

Derby's Innovation Hub

SUMMARY

- 1.1 This report provides an update of the progress made in the establishment of the Innovation Hub, previously known as the Innovation Campus, following the report provided to Cabinet on 17 October 2012. The report seeks approval to proceed with the implementation arrangements.
- 1.2 This is a very significant project for Derby, being the centrepiece of the Global Technology Cluster business park development, a much needed hi-tech business park development on the south side of the city.
- 1.3 The project is an £11.5m investment, split between the Council, the University of Derby, UK Government and European Regional Development Fund programmes.
- 1.4 The Innovation Hub will be a facility for new and existing SMEs in high technology sectors, particularly planes, trains and automobiles, to access research, technology transfer, and other innovation advice from the three partner universities – Aston, Cranfield and Derby. Rolls-Royce plc is a significant player, as it is donating the three acres of land required for the development of the Innovation Hub.
- 1.5 The project is also one of the key strands of our Regional Growth Fund programme, utilising an element of the £40m which we won from Government, to support our three key transport engineering sectors.
- 1.6 We are now at a stage where we require a significant number of approvals from Cabinet. These will enable us to proceed with a number of important matters, including acceptance of offers of grant and other financial assistance, procurement of the team to manage the centre, procurement of the construction company to build the Innovation Hub and to proceed with marketing at the earliest opportunity.

RECOMMENDATION

- 2.1 To authorise the Chief Executive and Strategic Director of Resources in consultation with the Leader of the Council to formally accept any offer from Derby's Regional Growth Fund Programme (RGF) and the European Regional Development Fund (ERDF).

- 2.2 To authorise the Chief Executive and Strategic Director of Resources in consultation with the Leader of the Council to agree to the final terms relating to the investment by the University of Derby into the project and to enter into a leasehold agreement and Marketing Agreement with Rolls-Royce for the land.

- 2.3 To note the position regarding RGF and, subject to the capital plan prioritisation process, delegate authority to the Chief Executive, in consultation with the Leader, to increase the Council's investment into the project from the capital programme up to a maximum of £4.45m depending upon the success of the ERDF application.
- 2.4 Pending confirmation of the above resources, to authorise the Chief Executive and Strategic Director of Resources in consultation with the Leader of the Council to enter into a contract with the selected construction company to build the Innovation Hub.
- 2.5 To authorise the Chief Executive and Director of Regeneration in consultation with the Leader of the Council to conclude negotiations with the University of Derby, Aston University and Cranfield University over the establishment of a joint venture vehicle to oversee the marketing of land at the Innovation Hub and to direct the operation of Engineering Supply Chain Solutions.
- 2.6 To confirm the Council's commitment to the appointment by the joint venture partners of the Managing Director of Engineering Supply Chain Solutions and to commence the recruitment of the remaining Executive Team and the marketing of the services on offer.

| |
|-----------------------------------|
| REASONS FOR RECOMMENDATION |
|-----------------------------------|

- 3.1 The project started as the key part of our bid for RGF resources, and has developed considerable momentum. Approval to the recommendations above will enable the project to proceed. A verbal update will be given to your meeting about our progress with the ERDF application, the latest advice on the State Aid and taxation issues, and the outcome of the design competition that is currently underway.



