



Lowlands and Uplands Scotland ERDF and ESF Programmes 2007 - 2013

Programme Monitoring Committee

OPTIONS FOR PRIORITISING AND TARGETING THE BALANCE OF FUNDS AND REPORTED UNDERSPENDS UNDER THE ERDF PROGRAMME PRIORITIES

1. Purpose

- 1.1 To set out recommendations for the use of the funds remaining in the LUPS ERDF Programme.

2. Background

- 2.1 Alongside the presentations on the economy, financial and physical progress and information contained in the annual reports, this paper aims to provide the PMC with a set of recommendations on changes that the MA believe are required to ensure that the LUPS ERDF Programme remains fully aligned with the Scottish and European policy agenda.
- 2.2 At previous meetings the PMC agreed to more focused calls for ERDF. This has been useful direction and we have been encouraged by the quality of the projects that have emerged from this more targeted approach. The MA do not feel that we need to make radical changes but we believe that this is an appropriate point to reflect on results and outcomes achieved so far and discuss how we can continue to make the best use of the remaining funds.

3 ERDF Programme - Policy Background

- 3.1 The new government has set out an ambitious and challenging vision covering employability, research and innovation, enterprise growth, urban regeneration and rural development. Ministers have been clear in recognising the contribution that Structural Funds have made to meeting their goals in the past and since the election have stressed the need for the LUPS ERDF Programme to continue to support that vision. Ministers also recognise the close alignment of the domestic policy and purpose with the priorities identified in the Europe 2020 Strategy (Smart, Sustainable and Inclusive Growth),

4 Priority 1 - Research and Innovation

4.1 We have **£8.6 million** of ERDF unallocated in this Priority. With prudent over programming based on expected levels of underspend within the Priority the MA propose to increase this amount to £15 million.

4.2 The PMC will recall that the MA worked with SG policy leads to develop the Scottish Innovative Low Carbon Fund. This targeted approach has been successful in bringing forward a number of high quality projects aimed at securing the economic development impact of the move to a low carbon economy. It seems clear that the relatively low level of funding now available means that we will not be in a position to revert to an open call and we propose that we work with SG policy leads to develop a targeted call that will focus on the economic development opportunities in the marine sector (e.g. offshore wind and wave and tidal technologies). Although we recognise the need to maintain this focus the MA will retain some flexibility to bring forward strategically important projects that do not meet this criterion.

4.3 Recommendation

The Committee is invited to;

- endorse this approach and to allow a further focussed call for applications under ERDF Priority 1 based on a specification to be agreed with SG policy leads. The specification will be circulated to the PMC by written procedure in advance of the call for applications.

5 Priority 2 – Enterprise Growth

5.1 We have **£4.2 million** of ERDF unallocated in this Priority. The high level of investment in VCLF projects and the low level of underspend that we can expect to arise from that type of activity will mean that the scope to increase the amount available will be limited.

5.2 As evidenced in the recent presentation to the PMC demand for Scottish Enterprise VC funds remains high and we anticipate that we may be asked to increase the ERDF allocated to the Co-investment Fund at some point in the future. The MA is aware of the importance of this project and we would like to retain some flexibility to ensure that Scottish Enterprise can continue to meet the demand from early stage and growing SMEs for equity investment. However, we do not believe that committing the funds available to us now to meet a demand that will not materialise until 2013 represents the best use of those limited funds. We anticipate that underspends will continue to emerge across the Priorities and we suggest that we undertake to utilise those underspends in order to respond to the pressure on the Co-investment Fund if it emerges later in the programming period. This PMC should be aware that this may require a virement of funds.

- 5.3** The PMC will be aware that the MA, IAB and Scottish Government policy leads worked with the Scottish Local Authority Economic Development Group (SLAED) to develop a framework that set out activity that would complement existing Business Gateway provision. Although the funding of generic business development support remained ineligible under the LUPS ERDF Programme we believe that by providing a menu of eligible activity we offered some clarity to sponsors, advisory groups and policy leads on the range of activity that we could support through Priority 2. We received 5 projects and allocated £5.1m of ERDF to sponsors through this targeted call.
- 5.4** As existing Business Gateway contracts are now in the final stages of delivery the MA believe that this is an appropriate point to engage with policy leads in SG and in SLAED. We accept that the generic business support that will be the core activity of Business Gateway will remain ineligible but we are keen to explore how ERDF can add value to the new contracts.
- 5.5** If the PMC endorse this approach then we will not know the value of the additional business support activity and we are working on the assumption that no open bidding round for Priority 2 will be required this year

5.6 Recommendation

The Committee is asked to:

- note the potential for an increased grant request from Scottish Enterprise in respect of the Co-investment Fund and that this may require a virement of funds between ERDF Priorities.
- note that the MA will continue to identify options for using the ERDF remaining in Priority 2 to fund additional business support activity alongside core BG offering
- note that we do not propose to hold an open competitive bidding round this year.

6 Priority 3 – Urban Regeneration

- 6.1** We have **£16.7** million of ERDF available in this Priority. With prudent over programming based on expected levels of underspend within the Priority the MA propose to increase this amount to £20 million. A higher level of capital projects in this Priority leads us to recommend a more cautious approach to overcommitment than in Priority 1. We will continue to monitor the level of underspend and increase the funding available if this is justified.
- 6.2** The PMC will note the achievement on the development of business space against agreed targets. As this is also activity that is likely to be a key feature of investment opportunities to the JESSICA Fund the MA propose that we should exclude revenue generating business space development activity from future grant calls. It is also clear that the State Aid implications and the revenue generated by the CHP and energy efficiency projects will again make

these projects more appropriate for JESSICA debt financing and difficult to deliver using grant funding. We will continue to try to overcome those issues for the projects already submitted but it seems sensible that we should focus new project development activity on other eligible activity.

