For Decision **LUPS/09/02/11**

Lowlands and Uplands Scotland ERDF and ESF Programmes 2007-2013
Programme Monitoring Committee

EXCEPTIONAL PROJECT PROCEDURE – CONSIDERATION OF ERDF STRATEGIC PROJECTS

1. Purpose

1.1 To advise the Committee of the recommendations from the Advisory Group arising from the appraisal of the ERDF strategic projects submitted under the Exceptional Project Procedure in the LUPS ERDF Programme 2007-13.

2. Background

2.1 The Exceptional Project Procedure for the 2007-13 Programmes was originally approved by the Programme Monitoring Committee at their meeting on 19 March 2008 and a revised version was approved by written procedure on 14 November 2008. The basis for this decision was a clear recognition that there may be special circumstances which prevent an application being submitted within the usual application deadlines. It was felt that an exceptional procedure needed to be established for such cases, particularly where projects for reasons of economic turmoil, large scale redundancy, market exploitation or private sector co-financing may be time critical. The Exceptional Projects Procedure is attached to this paper as Annex 1 for further details on the procedure.

2.2 Following discussions with the IAB and the Scottish Government Managing Authority, Stage 1 applications were submitted from Scottish Chambers of Commerce and Glasgow City Council on 16/3/2009 and 20/3/2009 respectively under ERDF Priority 2. Both applications were submitted in direct response to the current economic downturn and the perceived need for additional development finance for businesses. Both these strategic applications contained significant levels of private sector co-finance and as such required to be considered under the Exceptional Project Procedure in order to secure the crucial private investment. In line with the procedure, these Stage 1 applications were assessed by the IAB and the Managing Authority. As the applications addressed the appropriate criteria to be considered under the Exceptional Project Procedure the applicants were advised to submit Stage 2 applications which would be considered at the extraordinary Programme Monitoring Committee meeting in May 2009.

2.3 The Stage 2 applications were submitted within the timescale as set by the IAB i.e. 3 April 2009. The following requests for ERDF funding were received under the Exceptional Project Procedure.

2.4 Summary of ERDF P2 Bids received under the Exceptional Project Procedure:

Project Applicant	Project Title	Total Eligible Costs (£)	ERDF Request (£)	Intervention Rate (%)
Scottish Chambers of Commerce	Scottish Chambers of Commerce Business Growth Fund Programme	49,500,000	19,500,000	39.39
Glasgow City Council	Pivot Capital Partners Venture Fund Programme	60,500,000	24,000,000	39.67
Total		**110,000,000**	**43,500,000**	

2.5 The report of the Advisory Group is detailed below at Section 4 with project recommendations.

2.6 At section 5 of this paper there is a financial summary for each ERDF Priority of the financial implications in ERDF grant terms of agreeing the various project recommendations.

2.7 Overall, and subject to this Committee agreeing to the recommendations of the Advisory Group, **£0** ERDF grant will be allocated at this time.

3. Advisory Group Process

3.1 In the normal way, full applications were subject to technical/eligibility checks by the IAB and appraisal by the Managing Authority, the IAB Programme Mangers, Advisory Group members and Scottish Government policy experts. The policy experts provided input in particular into the fit with the strategic policies of the Scottish Government. External stakeholder members of the Advisory Groups were appointed by the Scottish Government as the Managing Authority.

3.2 The respective scores of the second stage application by the 'Virtual' Advisory Group members and the IAB Programme Managers, Managing Authority and Scottish Government policy experts were collated by the IAB and the previously agreed weighting factor applied. An average overall score was then calculated and checks were undertaken to ensure that any anomalous scores were justified and did not unreasonably affect the final score and ranking. As there were only two applications to be considered a Standing Advisory Group was convened to discuss both applications. This afforded the opportunity to test and validate the initial scores in an open and frank debate where Standing Advisory Group members had been selected on the basis that they had no conflict of interest in respect of the projects under consideration.

4. Advisory Group Reports

4.1 ERDF Priority 2 Advisory Group Report

4.1.1 The ERDF P2 Advisory Group met on 30th April 2009 to discuss the two strategic bids submitted under the Exceptional Project Procedure. Due to the complex nature of both investment vehicles and the fact that both proposals represented a significant departure from previously ERDF supported venture capital and loan projects the Managing Authority decided to engage an independent technical expert to supplement the normal Standing Advisory Group membership. Accordingly, Richard Hope (Alliance Trust Equity Partners) was recruited as technical expert to provide advice on specific aspects of the bids. Importantly, it was made clear in the letter of appointment and at the outset of the Standing Advisory Group meeting that Richard would not have a role in the discussion on project recommendations. In addition, in view of the commercial sensitivity involved in both applications Richard Hope completed a non-disclosure pro forma. Below is a summary of the Advisory Group discussion and overall recommendations.

4.1.2 **LUPS/ERDF/2009/2/2/0040 Scottish Chambers of Commerce Business Growth Fund Programme**

The application received a total score of 29.46 following assessment by virtual Advisory Group members. The Standing Advisory Group discussed the application and notwithstanding the substantial technical issues with the application the following points were raised:

- The evidence of market demand for the fund was not sufficiently justified in either the application or supporting documents. This was further weakened by references to outdated reports i.e. Smart Successful Scotland: Bridging the Finance Gap. In addition, it was not clear how the proposed fund would fit with existing funds i.e. Scottish Co-investment Fund and Scottish Venture Fund.

