

CARDIFF CAPITAL REGION CABINET

CABINET MEETING 02 May 2017

THE COMPOUND SEMICONDUCTOR PROJECT PROPOSAL

REPORT OF CARDIFF CAPITAL REGION PROGRAMME DIRECTOR

AGENDA ITEM: 5

Appendices 1, 2, 3a, 3b, 4, 5a, 5b, 6a, 6b, and 7 of this report are exempt from publication because they contain information of the kind described in paragraphs 14 and 21 of parts 4 and 5 of Schedule 12A to the Local Government Act 1972.

Reason for this Report

1. To present the Regional Cabinet with a proposal received from the private sector to invest funding from the Wider Investment Fund to support the development of a Compound Semiconductor Industry Cluster in the region by establishing an anchor space in the region for high end production and manufacturing.
2. To provide the Regional Cabinet with information, advise and analysis of the proposal to enable it to decide on this investment proposal.
3. To explain to the Regional Cabinet why the proposal would require the creation of a Special Purpose Vehicle to acquire a site and undertake associated works.

Background

4. The Cardiff Capital Region City Deal Document (Heads of Terms) included the following commitments to:
 - *“Transform the UK’s capability and help **position Cardiff as the European leader in Compound Semiconductor applications, the UK Government will invest £50million to establish a new Catapult in Wales. This new Catapult will complement the work of other organisations in Wales who are already working in this important area, including the Compound Semiconductor Institute at Cardiff University and the Compound Semiconductor Centre, a joint venture between Cardiff University and IQE;***
 - *Recognising this opportunity, the Cardiff Capital Region will **prioritise interventions that support the development of an internationally-competitive Compound Semi-Conductor cluster. Local partners believe that this will put the UK at the heart of an emerging global growth technology;***
 - *Accelerate the growth of innovation and facilitate investment in research and development, the Cardiff Capital Region will seek to prioritise:*
 - **Mechanisms to support high growth sectors;**
 - **The development of new facilities and employment sites;**
 - **Investment in intellectual property creation and commercialisation;**
 - **Adding value and complimenting existing innovation support.”**

5. The Cardiff Capital Region City Deal Implementation Plan 2016-2020, adopted by all 10 authorities as part of the Joint Working Agreement, included:

T2.5 /2 Developing an Internationally Competitive Compound Semiconductor Cluster

Accelerate growth of innovation by:

- Establishing an anchor space in the region for high end production and manufacturing in 2017/18.
6. The objective of these commitments is to create a complete compound semiconductor eco-system in South Wales to take advantage of the growing prominence of compound semiconductor technology. This requires the development and integration of a compound semiconductor supply chain in South Wales, with the economic and social benefits that will bring.
 7. The benefits of clusters are well understood, with Silicon Valley in the US being a prime example. Indeed, there are semi-conductor clusters across Europe, namely Eindhoven, Dresden, Leuven and Grenoble. However, these are based on silicon technology, hence this is a unique opportunity for Wales to establish the world's first compound semiconductor cluster and establish itself at the forefront of compound semi-conductor technology globally.
 8. The cluster would build on existing investment into this technology by Cardiff University, IQE Plc, and Welsh Government. It would see a complete eco-system for the compound semi-conductor market in South Wales, allowing full movement from research through to production and commercialisation. The establishment of a UK Government funded Catapult at the proposed site would further enhance the reputation of the cluster.
 9. A proposal has been received from the private sector to invest £37.9m funding from the Wider Investment Fund to support the development of a Compound Semiconductor Industry Cluster in the region by establishing an anchor space for high end production and manufacturing. It is proposed that this investment would be repaid, over an agreed period of time, by means of leasing and resale of the property, the detail is attached as **Appendix 1**.
 10. As this proposal supports the Regional Cabinet's aspiration to support innovation and specifically helping to develop an internationally competitive compound semiconductor cluster the Cardiff Capital Region Programme Board (CCRPB) approved the proposal going forward for full assessment. It was agreed that Monmouthshire and Rhondda Cynon Taf Councils would lead on the assessment work.

