

18 January 2012

SCOTTISH  
FUTURES  
TRUST

Alex Neil  
Minister for Infrastructure and Capital Investment  
The Scottish Parliament,  
Edinburgh, EH99 1SP

*Dear Alex*

Glasgow City Council Buchanan Quarter Tax Incremental Financing ("TIF") Business Case (the "Business Case")

**1. Introduction**

Scottish Futures Trust ("SFT") received the Buchanan Quarter final TIF Business Case from Glasgow City Council ("GCC") on 6 December 2011. The Business Case has been prepared by GCC with a view to obtaining Scottish Ministers' approval to capture the incremental Non-Domestic Rates which arise as a result of the proposed project, in line with the Non-Domestic Rating Contributions (Scotland) Amendment Regulations 2010 (the "Regulations").

Prior to the submission of the Business Case, SFT worked closely with Scottish Government and GCC on TIF in general and the creation of the related Buchanan Quarter TIF Business Case in particular. Our primary role included providing advice on TIF in general and the shape and content of the Business Case, a challenge function as regards key aspects of the document, including the enabling, economic and funding / financing analyses therein and ensuring that the submission is line with the Regulations. Consequently, we have seen and discussed various iterations of the document, which has culminated in our final review of the Business Case and the production of this letter.

This letter contains recommendations from SFT to Ministers and is intended to enable there to be a free and frank exchange of views between SFT and Ministers, and amongst Ministers and their other advisers, for the purposes of deliberating on the TIF proposal made by Glasgow City Council. The disclosure of this letter prior to a decision being reached on the proposal may or may be likely to inhibit substantially the free and frank exchange of views or otherwise prejudice substantially the effective conduct of public affairs.

You will be aware that the Business Case has been high-profile within Glasgow and that this interest culminated in a meeting of the GCC Executive Committee on 27 October 2011 which approved the finalisation and submission of the Business Case to SFT. Our overall assessment of the case is that:

- a) The proposal is projected to **unlock significant economic development and regeneration within Glasgow city centre and beyond**, whilst enhancing the cultural offering, attractiveness, security and connectivity of the city. The proposal is also projected to significantly contribute to the implementation of the City's and the region's economic development objectives and allow Glasgow to maintain its position as one of the UK's top retail destinations. It is intended also to serve to enhance the City's image ahead of the 2014 Commonwealth Games, thereby further promoting tourism in Glasgow and Scotland.
- b) GCC has demonstrated that the assets that have been chosen by GCC for TIF investment are capable of **enabling private sector investment and economic growth**. The assets are intended to enhance the cultural offering, desirability and connectivity of the area, leading to regeneration and the attraction of private sector investment, both within and beyond the City.
- c) **'But-for' the TIF structure and the investment in public infrastructure it enables, the opportunity to deliver regeneration, growth and the proposed private sector investment within Glasgow, on such a scale, would be lost.** The proposed TIF assets represent a concentrated investment in public realm, cultural assets and connectivity around the Buchanan Quarter of Glasgow. This is an important gateway to the City through Queen Street Station and a nexus between the retail heart, education and under developed hinterland of this quarter of the city centre. From our work with GCC on the Business Case, SFT believes that but-for TIF the anchor private development would not be able to go ahead as proposed and that broader economic growth and regeneration in this quarter of the city would be reduced. The assets will make a significant impact on private investment and economic activity, and there is no reasonable way in the current climate for them to be funded by the public or private sectors at this concentration and time-scale in the absence of TIF.
- d) **The economic and displacement case reflects the additionality of the forecast economic benefit and activity within Glasgow city centre and beyond.** This is predicated on the ability of the City to see continued demand and economic growth over a pro-longed period, whilst offering modern format retail, commercial and leisure space attractive to international brands and businesses. Again independent analysis (reports by GVA and DTZ./ CBRE) highlights a significant level of demand and interest internationally for space in the City, which is not currently available in the primary retail centres of the City. The pre-letting of the adjacent Atlas site which is currently being delivered by Land Securities, where a number of new entrants to the market have taken space, is practical evidence that there is demand for retail space of the right quality and configuration in Glasgow City Centre. This is despite other space being historically available within other areas of the City.

