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

Proof of Evidence

Of

John Knowles

On behalf of South Tees Development Corporation

CONTENTS

1. INTRODUCTION

Qualifications and Experience

1.1 My name is John Knowles and I am the Head of National Capital Markets at Colliers International, based in London. I am a Member of the Royal Institute of Chartered Surveyors, and hold an honours degree in Property Valuation and Finance from City University, London. I am a qualified real estate and finance professional with twenty nine years' experience in real estate Capital Markets, advising clients on large scale commercial investment and development projects. I am an approved person as defined and regulated by the Financial Conduct Authority.

1.2 My clients have included, and also currently comprise substantial UK and Global financial institutions including Aviva, Aberdeen Standard, M&G and L&G, along with major developers, landowners and overseas institutions and REITS. I have transacted over £20bn of deals in the UK and I specialise in complex multiphase development projects. My current instructions include major development and regeneration projects in London, Liverpool, Birmingham, Edinburgh and Farnborough which have a combined Gross Development Value on completion of approximately £3bn.

1.3 I joined Colliers International in December 2013 and head a team based across the UK and in Jersey of 36 people. I manage specialists in industrial, manufacturing and logistics properties and we transact over £1bn of direct property transactions per annum in this sector. These deals are across the country and aligned to our leasing instructions where we have a pipeline of over 15m sq. ft of new development. We have also just concluded the largest UK industrial letting of 1.9m sq. ft to Jaguar Land Rover. I also manage a team which arranges debt funding for clients and they have access to 220 lenders who provide senior and mezzanine debt along with structured finance solutions for clients.

1.4 Prior to joining Colliers my previous roles included Head of Capital Markets at Lambert Smith Hampton and Managing Director of DTZ Corporate Finance as well as which I have held real estate positions in Hong Kong and Manila.

Professional Declaration

1.5 Statement of Truth

I confirm that I have made clear which facts and matters referred to in this Proof of Evidence are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

1.6 Declaration

1. I confirm that my Proof of Evidence has drawn attention to all material facts which are relevant and have affected my professional opinion.
2. I confirm that I understand and have complied with my duty to the Inquiry as an expert witness which overrides any duty to those instructing or paying me, that I have given my evidence impartially and objectively, and that I will continue to comply with that duty as required.
3. I confirm that I am not instructed under any conditional or other success-based fee arrangement.
4. I confirm that I have no conflicts of interest.
5. I confirm that I am aware and have complied with the requirements of the rules, protocols and directions of the Inquiry.
6. I confirm that my Proof of Evidence complies with the requirements of RICS- Royal Institution of Chartered Surveyors, as set down in the RICS practice statements “Surveyors acting as expert witnesses”.

Instructions

1.7 My instructions are to:

- Review the Scheme and consider its viability and liquidity from a funding and investment perspective. This is to understand whether the scheme is financially attractive and profitable.

- Review the underpinning assumptions of financial modelling and the South Tees Regeneration Master Plan (“the Master Plan”) to confirm that the Scheme is viable and will appeal to equity and debt capital for investing in both bringing forward serviced land and subsequent development. I have also been asked to consider and the impact of scale of the development and its resultant viability.

- Consider whether private sector funding, both equity and debt, for the site will be available and at levels and costs likely to make development possible, and the overall impact on funding likelihood, level and value without the acquisition of the entire site through the proposed CPO.

- Review and consider whether there is a detrimental impact on the likelihood of scheme delivery if the Order is unsuccessful, any proposals are therefore smaller in scale and the current heavy industrial uses and/or legacy structures and services remain on the Order land.

- Consider current likely investor sentiment towards sites of this nature and the need for scale, place making, control and wider environment when making substantial investment decisions.

1.8 I have not been asked to consider:

- The public sector funding currently available to the South Tees Development Corporation ("STDC") to invest in the regeneration (dealt within the Proofs of Evidence of my colleagues, Gary McDonald, page 9 and David Allison [Ref TBC]).
- The wider regional economic benefit of the whole scheme or the constituent parts of the project (dealt within the Proof of Evidence of my colleague, Dan Aylward-Mills Page 15).
- The market demand from occupiers and potential tenants for the site (dealt within the Proof of Evidence of my colleague, Guy Gilfillan Page 10).