Assessment

11. As part of the assessment process several specialist independent reviews have been undertaken or commissioned.
12. External legal advice has been procured from Pinsent Masons and contained in **Appendix 2**.
13. External property advice has been commissioned from JLL and contained in **Appendices 3(a) and 3(b)**.

14. An external due diligence report including an economic impact assessment has been commissioned from KPMG and is contained in **Appendix 4**.
15. External advice has been sought from Pinsent Masons and KPMG in relation to delivery options and this is contained in **Appendices 5(a)** and **5(b)**.

Cardiff Capital Region Programme Board Observations

16. The CCRPB have met twice to review the proposal, at those meetings they acknowledged that the City Deal Assessment Toolkit is still being developed and the Advisory Bodies are yet to be put in place, however, due to time constraints the proposal requires a decision to be made.
17. The CCRPB have reviewed the proposal and the specialist independent reviews and have formed the views listed below:

17.1 The proposal has the potential to:

- Create the environment for the successful development of a CSC cluster that could generate 4,000-5,000 jobs;
- Directly create and safeguard over 2,400 well paid jobs in the region;
- Provide a positive ratio of £1 public funding to £9.90 of private sector investment.

17.2 The proposal is structured to maximise the potential for the £37.9m to be repaid over an agreed period of time.

17.3 The proposal represents value for money and can comply with the HMT 5 Case Business Model requirements.

17.4 The proposal is legal and state aid compliant.

17.5 The proposal meets the terms of the Joint Working Agreement and the Assurance Framework.

17.6 The risk related to this proposal is medium / low with the probability of moderate implication being “unlikely” to “very unlikely”.

17.7 To effectively implement this proposal there is a requirement for the Joint Cabinet to establish a Special Purpose Vehicle.

18. On the basis of the above views, in accordance with 3.10 of the Assurance Framework, the CCRPB recommendation to the Regional Cabinet is:

The proposal should be recommended to the Regional Cabinet for support via the Wider Investment Fund.

19. The full observations of the CCRPB are contained in **Appendix 7**.

Summary of Proposal

20. That the Regional Cabinet establish an anchor space in the region for high end production and manufacturing to assist in the establishment of a Compound Semiconductor Industry Cluster, by:
 - acquiring suitable premises;
 - entering into a development agreement to fit out the premises; and
 - entering into an agreement to lease the premises with an option for the lessee to acquire the freehold at a future date.
21. To enable this proposal to proceed to establish a Special Purpose Vehicle (SPV).
22. The full updated proposal is contained in **Appendix 6**, including a Risk Register.

Financial Implications

23. *(to follow)*

(received and inserted 26th April 2017)
24. The ten partnering Councils approved the Cardiff Capital Region City Deal (CCRCD) Wider Investment Fund (WIF) totalling £495 million, consisting of £375 million grant from HM Treasury, passported via Welsh Government over the next 20 years. The remaining £120 million will be contributed by the ten partnering councils based on their respective population base and is currently modelled as being 100% capital in nature. The latter will become available once the JWA Business Plan is approved by all ten partner Councils. This constitutes the 'Reserved Matter' and is scheduled to be discharged no later than the 28th February 2018.
25. In order to drawdown the £375 million, Regional Cabinet must first discharge the 'Condition Subsequent' by approving the funding terms and conditions. The funding terms and conditions outline that £10 million per year of revenue funding will be provided from 2016/17 through to 2020/21 i.e. £50 million in total. The first two tranches of grant totalling £20 million will be paid no later than 30th September 2017, although Welsh Government are considering a request made by the project for this cash to be released by the 1st June 2017.
26. At its meeting of the 17th March 2017, Regional Cabinet approved that £742,500 be set aside in 2017/18 to meet the costs associated with (1) Regional Bodies and (2) Programme Development and Support.
27. The attached report seeks approval of £38.4 million (£37.9 million investment ask plus £0.5 million to agree the SPV programme management budget for the first two years) from the Wider Investment Fund, to support a request for investment funding ahead of the Joint Working Agreement (JWA) Business Plan being prepared and considered for approval by the ten partnering Councils.
28. Clause 2.4 of the Joint Working Agreement (JWA) provides that up to £50 million may be committed from the HM Treasury Contribution on 'Initial Project Investments' pursuant to the terms of the Assurance Framework and Annual Business Plan.

