European Investment Bank

Final Evaluation of SPRUCE

Final Report

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Riaghaltas na h-Alba

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Limitations

The report has been prepared on the specific instructions of EIB and the Scottish Government for the sole purposes set out in our contract and for the sole use of EIB and the 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 use 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, which has been used to inform our analysis.

indigohouse

Registered office

15 Lauriston Place
Edinburgh
EH3 9EP

Contact: Andrea Paterson

Phone: 07969 726 064
Email: andrea.paterson@indigohousegroup.com
Web: indigohousegroup.com

Contents

Executive Summary

This report sets out the findings of the final evaluation of the Scottish Partnership for Regeneration in Urban Centres ("SPRUCE") fund, undertaken by the Indigo House Group ("Indigo House") on behalf of the JESSICA Holding Fund Scotland (JHF Scotland).

The 10-year investment period for SPRUCE ended on 28 November 2021 and the report contains a series of conclusions and recommendations which could provide a benchmark for future generations of similar type funds in Scotland.

It builds on the interim evaluation which was completed after the initial investing period for the fund ended (with 7 projects funded at that stage) and the findings are broadly consistent.

Overall, we found:

- SPRUCE has been successful in supporting the economic growth strategy of the Scottish Government at a very challenging time. Over £135m was invested in 18 urban development and energy efficiency projects by November 2021.

- The 18 SPRUCE funded projects have 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 the timeframe and priority areas had SPRUCE funding not been available.

- The case studies demonstrate that the benefits from the SPRUCE fund for Scotland extend well beyond the financial considerations. In particular, the place making impact of some of the projects has enabled wider regeneration of areas which otherwise would not have happened in the absence of SPRUCE. The Guardbridge project in St Andrews is an example.

- SPRUCE achieved strong leverage with £425m of capital invested from third parties through the process (a leverage factor of 4) against total investment of £0.5bn in the 18 urban development and energy projects funded by SPRUCE.

- The SPRUCE capital was deployed more than once with £135m of facilities provided from £94m of capital subscribed (so a recycling factor of 1.4 over the 10 year investing period of the fund). Our analysis suggests the fund would be fully recycled over a 15 to 20 year period.

- On the basis of the evaluation completed, SPRUCE represents the most economically advantageous option for achieving a set of desired impacts. SPRUCE demonstrates considerable value for money to the public purse when compared against alternative pricing interventions including non-repayable grant and/or other structured financing.

- The operating structure of the SPRUCE fund has been self-financing with interest earned on the loan book covering the fund management costs. There has been no further call on the public purse to fund the ongoing revenue costs of operating the fund which is another important and distinguishing feature.

SPRUCE helped to bridge a development funding gap in otherwise viable projects so contributed to getting things built. It is therefore fair to say that SPRUCE has been a successful intervention where access to capital has been problematic for infrastructure projects. In addition, the final evaluation found that:

- The rationale for the investments made was found to be consistent with the investment strategy; 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.

We also found:

- There was strong awareness and recognition of SPRUCE in the property market but still very low levels of engagement with SPRUCE within the Local Authority market, which was a missed opportunity. Feedback from the operation of similar funds elsewhere in the UK suggest much closer working relationships with the local authorities.

- Some of the feedback around the relatively modest scale of the limits on individual projects during the interim evaluation suggested these may have been preventing otherwise eligible projects coming forward. However, some of the projects invested in since 2017 have involved larger sums.

- Other challenges experienced with SPRUCE in the initial period, were consistent with the feedback received in the final evaluation. For example, the process was found to be longer and more onerous than they may have expected and some of the project sponsors also commented on the level of fees involved. That said, project sponsors found Amber, the fund manager, reasonable to work with. 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. Good stewardship of the fund was demonstrated.

- Whether the spread of projects was sufficiently balanced to deliver is difficult to quantify. For example, our analysis suggests a concentration of spend on similar projects (mainly office developments) and so it is fair to say that there could potentially have been more energy projects and more investment in deprived communities beyond Glasgow and Edinburgh City Centres. However, that said, we highlighted in the interim evaluation that shorter term lending will maximise the financial performance of the fund, and so there may have been a tendency towards funding projects where the payback period is relatively short (Grade A office accommodation being an example).

- Prioritising the output targets in directing SPRUCE resources to deliver the desired impacts is important. 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. It is not clear the extent to which this was a key consideration. As a result, our analysis found a concentration of SPRUCE funding in Grade A office accommodation projects.

In terms of the structure of the SPRUCE fund:

- The original intention was to increase the total funding available 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, RBS did not co-invest in any of the projects which SPRUCE funded. Additional funds were invested providing a total of £94m capital all in. However, that said, significant leverage has been secured at the project rather than the fund level and this is an appropriate financing mechanism.

- The interim evaluation found that 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. The recycling achieved was 1.4 times (i.e., £135m from £94m).

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 of projects have demonstrated, our analysis suggests the SPRUCE model 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.

- 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.