In terms of the impact of the current economic environment on Glasgow and its patronage by retailers, consumers and tourists, recent studies show that the City has continued to perform well with, for example, demand from consumers and retailers alike still being strong. This has meant Glasgow has continued to maintain its coveted second place in the UK's retail hierarchy, behind London, a position which GCC believes could be lost if the TIF does not go ahead. This would have a direct impact upon the Scottish tourism market and its related spend.

- e) **Agreement of the TIF Business Case would see an early start to the delivery of public and private sector infrastructure.** Such work would commence early in 2012, with a completion date

for the delivery of the enabling public sector infrastructure and the identified private sector investment by 2015. The project therefore enables early private sector development and activity, which to date on other projects, has lagged behind expectations.

- f) **The financial case has been modelled on a series of prudent and substantiated assumptions and the economic case appears reasonable.** Public sector risk in taking the project forward can be managed and mitigated through GCC's approach to the TIF and the phased delivery of the public sector enabling assets.

Our work with GCC and our review of the Business Case has been fully informed by our published guidance 'Tax Incremental Financing in Scotland' dated 23 June 2011. We are satisfied that we have had regard to all matters relevant to the making of a recommendation, including all matters referred to in our guidance. We have used our professional judgement in determining how much weight to give to specific issues or elements of the guidance given the degree of flexibility required within what remains a pilot phase for TIF in Scotland. Where aspects of the Business Case do not accord with our guidance we have highlighted that fact within this letter.

On this basis, we recommend that the Business Case is capable of acceptance by Ministers, subject to the conditions laid out in Part 5 of this letter.

## **2. Key Aspects of the Business Case**

By way of information, the key features of the proposal as set out in the Business Case can be summarised as follows:

- a) The project enables regeneration, economic growth and general improvements at both a regional and national level.
- b) The TIF proposals allow for the delivery of significant levels of public infrastructure investment within the Buchanan Quarter of Glasgow city centre. This investment is intended to:
- i. Deliver public realm and infrastructure improvements which increase the attractiveness, safety and security of the city centre;
  - ii. Facilitate a reconfiguration of the Queen Street station entrance and environment;
  - iii. Deliver highway improvements and traffic management;
  - iv. Improve city centre connectivity – linking several distinct areas and key aspects of the city e.g. the retail heart of Glasgow, leisure and cultural facilities, universities and the transport network
  - v. Enhance the cultural attractiveness of this quarter of the city, extending its economic hours and increasing footfall;

This public investment is required to enhance the vitality of this quarter of the city for private investment, and create the physical conditions under which it will be both attractive and possible in the current economic conditions for private investors commence development activity which will:

- i. Contribute significantly to the implementation of the City's economic development objectives, as well as support regional and national growth;
- ii. Engender further development within Glasgow;

- iii. Strengthen Glasgow's position as a tourism destination, particularly in relation to retail tourism; and

In addition to these economic outcomes, the works will enhance the city centre ahead of the Commonwealth Games 2014;

- c) Glasgow City Council produced the Business Case within input from the Buchanan Partnership (comprising Land Securities PLC and Henderson Global Investors) (the "Developer"). The Developer is the owner of Buchanan Galleries and plans to extend this as the anchor private sector development facilitated by the TIF investment. The Business Case demonstrates that the economic benefits of the TIF will be felt more widely than the immediate Buchanan Partnership interest, and that the enabling assets will benefit Glasgow and beyond. However given the initial relationship with the Developer in terms of delivering private sector investment and growth, the narrative of the Business Case sometimes focuses on the shorter term outputs rather than the scheme's wider local, regional and national benefits.
- d) As part of the development of the Business Case, GCC has considered whether but-for the investment in the identified enabling assets, private sector investment leading to economic growth would be likely to occur and whether alternative funding options for the infrastructure investment are available. The Business Case has concluded (and provided narrative and support) that 'but for TIF', the enabling infrastructure required to unlock private development and economic growth will not be able to proceed. The 'but for' test is predicated on the principle that 'but for' TIF (a) the enabling infrastructure that unlocks anticipated outcomes from regeneration and economic growth would not occur or (b) either or both of the enabling infrastructure and the regeneration and growth which it unlocks would not occur within the timeframes outlined in the business case. The Business Case concludes, and SFT concurs that without the identified enabling infrastructure:
  - i. the anchor private sector investment in the scheme would not be able to go ahead as proposed in the short time scales proposed thereby losing the immediate economic impact of construction employment and longer-term economic benefits discussed in the Business Case;
  - ii. the boost given to the wider quarter of the city and likely acceleration of development activity stemming from a concentrated uplift in the environment and extended hours of economic activity and footfall would be lost;
  - iii. the enhancement of connectivity and public realm at an important gateway and transport hub prior to the Commonwealth Games and the completion of the new Glasgow City College would be lost (note that not all assets will be complete in advance of 2014).