Scope of Evidence

1.9 My evidence relates to the availability of funding, investor attraction and the market viability of the proposed regeneration Scheme at the former Redcar steelworks, Redcar.

1.10 My evidence covers:

- Global Capital Markets, investment into real estate as an asset class and industrial investment as a sector;
- The economic drivers and metrics of the proposed Scheme;
- Likely investors and their key investment criteria;
- Key assumptions and their impact on the viability of the proposed project;
- The importance of securing the CPO land both quantitatively and qualitatively, and delivering the Scheme in a comprehensive manner;
- The importance of securing the CPO land for the eligibility of the South Tees site as a major development project within its peer groups and alternative investment destinations.

Reliance on other evidence

1.11 In preparing this report, I have relied upon documents supplied and prepared by STDC and other advisors, as well as data, studies and reports published by reputable organisations and experts. I have referenced these documents where they have been relied upon. Unless explicitly stated, I have not sought to validate the accuracy of the information relied upon.

1.12 The documents relied upon include:

- The Master Plan (CDF/1);
- Academic, government and industry reports and studies;
- Official and subscription data on economic indicators and investment;
- A cash flow model prepared by STDC for the project;

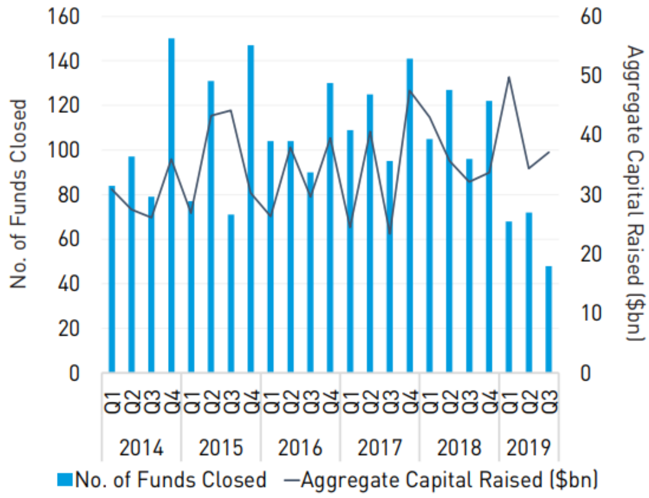
- Strategic documents shared by STDC;
- Proof of Evidence of John McNicholas (STDC2/2), which covers the objectives and importance of regenerating the area in accordance with the South Tees Regeneration Master Plan;
- Proof of Evidence of Gary McDonald (STDC3/2), which demonstrates the financial standing of STDC (as the acquiring authority) and the funding commitments in place to acquire the CPO land;
- Proof of Evidence of Dan Aylward-Mills of Vivid Economics (STDC7/2);
- Proof of Evidence of Michael King (Avison Young) (STDC8/2), which demonstrates the efforts made by STDC to acquire the CPO land through negotiation;
- Proof of Evidence of Guy Gilfillan of Colliers (STDC5/2), which demonstrates the demand in the industrial sector to deliver the scheme; and
- Proof of Evidence of Anthony Greally (Lichfields) (STDC4/2), which assesses whether there are any obvious reasons why planning permissions would not be granted for the Scheme.
- Proof of evidence of David Allison (STDC1/2) which provides context and background and discusses support from the public sector for the site.

1.13 Definitions used:

- **Asset Valuations -** determining the fair market or present value of assets
- **The SDTC Area -** The STDC area covers approximately 4,500 acres of land to the south of the River Tees in the Borough Redcar and Cleveland. It includes the former Sahaviriya Steel Industries ("SSI") steelworks, as well as other industrial assets. It also includes the deep-water port of Teesport, England's largest exporting port.
- The **Order Land -** lies within the STDC Area and comprises approximately 1,752 acres of land of the former Redcar Steel Works, Redcar, which is bounded by private access road known as Breakwater South Gare to the north, the Trunk Road (A1085) to the east, Tees Dock Road and South Bank to the south and the River Tees and the port to the West.
- **The Site/Scheme –** land and proposals for development as defined in the Masterplan.
- **Sticky Tenants –** Tenants and occupiers that are more likely to renew their occupation after lease expiries and are attracted to remain and grow in locations for reasons beyond pure economics and costs.

