

**Localism Act 2011
Acquisition of Land Act 1981**

**Inquiry into:
THE SOUTH TEES DEVELOPMENT
CORPORATION
(LAND AT THE FORMER REDCAR STEEL
WORKS, REDCAR) COMPULSORY
PURCHASE ORDER 2019**

**Summary Proof of Evidence
Of
John Knowles
On behalf of South Tees Development Corporation**

CONTENTS

- 1.0 INTRODUCTION**
- 2.0 GLOBAL CAPITAL FLOWS AND REAL ESTATE MARKETS**
- 3.0 THE IMPORTANCE OF SECURING THE CPO LAND FOR THE
ELIGIBILITY OF THE SOUTH TEES SITE AS A POTENTIAL FREE
ZONE**
- 4.0 THE BENEFITS OF A SINGLE CONTIGUOUS SITE**
- 5.0 TRADITIONAL METHODS OF FUNDING DEVELOPMENT AT THE SITE**
- 6.0 ALTERNATIVE METHODS OF FUNDING DEVELOPMENT AT THE SITE**
- 7.0 FUNDING AND VIABILITY**
- 8.0 SUMMARY AND CONCLUSIONS**
- 9.0 DOCUMENTS RELIED UPON**

1. INTRODUCTION

Qualifications and Experience

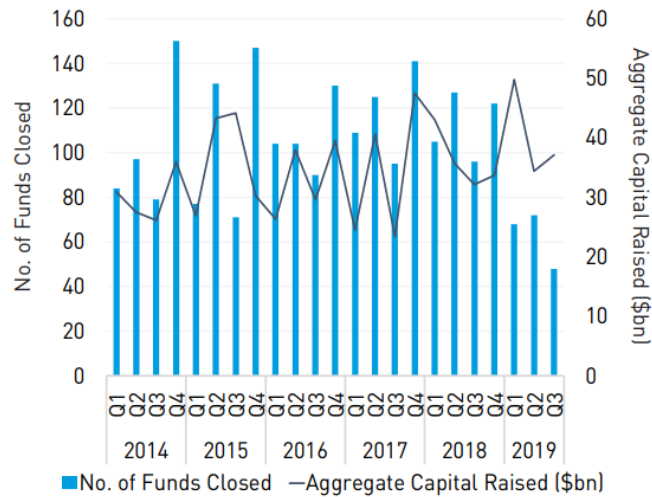
- 1.1 My name is John Knowles and I am Head of National Capital Markets at Colliers International. I have significant expertise and experience in investment and funding of large and complex development projects.

Scope of Evidence

- 1.2 My evidence relates to the availability of funding in real estate global markets, investor attraction and the market viability of the proposed regeneration Scheme at the former Redcar steelworks.

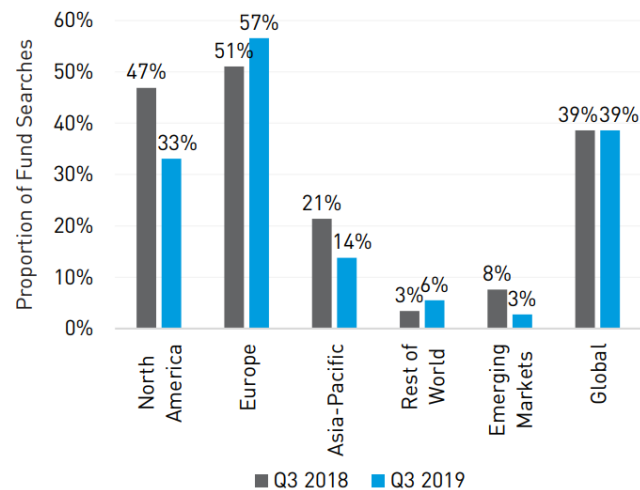
2. GLOBAL CAPITAL FLOWS AND REAL ESTATE MARKETS

- 2.1 There are substantial capital flows being raised by investors for allocation into real estate with US\$121bn being raised in the 9 months up to Q3 2019 (JK 1).