6.3 The MA is dealing with a number of queries on the continuing justification for the SME focus for ERDF funded business space. Although a rigid focus on SMEs made sense at the time of drafting the Operational Programme in 2006, it is apparent that the market for business space in Scotland has changed dramatically in recent years. This issue has been raised in the context of grant applications but also by potential project sponsors of JESSICA projects who contend that this restriction will limit the availability of private sector co-funding and risks developed business space in regeneration areas remaining underoccupied thus reinforcing negative perceptions. Although we are recommending that no new business space is developed using ERDF grant the MA believe that the case to change the OP is already strong and we intend to work with project sponsors to build the evidence base to support a proposal to remove the SME restriction. The change would be aimed at allowing us to focus instead on private sector usage that creates new employment opportunities either directly or through increased economic activity in regeneration areas. We believe it is important that this change applies to projects funded in earlier rounds and also to projects funded through JESSICA.

6.4 Previously the PMC agreed that we should place an emphasis on projects that demonstrate a link between urban regeneration and carbon reduction/renewable energy. Although this was useful in drawing out different projects and new sponsors, it is clear that to deliver on the OP targets and to make a real difference in the targeted areas we need to narrow this focus and be clearer in defining what activity is likely to be funded. The MA proposes that we should work with SG policy leads to draw up a specification that will target the remaining funds on two themes:

- projects that encourage the development and use of clean, sustainable public transport systems to link areas of need with employment and training opportunities. This activity may include the development of safe transport hubs in deprived areas and smart transport and ticketing systems.
- projects that invest in the rehabilitation of the physical environment – decontaminating and servicing brownfield sites, but only if it can be shown that the end use of the land is linked to ERDF eligible activity

In all cases the activity will only be allowed if it forms part of an integrated urban development plan.

6.5 If the Committee agree to this revised focus the MA will work with SG policy leads to develop options for delivering this activity through an open grant call or through the creation of a thematically focused urban regeneration fund.

6.6 Recommendation

The Committee is asked to:

- agree that we exclude development of new business space, CHP and energy efficiency measures from the next call and that we signpost new activity towards JESSICA.
- agree that the MA work with partners to build an evidence base to support a proposal to remove the SME restriction on SME use of business space from the OP and JESSICA eligibility criteria.
- agree that the next call should be based on a specification based on the eligibility criteria set out at 6.4 and note that the MA will work with SG policy leads to develop thinking around the optimum delivery mechanism for this funding.

7 Priority 4 – Rural Development

- 7.1 We have **£21.1 million** of ERDF available in this Priority. We do not believe that we need to consider overcommitment at this time but will reconsider this position if the project pipeline increases dramatically in the next round.
- 7.2 Unfortunately, it is recognised that the level of new project development remains low. With a low number of projects approved and a weak pipeline of projects it is clear that project sponsors continue to find the eligibility criteria in the Operational Programme restrictive to the extent that it does not match the priorities of potential sponsors. This has clearly been a barrier to the development of eligible projects and the PMC and Commission agreed to widen the eligibility of Priority 4.
- 7.3 The PMC has been kept up to date with the actions taken by the IAB and the Global Grants Body (GGB) to stimulate activity and the MA believe that we have been reasonable in allowing time for potential project sponsors to reflect on the ideas flowing from the various work streams that followed on from the workshops and to work up ideas into eligible projects.
- 7.4 One of the options identified at the workshops was to allow Priority 1 and Priority 2 activity to be funded through Priority 4. Partners believe that this would allow the development of applications that address the need to stimulate research and innovation and provide tailored business support interventions in rural areas. It does appear reasonable to assume that Priority 1 proposals from sponsors in rural areas of Scotland will find it difficult to compete in an open bidding situation with applications made by leading research centres. We have no clear evidence to support that claim but that may be because of an element of self selection by potential sponsors not to enter an open competition. Some partners also suggest that the needs of rural Scotland are squeezed out in Priority 2 by national projects that seek to target potential high growth SMEs.

- 7.5** The MA still do not believe that transferring activity between priorities would be possible. However, the same benefits could be delivered by moving some of the funds currently allocated to Priority 4 to Priority 1 and/or Priority 2. This could be done with a condition that the transferred funds would, at least for a reasonable period, be allocated only to projects in those areas currently eligible under Priority 4.
- 7.6** An alternative to the immediate transfer of funds would be to explore a proposal from SG policy leads to widen the scope of Priority 4 to allow us to run a focused call based around improving broadband connectivity. The projects could potentially access match funding from the UK government and possibly also some additional SG funds. The activity would be in line with the aims of the EC Digital Agenda for Europe and the recently published Scottish Government digital strategy – Scotland's' Digital Future. In order to remove any uncertainty over eligibility the MA believe that this will require a change to the LUPS ERDF Operational Programme.
- 7.7** Although the regulation appears to restrict eligibility to improving access and take up of ICT to SMEs we also recognise that a number of rural businesses will be home based and that any proposed change to the OP should allow a degree of flexibility.
- 7.8** We also recommend that we work with partners to make a case to increase the agreed output target for the creation of business space and introduce a new target for the decontamination and servicing of brownfield land. Although it seems clear that a lack of match funding will limit new applications the increase is required to accommodate the current pipeline of projects.

7.9 Recommendation

The Committee is asked to:

- agree that the MA work with SG policy leads and discuss with the Commission what opportunities we have to change the Operational Programme to allow a focussed call aimed at improving broadband connectivity in rural areas.

8 Recommendations

8.1 The Committee is invited to:

- 8.1.1 Agree the recommendations at 4.3, 5.6, 6.6 and 7.9.

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