In the current economic and financial climate, the Business Case identifies, and provides evidence that the anchor developer could not reasonably fund the infrastructure required. It concludes that the only feasible means through which the Council could access the required funds required is through TIF.

- e) The proposals will see c. £80m of public sector expenditure enable initially c. £310m of private sector investment. This equates to an initial conservative private:public investment ratio of 4:1. It is envisaged that further private sector development will also be enabled, increasing this

private:public investment ratio further as well as generating additional outturn economic activity.

- f) The Business Case highlights that developer contributions will still be due from the developer. GCC is considering how such contributions should be utilised upon receipt, however, SFT recommends that any approval of the proposals by the Scottish Ministers is conditional upon developer contributions received in relation to the project being used to repay the TIF debt, if possible.
- g) A single economic displacement figure of 30% has been assumed. The single displacement figure is derived from the midpoint between a high retail floor space growth scenario (10% displacement) and low-growth scenario (50% displacement). The economic analysis is made, based on an overall growth assumption in the medium term, that demand for retail floor space in the wider Glasgow area will exceed supply but that as the Buchanan Quarter scheme is built and increases the supply of floor space, some displacement from other retail offerings will occur in the shorter term. At the point where demand in the city can again equal supply (including the anchor development) then displacement will cease. This is expected to occur alongside increased supply in out of city centres in the medium to long term i.e. displacement will be higher in early years but lower over the longer term. The nature of the space being created was considered likely to generally lower the displacement. Given the class of space will be of a primary retail nature, configured to match that demanded by occupiers, the displacement impact is likely to be reduced compared to any consideration generically of all retail space within the city centre.
- h) SFT is satisfied that this level of displacement reflects the additionality of the forecast economic activity within Glasgow city centre and beyond over the long-term based on the assumptions used. The level of displacement is supported by the ability of the new retail and business space to attract new international retail brands to Scotland, thereby offering a complimentary solution rather than relocation. It is also supported by the proposal for modern format commercial and leisure space, for which independent analysis (GVA, DTZ and CBRE) in the Business Case highlights there is a demand for in the City regardless of current space availability. GCC has confirmed to SFT that the retail demand reports have been updated for the final Business Case. GVA Grimley, CBRE and URS /PwC (the latter being GCC's economic advisers) have all confirmed that the assumptions used within their reports remain relevant, accurate and reflective of the current economic conditions. This includes forecasts in relation to economic activity, jobs, etc.
- i) Allied to the above, URS has assumed real retail demand growth to be between 2.5% and 5.15% between 2011 and 2018 for low and high growth cases. A mid-point growth figure of 3.75% has been used in the calculation and development of the base case. Supporting independent analysis contained in the Business Case (Oxford Economics / Pitney Bows: Retail Expenditure Guide 2011), explains that this figure is reflective of historic trends and future forecasts. Anecdotal evidence also suggests that demand continues to be strong within Glasgow, with a more muted impact from the economic downturn being seen. It should however be noted that the displacement level is highly sensitive to the medium and longer-term trend growth in retail activity. SFT considers that while economists may reasonably disagree as to the validity of these assumptions, the assumptions used have been derived from reputable economists and are acceptable.

- j) The forecast base case projects economic outputs of:
- i. c.1,486 FTE post construction
  - ii. £36.2m GVA p.a.
  - iii. 3,660 Construction Period Employment (Person Years)
- k) The Business Case envisages that public sector TIF works will be undertaken on a three-phase basis commencing in 2012.