Conclusions

SPRUCE has successfully contributed to the economic growth strategy in Scotland. It has delivered several significant benefits to the Scottish economy at a very difficult time, including through the Global Covid Pandemic. 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.

1. Introduction and background

1.1 Introduction

This report sets out the findings of the final evaluation of the Scottish Partnership for Regeneration in Urban Centres ("SPRUCE") fund, undertaken by the Indigo House Group ("Indigo House") on behalf of the JESSICA Holding Fund Scotland (JHF Scotland).

The 10-year investment period for SPRUCE ended on 28 November 2021 and the report contains a series of conclusions and recommendations which, it is expected, could provide a benchmark for future generations of similar type funds in Scotland.

1.2 Scope of the Brief

The purpose of the study, requested by Scottish Government, is to evaluate the performance of SPRUCE as of the end of the investment period. It sets out the achievements and impacts of SPRUCE activities in Scotland to date within the policies and the strategy initially established and considers the value for money ("VFM") offered by SPRUCE in contrast to traditional grant funding and other ways to address market failure.

It includes a comprehensive assessment of the fund overall and details the 18 individual projects funded by SPRUCE since 2011, setting out the direct impacts delivered and other spill over effects arising, such as wider benefits in the context of the Scottish Government's Regeneration strategy. It also sets out the additionality achieved from the revolving nature of the fund.

Case studies for all 18 projects funded are included in Appendix 1. In addition, 3 projects are set out in more detail, as exemplars of the exceptional impact that SPRUCE type funding can deliver in Scotland. The final evaluation builds on, and concludes, the interim evaluation also completed by Indigo House in 2018.

1.3 Our methodology

In undertaking the evaluation, Indigo House met with officers from EIB, Scottish Government and Amber Infrastructure and undertook fieldwork including structured interviews with project sponsors. This included site visits where possible. We also interviewed a range of stakeholders including property agents and representatives of both the Investment Committee and Advisory Board.

We reviewed a comprehensive range of documents including those provided by Amber and EIB, project sponsors and property agents alongside other documents available in the public domain.

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.

1.4 Limitations

The report has been prepared on the specific instructions of EIB and the Scottish Government for the sole purposes set out in our contract and for the sole use of EIB and the 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 use 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.

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2. Overview of SPRUCE

2.1 Background to SPRUCE and The JESSICA Holding Fund

SPRUCE was originally set up in 2011 using the European Regional Development Fund (ERDF) as part of the "Lowlands and Uplands Scotland ("LUPS") operational programme and the European Commission's JESSICA initiative (Joint European Support for Sustainable Investment in City Areas). The JESSICA Holding Fund Scotland ("JHF") was set up a year earlier in 2010.

JESSICA 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. It is expected to deliver improved longer term outcomes through creating value in the built environment and the communities that the fund serves.

It has enabled ERDF and match funding to be invested in urban projects in Scotland via loans. Returns from these investments are used to make new investments in new projects thereby creating revolving funds. Investments under the JHF Scotland have been provided by SPRUCE, the urban development fund procured and contracted by the Scottish Government.

2.2 Regulated Investment Fund

JESSICA is based on adopting a more commercial approach to the use of public funds to drive and deliver regeneration and economic development and so SPRUCE is a regulated investment fund. Unlike more traditional forms of public finance including urban development funding (particularly grant) SPRUCE could provide loans, mezzanine debt and equity investments to revenue generating, infrastructure and energy efficiency projects supporting regeneration in Scotland.

The fund is led by a private sector independent manager (AMBER infrastructure) with a private governance structure in place. The governance structure was set out in detail in the interim report which is available at Interim Evaluation.

2.3 Overview of SPRUCE investment activity in Scotland

Over the 10-year period from 2011 to 2021, a total of £94M was invested in the SPRUCE fund by the Scottish Government. Initially £49M in 2011, £15M in 2016 and £30M in 2018. Over that same period Amber utilised the SPRUCE capital to invest £135M in 18 projects. This supported total development activity of just over £0.5BN with £425M from third parties funding the rest. Recycling (or utilisation) of SPRUCE capital and the leverage achieved was good at 1.4 and 2.8 respectively. Leverage on the original £94M invested was 4.1.

At the time of completing the final evaluation:

- SPRUCE had invested in 16 urban development projects and 2 sustainable energy projects. The 16 urban development projects included 11 Office developments in Glasgow and Edinburgh (including preparatory land remediation work at Haymarket) and 5 industrial projects in Edinburgh, Glasgow, Lanarkshire and West Lothian. As already mentioned, case studies for each of the projects is provided in Appendix 1.

- A number of the projects have already repaid in full including some that have repaid early and the remaining 4 are due to repay over the next three years between Sept 2022 and Sept 2025;

- The operating structure of the SPRUCE fund has been self-financing with interest and fees covering the fund management costs. This means there has been no further call on the public purse to fund the ongoing revenue costs of operating the fund. This is an important and distinguishing feature with capital being put to effective use and reducing the requirement for revenue funding on the public purse;

- Of the £94M invested by the Scottish Government, £14M in total is being repaid in the form of interest and fees and £80M is being repaid as capital. At the end of the investing period (November 2021) a total of £7.7M in capital had already been repaid meaning there is a further £72.2M in capital to be repaid between now and September 2025.