| |
|-------------------------------|
| SUPPORTING INFORMATION |
|-------------------------------|

- 4.1 The previous report to the Council Cabinet (17 October 2011) outlined the rationale for this project, is part of our RGF Programme, which addresses three key issues:
- Over-reliance of the local economy on the fortunes of a handful of large companies.
 - Low levels of R&D and weak innovation systems amongst many SMEs.
 - The need for smaller companies to generate growth by diversification within and outside their traditional supply chains.
- 4.2 The Council has developed a strong partnership with the University of Derby, Aston University and Cranfield University to address these issues – led by a project board chaired by Professor John Coyne (University of Derby). The Council is represented by the Chief Executive and Director of Regeneration. It is proposed that this partnership will be called ‘Engineering Supply Chain Solutions’ (ESCS). An Interim team has been created with staff seconded from the three Universities. This team, funded by the City Council, has undertaken market research and developed a support programme to offer to SMEs. The team has been taking legal advice to help overcome potential State Aid challenges, as well as to draw up Heads of Terms, and has engaged specialist tax advisors. A verbal report on these matters will be provided at your meeting.
- 4.3 The Interim Team has created an outline Business Plan, and produced a proposed permanent staff structure. The recruitment to the Managing Director post has been undertaken with the support of the HR service at the University of Derby and a verbal update can be provided to your meeting about the outcome.
- 4.4 Whilst proactively engaged in the above issues, the Council has further developed plans to create a specialist Innovation Hub that will become the home for this consortium of Universities. In May the Council appointed an external project management team lead by Turner & Townsend and supported by, amongst others, Bond Bryan (architects). This team has created a Masterplan for the 9.6 acre site to be known as the “Innovation Hub”. The team has also prepared a design specification for the Innovation Hub and facilitated a design competition from which the Council will select a preferred contractor/designer once detailed designs and tenders have been returned on 6 September.

- 4.5 This Innovation Hub will be the flagship development at the heart of the new business park in Chellaston (the working title for which is the “Global Technology Campus”). The building will offer a range of support services to SMEs delivered by ESCS alongside demonstration spaces, training suites, meeting rooms and up to 30 offices and industrial workspace units. This Innovation Hub will be the first development on the Innovation Hub of this business park, adjoining the Rolls-Royce HQ at Sinfen. It will showcase R&D opportunities for SMEs operating in the aerospace, rail and automotive sectors. The vision for this facility is that by 2020 it will become recognised globally as “the UK Centre for Supply Chain Innovation in Transport Engineering”.

- 4.6 The total construction cost for the Innovation Hub is estimated at £11.5m. This will become more certain following the tender returns due on 6 September. This sum includes fit-out costs but excludes the value of land (provided at nil consideration by Rolls-Royce, subject to terms). The funding for the Innovation Hub would comprise:
- University of Derby - £1m investment by way of a soft loan (i.e. until such time as the Council sells the building or generates a return that is not otherwise re-invested in the Innovation Hub project); this investment is committed subject to the agreement of terms.
 - European Regional Development Fund (ERDF) - £4.4m capital grant; application is in appraisal and a verbal update will be provided at your meeting.
 - Council capital programme - £1m prudential borrowing (confirmed) and up to a further £3.45m (subject to the current capital plan prioritisation process; this amount would reduce substantially if the ERDF application is successful).
 - Regional Growth Fund (RGF) - £5.1m grant; this funding is committed subject to the approval to proceed from the Strategic Director of Resources as the Council's Section 151 officer.
- 4.7 The ERDF application also seeks additional resources to support the delivery of services to transport engineering SMEs – by 'Engineering Supply Chain Solutions'. It therefore also comprises £300k of capital grants to assist SMEs introduce new technology and £775k revenue contribution towards the operational costs of the ESCS project.
- 4.8 The ERDF revenue is matched in the following way:
- £28k from the 3 Universities providing "in kind" support; this funding is committed.
 - RGF £1.1m grant; this funding is committed subject to the approval to proceed from the Strategic Director of Resources as the Council's Section 151 officer.
- 4.9 If the ERDF application is successful the Council would be accountable for the grant. As such it would take responsibility for compliance with State Aid and public procurement regulations, for the achievement of outputs and outcomes, and for the repayment of any monies owed through clawback clauses. Pending the receipt of Counsel opinion in late August, for which a verbal update will be given, Officers have a good level of confidence that the project will not breach State Aid or public procurement rules.