**Phase 1** is due to be completed by June 2014. Works include a new entrance atrium for the Royal Concert Hall, improved pedestrian access on Dundas Street and Dundas Street Lane, George Square improvements, structural strengthening of the Cathedral Street Bridge and associated public realm and infrastructure improvements.

**Phases 2 and 3** are due to be completed by October 2015. Work includes the creation of new public walkways linking Queen Street Station to Cathedral Street, various public realm and infrastructure improvements to Buchanan Street, North Hanover Street, Killermont Street and the underpass at Cowcaddens Road, the refurbishment and extension to the Royal Concert Hall, and the Cathedral Street connection to the University district.

- l) From a procurement perspective, GCC envisages that c.£55m of the c.£80m project will be delivered on its behalf by the Developer. GCC will rely on regulation 14(a) (iii) of the Public Contracts (Scotland) Regulations 2006 to enable this approach due to the proximity and the interrelated nature of the enabling assets and the private sector development. For transparency, the Developer has agreed to proceed as if this element of procurement was required to follow public sector procurement regulations. As a result of this approach, GCC will only pay for the assets upon their completion. This approach mitigates construction risks such as delay, cost over-runs, and sees GCC only fund the assets upon their completion. GCC will also continue to monitor and consider the relationship of these assets and the nature of their delivery. Where Regulation 14(a)(iii) is not applicable to the enabling assets, GCC will deliver those assets in accordance with the relevant public procurement regulations.
- m) The Business Case base case takes a prudent approach (i.e. with optimism bias, revenue forecasting etc) in relation to the costing, funding and financing of the project. Appropriate sensitivities also provide comfort that risks have been satisfactorily considered. Under the base case, GCC envisages that the debt associated with the enabling assets will be repaid within 23.5 years, leaving a 1.5 year tail.
- n) Red-line / Black-line - The TIF red-line area for the Project covers a smaller footprint than the other TIF pilot projects. GCC's perspective is that the smaller red-line area is easier to manage, whilst the revenues would service the related enabling asset debt. The direct economic impact, however, is expected to be felt across a wider area and GCC has drawn a 'black-line' to highlight the larger zone expected to benefit from the TIF project. It is also envisaged that the economic benefits of the project will be felt wider at a regional and national level.

### 3. Key Considerations

Given the above, there are a number of key considerations arising from the Business Case. These are as follows:

- a) The 'Red-line' v the 'Black-line': The project, as highlighted above, uses a red line to define the financial capture area, whilst a black line represents the area of economic impact where a wider uplift is expected. GCC believes such an approach is:
- i. Easier to manage from a revenue collection perspective;
  - ii. Improves monitoring / data collection;
  - iii. Simplifies the baseline calculation;
  - iv. Eases administration for collection; and
  - v. Provides an upside to Government as the incremental rates associated with the black-line will flow back to Scottish Government.

The smaller red-line also sees the forecast incremental NDR sums derived from effectively a limited level of private sector development. The importance of this identified private sector anchor investment (the Buchanan Galleries) is therefore very high in relation to the financial viability of the TIF. That said, GCC has sought to protect itself by limiting its expenditure in line with the private sector investment. In addition, minimum pre-let levels have been incorporated into the viability of the project which should enable GCC to mitigate the risk to a large extent in relation to NDR creation.

Overall the red-line:black-line approach does depart from that envisaged in SFT's TIF Guidance, however, it creates a financial and economic approach that still supports the project. Scottish Government may also benefit directly from such an approach in terms of the NDR central pool, as additional and uplifted activity outwith the red-line will flow to it. This approach also mitigates to an extent the impact of the TIF proposals and potential displacement on the central NDR pool. Ultimately, it may be that Glasgow has one eye to further TIF projects in the City and is considering how potential TIF red lines may lie across the City. It would be possible to include incremental NDR from the wider black-line area as the basis of capture, however on balance and given all the circumstances, SFT is content with the approach taken by GCC on assumption that GCC will manage the associated risks therein.

- b) **Nature of the unlocking infrastructure and "but for" test:** As with TIF proposals brought forward by other local authorities, SFT has not sought to identify whether the Buchanan Quarter TIF proposals made by GCC represent the "best" or only potential use of TIF in that Local Authority area. SFT's role is to work with the Council to develop its selected Business Case and then make a recommendation on its acceptability.