Our analysis of the performance of the fund and nature of the investments made by investing period, by area and by sector now follows. This demonstrates that performance of SPRUCE varies and so prospects will be very much driven by, and dependent on, the balance of these aspects.

2.4 Initial Investing Period and Recycling Phase

A key premise of the approach was the creation of a revolving fund for recycling of capital into new projects. The fund was therefore clearly split into two 5-year phases. An initial investing phase from 2011 to 2015 and a recycling phase from 2016 to 2021. A total of 7 projects were funded in the initial investing phase and 11 projects were funded in the recycling phase. Table 1 provides an overview of the financial performance of the fund over the two phases.

Table 1: Overview of SPRUCE Investing Activity

	10 YR Total £M	2011-2015 Initial £M	2016 -2021 Recycling £M
Spruce Facility	£135.8	£48.6	£87.2
Third Party Funding	£383.3	£184.0	£199.4
TDV	£519.1	£232.6	£286.5
Spruce as % of TDV	26%	21%	30%
Utilisation	1.4	1.0	1.9
Leverage	2.8	3.8	2.3

Table 1 highlights a total of £48.6M was invested in the initial 5 year investing period and £87.2M in the recycling period. This funded total development activity of £232.6M and £286.5M respectively, suggesting SPRUCE funding as a percentage of the total development activity was lower in the initial investing period at 21% and higher at 30% in the recycling period.

It also shows:

- Capital was fully deployed (as indicated by the factor of 1) in the initial period and recycled from 2016 to 2021 (almost twice) giving an overall utilisation or recycling factor of 1.4

- The leverage achieved was almost 4 times (3.8) in the initial investing period and just over double (2.3) in the recycling period.

2.5 SPRUCE activity by sector

An overview of SPRUCE activity by three key sectors is provided in table 2.

Table 2: Overview of SPRUCE Investing Activity by Sector

All Projects	Energy	Industrial	Office	Total
SPRUCE Facility	£16.0	£19.0	£100.8	£135.8
Third Party Funding	£15.8	£12.9	£354.6	£383.3
Sum of TDV	£31.80	£32.0	£455.3	£519.1
SPRUCE as % of TDV	50%	59%	22%	26%
Leverage	1.0	0.7	3.5	2.8
Initial Investing Period	**Energy**	**Industrial**	**Office**	**Total**
SPRUCE Facility	£16.0	£3.8	£28.8	£48.6
Third Party Funding	£15.8	£2.3	£165.8	£184.0
Sum of TDV	£31.8	£6.1	£194.6	£232.6
SPRUCE as % of TDV	50%	62%	15%	21%
Leverage	1.0	0.6	5.8	3.8
Recycling Period	**Energy**	**Industrial**	**Office**	**Total**
SPRUCE Facility		£15.2	£72.0	£87.2
Third Party Funding		£10.6	£188.7	£199.4
Sum of TDV		£25.8	£260.7	£286.5
SPRUCE as % of TDV		59%	28%	30%
Leverage		0.7	2.6	2.3

Table 2 highlights:

- A total of £16M was invested in energy projects, £19M in industrial projects and £101M in office (including some mixed development schemes);
- There was growth in SPRUCE investments in both Industrial and office projects during the recycling phase compared to the initial investments made. Industrial investment grew from
  £3.8M to £15.2M and office investment grew from £28.8M to £71.9M;
- No investment was made in energy projects in the recycling phase and this is perhaps disappointing given the strategic priority attached to energy in Scotland.

In addition, table 2 also details:

- Significantly higher leverage was achieved on the office projects than on the energy and industrial projects (3.5 compared to 1 and 0.7); and,

- Overall leverage was higher in the initial investing period than the recycling period.

It is important to note that the varying levels of leverage observed provide useful insight into the different characteristics of the sectors and specific projects SPRUCE has supported. They do not however, provide an appraisal of relative performance in the sense of good versus bad indicators of performance and should not be interpreted as such.

2.6 SPRUCE activity by Geography

An overview of SPRUCE activity by area is provided in tables 3.

Table 3: Overview of SPRUCE Investing Activity by Area

Area	Edinburgh City Centre	Glasgow City Centre	Glasgow Conurbation	Other Areas	All Projects
SPRUCE Facility	£45.0	£55.3	£20.5	£15.1	£135.8
Third Party Funding	£131.9	£215.3	£23.1	£13.0	£383.3
Sum of TDV	£176.9	£270.5	£43.6	£28.1	£519.1
SPRUCE as % of TDV	25.4%	20.4%	46.9%	53.7%	26.2%
Leverage	2.9	3.9	1.1	0.9	2.8

Our further analysis by area highlights the following:

- Almost 75% of the SPRUCE funds were invested in projects in Glasgow and Edinburgh City Centre, a further 15% was invested in the wider Glasgow area and 11% in other areas in Scotland.