- The degree of subordination within the proposed model was deemed to be excessive in terms of the disadvantage this represented for the public sector investors i.e. ERDF returns. Whilst it is acknowledged that subordination is designed to act as an incentive to private investors it was felt that the level of subordination present in the model was beyond acceptable levels and certainly deviated from the 'pari passu' (equal risk/equal reward) terms of other Funds supported by Structural Funds. This in turn would have State Aids implications requiring notification to DG Competition.

- In terms of deal flow, it was not clear from the application or supporting documents how this would be generated to a sufficient level to meet the ambitious targets set in terms of the number of investee companies. It is recognised that it can be difficult to find good quality deals and it was felt that insufficient time had been built into the proposal to undertake this work. In addition the size of portfolio was felt to be unrealistic to enable the necessary portfolio management to be undertaken, particularly in relation to monitoring requirements.

- The track record of the Fund Manager was not sufficiently justified in the application and supporting documents. In particular there was no information on prior fund investing in the same area. In addition, there was no detail provided in terms of the investment track record of the Fund Manager.

- There was a lack of information regarding the substantial level of private capital being sought to invest in the fund and no indication on how this capital would be raised or the ability of the Fund Manager to raise this level of capital.

- In addition, to the above points there are a number of fundamental technical issues in relation the proposed fund in its current form i.e. State Aids and Procurement. It was felt that the nature of these issues was such that these could not be readily resolved within the necessary time-frame for this proposal and not without substantial changes to the proposed model.

Advisory Group Recommendation: Not recommended

4.1.3 **LUPS/ERDF/2009/2/2/0039 Glasgow City Council Pivot Partners Venture Fund Programme**

The application received a total score of 28.5 following assessment by virtual Advisory Group members. The Standing Advisory Group discussed the application and notwithstanding the substantial technical issues with the application the following points were raised:

- The evidence of market demand for the fund was not sufficiently justified in either the application or supporting documents. In particular, it was not clear how the proposed fund would fit with existing Venture Capital and Loan funds, in particular Scottish Co-investment Fund and Scottish Venture Fund, or that there was unsatisfied demand for this new investment vehicle.

- In terms of deal flow, it was not clear from the application or supporting documents how this would be generated to a sufficient level to meet the ambitious targets set in terms of the number of investee companies. It is recognised that it can be difficult to find good quality deals and it was felt that insufficient time had been built into the proposal to undertake this work. In particular, the proposal that referrals to the fund would come through Business Gateway (BG) was felt to be unrealistic as the type of companies assisted through BG are not normally 'high growth' and therefore it is doubtful that these would be suitable candidates for the proposed fund. In addition the size of portfolio was felt to be unrealistic to enable the necessary portfolio management to be undertaken particularly in relation to monitoring requirements.

- The track record of the Fund Manager was not sufficiently justified in the application and supporting documents. In particular there was no information on prior fund investing in the same area. In addition, there was no detail provided in terms of the investment track record of the Fund Manager.

- There was a lack of information regarding the private capital to invest in the fund and no indication on how this capital would be raised or the ability of the Fund Manager to raise this level of capital. In addition, an investment of £16.9m is expected from the European Investment Fund but no information was provided on the status of this investment. Further information would be required to assess the realistic nature of this substantial investment in the fund and the timescales for achieving approval.

- The arrangements for providing advice to investee companies, particularly through 2in10, also presents some potential conflicts of interest and further information would be required in order to ascertain the financial terms of this service.

- In addition, to the above points there are a number of fundamental technical issues in relation the proposed fund in its current form i.e. State Aids and Procurement. It was felt that the nature of these issues was such that these could not be readily resolved within the necessary time-frame for this proposal and not without substantial changes to the proposed model.

Advisory Group Recommendation: Not recommended

4.1.4 Advisory Group members also discussed the remaining allocation under ERDF P2 and how this could be best utilized. Advisory Group members agreed that, notwithstanding the possibility of a Loan Fund (based on the West of Scotland Loan Fund model) being developed in the East of Scotland, sufficient funds have been invested in Venture Capital and Loan Fund vehicles. It was felt that future interventions should be focused on the other themes of ERDF P2 i.e. encouraging entrepreneurship and improving business processes.

5. Implications of Approving Advisory Group Recommendations

5.1 The implications of approving the Advisory Group recommendations are summarised in the table below:

Priority	Total Grant Allocation* (£)	Approved Grant Commitments to date (£)	Available Allocation (£)	Value of bids recommended for approval (£)	Remaining Balance for 3rd Round (£)
Priority 1: Research and Innovation	76,758,059	68,068,929	8,689,130	0	8,689,130
Priority 2: Enterprise Growth	101,821,916	70,475,704	31,346,212	0	31,346,212
Priority 3: Urban Regeneration	84,590,515	12,899,999	71,690,516	0	71,690,516
Priority 4: Rural Development	42,608,557	14,033,814	28,574,743	0	28,574,743
Priority 5: Technical Assistance	7,519,157	4,205,982	3,313,175	0	3,313,175
Total	**313,298,203**	**169,684,428**	**143,613,776**	**0**	**143,613,776**

*An average exchange rate of 1 EURO = £0.833333333 or £1 = 1.20 has been used. This is based on actual ERDF grant drawdowns received to date and the April 2009 exchange rate.

6. Recommendations

6.1 The Committee is invited to:

6.1.1 agree in principle the recommendations for this extraordinary round of ERDF applications as detailed at sections 4.1.2 and 4.1.3 above.

6.1.2 note and agree the Advisory Group reports summarised at section 4 above;

6.1.3 note the level of commitments for each Programme Priority as detailed at section 5.1 above;

6.1.4 acknowledge the additional work carried out by the respective Advisory Groups in appraising these project applications.

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