2. GLOBAL CAPITAL FLOWS AND REAL ESTATE MARKETS

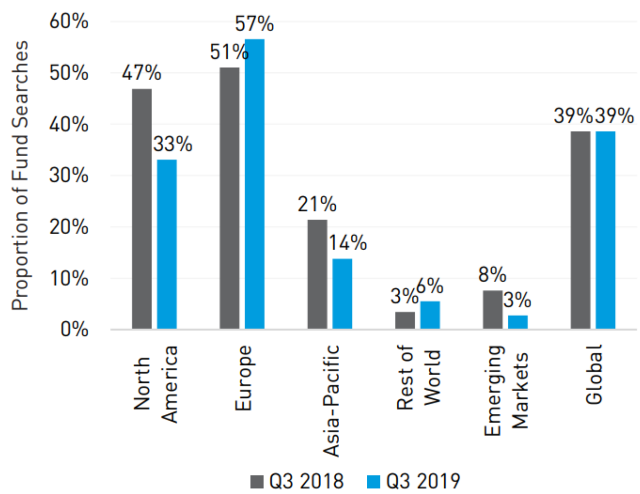
2.1 Private real estate fundraising momentum continued strongly through Q3 2019, the latest period for which figures have been published; $121bn has been secured through this period in 2019, keeping the year on track to break the annual fundraising record and building on the 10 year trend of funds coming into real estate as a global asset class (JK 1).



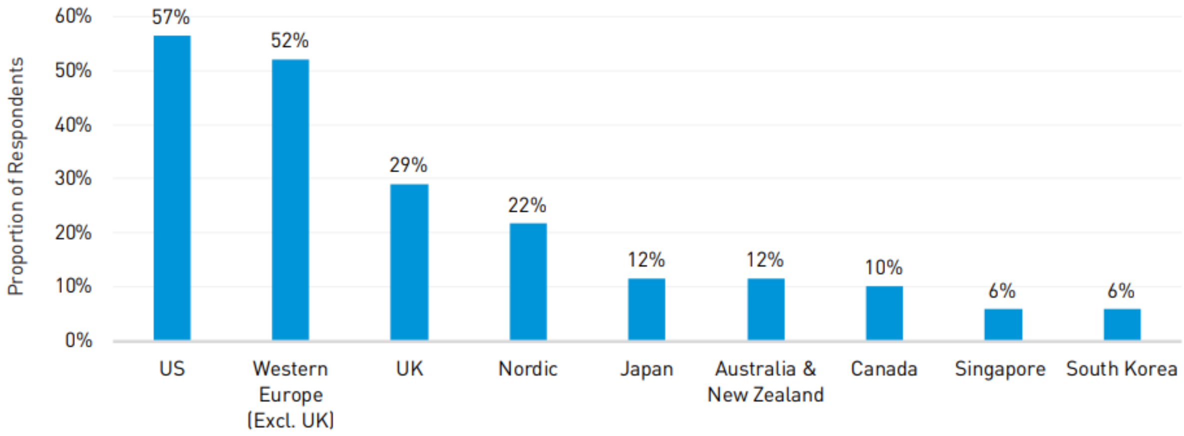
Source: Preqin Pro

2.2 Among private real estate funds closed so far in 2019, two-thirds have either achieved or surpassed their targets. Fund managers are also completing these raises in less time, with 88% of funds closing inside 24 months, compared to 82% in 2018. This means there are substantial funds looking for investment opportunities in real estate (JK 2).

2.3 Investors appear to have shifted their focus somewhat 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 3).



2.4 The established markets of the US and Western Europe (excluding the UK) are viewed most favourably among investors: 57% and 52% believe they are presenting the best opportunities at present (JK 4).



Source: Preqin Investor Interviews, June 2019

2.5 I expect a resurgence of investor appetite in 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.

2.6 The current cycle is different to those that have come before – for one it has extended in duration and it has also been fuelled by quantitative easing that has pushed down the yields available in other asset classes making real estate a more attractive relative proposition (JK 5).