- Leverage in the City Centre projects was considerably higher at almost 3 to 4 times than in other areas (between 0.9% and 1.1%).

Overall the recycling and leverage metrics were good and tables 1, 2 and 3 highlight how they can change over time and depending on the portfolio of projects and key characteristics (including area) involved. These features are interesting to note and raise issues for further consideration in the design and delivery of future SPRUCE type funds including:

- A portfolio approach to investment will be required to maximise the use of the funds in terms of delivering the desired financial and broader socio-economic outcomes.

This suggests a strong governance framework is required to maximise the allocation of resources in line with expectations and to monitor risk;

- The varying nature of the risk exposure and return necessitates a comprehensive understanding of the assets involved from both a property and financing perspective (both corporate and project financing arrangements) beyond the simpler terms of the loans being provided;

The analysis has shown that not all SPRUCE investments performed the same. That said, our analysis has also shown that SPRUCE is a highly tailored, facilitative financing facility meaning there is no simple cookie cutter/one size fits all administrative approach.

3. Value for Money

3.1 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 also against a longer-term structured financing arrangement of 10 years.

We also considered alternative intervention models available to support infrastructure investment in Scotland such as the Growth Accelerator Model and Tax Incremental Financing, albeit these were not subject to a full financial appraisal.

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

3.2 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 the following time frames:

- At the end of the current investment period (28 November 2021). As set out previously, SPRUCE funds were partially reinvested with some £135M invested in 18 projects, some of which are still in receipt of SPRUCE funding at this point.

And for comparison purposes, the assessment considers as also set out in the interim valuation, the VFM offered by further recycling/a longer term investment period for SPRUCE:

- To 2032 at which point the fund would be expected to have been fully recycled twice

- To 2042 at which point the fund would be expected to have fully recycled three times.

The comparison assumes the same profile of projects supported, timing of investment and repayment periods, and benefits achieved to date with the current SPRUCE. The VFM assessment is provided for illustrative purposes only.

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

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. Based on the alternatives assessed, 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 supported by the relatively short payback period on the business space projects which repaid on average within 3 .5 years for the offices and 4.25 years on average for the industrial units with most of the offices sold on since completion. The post completion sale remains a key part of the private developer 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 for both the office and industrial unit projects. The energy projects involve longer term loans.

- SPRUCE has financially outperformed the forecast in the interim evaluation partially as a result of the early repayment of some of the loans and also due to the concentration of office projects supported in the recycling phase. This strong financial performance has to be balanced against the broader outputs delivered.

We set out in earlier sections of the report the strong leverage (almost 3 times) achieved by SPRUCE investment of £135M supporting total development activity of £0.5BN and £425M from third parties funding the rest. Tables 4 and 5 provide a simple illustration of the potential value from SPRUCE, the potential leverage and impacts from a fully recycled fund to 2032 and 2042 respectively.

Table 4: Potential leverage from fully recycled SPRUCE funds

Leverage	Actual to Nov 2021	Recycled Once	Recycled 3 times
SPRUCE investment	£135.8	£187.90	£281.86
Other Funds (excludes Haymarket build out)	£383.3	£530.51	£795.76
Total Investment	£519.1	£718.41	£1,077.62
Recycled Funding	£41.8	£93.95	£187.90
Original SPRUCE investment	£94.0	£94.0	£94.0
<u>Leverage achieved on SPRUCE investment £135M</u>			
SPRUCE as %	26%	26.16%	26.16%
SPRUCE leverage per £1	£2.82	£2.82	£2.82
<u>Leverage achieved on SPRUCE capital £94M</u>			
SPRUCE as %	18%	13%	9%
SPRUCE leverage per £1	£4.08	£5.65	£8.47

This shows significant increase in the leverage gained from recycling the initial investment (increasing from £2.82 to £8.47) and is very significant compared to other options.

Table 5: Potential impacts from fully recycled SPRUCE funds

Outputs Delivered	Total	Recycled Fully *1 To 2032	Recycled Fully *2 To 2042
Business Space with BREEAM excellent (m2)	45,989 m2	65,698 m2	98,547 m2
Business Space created or modified (m2)	100,152m2	143,074m2	214,610m2
No. of renewable energy projects supported	2m2	3m2	4m2
No. of enterprises supported	88	126	189
No. of social enterprises supported	0	0	0
No. of enterprises operating in key sectors	15	21	32
No. of startups supported	3	4	6
Brownfield Land treated (ha)	7.54	11	16
CO_2 Savings (tonnes/annum)	11000	15714	23571
Energy Savings Ratio	1	1	2
Business Space Occupied (BREEAM excellent m2)	37,864.00	54,091.43	81,137.14
Number of gross jobs created	5,136	7,337	11,006
Projected Total Development Cost	£519M	£741M	£1.112M

Table 5 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 and so an original £94M investment by the Scottish Government delivering almost £1.1BN infrastructure activity by 2042.