SFT's guidance states that:

*"The use of TIF is predicated on a project's ability to deliver regeneration and sustainable economic growth. The use of TIF will normally be predicated on a 'but for' test i.e. that but for TIF the anticipated outcomes from a regeneration and economic perspective, as envisaged by any supporting Business Case, would not occur or not occur in the timeframes which TIF would enable. A TIF project must therefore demonstrate, if it is to be taken forward, that the enabling infrastructure will unlock regeneration and sustainable economic growth that will generate additional (or incremental) public sector revenues (net of a*

*displacement effect) that are capable of repaying, over an agreed timescale, the financing requirements of the enabling infrastructure”*

As discussed in Section 2 above, the Business Case supports the conclusion that all of the public sector infrastructure identified in the Business Case enhances the offering of the city centre, promotes regeneration within the centre and wider quarter of the City and enables economic growth within defined time lines. For instance, in relation to the Concert Hall where a direct contribution to increased economic activity may not be immediately clear, the Business Case explains that the proposed works and accessibility will provide a world class facility which will attract further events from around the world, promote use across the city and raise the profile of Glasgow outwith Scotland. GCC also believe it will increase the cultural offering in the city and engender further support services for the arts and leisure sector. On this basis GCC believes that there is a regenerative and enabling element in relation to all of the TIF assets including the Royal Concert Hall works in respect of the anchor development, and the wider development and economic activity in the Buchanan Quarter of the city. SFT has not sought to comprehensively test every individual proposed TIF asset to identify whether the anchor development is likely to go ahead, and the wider economic regeneration expected from TIF funding is likely to be achieved, if that asset was individually excluded from the TIF plans. In line with SFT's TIF Guidance, SFT has concluded that the 'package' of TIF assets which has been selected is designed to, and should, maximise regeneration and / or economic growth within the black-line area identified by GCC. The infrastructure assets comprise a mixture of elements intimately linked to the anchor development and those that will increase connectivity, amenity, public safety and cultural / evening vitality of the Buchanan quarter required to unlock private investment and economic development. It should be noted that an early version of the proposals included redevelopment of the Buchanan Street bus station as an element of the unlocking infrastructure. As the proposals developed this was replaced by works to the Queen Street station area which required the economic analysis and stakeholder survey to be revisited.

In considering the but-for test and associated enabling of private development leading to economic growth, what is relevant is the whole 'package' of infrastructure works intended to enable economic growth and the timescale within which they are to be delivered. That is because the package must be developed coherently and in a reasonably compressed time-line to deliver the anticipated impact on the environment and hence developer sentiment needed to kick-start development activity in the Buchanan Quarter. As discussed in Section 2 above, the Business Case concludes and SFT concurs that without the package of identified infrastructure and its delivery within the proposed timescale, the economic benefits would not be delivered as envisaged. It further concludes and presents evidence that the developer of the anchor development cannot reasonable fund the identified infrastructure. Finally it concludes that in the current economic climate TIF presents the only possible way for GCC to fund the assets required. It is SFT's judgement that this meets the but-for test.

The Business Case originally included NDR revenues from a private development on what is known as the "Atlas Site". As this has now proceeded without TIF infrastructure it has been removed from the Business Case as it clearly was not enabled by TIF funded infrastructure. However, we understand that this was an isolated case and the anchor development contained within the Business Case would not be forthcoming without TIF.



SFT is content that the original economic analysis and stakeholder survey remain relevant to, and valid for the purposes of, the finalised Business Case given the degree of overlap between the original and finalised Business Cases.

