Report to the Cabinet
Meeting to be held on Thursday, 5 November 2020

Report of the Head of Service - Business Growth

Part II

Electoral Division affected:
(All Divisions);

Clean Energy and Technology Diversification Fund

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Executive Summary

The economic impact of the current pandemic is increasing the pace at which the industrial base of Lancashire is shifting. The loss of much of the capacity in engineering firms like Rolls Royce and Safran, compounded by the secondary impact on their supply chain is seeing high value, high skilled jobs disappear. Whatever the shape of the post-Covid recovery, these sectors will remain scarred for the foreseeable future.

Despite this, there remains a strong pipeline of potential investments where pro-active public sector support can work with the existing business base to find new partners and new technologies which can be the industries of the future driving recovery and growth in Lancashire. A loan fund would allow Lancashire to make a more rounded offer to inward investing companies.

These new industries will be at the forefront addressing social and environmental challenges, will provide good jobs for those displaced by recession and give substance to the government's levelling-up agenda.

This is deemed to be a Key Decision and the provisions of Standing Order C20 have been complied with.

Recommendation

Cabinet is asked to:

(i) Approve a county council £10 million loan fund to support Lancashire to attract inward investment in new and emerging growth sectors as detailed in the report.

(ii) Authorise the Executive Director of Growth, Environment, Transport & Community Services, the Director of Finance and Director of Corporate Services to conclude all necessary processes and sign off such loans in consultation with the Cabinet Member for Economic Development, Environment and Planning.

Background and Advice

The approach to supporting innovation and working within the key sectors of Lancashire has always had two streams:-

- What do we need to do to stay ahead in the sectors where we have recognised strengths?

- How do we encourage and bring forward the new technologies and businesses which will constitute the sectors of the future?

Recent announcements from the government have focussed on the importance of a green recovery, where the sectors and technologies that will support the UK's aspiration to be carbon neutral by 2050 are backed and brought to scale.

The UK Industrial Strategy also pointed to four grand challenges to put the UK at the forefront of the industries of the future, ensuring that the UK takes advantage of major global challenges, improving people's lives and country's productivity.

The 4 Grand Challenges are:-

- Artificial Intelligence and data
- Ageing Society
- Clean Growth
- Future of Mobility

Lancashire can already evidence some nationally significant business or university led research and development in most of these categories but as yet, this is not translating into significant jobs growth or helping Lancashire become a defined national or international centre of excellence for a given technology or production specialism.

In terms of **Artificial Intelligence and data**, Lancashire can boast a broad base of digital businesses with many of the larger employers being agencies which service a client base well beyond the county itself. Lancaster is notable for a number of established businesses working with data and Artificial Intelligence as well as cyber security. There are also a number of outstanding firms in sectors such a digital animation or educational software, but, as yet, Lancashire is not seen as a match for the core cities.

The development of solutions which address the UK and worldwide issue of an **ageing population** are spread across a number of sectors but focussed on health care. Strong medical schools and facilities at both UCLAN and Lancaster Universities Health Innovation Campus are now beginning to define their own specialisms around this theme alongside some strong local businesses developing their own health based technologies and manufacturing.

Lancashire**'s Clean Growth** economy is broad with a number of projects and businesses helping delivering products and services to reduce carbon emissions from home, businesses and transport. Whilst the County has emerging products and technologies around the production and use of hydrogen, the established strength of the County is in the production of electricity using nuclear processes. The government's much anticipated Energy white paper will establish the extent to which nuclear is seen as part of the UK's decarbonised energy mix moving forward.

Future Mobility plays to some of the existing strengths of the County's automotive and aerospace sector businesses, but they will need to actively embrace the considerable challenges of moving to electrification or other decarbonised fuels. Lancashire is also developing capabilities around the use of autonomous vehicles through facilities like the Engineering Innovation Centre at UCLAN and the North West Advanced Manufacturing Research Centre (NWAMRC) now being built at Samlesbury Enterprise Zone.

These sectors need the confidence that the local public sector will back the development of new technologies where a fully developed case for private investment does not yet exist.

The Importance of Inward Investment to strengthen and diversify Lancashire's Economic Base

In order to remain competitive and grow into these new industries Lancashire needs to be a seen as a compelling location for inward investment, building from traditional strengths to embed new technologies. Whilst some of this will come from the growth of the indigenous base, inward investment offers an opportunity to fast-track the acquisition of new technology and diversify the mix of jobs available.

Increasingly Lancashire businesses are working in collaboration with international partners or are partly of wholly owned by foreign investors. These linkages are one of the most effective ways to promote Lancashire's attributes, bringing in partners who value the skills base, assets and markets that Lancashire can provide access to.

Over the summer, Redefining Lancashire set out an approach to economic recovery and its objectives include refunctioning of the economy acknowledging key growth sectors such as low carbon and energy. Cabinet subsequently approved a £12.8m recovery and growth programme providing grant funding to a number of key projects as part of the economic response.

