Forward Plan reference number: FP/AB/251

Report title: Discovery Park Growing Places Update Report	
Report to Accountability Board on 15th November 2019	
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Date: 11/11/2019	**For:** Decision
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SELEP Partner Authority affected: Kent	

Confidential Appendix
This report has a confidential appendix which is not for publication as it includes exempt information falling within paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972, as amended.

1. Purpose of Report

1.1 This report provides the Accountability Board (the Board) with an update on the delivery of the Discovery Park project (the Project).

1.2 The Project was awarded £5.3m Growing Places Fund (GPF) capital loan funding in September and December 2014.At the last meeting in September 2019, the Board agreed a new repayment schedule for the loan subject to certain conditions being satisfied as set out in section 4 below.

1.3 The conditions include the requirement for Kent County Council (KCC) to enter into a legal agreement with the project promoter by 31 January 2020. If this legal agreement is not in place, the full GPF allocation must be returned in 2019/20 to Essex County Council, as the Accountable Body for SELEP, for investment in new GPF pipeline projects; and

1.4 The Board also agreed that before entering into a legal agreement with the Midos Group for the transfer of the loan, KCC must provide the SELEP Accountable Body with confirmation that:

- The £5.3m loan will only be spent on capital; and
- **the expenditure of the GPF does not constitute as State Aid;** and
- the GPF will be spent on contracts which are competitively procured in accordance with the UK and EU procurement guidelines and regulations, to the extent reasonably expected by a private sector company.

1.5 KCC has informed SELEP that the loan would constitute state aid if an interest rate were not applied.

1.6 The report also seeks an extension to the deadline previously agreed by the Board for KCC to enter into a legal agreement with the project promoter and asks the Board to note KCC's intention for an administration fee to be charged to cover the cost incurred by KCC in setting up the loan.

2. Recommendations

2.1. The Board is asked to:

2.1.1. **Agree** that interest is charged on the £5.3m GPF loan. The exact interest rate will be determined by KCC in accordance with the methodology set out in the attached confidential appendix

2.1.2. **Agree** that the rate of interest will be confirmed to the SELEP Accountable Body prior to the legal agreement being signed between KCC and the Midos Group, and the interest will be repaid to Essex County Council (ECC), the SELEP Accountable Body, to be reinvested in SELEP projects.

2.1.3. **Agree** an extension of the deadline for the legal agreement to be entered into between KCC and the Midos Group from 31st January 2020 to 31st March 2020. If the legal agreement between KCC and the Midos Group has not been entered into by 31st March 2020, the GPF must be returned in Q1 2020/21 to ECC, as the Accountable Body for SELEP, for investment in new GPF pipeline projects

2.1.4. **Note** KCC's intention to charge an additional 5% administration fee (£265,000) to cover the activities described in section 6 of the report.

2.1.5. **Note** KCC's intension to write to the Midos Group to provide notification to the applicant of the intention to charge market rate interest and for an administration fee to apply. A deadline of the 1st December 2019 will be set for the developers to confirm whether the Midos Group wish to proceed with the loan.

2.1.6. **Agree** that if confirmation is not received from the Midos Group by the 1st December 2019, as set out in 2.1.5, the Project will be removed from the GPF programme and funding must be returned to ECC, as the SELEP Accountable Body, by 31st January 2020.

2.1.7. **Note** that a Variation to the Credit Agreement between KCC and ECC, as SELEP Accountable Body, is required to incorporate the changes set out in this report.

3. Discovery Park Update (SELEP)

3.1. The Discovery Park is as a multi-business science park, which offers high-quality laboratory, office and manufacturing facilities. It occupies the former Pfizer site in Sandwich (Kent), and benefits from Enterprise Zone status. It is renowned as a centre for drug discovery, with some of the most famous drugs in the world (Viagra and Diflucan) discovered and developed here. It also includes a large parcel of land which is suitable for residential development.

3.2. £5.3m of GPF was allocated by SELEP (in GPF round one) to KCC to support works at Discovery Park to build a spine road and deliver infrastructure enabling works which are required to enable 500 homes to be built on part of the site.

4. Background

4.1. GPF was allocated to the Project in September and December 2014 by the SELEP Strategic Board.

4.2. A legal agreement was entered into between ECC as the SELEP Accountable Body, and KCC, under which £5.3m GPF was transferred to KCC during 2017/18. Since then, the Project has been subject to delay due to a change of ownership of the site to the Midos Group in June 2018 and some Environmental Agency planning conditions; these issues have now been resolved.