Source: Preqin Pro

- 2.2 Investors appear to have shifted their focus away from North America, Asia-Pacific and emerging markets in favour of investment in Europe and Rest of World, which are the only regions to have recorded an uptick in interest as compared with Q3 2018 (JK 2).



- 2.3 I expect a resurgence of investor appetite into the UK in 2020 following improved business certainty created by the general election result and a direction and timing, if not a clear picture, of what BREXIT might mean for investors.
- 2.4 As investment appetites have grown and investors have raised larger pools of equity for investment they are seeking larger lot size investments to create meaningful returns for their funds and more guaranteed delivery of investments on sites over time.
- 2.5 This in turn means that the STDC Scheme is highly attractive to investors in terms of macro location, scale and lot size, as well offering the opportunity to deliver high quality product in a growth and attractive market sub sector.
- 2.6 I consider that the scheme proposed by STDC would be attractive owing to considerable global investor demand for real estate products, and increasingly attractive industrial and logistics sector.

3. THE IMPORTANCE OF SECURING THE CPO LAND FOR THE ELIGIBILITY OF THE SOUTH TEES SITE AS A POTENTIAL FREE ZONE

- 3.1 A freeport is a clear potential economic driver for the STDC site and would increase investor interest and appetite.
- 3.2 There is research that the deadline forcing shippers to reduce emissions will provide opportunities for logistics investors around the world. This article and research summarises the changes occurring in global shipping and distribution in terms of scale, costs and environmental regulation being introduced in 2020 that will create a need for larger ships, ports and supporting facilities which will need larger sites.
- 3.3 It is therefore my professional opinion that promoting uses with synergies with the freeport will substantially increase the attractiveness of the STDC site as a funding opportunity owing to the increased demand for logistics real estate.
- 3.4 In my opinion, the viability and attractiveness of the South Tees Site is as a contiguous site and the current disjointed ownerships will not attract the investment required to bring forward a free port development.

4. THE BENEFITS OF A SINGLE CONTIGUOUS SITE

- 4.1 There is a long established understanding and principle in property investment that clustering of occupiers and creating larger investment opportunities adds value to underlying real estate, and that larger ownerships therefore have inherent portfolio value over and above the sum of the individual investments, or smaller isolated investment assets. Key factors are as follows:

a) Placemaking and Brand

In my opinion, if we marketed a single isolated investment in Teesside in the absence of a large branded development then we would see lower investment values – the buyer pool would be domestic and concerned about the long term investment value of their purchase.

b) Active Asset Management

Active asset management is the method that Investors use to generate investment returns over and above their expected base return. Multiple tenants reduce letting risk on expiry and create an internal market also allowing investors to actively manage their investments by relocating tenants, improving redevelopment options and creating flexibility.

c) Portfolio and cashflow

Finally there is a mathematical improvement for portfolio investment which is offers smoother cashflow and better financing possibilities. Smaller sites are exposed to individual lease events which materially affect returns in a single period. With scale the effects of these lease events are smoothed and scale also offers diversification of tenants, greater diversification of lease events and therefore lower risk.

- 4.2 I consider that securing the entire STDC area is fundamental in attracting CRE investors and is necessary in making the development as profitable as possible. Only if the scale and opportunity of the project is large enough will major investors with sufficient financial firepower be interested.

5. METHODS OF FUNDING DEVELOPMENT AT THE SITE.

- 5.1 There are a number of ways to fund development in the UK. I examine these here to look at the options that would be available to STDC to bring forward development on the site, in parallel or instead of public sector funding that would be available.
- 5.2 The traditional private sector methods involve both equity and debt funding. I consider that both of these would be jointly available to STDC for the combined site.
- 5.3 Increasing the size of the scheme, through a CPO process will, in my opinion, increase the value of the security which will mean the bank will view the development as having a lower risk. This will reduce the cost of finance and help increase the deliverability of the scheme. Increasing the value of the security will also increase the debt funding capacity.