29. The Annual Business Plan has been prepared and presented to Regional Cabinet for consideration and approval at its meeting of the 2nd May 2017 – Agenda Item 4. This report is prepared on the basis that the Annual Business Plan is duly approved by Regional Cabinet.
30. The 'Total Costs' outlined for the project amount to £38.4 million and are scheduled to be paid on a quarterly basis from around June 2017 to 31st March 2019. This excludes the cost (£2 million) of acquiring the building from Welsh Government as it is anticipated, that subject to the Cabinet Secretary's approval, this sum will represent Welsh Government support towards the project. If approval is not secured, then the total investment cost will increase by this amount, albeit the costs will be met from the receipt generated by a future sale of the site.
31. Whilst Welsh Government are yet to confirm the exact timing for releasing the 2016/17 and 2017/18 grant monies, it is anticipated that a shortfall in cashflow will arise in both 2017/18 (circa £7.1 million) and in 2018/19 (circa £2.8 million). If Welsh Government are unable to meet the June 2017 date, then the short-term borrowing requirement will increase further. The proposal outlines the need to identify one or more councils to make available a temporary bridging loan to meet the cashflow requirements associated with the project's required investment profile. Therefore once approved, Recommendation B will be subject to the nominated Authority / Authorities budget framework approval processes and timescales for securing the same.
32. If the request for investment funding is approved, then Regional Cabinet should note that it will be committing just under 76.8% of the HM Treasury contribution due over the first five years to 2020/21. Furthermore, if Regional Cabinet decide to commit similar sums in respect of Regional Bodies and Programme Development and Support, then this will represent a further commitment of 5.9% over the remaining funding term to 2020/21. Therefore, the amount available to support other schemes will be greatly reduced over this period and will be largely dependent on funding from the Council contributions.
33. Furthermore, the scope for approving new revenue based projects will amount to around £8.63 million or 17.3% and be available in Year 5 only, and is likely to result in partnering councils having to consider whether a proportion of their respective capital allocations may now need to be provided as revenue. Whilst this would reduce the total cost of their contributions, it could have a disproportionate impact on the annual affordability cost approved as part of the affordability envelope. An alternative would be to approach Welsh Government / HM Treasury and request that an element of capital funding from Year 6 is provided as revenue.
34. The 'Project Proposal' is attached at Appendix 1 and is supplemented by the work carried out by a number of specialist advisors as detailed in paragraphs 11 to 15, with the advisors final reports attached as confidential appendices. Regional Cabinet should satisfy themselves that the format and detail of information referred to above complies with the requirements of its Assurance Framework.
35. The reports represent a substantial amount of complex technical, legal and financial information and therefore it is imperative that Regional Cabinet are given sufficient time to read and understand the advice given, as well as having the opportunity to raise any clarifications deemed appropriate. In particular, Regional Cabinet should note any key assumptions listed within the reports and be mindful of any caveats outlined. Equally important is the need to ensure that any risks identified (and the

associated mitigation measures) are fully understood, accepted and arrangements for their ongoing review and management are in place. Furthermore, Regional Cabinet should be confident that any residual issues outlined at this time are clearly articulated, and are capable of being resolved within the parameters e.g. cost estimates etc., before entering into legally binding commitment.

36. The Assurance Framework forms Schedule 8 of the JWA and was formally approved on the 1st March 2017. Schedule 2 of the JWA (Joint Committee Terms of Reference), states:

“Agree the detail of the decision-making process and assessments (as referred to in the Assurance Framework and where yet to be completed) prior to Joint Cabinet considering individual projects.”