2.7 As the European Central Bank restarted quantitative easing in November 2019, it will further prolong the investment cycle by keeping interest rates low. How long for is hard to predict, especially as this latest round of QE has no end date. Higher priced markets, such as London and Paris, could become even more expensive. This is likely to push further investment into developing regions where returns are more attractive (JK 5).

2.8 Industrial, Manufacturing and Logistics is already, and increasingly so, an attractive asset class for investors. The 'Beds & Sheds' strategy is a well-documented trend for investors and the ongoing movement from retail to internet based activities is creating a larger need for enhanced logistics and distribution chains. High value manufacturing is also a sought after sector for investors looking for growth sectors (JK 6).

2.9 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.

2.10 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.

2.11 I have assessed the market size for funds whose specific focus in Europe is Industrial and Logistics. This makes up a small proportion of the total investor demand for Industrial and Logistics as it ignores allocations toward multi-sector funds. See the below analysis:

Row Labels	Average of Target IRR - From (%)	Average of Target IRR - To (%)	Sum of Gross Asset Value of the Vehicle (EUR)
CBRE EUROPEAN INDUSTRIAL FUND	10.00	11.00	1,097,165,598
CBRE LOGISTICS PROPERTY FUND EUROPE	12.00	12.00	33,782,486
CBRE LOGISTICS VENTURE SCSP	8.00	10.00	118,522,000
ERGO TRUST LOGISTIKFONDS NR 1	7.00	7.00	249,894,989
EUROPEAN LOGISTICS INCOME VENTURE	12.00	12.00	-
GOODMAN EUROPEAN LOGISTICS FUND, FCP-FIS	9.50	9.50	3,702,117,751
LOGISTIS	8.00	10.00	3,148,918,990
PROLOGIS EUROPEAN LOGISTICS FUND	9.00	10.00	11,192,674,000
SAVILLS IM EUROPEAN LOGISTICS FUND 2	6.00	6.50	431,521,840
TARGETSELECT LOGISTICS			693,124,254
TRIUVA GARBE LOGISTIK EUROPA			85,268,617
Grand Total	9.06	9.78	20,752,990,524

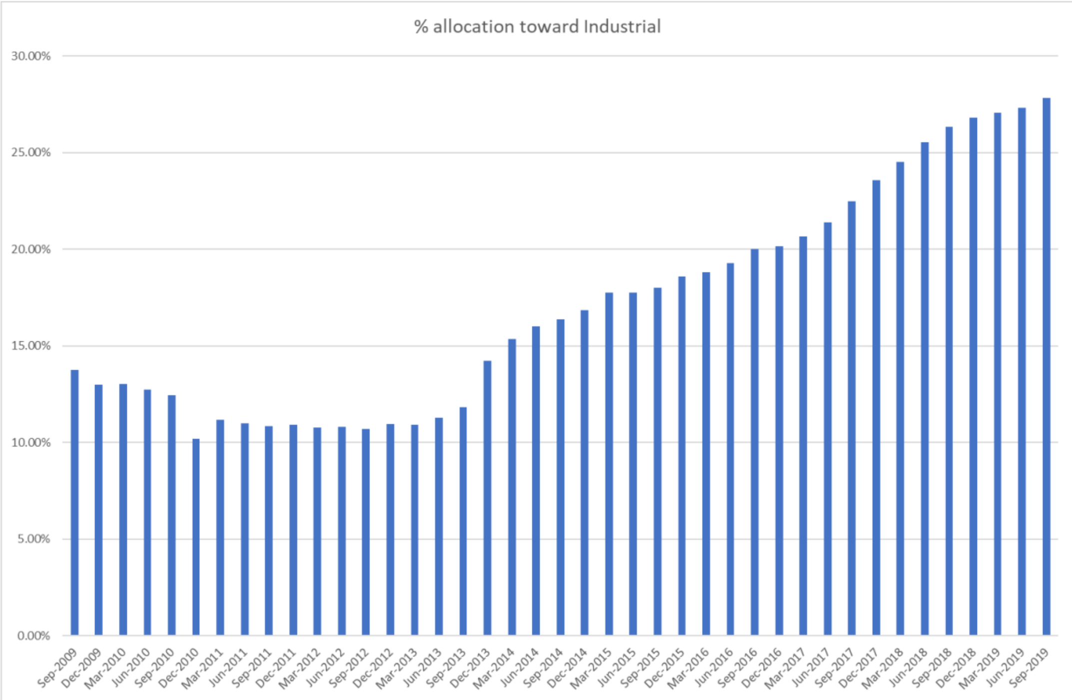
The total size of funds currently raised in Europe specifically with an Industrial and Logistics focus is €20.752bn. This is a considerable quantum of current investment. I have also highlighted the typical cost of money for each fund which ranges from 6-12% unleveraged IRR for the funds currently raised in the market, which with appropriate debt gearing levels of 50-65% will offer total returns in the order of 10-20% (JK 7). The IRR shows potential investors the average annual return they can expect to make over the lifetime of an investment. As an example, if an asset was bought for £100 and then sold exactly one year later for £110 the IRR of the investment would be 10.00%.