4.3. On 13th September 2019, the Board received an update report on the Project and approved a new repayment schedule; this was subject to the following conditions. The decisions by the Board were to:

- **Agree** the updated repayment schedule for the Project.
- **Note** the intention for Kent County Council to seek a legal charge over the development to ensure the completion of the Project and the timely repayments of the GPF.
- **Agree** that if Kent County Council have not entered into a legal agreement with the project promoter by 31 January 2020, the GPF must be returned in 2019/20 to Essex County Council, as the Accountable Body for SELEP, for investment in new GPF pipeline projects; and
- **Agree** that before entering into a legal agreement with the Midos Group for the transfer of the loan, Kent County Council must provide the SELEP Accountable Body with confirmation that:
  - The £5.3m loan will only be spent on capital; and
  - **<u>the expenditure of the GPF does not constitute as State Aid</u>**; and
  - the GPF will be spent on contracts which are competitively procured in accordance with the UK and EU procurement guidelines and regulations, to the extent reasonably expected by a private sector company.

4.4. Work is progressing to ensure that these conditions are met, where it is feasible to do so. Since the September 2019 Board meeting, KCC commissioned legal counsel advice on whether the expenditure of GPF constitutes state aid. The confidential appendix 1 contains the advice that KCC received. This states an interest rate must be charged on the loan to ensure that the expenditure of GPF does not constitute as State Aid. Discussions with applicant have ceased until the position in relation to the charging of interest has been confirmed. The deadline agreed in September 2019 to conclude the legal agreements by the 31 January 2020 is no longer feasible (see Section 7 of this report).

5. Interest Rate - SELEP additional context

5.1. GPF was established in 2011 as a recyclable loan scheme. Until June 2017, no interest was charged on the loan. On the 9th June 2017, the Strategic Board agreed that interest will be charged on new GPF loan investments at two percent below the Public Works Loan Board (PWLB) Fixed Maturity Rate or zero (whichever is higher).

5.2. The Strategic Board agreed to apply interest to serve two purposes; (i) to incentivise the early repayment of the loan and (ii) to reduce the depreciation of the GPF through time as a result of inflation.

5.3. As the PWLR rate has remained relatively low since 2017, a majority of the GPF loans agreed since June 2017 have been agreed with a zero percent rate of interest. In most instances, this rate of interest would be below Market Rate and as such, the GPF loans could constitute as State Aid; to address this, all Projects are required to confirm that investment of GPF in the Project will not be providing State Aid.

5.4. As the GPF loan to this Project was agreed by SELEP Strategic Board in 2014, these processes for the charging of interest had not been agreed at the time of decision being made by SELEP to invest in the Project. However, as with the award of any public funding, there was a firm requirement to ensure that investment in GPF projects does not contravene State Aid provisions. This requirement is reflected within the agreement between ECC and KCC in relation to the Project.

6. Interest Rate – KCC proposed approach

6.1. As a public body, all loans provided by local authority partners (such as KCC) to private-sector borrowers are subject to EU State Aid rules.

6.2. If KCC do not charge interest on the GPF loan, State Aid rules will apply and therefore the loan cannot be awarded to the Midos Group.

6.3. To comply with State Aid rules, KCC has commissioned legal advice which confirms that KCC's standard approach to charging interest (as set out in 6.5 below) is compatible with EU proxy methodology and has the effect of minimising State Aid.

6.4. The Board is therefore asked to agree to the charging of interest on the loan, as per KCC's standard approach, to meet the Board's request that the loan must not, 'constitute state aid'.

6.5. KCC uses an EU approved proxy methodology for determining the interest rate payable, which has two basic elements, defining a base rate and a margin. The base rate is the prevailing EU Base Rate for the UK, this rate is variable. An appropriate margin will be offered based on an appraisal of the creditworthiness of the applicant, nature of the investment and collateral offered, this rate will typically be fixed.

- **Creditworthiness -** Credit scores are used from a recognised credit rating agency to support the creditworthiness assessment process. Where an applicant does not have an external rating, an assessment of financial standing and the risks associated with lending to the business and the project will be carried out by the KCC external appraisers.
- **Collateralisation -** Collateralisation is based on the security offered for the loan and the amount the KCC could expect to recoup in the event of default. We will require satisfactory demonstration of an ability to repay and adequate security, usually in the form of property assets. Security are typically provided as a first ranking charge over property, debentures over companies or non-property related security such as capital guarantees from a suitable parent company.
- **Margin Matrix –** The table in section 7.3 of the Confidential Appendix 1 shows how this process works. Please note that the "margin matrix" determines minimum margin and therefore the minimum interest rate, KCC/SELEP may wish in certain circumstances to charge a higher interest rate after taking into account additional risk factors i.e. sector, wider economic issues etc.

6.6. Section 7.3 and 7.4 of the Confidential Appendix 1 explains the possible interest which could be charged. The exact rate of interest cannot be confirmed until the full application, supporting documents and the type of security offered has been independently appraised and valued.