The VFM assessment details 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.

Our analysis has also confirmed:

- 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 with the requirements of individual projects to be funded. Feedback also suggests a need for longer term money in some cases; and therefore,

- The increasing importance of the targets in the recycling investment phases so that an appropriate balance of financial performance and impacts can be achieved rather than over achievement in some and no progress in others. This balance increases in importance relative to the size of the fund available.

Whilst currently delivering significant additional value compared to traditional grant our analysis concluded that the fund is not currently reaching its potential due to the above and that the following constraints have been noted.

- The fund was insufficient in scale relative to the infrastructure needs of Scotland when considered in light of the domestic policy agenda for a just economic transition.

- The 10-year term may be satisfactory in commissioning terms but is insufficient in policy imperative terms as it provides insufficient time for all initial funding to be fully reinvested (as has been borne out in practice with a recycling rate of 1.4 times rather than full reinvestment and a recycling rate of at least 2);

- The 10-year term also appears to have impacted on the likely selection of projects for SPRUCE funding. Investments to date have been focussed on refurbishment and/or shovel ready projects. An extended time would allow an opportunity to invest in longer term initiatives with stronger strategic alignment of SPRUCE to support specific aspects of the economic and regeneration strategies of the Scottish Government. including:

(1) Transition to net zero and retrofitting of existing assets. The lack of energy efficiency in Scotland's property sector and the ability to meet government ambitions for a carbon neutral/net zero economy. Around 200m sq ft of industrial space and 60m sq ft of office space is not energy efficient and the market is moving out of it. These properties could be renovated and reoccupied if there was funding to support it.

(2) Assembly of strategic sites is limited in Scotland beyond Clyde Gateway. This is a long run concern as the inability to bring forward key sites now (in the short/medium term) will put a brake on economic growth/transition arrangements over the longer term. The concern here recognises we are now competing in a global market and, in that sense, Scotland's competitiveness/attractiveness for inward investment relative to other destinations must also be global;

(3) Ability to undertake more comprehensive placed based interventions – either creating new places to live and or regenerating deprived areas. Without major public sector intervention, there will be insufficient supply and some areas are most likely to continue suffering economic decline which in turn impacts on wider wellbeing and the prosperity of residents who live and work in the area and ultimately on Scotland economic aspirations. Feedback was also made here relative to wider City Centre and wider place/town perspectives rather than individual pepper potted projects.

3.3 Other infrastructure interventions

We looked briefly at the Growth Accelerator Models and Tax Incremental Financing alternatives and whilst these were not subject to a full financial appraisal, we found that SPRUCE is likely to outperform both the Growth Accelerator model and TIF approaches in a number of situations including where access to capital is the primary market failure, for otherwise viable projects.

Both the growth accelerator and TIF approaches are very long-term variants on PPP and PFI structures which require ongoing annual revenue (and/or grant) subsidy payments from the Scottish Government and which are not features of SPRUCE. That said, for some major infrastructure works, with multiple market failures to address, SPRUCE could be part of, but not a whole solution. Nevertheless, our analysis suggests the VFM case for SPRUCE is strong and should be considered on a bigger and broader scale as a mainstream tool for intervention to support infrastructure investment in areas of market failure.

Progress in thinking around sustainability and circular economy models which could usefully also be considered in the context of a SPRUCE or similar fund in future.

3.4 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 also set out in 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 by interest earned on the fund.

4. Impact Assessment

4.1 Introduction

The impact assessment of SPRUCE is based on the material provided to Indigo House for the purposes of the final evaluation along with structured interviews with several consultees, including project sponsors. 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.

4.2 Summary findings

Overall our impact assessment found:

SPRUCE has been successful in supporting the economic growth strategy of the Scottish Government. It has delivered a number of significant projects and benefits in Scotland which otherwise would not have occurred either in the same timeframe or in those priority areas.

It has supported more than £0.5bn of development activity during an extremely challenging period for the Scottish economy including a long run recovery from the global financial crash during the initial investing period and Scotland's departure from the European Union and response to the global COVID pandemic during the recycling period. This demonstrates a number of positive attributes for investment led interventions including resilience and sustainability but perhaps most importantly for the evaluation it demonstrates the strategic need for SPRUCE type funding in challenging times.

The business space projects, both Office and Industrial space, are supported by significant market need and demand and the SPRUCE funding is justified by market failure, particularly access to capital issues. The energy projects address wider socio-economic (including fuel poverty) and environmental concerns. The rationale for the SPRUCE investments was therefore found to be consistent with the investment strategy.