6. FUNDING AND VIABILITY

6.1 Equity

I have reviewed the financial modelling for the combined scheme undertaken by STDC and reviewed by Vivid Economics. This shows potential equity IRR returns to a private sector investor of 16-20% for the Scheme as described. This in line with the anticipated returns of many major investment funds.

6.2 Debt

The modelling undertaken by STDC assumes a debt interest rate of 3.00%. I consider this to be a realistic assumption for debt that will support the potential IRR returns and in line with other major development projects. I consider if public sector debt funding was not available to the project for whatever reason, that private sector debt would be available at equivalent market rates.

7. IMPACT ON FUNDING OF THE ORDER NOT BEING GRANTED AND THE SSI LAND REMAINING OUTSIDE THE PROPOSED SCHEME.

7.1 I have considered the impact of the Order not being granted and the existing STDC landholding being brought forward in isolation.

7.2 The main reasons for this are as follows:-

- i. Investors will be concerned by the residual structures and environmental issues on the adjacent site and the legacy assets. A number of large global investors, especially US and Sovereign wealth Funds will simply not feel they are able to invest at all and reduced investor appetite will lead to lower pricing and less viable development.
- ii. In addition to the current issues, the unknown future uses of, an control over, the SSI land will impact on values, viability and investment returns.
- iii. The smaller scale of the scheme will impact on placemaking ability, overall portfolio value and less flexibility in bringing forward comprehensive masterplan.
- iv. The smaller scale of development will not attract the global capital investors who require scale and blended portfolio risk (4.1c).

8. SUMMARY AND CONCLUSIONS

8.1 In my opinion the following conclusions can be drawn from my review of the Scheme.

- i. There is a deep and growing global allocation of private capital for real estate investment from the private sector, both debt and equity.
- ii. There is also an increasing attraction and focus of investors on manufacturing and logistics real estate assets.
- iii. Global investors have the lowest cost of capital, mainly through efficiencies of funding and access to Sovereign Wealth and major institutional funds and these investors require scale and vision in investment opportunities.
- iv. There are real financial benefits in larger development schemes through clustering of occupiers, asset management and placemaking which add to rental growth and deliver higher financial performance.
- v. The combined STDC scheme is a major development opportunity and would be highly attractive to equity investors and debt providers.
- vi. Looking at the STDC financial model and development costs and comparing it to other schemes where substantial recent development has taken place confirms the viability of the scheme and the strong occupier interest that already exists (referred to by Guy Gilfillan and STDC themselves).

8.2 I consider that there is a fundamental difference between the scheme with and without the Order land in terms of returns, attractiveness to investors and the potential for major development. A major and comprehensive development of the former industrial uses on Teesside is required to attract the required quantity and quality of external investment, and this needs to be within one overall masterplan controlled by a single party to make this happen. A piecemeal development of the two sites would lead to more uncertainty, less viability and liquidity and increased doubt that any development, let alone high value advanced technology would be brought forward in a reasonable timeframe.

Referencing

JK 1- Prequin Real Estate-Q3 2019

Prequin (2019) Real Estate-Q3 2019 (page 5, figure 1) (<https://docs.prequin.com/quarterly/re/Prequin-Quarterly-Update-Real-Estate-2019-Q3.pdf>).

JK 2- Prequin Real Estate-Q3 2019

Prequin (2019) Real Estate-Q3 2019 (page 5, figure 2) (<https://docs.prequin.com/quarterly/re/Prequin-Quarterly-Update-Real-Estate-2019-Q3.pdf>).

JK 3- INREV (2019) Direct Vehicles Europe

INREV (2019) Direct Vehicles Europe. <https://www.inrev.org/library/inrev-vehicles-universe-direct-vehicles-europe>