6.7. The Confidential Appendix 1 outlines the implications for the UK State Aid process after Brexit.

7. Administration Fee

7.1. In 2014, it was agreed by the SELEP Strategic Board that the Project should be considered through KCC's own Expansion East Kent (now the Kent and Medway Business Fund - KMBF) processes for the assessment, evaluation and monitoring of the programme, rather than through SELEP's own processes. This flexibility for the oversight of the Project by KCC was agreed as SELEP's current governance processes and procedures were not in place. The Accountability Board had not yet been established and there was no Local Assurance Framework in place, to set out the SELEP processes for funding decisions to be made and investments to be monitored. This Project therefore is somewhat unique in its arrangements.

7.2. KCC's KMBF standard process is to charge applicants a 5% administration fee (in addition to any interest rate) to cover the cost of the independent appraisal, legal fees and asset valuation. It is expected that the administration costs that KCC will incur in just establishing the loan will be in excess of £40k. Further costs will be incurred by KCC over the lifetime of the loan, including quarterly monitoring, auditing, and the evaluation of the Project.

7.3. Section 7.3 of the Confidential Appendix 1 highlights the need to reflect within a loan agreement additional charges to replicate what a private comparable lender would charge. A 5% administration fee is commonly required by banks and financial institutions. The Board is asked to note KCC's intention to apply this administration fee, over and above the charging of interest. Based on a 5% charge, the administration fee will total £265,000.

8. Timeline to set up the legal agreement

8.1. The confirmation by the legal counsel that the loan constitutes state aid has obliged KCC to pause commissioning the market valuation and setting up the loan until the Board confirms that it wishes to continue to progress with the loan.

8.2. In addition, as paragraph 6.1 sets out, this loan is subject to governance considerations by two separate decision-making bodies – firstly the SELEP Accountability Board, and secondly, the KCC Investment Advisory Board which ran the Expansion East Kent process and now operates the Kent and Medway Business Fund process. By pausing to seek approval from the SELEP Accountability Board on 15 November to continue with the GPF loan, it has meant the necessary paperwork cannot be taken to the next Investment Advisory Board meeting at the end of November 2019 for them to issue an Offer in Principle.

8.3. This hinders the ability of KCC and the Midos Group to conduct all the necessary actions to sign and seal by 31 January 2020.

8.4. In October 2019, SELEP launched a call for new expressions of interest from applicants seeking GPF capital loan funding through the next funding round. The SELEP Investment Panel is scheduled to meet in April 2020 to agree a new prioritised pipeline of GPF projects.

8.5. The Board is asked to agree to extend the timeframe which Kent County Council has to enter into a legal agreement with Discovery Park to 31st March 2020. If no legal agreement is signed by this date, the £5.3m will be reinvested by the SELEP Investment Panel when it meets in April 2020.

9. Next Steps

9.1 The next steps include:

- Receiving an agreement from Midos Group by 1st December 2019 to proceed with the loan to include the charge of a 5% administration fee and interest charged on £5.3m (% of interest rate to be confirmed with the SELEP Accountable Body) ;
- Instruct valuers. This will include a valuation of the site ;
- Receiving full application and supporting documents from the Midos Group;
- Consideration of the Project at KCC Investment Advisory Board on 22nd January 2020;
- Agreeing a variation to the Credit Agreement with Essex County Council, as the SELEP Accountable Body.

9.1. Whilst the timescales are tight, an eight week period has been allowed between the KCC Investment Advisory Board decision and the 31st March 2020 deadline.

9.2. As per the list of activities above, a full application and supporting information will be sought from the Midos Group in advance of the KCC Investment Advisory Board. This will help inform whether the other two funding conditions can be satisfied. These conditions include confirmation being received by SELEP Accountable Body that:

- The £5.3m loan will only be spent on capital; and
- The GPF will be spent on contracts which are competitively procured in accordance with the UK and EU procurement guidelines and regulations, to the extent reasonably expected by a private sector company.

9.3. Subject to the Board agreeing the recommendations of this report, KCC will formally write to the Midos Group to provide notification to the applicant of the intention to charge market rate interest and for an administration fee to apply.

9.4. The Midos Group will be asked to provide a formal response by the 1st December 2019 to confirm whether they wish to proceed with the loan, accepting that interest will be charged at market rate and the administration charge will apply.

9.5. If the Midos Group does not provide confirmation by the 1st December 2019 that they wish to proceed with the loan, the Project will be removed from the LGF programme and the GPF must be returned to ECC, as the SELEP Accountable Body, for reinvestment through the next round of GPF by the 31st January 2020.

