social enterprises supported	0	0	0
No of gross jobs created	2399	4798	9596

- ✓ Table 2 illustrates the benefit of recycling the original capital. Each time the capital is recycled that offers direct benefits over and above the non-repayable grant alternative.

4. VFM AND FUTURE PROSPECTS FOR SPRUCE

- ✓ It also shows the increasing importance of the targets in the recycling investment phases so that a balance of impacts can be achieved rather than over achievement in some, and no progress in others. This increases in importance again relative to the size of the fund available.
- ✓ Whilst currently delivering significant additional value compared to traditional grant, the fund is currently sub-optimal: it is not reaching its potential;
 - The fund is insufficient in scale (at £50m).
 - The 10-year term may be satisfactory in commissioning terms but it is insufficient in policy imperative terms as it does not allow adequate time for the initial funding to be fully reinvested and the capital to be fully utilised. Previous research suggested the investments to date have been focussed on shovel ready projects and that the extended time frame for re-cycling could allow an opportunity to invest in longer term initiatives, taking account of the constraints and issues which require to be addressed to allow the recycled fund to evolve to build a pipeline of projects for the future.
 - The cap at £9.6m on individual projects is considered a barrier that may be preventing good projects coming forward or SPRUCE from supporting otherwise eligible projects.

4.3 VFM methodology

We conducted the VFM assessment using the net present value (NPV) methodology at a real discount factor of 3.5% which is in line with UK's HM Treasury Green Book appraisal. The sensitivity of the appraisal to movements in the discount rate was also examined and these results are set out below. See Appendix II.

The NPV appraisal of the SPRUCE fund includes the fees charged by Amber and EIB to the fund and so it outperforms the traditional grant routes even with the higher cost as this is offset to a large extent by interest earned on the fund.

4.4 Conclusion

A central principle for SPRUCE is that the investment-based approach rather than traditional grant funding is a distinguishing feature expected to deliver improved longer-term outcomes through creating value in the built environment and the communities the fund serves.

The interim evaluation found SPRUCE offers **considerable value for money** to the public purse where compared against alternative pricing interventions including non-repayable grant and/or other structured financing alternatives. SPRUCE achieved strong leverage in the first tranche and represents the **most economically advantageous** option for achieving a set of desired impacts compared to other funding options in the short, medium and long term.

The interim evaluation also found that the additional value created by SPRUCE is powered by the **combination of the investment led approach and the recycling of funds**. Both the investment led approach and the recycling aspects improve VFM for the public pound in their own right, but value is accelerated and optimised when they are combined, and **this is the distinguishing feature of SPRUCE**.

5. CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

The brief set out three key issues to be considered in the interim evaluation of SPRUCE. These included the **relevance, effectiveness and efficiency of SPRUCE**.

In terms of **relevance** we found:

- ✓ In the main we found SPRUCE and its objectives **to be consistent** with the underlying policies and market needs. Based on the structured interviews the future demand for SPRUCE is strong and the view is that the market is no better now than it in 2011 when SPRUCE was launched. This point was made by a number of the project sponsors and property agents.

In terms of **effectiveness** we found:

- ✓ SPRUCE has been **successful in supporting the economic growth strategy** of the Scottish Government at a very challenging time. Over £48m was invested in five urban development and two energy efficiency projects by December 2015.

The first seven projects to be funded by **SPRUCE delivered a range of social, economic and environmental benefits in Scotland** (including land remediation, business space, jobs, carbon savings and some additional community benefits) which would not have occurred in that timeframe or in those priority areas had SPRUCE funding not been available.

- ✓ The co-investment attracted has been strong and it has been used successfully to move forward solid commercial propositions, like in Glasgow City Centre, where there was market failure in terms of lending.
- ✓ More development work to is required to bring forward opportunities to **apply the investment led approach** which is a distinguishing feature of SPRUCE in more deprived areas (beyond Scotland's City Centres) and where there is wider socioeconomic and market failure. This would allow SPRUCE to contribute more fully to the **regeneration challenge in Scotland**, perhaps as one strand of a wider policy or by following earlier pump-priming grant interventions in priority areas.