In terms of the core qualitative objectives initially set we found:

SPRUCE invested more than £135m in 18 projects. A total of £48.7m was invested in 7 initial tranche projects by 31st December 2015 thereby meeting the first core objective to defray £48m in that period and a further £87.2m was invested in another 11 projects over the following 5 years from to the investment period end of November 2021;

The SPRUCE investments included:

- Grade A office accommodation and Industrial business units resulting in just under 46,000 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 90,000m2 to those standards has been more than met. It is worth noting that this had already been exceeded at the interim evaluation stage with around 29,000 square meters of business space created to BREEAM standards at that point.

- Two Energy Efficiency projects funded in Glasgow and St Andrews contributing significantly to the stated objectives of investing in projects which deliver circa 20,000 tonnes of C02 savings and aggregate Energy Savings of at least 20% annually. These objectives have been partially met – around 11,000 tonnes of CO2 savings are delivered from the 2 projects and Energy Savings Ration has been exceeded at 25%. One more energy project would have gone a long way to exceeding the C02 savings.

Remediation of a large and strategically important sites at Haymarket and Edinburgh Park in Edinburgh which, in addition to the above projects has involved the remediation of 7.57 ha of brownfield land thus 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 of the Lowlands and Uplands Scotland Operational Programme output targets and a broader range of economic, social and environmental benefits for Scotland, is considered at section 4.4. Three projects, stand out as exemplary in their contribution to the wider regeneration impact of SPRUCE and these are set out in detail in Appendix I.

In terms of the investor return objectives we found:

Over the investing period from 2011 to 2021, a total of £94M was subscribed/invested in the SPRUCE fund by the Scottish Government. Initially £49M in 2011 and a further £45M in three separate tranches during 2016 to 2018.

Over that same period Amber utilised the SPRUCE capital to invest £135M in 18 projects. The SPRUCE capital was therefore recycled,1.4 times. SPRUCE was recycling its original capital from late 2015 and this compares favourably to other interventions, particularly non repayable grant which, by its nature, can be invested only once. SPRUCE funding achieved strong leverage of £2.82 for each SPRUCE pound invested. The total development cost of the projects supported exceeded £519.1m with SPRUCE providing 26% of the total funding requirement. Again, this leverage compares favourably.

SPRUCE investments involved senior debt facilities in line with the expectations of the Investment Strategy. No mezzanine or equity investments were made, albeit these were explored and this flexibility should remain an option for future SPRUCE type investments.

Repayment of SPRUCE loans by borrowers commenced from as early as 2013. A total of £28M has been repaid to date, with £66M repayable to the fund by September 2025. Fourteen projects have repaid in full, one project is expected to repay in early 2023 and the remaining three by September 2025. The original expected repayment date for the fund was November 2023, so extensions to repayment periods appear to have been approved by the Investment Committee.

Earnings from interest and other charges applied (for example, commitment fees) have been used to meet the cost of administering SPRUCE, which is another positive feature of SPRUCE, meaning that the Scottish Government capital subscribed has been fully deployed within the fund in supporting projects rather than management and administrative costs.

Of the £94M repayable from the fund to the Scottish Government, a total of £14M has been repaid to date with a further £80M profiled in 5 tranches to December 2026. A modest return for investors of just under £0.250M is estimated (though this needs to be confirmed).

Of the £94M being repaid to the Scottish Government around 15% is categorised as revenue suggesting ultimately £80M (85%) of the original capital subscribed by the

Scottish Government may be available to support future investment beyond 2025 (though again this needs to be confirmed, particularly for the final few years).

The original intention was to increase the Total SPRUCE 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 copartner was established. However, that said, significant leverage has been secured at the project rather than the fund level and this is an appropriate financing mechanism.

4.3 Wider impacts delivered

The relevant information for the wider 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 for each project was signed off.

The output targets were reviewed and updated in June 2016. Seven were retained and classified into primary and secondary indicators. Projects satisfying a higher number of primary targets would take priority in being financed through SPRUCE.

Primary	Secondary
Area of business space created or modified under the BREEAM classification	Leverage of SPRUCE funding at the project level
Enterprises supported	Renewable energy and resource/energy efficiency projects supported
Number of gross jobs created/safeguarded	Brownfield land reclaimed or redeveloped
CO_2 Savings	

Three of the primary indicators were split into sub indicators but these have not been reported on. The report in June 2016 stated that reporting on sub-indicators should not be mandatory but should rather follow the availability of the information. Also, as part of the update in June 2016, seven outputs were removed and these are noted in Appendix III for completeness.

At the end of investing period (November 2021), SPRUCE reported on the outputs achieved as follows:

Over 100,000 square meters of business space created or modified under the BREEAM classification against a target of 90,000 with just under 46,000 square metres of the Grade A office accommodation and Industrial business units created to BREEAM standards (Excellence for new build, Very Good for refurbishment).

88 enterprises supported against an increased target of 100 (the original target was 54).

Over 5,100 jobs created (against a target of 4500 jobs). 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 but could not be split out further.

Around 11,000 tonnes of CO2 savings delivered from the Biomass projects in Glasgow and St Andrews. One more energy project would have gone a long way to perhaps exceeding the primary energy targets which appear to have been increased from an original target of 20,000 to 30,000 tonnes of C02 savings. Several more energy projects would have been required to meet the secondary target which was to support 6 renewable energy and resource/energy efficiency projects.