2.12 In addition to the funds outlined above I am aware of a number of agglomeration strategies currently underway by a number of the large Private Equity funds. Notably there have been two transactions where an agglomeration strategy has been implemented.

2.13 Blackstone (NYSE:BX) has announced that real estate funds managed by them have agreed to sell their pan European logistics company, Logicor, to affiliates of China Investment Corporation ("CIC") for €12.25 billion. Logicor owns and operates a portfolio of high-quality logistics assets totalling 147 million square feet, in 17 countries, with over 70% concentrated in the UK, Germany, France and Southern Europe. Located throughout Europe's major economies, along primary transport corridors and in close proximity to large population centres, the portfolio is ideally positioned to benefit from the structural shift in demand driven by the rapid growth in e-commerce (JK 8).

2.14 Blackstone's Logicor platform awakened other private equity funds looking to establish a pan-European logistics vehicle. Cerberus Capital Management have partnered with Arrow Capital on a $1bn vehicle pan European logistics platform. Blackstone and M7 real estate have partnered together to build a light industrial platform and have recently acquired a €1.28bn light industrial portfolio managed by Hansteen to expedite growth.

2.15 I have demonstrated below an analysis of allocations toward Industrial accommodation for a 10 year period from September 2009 to September 2019. It is clear from the below graph that over a 10 year period UK balanced funds have increased their allocations toward industrial (JK 9).



2.16 This trend has largely seen investment into distribution and multi-let industrial property but the resurgence of advanced and high value manufacturing, referred to by my colleague Guy Gilfillan (STDC7/3 Appendix 6), has seen the creation of high value developments with strong income potential from major corporate occupiers which is attractive to the long income funds of institutional investors and especially Triple Net Lease funds who are US based and seek what they refer to as "mission critical" investments.

2.17 This section of my Proof of Evidence has been centred on demonstrating investor demand for real estate in the wider context of global capital flows. I have then demonstrated that investors, where industrial and logistics is a part of total investor demand for real estate, have increased their allocations toward industrial and logistics sector.

2.18 I therefore consider that the scheme proposed by STDC would be attractive owing to considerable global investor demand for real estate products, compounded by the fact that investors are increasingly more attracted to the industrial and logistics sector demonstrated by their increased allocation toward the sector.

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

3.1 I have relied on Vivid Economics (JK 10) on the benefit of freeports in the UK but refer below to a trend that a number of our clients have discussed in terms of how they leverage investment around changes in global trade and growth in infrastructure projects which drive economic benefit.

What IMO 2020 means for logistics investors (JK 11) – JLL Article 7th October 2019

3.2 I have considered an article published by JLL (JK 11) on how the deadline set to force international shippers to substantially reduce emissions will provide opportunities for logistics investors around the world's secondary ports:

> *"On the 1st January 2020, the United Nations International Maritime Organisation (IMO), the regulatory authority for international shipping, will enforce a sulphur cap on the fuel of marine vehicles.*
>
> *The regulation – IMO 2020 – will force ocean carriers to use more expensive, cleaner fuel or install expensive scrubbers which reduce pollution. Either way, their operating costs will be higher. To offset costs, shipping companies will deploy larger vessels, since an increase in ship size does not mean an equal increase in fuel consumption, says Walter Kemmsies, Economist and Chief Strategist of JLL's US Ports, Airports & Global Infrastructure Group.*
>
> *Most ports can accommodate the sheer size of the larger ships, but they might not be so well placed to process the extra cargo the ships carry.*
>
> *On the water side, most large U.S., European and Asian ports are ready to receive 14,000-plus TEU vessels. US West Coast ports could handle 18,000-plus TEU vessels, while most major European and Asian ports can handle 22,000 TEU vessels.*
>
> *But, the question is how well they can handle these vessels on the land side, says Kemmsies.*
>
> *Los Angeles and New York already have severe traffic congestion and larger ships dropping off more cargo could result in paralysis. In Europe, the larger ports of Rotterdam and Hamburg, while in Asia, Shanghai and Hong Kong have similar land side issues.*
>
> *JLL estimates that ports need 60 million square feet of logistics real estate in order to be able to cope with processing the cargo from 14,000 TEU ships.*
>
> *More pressure on the busiest ports means nearby ports with the capacity to develop further logistics infrastructure could win new business, creating opportunities for logistics real estate investment, says Kemmsies, pointing to Seattle, Tacoma and Oakland on the west coast*

and Savannah, Norfolk and Charleston on the east coast as examples of ports that could benefit."

3.3 The JLL Article refers to an increase in vessel size generating an increase in demand for industrial accommodation. Establishing a freeport is therefore highly likely to lead to an increase in demand for logistics real estate owing to the increased number of vessels. I consider that the JLL article establishes a clear link between logistics demand for real estate and number & size of vessels.

3.4 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.

3.5 In my opinion, the viability and attractiveness of the South Tees Site is as a contiguous site. In my opinion strategic uses such as a free port would require control over the whole site in order to create a successful functioning free port area.

3.6 In my opinion disjointed ownerships will not attract the scale of investment required to bring forward a free port development. This would be considered by investors as a challenging implementation and therefore would reduce investor sentiment to the extent that viability becomes stretched.

3.7 Having a single entity driving toward the same goal is the only practical way to ensure that the re-development of the South Tees Site is a success.

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.

4.2 There are a number of drivers for this, the main three being:

i. **Placemaking and Brand**
ii. **Active Asset Management**
iii. **Portfolio and cashflow premium**

4.3 In considering each of these three areas for STDC, in my view there will be a significant impact and positive uplift from the inclusion of all the CPO land:

i. Placemaking and Brand

4.4 The creation of a combined distribution hub will have a meaningful uplift in value. In my colleagues Mr Gilfillan proof of evidence (page 37) he refers to the benefits of the comprehensive regeneration of the STDC Area highlighting the attraction to occupiers, branding and ability to accommodate much larger requirements than otherwise would be the case. In addition, the ability to invest in a larger branded scheme will increase the number of substantial Commercial Real Estate (CRE) investors to Teesside. In my opinion, if STDC 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.

4.5 A lack of placemaking would lead to an investor treating a plot of land in isolation thus effectively reducing the size of the site. Investors have concerns about smaller sites owing to the fact they are exposed to the underlying occupier market and the attractiveness of the area to new tenants at the end of the current lease term, rather than the occupational market in the context of a wider site that has been comprehensively planned and thought out. In response, an investor of a smaller site will apply longer reletting periods and void costs and seek a higher equity return from their investment. In addition, the investors looking at isolated investment are smaller domestic investors and private property companies with a higher cost of capital thus reducing viability of the development.

4.6 A typical example of comprehensively planned investments is:

Advanced Manufacturing Park, Sheffield

AMP has subsequently become a global centre of excellence for advanced manufacturing and process engineering. Companies established there include Boeing, McLaren Automotive ITM Energy. Placemaking and the creation of a destination will attract much larger occupiers to an area outside of their typical target locations. This in turn attracts global investors owing to a decrease in covenant risk and an increase in attracting more attractive and valuable tenants. Attracting global occupiers results in access to larger pools of cheaper institutional and Sovereign Wealth investment.

ii. Active Asset Management

4.7 Active asset management is the method that investors use to generate investment returns over and above the base return. The base return could be described as a return which an investor receives associated with the underlying property market. As mentioned above the existence of multiple tenants reduces letting risk on expiry and creates an internal market for tenants – it also allows investors to actively manage their investments by relocating tenants, improving redevelopment options and creating flexibility. There are asset management techniques which can be employed to help generate value over and above the base return, an example of which follows:

Clustering

Clustering of synergistic occupiers leads to cost savings for those occupiers. These cost savings are primarily driven by lower transport costs which mean business can benefit from lower overhead costs when co-located. This creates sticky tenants, (tenants that are likely to stay in a location at a lease event), who are wedded to being in close proximity to complimentary occupiers. This is most evident in the UK car industry with Jaguar Land Rover, for example, creating a substantial supply chain of occupiers in close proximity to their headquarters in Coventry. Availability of land and competition over sites has led to occupiers being spread over a wider area in the case of JLR, but it is no coincidence that the supply chain are near to the main JLR facility. The competitive advantage for STDC is that there is no shortage of land where occupiers can co-locate to drive these cost savings, combined with an attractive opportunity of clustering uses around the potential freeport.

In my experience, clustering leads to rental outperformance in comparison to the regional baseline owing to greater localised competition and enhanced investment returns.

iii. Portfolio and cashflow premium

4.8 Finally, there is a mathematical improvement for portfolio investment which is driven by multiple tenants offering a smoother cashflow and better financing terms from banks. 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, owing to the diversification effect of having multiple unaligned events. Therefore, with scale, investors are able to rely on stable income returns which traditionally in UK real estate are considered a more sustainable and reliable form of return as opposed to capital growth which is more cyclical. Scale offers greater diversification of tenants, greater diversification of lease events and therefore a blended risk which would be considered by investors as lower risk.

4.9 As a result, a larger STDC development site would offer more optionality for uses, occupiers and scale which in turn would lead to higher anticipated returns for investors. In addition a larger site would attract larger investors who have more capital efficiency and are able to invest more capital at lower rates. I therefore consider that a larger comprehensive STDC site would have significantly more attraction for investor, improving development progress and probability.

4.10 In addition, major industrial and manufacturing investors such as Panettoni, Blackstone and Prologis would not invest in smaller compromised investments in locations like Middlesbrough and Redcar. For these reasons, in my opinion the comprehensive regeneration of the STDC area will significantly enhance the viability and attractiveness of the scheme.

4.11 I consider that securing the entire STDC area is fundamental in attracting substantial institutional Real Estate investors and is necessary in making the development more profitable to ensure this happens. Investor attraction to the scheme will be created through knowing they are able to generate high level returns throughout the long term, eliminating risk where possible. Options as described above to increase returns and decrease risk are only available when the scheme is considered a whole.

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 in bringing forward development on the site, in parallel or instead of public sector funding that would be available. Differing methods have been used recently in the UK to bring forward large and complex development and urban regeneration schemes by both private and public sector developments.

5.2 The traditional private sector methods involve both equity and debt funding.

5.3 Equity funding is a traditional method of financing development. I have demonstrated in this Proof of Evidence in section 2 that there is a large quantum of equity which is focused on investing in the Industrial and Logistics sector. Due to the scale of the funding required for the Scheme, an equity funder would want to demonstrate longevity and scale to their investment committee. Including the CPO land creates this scale.

5.4 The perceived lack of value add and opportunistic development opportunities in the UK and increased competition for those assets places STDC in a unique position, offering both scale, assuming the inclusion of the CPO land is included, and a value add opportunity where an investor can demonstrate meaningful returns to their investment committee. My colleague Guy Gilfillan has referred to the unique nature of the Scheme in terms of competition across the UK and Europe.

5.5 Due to the attractiveness of the sector demonstrated by the increased allocations toward Industrial and Manufacturing, interest is expected to come not only from investors as mentioned earlier in the Proof but also from developers looking to provide differing end products to the investors.

5.6 This may include but is not limited to the following parties:

i. **SEGRO** - a UK Real Estate Investment Trust (REIT) and a leading owner, asset manager and developer of modern warehousing and light industrial property.

ii. **Panattoni** - the UK development arm of Panattoni Europe, the largest developer of logistics facilities in Europe.

iii. **Prologis** - a multinational logistics REIT and the largest industrial real estate company in the world focusing on building smart industrial warehouse on their own industrial parks.

iv. **Cerberus Capital Management** - an American private equity firm and global leader in alternative investing.

v. **Arrow Capital Partners -** Private real estate company specialising in sourcing, investing in and delivering value add, repositions and development opportunities.

vi. **Blackstone Capital** - The largest alternative investment firm in the world, Blackstone specialises in private equity, credit and hedge fund investment strategies.

vii. **Tritax Big Box REIT** - The UK's leading investment company focused on larger scale logistics real estate.