- 4.10 It must however be noted that the Council would remain liable for ERDF clawback if it makes “net revenues” (surpluses) from the operation of the Innovation Hub or if it benefits from the residual value of the building if it was ever sold. It is proposed that the operation and management of the centre will be out-sourced to a professional facilities management organisation. This would remove the risk of ERDF clawback from the building’s operation. Commercial advisors have indicated that the Innovation Hub residual value in, say, 15 years would be around £150,000 more than the market value on completion in 2015. As such, the Council would be liable for this sum [note this is an estimate based on a number of variables that are subject to normal market forces].
- 4.11 The Innovation Hub will be built on a three acre site, owned by Rolls-Royce. Draft Heads of Terms have been agreed for the 125 leasehold interest that the City Council would have in this three acre site. This agreement requires no capital payments to the owner unless the Council sells the Innovation Hub or participates in a distribution of proceeds that arise from the operation of the Innovation Hub. As mentioned above, the Council and its partners shall not benefit from revenues generated by the Innovation Hub. The joint venture vehicle governing the ESCS initiative must be “not for profit” and take cognisance of the terms with Rolls-Royce i.e. seeking to invest any surpluses generated back into ESCS.
- 4.12 There is also a proposed Marketing Agreement for the residual Innovation Hub site around the 3 acre plot that the Innovation Hub will occupy. This agreement is in development (at the time of writing Heads of Terms are almost agreed). This Agreement places the obligation on the City Council to market residual land for complementary uses. At the point of disposal, capital receipts generated would be shared to a pre-determined formula and the City Council would become a beneficiary. It is believed that this income stream will substantially off-set the ERDF clawback liabilities described in 3.10 above.
- 4.13 The next steps for the project hinge on the outcome of several issues:
1. The outcome of the ERDF application – this will determine the extent to which the City Council has to commit prudential borrowing to the project.
 2. The tender returns for the construction project – this will result in certainty about the tender price and determine the preferred design solution.
 3. The identification of a strong candidate to become the Managing Director of ESCS – which will provide confidence to the project board to proceed with the recruitment of the remainder of the small staff team.
 4. The formalisation of the joint venture between the Council and the three Universities – to create a legal structure within which the draft Business Plan can be further refined and developed.
 5. Agreement of terms with the University of Derby to enable them to invest in the Innovation Hub without giving rise to taxation liabilities to the Council.

6. Receipt of the final State Aid and detailed taxation advice (due end August and mid-September, respectively) – thus enabling the Council to proceed with greater certainty about financial liabilities.
7. Agreement to the lease for the land to enable the Innovation Hub to be built and to the Marketing Agreement to set out the terms within which the City Council can generate future capital receipts.

4.14 Members should be aware of the following headline risks:

- Delays in the ERDF decision – this will jeopardise the ability of ESCS to achieve the stated outputs targets within the funding application. Furthermore, it would result in the Council incurring further unrecoverable costs (to date this figure is circa £50k) as it must commit to progress the planning application for the Innovation Hub. The latest that a decision will be made is pre-Christmas. This is the worst case scenario and unless the contractor is able to commence construction by April/May 2014 the deadlines for funding drawdown (particularly RGF) would make the construction programme impossibly tight. The likelihood of this risk arising in relation to this project is ‘medium’ and the potential impact is ‘high’.
- Delays in obtaining planning permission for the Innovation Hub beyond March 2014 – also jeopardising the construction programme as above. The likelihood of this risk arising in relation to this project is ‘medium’ and the potential impact is ‘high’.
- Forced sale of the Innovation Hub – whilst not considered very likely this would result in potential partial clawback to funders (RGF and ERDF); although this could be off-set by onward sale as managed workspace. A forced sale would trigger the need to repay the University of Derby loan. It would require also the Council to provide a capital receipt to Rolls-Royce (net site value of £570k uplifted by the Consumer Price Index). The likelihood of this risk arising in relation to this project is ‘low’ and the potential impact is ‘high’.
- Construction cost over-runs – depending upon the outcome of the tender prices this risk will be more quantifiable by the date of your meeting. However, the form of contract with the construction company and the nature of the fixed price tender should offer a good level of comfort that these costs can be contained so long as the tender prices do not exceed our budget. In this case, the scope of the construction project would have to be re-defined. The likelihood of this risk arising in relation to this project is ‘low’ and the potential impact is ‘low’.
- Sustainability of ESCS beyond the initial ERDF period – the draft business plan does show the initiative has a sound future, but this is dependent upon achieving targets for member subscriptions matched to securing future grants (primarily from the EU and Technology Strategy Board – both of which could be lucrative sources in the short to mid-term). The likelihood of this risk arising in relation to this project is ‘low’ and the potential impact is ‘medium’.
- Facilities management contract unsustainable due to occupancy levels and/or rental income being lower than forecast – this would probably force the Council to take on the management and operation of the Centre. Our track record in successfully managing a range of other smaller workspaces in Derby should mitigate against this being a serious consequence, but the Council would need to take care to avoid receipt of “net revenues”. The likelihood of this risk arising in relation to this project is ‘low’ and the potential impact is ‘low’.