Leverage of £2.82 for each SPRUCE pound invested. As previously set out, the total development cost of the projects supported exceeded £519.1m with SPRUCE providing 26% of the total funding requirement. A quantitative target for leverage was not established in the June 2016 update to avoid disadvantaging projects initiated by the public sector despite significant benefits reflected elsewhere.

7.57 ha of brownfield land including 1.7 ha at Haymarket in Edinburgh thus making a valuable contribution to the first of the Priority 3 objectives. The target for land remediated was not quantified/established.

It is clear from the above that the SPRUCE investments delivered solid achievements and whilst it overachieved on some of the outputs it did not achieve 100% of outputs expected including, most notably, the CO2 emissions.

Again, this points to the balance of impacts and risks required from SPRUCE (investment/financial objective balanced with broader socio-economic objectives) requiring some further consideration. That said, the investment strategy had previously made it clear that the outputs are ‘a non-binding indicative list of Output Targets’ which the fund hopes to achieve.

4.4 Contribution to Priority 3 Objectives

SPRUCE was also expected to contribute to the objectives of Priority 3 in two ways as follows:

- Linking urban areas of need with areas of opportunity – by ensuring that people living in less privileged areas can benefit from employment and training opportunities across the region; and,

- Improving the potential of urban area to develop – by encouraging enterprise start-ups and Small and Medium Sized Enterprises.

Amber agreed commitment to community benefits with each of the project sponsors during negotiations and this generated additional wider impacts from the SPRUCE investments including examples of local employment and apprenticeships (particularly in the construction phases) in most of the projects.

Our final evaluation found three projects stand out as exemplar in terms of their early contribution to the wider regeneration of the urban area and their on-going potential. The three exemplar projects include the Biomass plant at Guardbridge, the Industrial Units at Clyde Gateway and the Grade A Office development NW1A at South Gyle. The early land remediation at Haymarket (as difficult as it was at the time) is also worthy of mention. Case studies for these exemplar projects are provided in Appendix I and demonstrate the priority 3 outputs from SPRUCE are very significant when you consider the broader regeneration programme/activity which the early SPRUCE investment has facilitated/pump primed.

These case studies demonstrate a number of things buts importantly the multiplier effects when you consider the broader regeneration programme/activity which the early SPRUCE investment has facilitated/pump primed.

4.5 Additional outputs

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. The full range of outputs monitored by Amber, including those in the original IPSUDs are set out in Appendix III.

For any future fund, the output indicators and targets would require consideration to adequately balance the financial and investor return objectives with the wider outputs required to support domestic policies. These could include, additional indicators focussed on promoting regeneration, energy efficiency and community well being. Some VFM metrics should also be considered e.g. public funding cost per job, GVA per job created.

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 with the project sponsors and with the property industry confirms 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 some level of displacement though this does not appear to be significant as the demand for office and industrial space remains strong. It is also difficult to be precise on the size of this without consulting with the companies themselves and equally there are likely be productivity impacts from operating in more modern, bespoke and energy efficient 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 direct, indirect and induced effects).

4.6 Overall impact assessment

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 Lowands 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 final evaluation confirms this remains the case.

Overall we found:

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.

Feedback from consultees suggests access to capital continues to be a considerable constraint (particularly with regards to development finance and early stage finance) for infrastructure projects including new build and refurbishment (or retrofit) works.

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 invo

lving energy efficient district heating schemes in Glasgow and St Andrews.

The scale of SPRUCE invested in individual projects is modest and with the cost of inflation a gap 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. Increased approval levels may be worth considering.

Feedback around the relatively modest scale of the fund and the limits on individual projects suggests these may have prevented otherwise eligible projects coming forward. However, special investor consent was 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 have been 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.

Other challenges experienced with SPRUCE included the process being considered to be longer and more onerous than sponsors 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.

Market engagement suggests access to capital remains as much a concern now as it was when SPRUCE was originally implemented. As well as increasing the recycling rate, the interim study identified that 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 where there is wider socioeconomic and market failure. The final evaluation found this still be the case. As set out previously in table 2 only £35M was invested out with Glasgow and Edinburgh City Centre areas. Further consideration of the governance arrangements may also be required to ensure the portfolio of future projects and investments optimises the balance of socio-economic returns required. For example, delivery of a third and possibly fourth energy project in the recycling phase rather than one or two more office developments would have provided a broader range of outcomes more closely aligned to the targets initially set rather than a significant overachievement of a more limited range of outcomes. However, this assumes perfect choices are available in the capital rationing decisions, which is not often the case.

It is fair to say that the financial profile of the Office type project fits the investment/commercial aspects of SPRUCE well, i.e. shorter term lending and money repaid quicker than say the energy projects and/or land remediation works. 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.

4.7 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 final evaluation found 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 the other funding options assessed in the short, medium and long term.