9.6. If the project promoter does not confirm in writing to KCC that they wish to proceed, by the 1st December 2019, there will be insufficient time for the activities listed in 9.1 to be completed and legal agreement entered into by the 31st March 2020.

9.7. If this legal agreement is not in place by the 31st March 2021, the £5.3m GPF must be returned to Essex County Council, as the Accountable Body in full during Q1 2020/21, for investment in new GPF pipeline projects.

10. Financial Implications (Accountable Body comments)

10.1. On the 4th August 2017, Essex County Council transferred £3.4m of GPF funding to Kent County Council under the terms of the Credit Agreement in place to support delivery of the Discovery Park GPF scheme; A further £1.9m was transferred on the 6th March 2018, giving a total investment of £5.3m.

10.2. To date, the Accountable Body has accounted for in excess of £115,000 of interest foregone on this investment as it has been allocated to KCC as an interest free loan.

10.3. In considering the recommendation to enable Kent County Council to charge interest on the loan, the Board may wish to note the following:

10.3.1. The purpose of the GPF scheme is to provide loan funding to support projects with a demonstrable need for intervention, including demonstrating that they are unable to secure funding through other routes; paying interest on a secured loan at market rate might suggest that this requirement is no longer met.

10.3.2. Kent County Council have yet to establish whether a loan with interest at Market rate would be acceptable to the current owner.

10.3.3. In the bid for GPF funding made in 2014, the then applicant indicated that without the subsidised loan, the cost of providing site infrastructure for the housing development would impact the viability of the development. It was advised that the absence of appropriate housing as part of the comprehensive site offer could delay the letting of the commercial and science buildings. This position may no longer be the case due to market changes in the 5 years since the original bid was applied for.

10.3.4. The existing credit agreement in place with KCC does not allow for the application of interest at Market rate and would need to be amended by way of a variation to the agreement.

10.4. It is a requirement of all SELEP investments that state aid regulations are adhered to; should the Board choose not to agree to the recommendation by KCC to charge interest, the Project would not be able to progress in its current form. In this circumstance, the Board is advised to agree to cancel the Project and for the £5.3m of funding currently held by KCC to be returned to the Accountable Body as soon as practically possible to enable reinvestment through the next round of GPF allocations.

10.5. It is noted in the report that an administration charge will be applied to the loan. There is no requirement from SELEP for an administration charge to be applied to any GPF loan. The Accountable Body would not expect the charge to exceed the costs incurred by KCC.

10.6. The Board is advised to review all GPF schemes to assure itself that no further projects are experiencing similar issues where funding has been allocated, but delivery is delayed, as this potentially risks further erosion of the investment value of the GPF scheme. Agenda item 12 provides the latest update on the GPF programme.

11. Legal Implications (Accountable Body comments)

11.1. It is a requirement of all SELEP investments that state aid regulations are adhered to.

11.2. Each award of GPF approved by the Board is supported by a Loan Agreement, which sets out the terms and conditions of the loan and sets out the repayment schedule. Where changes are proposed to the project and/or repayment schedules, then where an agreement is in place, a Deed of Variation will be required to amend the agreement and place the revisions within the terms of the Agreement.

11.3. The Agreements stipulate that the dates provided within the Drawdown Schedule are the earliest date by which a request to draw down the instalments can be made by the recipient authority. Accordingly changes to those dates and instalment values will require a deed of variation to the agreement currently in place, to ensure that the new Drawdown Schedule is brought within the terms of the Agreement.

12. Equality and Diversity implication

12.1. Section 149 of the Equality Act 2010 creates the public sector equality duty which requires that when a public sector body makes decisions it must have regard to the need to:

(a) Eliminate unlawful discrimination, harassment and victimisation and other behaviour prohibited by the Act;
(b) Advance equality of opportunity between people who share a protected characteristic and those who do not;
(c) Foster good relations between people who share a protected characteristic and those who do not including tackling prejudice and promoting understanding.

12.2. The protected characteristics are age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, gender and sexual orientation.

12.3. In the course of the development of the project business case, the delivery of the Project and the ongoing commitment to equality and diversity, the promoting local authority will ensure that any equality implications are considered as part of their decision making process and where it is possible to identify mitigating factors where an impact against any of the protected characteristics has been identified.

13. List of Appendices

Confidential Appendix 1 – Legal Counsel advice

14. List of Background Papers

14.1. Accountability Board Agenda Pack 13 September 2019 (previously update report to the Board).

(Any request for any background papers listed here should be made to the person named at the front of the report who will be able to help with any enquiries)

Role	**Date**
Accountable Body sign off Stephanie Mitchener (On behalf of Nicole Wood, S151 Officer, Essex County Council)	11/11/19