5.7 Debt funding is often utilised alongside equity to increase the funding capacity at projects. If structured correctly, debt can also improve returns to investors. I would therefore anticipate that a holistic approach to financing the development at STDC will be adopted incorporating both equity funding outlined in 5.3 and debt financing demonstrated below.

5.8 Equity and debt are not mutually exclusive in the sense that equity finance can facilitate development in its entirety however the majority of global investors opt to use third party finance to increase the funding capacity at project level. It is therefore my professional opinion that a rational incoming investor will incorporate debt finance in the development of the site.

5.9 Debt financiers will need security over any development project they opt to finance, part of this security is provided by the counterparty to the loan agreement. In the case of STDC, this would be the third party investor/developer at the project. As another form of security, a debt financier would look at the site itself. The land has a value on an undeveloped basis which would be used as collateral against the development finance provided to the investor.

5.10 Increasing the size of the scheme, through a CPO process, will 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, in other words, you can borrow more money from debt financiers.

5.11 I consider that the site would be more attractive to debt financiers if the CPO land was included. I have provided below a list of funders who I believe would be attracted to the scheme:

i. **High street lenders**

(a) HSBC
(b) RBS
(c) Lloyds Banking Group

ii. **Specialist lenders**

(d) ICG Longbow
(e) Starwood
(f) Lombard

5.12 There are other methods of finance that are available to STDC to finance this development if the traditional methods of Equity and Debt are not forthcoming.

6. FUNDING AND VIABILITY

Equity

6.1 I have reviewed the financial modelling for the combined scheme undertaken by STDC and reviewed by Vivid Economics, and referred to in the respective proofs of Gary MacDonald (STDC3/2) and Dan Aylward Mills (STDC7/2). This shows a likely equity IRR return to a private sector investors in a range of 16-22% for the Scheme as described. This IRR figure is the annualised rate of return that an investor seeks, looking at the business plan for the development. It is a figure that reflects the risk and timing of the scheme when compared to alternative investments and a risk free return, which is a benchmark such as the Bank of England base rate or the return on UK Government gilts of a similar duration to the project.

6.2 This range of 16-22% is in line with the anticipated returns of many of the investment funds that I have highlighted earlier in the report and appropriate to the risk and return profile for a scheme of this nature. As examples, my firm are currently sourcing funding for a multi-phase £250m development scheme at Granton Harbour Edinburgh based on an equity return of 18% per annum to the identified investor. We are also undertaking major development projects at Pall Mall Liverpool (£200m Gross Development Value), Blackfriars London (£1bn GDV) and New Garden Square, Birmingham (£250m GDV), all of which offer investor IRRs in a range between 15-22% IRR.

Debt

6.3 The returns highlighted above are for the equity component of the scheme. The modelling undertaken by STDC assumes a debt interest rate of 3.00% on debt used within the financing structure. I consider this to be a realistic cost of debt and in line with other major development projects. If Public Works Loan Board ("PWLB") funding was not available to the project for whatever reason, in my view private sector debt would be available at equivalent market rates.

6.4 I have reviewed the financial metrics of other successful schemes and compared those with the financial modelling undertaken by STDC and can confirm that the STDC Scheme is equally viable in terms of private sector development and would offer appropriate return to investors.

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. In my professional opinion this would have a seriously deleterious effect on values, appetite and certainty for development. 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, and 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 (see paragraph 4.1c above).

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 as the sector continues to show strong occupational demand and there is a continued shift of retail and associated distribution from physical high street to online. In addition, a resurgence in high value manufacturing and the development of environmentally relevant industry is also an attractive proposition for many investors.

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 STDC scheme is a major development opportunity and would be highly attractive to equity investors and debt providers– if public funding were not available or insufficient to deliver the aims and objectives of STDC then in my opinion there would be funding available at rates that make delivery of the scheme viable.

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). The Scheme would be highly attractive to investors.

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.

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