- c) **Procurement:** GCC has highlighted a strong link between the procurement of parts of the public sector enabling infrastructure and the private sector development leading to the procurement approach outlined at 2.1. above. Scottish Government Procurement Directorate has been involved in discussion of this and has not highlighted any substantive issues to date. SFT is clear that it is fundamentally important that the proposed approach is compliant with procurement law and suggests that a condition of approval should be that the procurement approach is scrutinised by the TIF Executive and appropriate legal advice is taken once the level of detail required for a proper analysis becomes available.
- d) **State Aid:** SFT has consistently discussed with GCC the need to analyse the potential risk in relation to State Aid and the proposed project. The Business Case acknowledges this risk but concludes that there are grounds for a view that the project does not involve State Aid and notes that initial discussions with Scottish Government's state aid unit have not highlighted any significant issues. SFT considers that ongoing analysis and dialogue with the State Aid unit will be required to ensure a compliant approach and that GCC, as a condition of approval, should continue to work closely with the Scottish Government state aid unit.
- e) **Developer Contributions:** As per current planning guidance for Glasgow (City Plan 2), it is expected that developer contributions will be payable within the TIF red line and black-line. Such an approach should mitigate the risk of a successful state aid challenge as contributions are not being waived. In terms of the contributions themselves the timing of the receipt of these sums may be back ended and not dovetail with expenditure on the enabling public sector infrastructure. Consequently GCC is considering how these sums should be used. SFT considers that developer contributions for infrastructure investment should be directed towards the infrastructure considered essential for the development to go ahead which must be that identified for TIF funding. As such, SFT recommends that approval is on condition that any developer contributions received in relation to the project be used to reduce or repay TIF debt.
- f) **Use of Prudential Borrowing:** The Business Case concludes that GCC has the relevant powers under legislation and the CIPFA Prudential Code to borrow to finance the assets proposed as part of the TIF project. SFT has made it clear to the Council that it must comply with these requirements but not sought to verify compliance as it is clearly a responsibility of the Council. SFT recommends that approval is on the basis that the Council continues to monitor its prudential borrowing ability in respect of all TIF assets and that compliance remains its obligation.
- g) **Movement in Public Works Loan Board ("PWLB") interest rates:** Given debt will not be drawn for c. 2 years, although development will occur in the very near future, GCC needs to consider the potential impact from movements in interest rates in the short to medium term. The PWLB rate assumed in the base case is 5.0%, which is reflective of current rates and offers an interest rate buffer of 0.4%. The rate used in the Business Case is GCC's pooled interest rate. Balanced against this the Business Case contains a series of prudent assumptions which mean that GCC should be in a position to manage any increases in rates.

This is also reflected in the sensitivity analysis contained in the document. SFT considers that the assumptions used are reasonable at this stage and that, ultimately, interest rate movement risk is a GCC risk which will be managed as part of the overall TIF project.

- h) **Fit with Scottish Government Definition of Regeneration:** The proposed TIF project fits with the Scottish Government's high-level definition of regeneration as "lasting transformation of places to benefit those who live and work there" but given its city centre location would not necessarily align with a narrower definition of "reversing decline". SFT considers that the proposed TIF project will contribute to the economic success of the city centre and will raise the economic potential of the hinterland surrounding the centre and accelerate growth there. This will assist in reversing economic decline across the wider city through spill over benefits.

#### 4. Recommendation

Overall, SFT recommends that this Business Case is capable of acceptance for approval in principle by Ministers under the TIF Pilot Scheme (approved by Ministers in November 2010), subject to the following conditions:

- a) The inclusion of a long-stop date linked to the first proposed investment in the project by GCC;
- b) GCC continuing to work closely with the Scottish Government State Aid team to satisfy itself that the proposals do not constitute state aid and to mitigate the potential for any third party challenge;
- c) The acceptance of the TIF approval terms and conditions largely in the form of the standard TIF approval letter, as previously issued on the City of Edinburgh Council Waterfront TIF project;
- d) That an appropriate public sector governance structure, as currently envisaged for all TIF projects, the TIF Executive, be established;
- e) The procurement approach is scrutinised by the TIF Executive and appropriate legal advice taken in due course; and
- f) That developer contributions, which are expected to be payable in line with current planning policy in the City be used to repay TIF debt; and
- g) That GCC remains responsible for compliance with all relevant legislation and guidance in respect of Prudential Borrowing and that it retains the risk around interest rate movements.

Satisfaction of these conditions will result in a lower risk proposal for both GCC and Scottish Government. The stipulated conditions are also deemed appropriate to ensure risks are properly managed and that the economic regeneration and additionality which is anticipated in the Business Case are more likely to occur.

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Following approval in principle from Scottish Government the next step will be the development of the formal TIF agreement letter in a similar form to that agreed with the City of Edinburgh Council, subject to the above conditions.

Yours sincerely



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Director of Finance  
Scottish Futures Trust