Local incentives provide an added tier to the propositions which are made to inward investing companies. The UK's Devolved Administrations already have strong offers for inward investing companies and dependent on the state aid position post Brexit it is likely that the UK as a whole and individual locations will become more active in this space.

In Lancashire we have previously used Lancashire County Developments Limited's Rosebud fund to provide loan resource to businesses, minimising state aid risk and ensuring we get a return on the help we provide for businesses to land and thrive in the County. The £10million fund proposed in this report would allow us to do more of this.

Incentives and State Aid

Under the existing EU regime state aid regime, public funds used to selectively support businesses which distorts competition is illegal state aid and is subject to potential clawback with interest penalties. This could apply to grants, loans made on preferential terms, tax breaks or the sale of state assets for less than market price.

The proposed Fund will therefore need to be administered in a way which does not contravene State Aid rules (whether the EU rules or whatever replaces them after the Brexit Transition Period). Where the assistance is being provided direct to businesses the following tiered categorisation approach is usual:

1. Assistance which is not state aid. This would be assistance which does not distort competition. It would apply for example to loans made on commercial terms having been objectively assessed against robust acceptance criteria, ideally after an open call for applications.

2. Aid which falls below the general De Minimis Levels. If a loan was provided at a preferential interest rate (less than market), then this would be state aid. However if the value of the benefit (when added to any other de minimis state aid received by the recipient over the last 3 tax years) is less than 200,000 Euro then this is allowed and is not considered to be illegal state aid. Recipients would be asked to sign Declarations as to how much other aid they have received in the previous 3 years as part of their applications.

3. Aid which is above the general De Minimis levels but is otherwise considered to be "preapproved" as it falls within established categories within the General Block Exemption. This is quite a complex set of exemptions to administer and would require quite technical information on matters such as eligibility, intensity of aid and incentive effect. The exemption also requires periodic notification and reporting to the EU Commission by both the recipient and the funder. Nevertheless it is an option for more specific projects and infrastructures.

Due Diligence and Legal Documentation

Whilst the primary risk of having to repay illegal state aid would fall on the Recipient of the funds, there would be a residual PR risk on the Council if it could not recover due to the stability/covenant strength of the Recipient – hence the need for appropriate due diligence (asking recipients to take state aid legal advice/asking for Declarations, etc.) and the need to consider in appropriate cases whether we should take some form of security over the Recipient's assets.

Any assistance would need to be constituted by proper legal documentation to ensure the funds are put to the use for which they are intended. In such legal documentation (for example a Loan Agreement or a Grant Funding Agreement) we would place an obligation on recipients to comply with State Aid and have clawback provisions if they did not.

In this space, the businesses we are working with tend to be looking for a mixture of incentives which de-risk the initial phase of new activity. Any grant or payment holidays count directly against state aid so would typically be limited. Loans and skills development support tend to offer more flexibility in terms of the offer to business and offer a longer term return to the lending organisations which might well exceed what can be earned from monies on deposit in banks or savings vehicles.

Benefits to Lancashire

This fund would be used to back emerging businesses, technologies and investors who build on and diversify the economic base of Lancashire offering good quality jobs in sectors where business development mirrors the objectives of the Grand Challenges to improve lives and productivity, Redefining Lancashire and the county council's recovery and growth programme.

In addition to being targeted at specific types of inward investment as set out in the report, typical key performance indicators would include:-

- Volume and quality of new jobs
- Extent to which the project promotes diversification from declining employment sectors
- Assets or jobs retained within Lancashire
- Contribution to local productivity (GVA)
- Wider societal benefits

Consultations

N/A

Implications:

This item has the following implications, as indicated:

Risk management

Failing to create this fund could mean that Lancashire might miss out on inward investment projects which could chose other locations in Europe. This in turn constrains our ability to diversify the economic base and create new, high quality jobs.

Financial

Advancing loans always carries the risk that recipients might default. This will be mitigated by undertaking appropriate due diligence on potential investments and taking security against the loan.

It is anticipated that the use of these loan funds will be on capitalisable expenditure and we would therefore add the expenditure to the capital programme funded from borrowing.

The interest rates charged to each lender, while specific to each deal, will be on the basis that the interest charged being at or above the EU reference rate to minimise state aid risk, and should give the council a margin on borrowing costs over time on the returns which can potential increase the fund once recycled.

Reports on the progress of the scheme will therefore form part of the capital finance section of Money Matters.

Legal

The main legal risk in operating such a fund is in ensuring it adheres to the prevailing state aid legislation. This is dealt with in the body of the report.

List of Background Papers

Paper	Date	Contact/Tel
None		

Reason for inclusion in Part II, if appropriate:

Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972. The report contains information relating to the financial or business affairs of any particular person (including the authority holding that information). It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interest in disclosing the information.