5. Conclusions 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 at a very difficult time, including through the Global Covid Pandemic. 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.

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

In terms of relevance:

- 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 similar funding is strong and the view is that the market is no better now, in many respects, than in 2011 when SPRUCE was launched ;

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 £135M was invested in 16 urban development and 2 energy efficiency projects by November 2021, supporting over £0.5BN gross development activity.

The 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. The financial leverage was strong and used successfully to move forward solid commercial propositions where there was historic market failure in terms of access to capital.

As also concluded in the interim evaluation, 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 (beyond Scotland's City Centres) and where there is wider socioeconomic and market failure.

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 and based on the options examined 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;

Overall the evaluation demonstrates SPRUCE offers considerable value for money to the public purse and that it has delivered both increased and accelerated economic outputs.

The evaluation has also highlighted that SPRUCE has broad application and the potential to unlock significant value across Scotland over and above what traditional grant funding can deliver. 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 optimised when they are combined and this is the distinguishing feature of SPRUCE.

At a time when the public finances are constrained and each pound available must deliver more, the evaluation suggests that SPRUCE or a similarly constructed type fund merits further serious consideration by the Scottish Government.

Appendices

Appendix I – Case Studies – Provided Under Separate Cover

Appendix II – VFM

NPV appraisal (litmus test of VFM) *Draft - to be finalised following discussion*	SPRUCE (current 10 year fund)		SPRUCE Longer term Revolving Fund	
	To Dec 2023	**To Dec 2026**	**Recycled fully** **1 re-cycle**	**Recycled fully** **3 re-cycles**
Option 1: SPRUCE intervention		**<u>40% Recycled</u>**	**<u>0%</u>**	**<u>0%</u>**
Gross NPV at 3.5%	**£50,073,423**	**£57,143,205**	**£71,429,007**	**£60,714,656**
NPV per £1 invested	**£0.38**	**£0.43**	**£1**	**£0**
Yr fully repaid	**12/2025**	**12/2025**		
Cash available for future reinvestment	**£68,087,025**	**£79,966,992**	**£57,490**	**£48,867**
Cash at Year 30	**n/a**	**n/a**	**£78,846,992**	**£77,166,992**
<u>Discount rate sensitivity</u>				
Gross NPV at 2.5%	**£54,291,803**	**£61,682,890**	**£77,103,612**	**£65,538,070**
NPV per £1 invested	**£0.41**	**£0.45**	**£0.56**	**£0.48**
Option2: Non Repayable Grant				
Gross NPV at 3.5%	**-£103,847,123**	**n/a**	**n/a**	**n/a**
NPV per £1 invested	**-£0.80**	**n/a**	**n/a**	**n/a**
Cash available for future reinvestment	**Nil**	**n/a**	**n/a**	**n/a**
<u>Discount rate sensitivity</u>				
Gross NPV at 2.5%	**-£111,320,698**	**n/a**	**n/a**	**n/a**
NPV per £1 invested	**-£0.86**	**n/a**	**n/a**	**n/a**
Option 3: Structured Finance (10 year term)				
<u>Gross NPV at 3.5%</u>	**£96,522,103**	**-£9,057,088**	**n/a**	**n/a**
NPV per £1 invested	**£0.72**	**-£0.07**	**n/a**	**n/a**
Yr fully repaid	**n/a**	**2031**	**n/a**	**n/a**
Cash at that year	**n/a**	**n/a**	**n/a**	**n/a**
Cash available for future reinvestment	**n/a**	**n/a**	**n/a**	**n/a**
<u>Discount rate sensitivity</u>				
Gross NPV at 2.5%	**-£103,015,802**	**-£1,370,640**	**n/a**	**n/a**
NPV per £1 invested	**-£0.77**	**-£0.01**	**n/a**	**n/a**

Notes:

1. Current fund partially recycled in initial 10 year term as substantial repayment not due until 2023-2025
2. SPRUCE appraisal includes cost of fund operating costs (Amber + EIB). SPRUCE outperforms other options, after allowing for fees.
3. SPRUCE cashflow valuation stronger as cash repaid and recycled earlier.
4. Grant option is negatively valued in short, medium and long term.
5. 10 year structured finance intervention is negatively valued in short and medium term, but positive over longer term highlighting the longer payback period involved.
6. Fee level on Structured Finance assumed at same level as SPRUCE. No fees assumed on Grant Provision as Assumed Marginal Absorption by SG.

Appendix III – Outputs

Outputs removed June 2016

Ref	Indicator name	Unit of measurement	OP Target
1	Job brokerage initiatives supported	No of	30
2	ICT and e-learning facilities supported	No of	40
3	Childcare and other community facilities supported	No of	30
4	Transport Hubs supported	No of	25
5	Increase in the number of individuals gaining employment through supported job brokerage schemes	No of	650
6	Increase in the number of individuals gaining employment through supported e-learning and ICT facilities	No of	650
7	Social Enterprises supported	No of	350

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