- 4.15 If the ERDF application is unsuccessful, or if there is a funding gap when all the funding is in place, the Council's capital programme would require some reconsideration. This would need a separate exercise through our capital programme process to compare the needs of this project with other prioritised capital projects. The maximum exposure is £4.45m, but at the time of writing the total funding gap was approximately £0.5m.

Conclusion

- 5.1 In summary, the project has made very good progress since Members gave approval for Officers to proceed. The project is now at a critical stage of development and the Council must decide if it can accept the liabilities and risks. Officers believe that this initiative will provide the perfect first piece in the jigsaw of the wider business park (the GTC). The Innovation Hub will lead to the direct creation of at least 120 new jobs over first four years.
- 5.2 The partnership with three Universities will offer an unparalleled opportunity for local SMEs to engage with research and development expertise. This should stimulate their growth, and improve the whole economy's resilience to major shockwaves like those experienced at the time of the Thameslink decision. The ERDF project will also create another 20 jobs, help 60 businesses improve performance, increase GVA in the Derby economy (circa £1.5m a year.) and lever at least another £1m in public and private sector funding.

OTHER OPTIONS CONSIDERED

- 6.1 Cessation of the project has been considered pending the resolution of uncertainties surrounding capital funding. However, this project is considered to be of the utmost significance to the long-term fortunes of many SMEs in Derby so, on balance, it is considered necessary to proceed at risk.

This report has been approved by the following officers:

| | |
|--|--|
| Legal officer Financial officer Human Resources officer Estates/Property officer Service Director(s) Other(s) | Director of Legal and Democratic Services Director of Finance and Procurement N/A N/A |
| For more information contact: Background papers: List of appendices: | Alan Smith 01332 641624 alan.smith@derby.gov.uk None Appendix 1 – Implications |

| | |
|--|--|
| | |
|--|--|

| |
|---------------------|
| IMPLICATIONS |
|---------------------|

Financial and Value for Money

- 1.1 The project provides the opportunity to assist the long-term diversification of the economy of the city. It will create at least 120 net new jobs, lead to the attraction of many new companies to the City and assist Derby companies to flourish. The estimated borrowing costs for the City Council's prudential borrowing requirements range from £68k p.a. up to £302k p.a. (max potentially required is £4.45m). [Treasury Management section need to confirm this DCC borrowing cost estimate and a verbal update will be provided].
- 1.2 The £1m University of Derby interest-free loan (paragraph 4.6 refers) would be repayable only upon sale of the Innovation Hub. The details of the loan terms are yet to be determined following receipt of taxation advice from RSM Tenon (due in early to mid-September. Similarly underwriting of the loan has also not yet been discussed.

Legal

- 2.1 There are various legal issues that have been given careful consideration prior to the preparation of this report. Officers have taken advice from external solicitors and Counsel, on every element of the proposals described in this paper. The Director of Legal and Democratic Services has considered each of these elements of advice, and confirms that the Council's position is currently safeguarded. The advice that we have received will be taken into account and elaborated upon at each stage of each element of the Innovation Hub project.

Personnel

- 3.1 None

Equalities Impact

- 4.1 None

Health and Safety

- 5.1 None

Environmental Sustainability

- 6.1 None

Property and Asset Management

- 7.1 More details about the transfer of land and construction of the building, together with any implications for the Council will be reported verbally to your meeting. Draft Heads of Terms with Rolls-Royce are also available upon request.

Risk Management

- 8.1 The headline risks of most significance to this report and the decision to proceed are as stated in paragraph 4.14 of the report.

Corporate objectives and priorities for change

- 9.1 The RGF programme and this project in particular will support a number of the Corporate Objectives, especially:

CG1 To help create a healthy, vibrant economy with the physical and educational infrastructure to sustain the prosperity of business and citizens.

CYP2 To help build ambition, aspiration and achievement.