In terms of **efficiency we found:**

- ✓ SPRUCE offers **considerable value for money** to the public purse where compared against alternative funding interventions. SPRUCE achieved strong leverage in the first tranche and represents the **most economically advantageous** option for achieving a set of desired impacts compared to other funding options in the short, medium and long term.
- ✓ Whilst SPRUCE offers considerable value for money to the public purse and from the Governments perspective, Local Authorities may continue to more narrowly focus on the availability of grant to fund public sector investment. Grant will clearly continue to play an important role. However, a broader investment led approach at the local level is required as SPRUCE funding can be used to unlock and bring forward projects which are currently not progressing and this broader perspective appears lost. This also points to a possible disconnect on the pace at which projects are developed. A broader understanding of project financing and capital structures is required across the public services in Scotland would help address this potential tension.

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5.2 Recommendations

The 10-year investment period for SPRUCE is ending on 28 November 2021. Based on the findings of the interim evaluation we have set out the following recommendations which, it is hoped, can influence the remaining operating period for the current SPRUCE fund and the future of the SPRUCE fund post 2021.

Based on our analysis we recommend consideration is given to the following:

- ✓ For the **current SPRUCE fund**: An extension of the current investing period beyond 2021 to enable the fund to be fully reinvested in the Scottish economy with a particular emphasis on regeneration; and,
- ✓ Creation of a **more significant and longer-term, possibly Evergreen, SPRUCE 2 fund** to support delivery of the Scottish Governments economic aims beyond 2021. Consideration should be given to whether a single SPRUCE programme or multiple programme approach is required for example to support interventions in broader areas of public policy.

In addition, based on the findings of the interim evaluation we are also recommending for a future SPRUCE fund beyond 2021 the following:

- ✓ The size of the fund should be increased. We are recommending a **substantial increase in the size of the fund** so that SPRUCE can fully contribute to addressing market failure and support regeneration across Scotland rather than simply correct specific localized market issues, in specific priority areas. A fund of scale will also help overcome any potential lack of engagement issues.
- ✓ The term of the investing period of SPRUCE 2 should be **longer than 10 years, possibly on an Evergreen fund basis**, to ensure the funds can be fully recycled (more than once). A 10-year term is an insufficient timeframe to ensure the full recycling of the funds and to realize the full benefits expected. We did not consider in further detail the arrangements for the independent investment manager but commissioning in blocks of 10-year agreements would seem sufficient.
- ✓ Any **funds repaid are reinvested as soon as they become available**, subject to maintaining appropriate liquidity in the fund. The restriction on the SPRUCE fund between the initial investing period and the recycling period was imposed to meet EU regulation of the funding and this would no longer apply.
- ✓ A **programme of 'investor ready' support** should be provided and sufficiently well in advance of the launch of SPRUCE 2 so that the market (including local authorities) are equipped to respond and to ensure that appropriate sustainable investment led projects, at the right stage, come forward.
- ✓ **Further consideration of the output targets and the eligibility criteria is required** for example, broadened to include other sectors where it could usefully be applied to deliver Scottish Government economic targets.
- ✓ The governance arrangements should include sufficient **monitoring of the fund on a portfolio basis** to prevent any imbalance in the outputs delivered. This becomes increasingly important as the size of the fund, the term, and the number of times it is recycled increases.

5. CONCLUSIONS AND RECOMMENDATIONS

- ✓ Plans to create a **pipeline of sustainable public-sector investment led projects** requires some development and attention.

It may also be of interest to note that the Northern Ireland Executive announced a new £100million Northern Ireland Investment Fund last year and have now appointed CBRE to manage the fund. The aims of this initiative are to increase investment in private sector led development, infrastructure and low carbon projects to deliver economic growth. CBRE are expected to lever in private finance and reinvest the £100million over a 10-year investment period.