37. The detailed decision-making processes and assessments will be developed in parallel with the timescales for finalising the JWA Business Plan. However, as an interim measure, the Programme Management Office (PMO) has developed a ‘Candidate Scheme Observation Record’ which will capture and reflect the consensus views of Programme Board. To assist Programme Board in formulating their individual views, PMO have also developed and populated an ‘Assessment Against 5 Case Business Model Requirements’, based on the information available at this time.
38. Cardiff Capital Region Programme Board observations are attached at Appendix 7 and summarises the Board’s view of the extent to which the Project Proposal has met the requirements outlined above.

Structure of the deal and Financial Standing

39. In addition, Regional Cabinet should be satisfied that the Project Proposal and related advice adequately covers the following key financial and commercial points:
- Matters pertaining to the financial standing and creditworthiness of the applicant at this time. Furthermore, that the forecasted performance of the applicant over the period of the proposal remains within an acceptable range, given the level of investment planned;
 - That the applicant remains incentivised at all times to manage costs and ensure that works are completed on time and within budget;
 - The Project Proposal is structured in a way which ensures the transfer of risk associated with delays and/or costs over-runs to the applicant;
 - That agreed benefits are realised and that all rental income due to Council’s SPV is received as expected;
 - All income and costs in relation to the Catapult are appropriately reflected within the terms of the proposal and where appropriate reflected within the level of investment being sought;
 - That Parent Company Guarantee provided will be enforceable and provides the required level of security, given the planned scale of investment;
 - An assessment of the ‘opportunity cost’ forgone in approving this request for investment versus over any other proposal or opportunity available;
 - Regional Cabinet need to be satisfied with the advice provided in relation to the deal needing to be structured as an operating lease and therefore being accounted for as being off-balance sheet;

- Matters relating to the funding terms and conditions, including but not limited to State Aid, Procurement, the purposes etc;
 - An assessment of VAT, SDLT and wider taxation implications in respect of the proposed delivery vehicle;
 - That the proposal is ultimately affordable and represents value for money.
40. The report seeks approval to create a Special Purpose Vehicle (SPV) through which all approved investment monies will flow. Legal advice on Regional Cabinet's powers in this regard is attached at Appendix 5a. Setting-up and managing the day to day operations of the SPV will give rise to budgetary implications, for example legal costs associated with constituting and registering the SPV, the need to discharge financial and administrative duties etc. In addition, costs associated with taking forward the project's next steps i.e. Implementation Plan, ongoing contract monitoring and evaluation arrangements, including landlord obligations. Regional Cabinet should satisfy itself that the costs identified within the Financial Case are sufficient to meet the above.
41. These financial implications were written ahead of all external advice being finalised and may require to be supplemented once the Authority has had sight of the final advice reports.

Legal Implications

42. *(to follow)*

(received and inserted 26th April 2017)

43. The legal advice in respect of the Compound Semiconductor Project Proposals ('the Project') has been provided by external lawyers Pinsent Masons and Members are referred to that advice set out in the confidential appendices to the report.
44. As will be seen from the body of the report, the Project has had the benefit of taking external advice from a number of advisers; KPMG, JLL, GVA, Pinsent and a QC, which recognise the exciting potential of the proposals. In looking at the external advice, please note, however, that each advice:-
- (a) is based on a number of assumptions and
 - (b) contain caveats which serve to limit the advice
45. Whilst it is not unusual for external advice to be based on assumptions and to contain caveats, it is important that the decision makers are satisfied as to the robustness of the assumptions made and, as regards any caveats, the resulting limitation on the advice given.
46. From the report it can be seen that the investment required is of significant magnitude. As with any decision, Members will need to be satisfied that they have before them all material information and have had appropriate time to consider matters and raise any queries they may have, so that a reasonable and informed decision may be made.
47. In considering this matter Members should be mindful of the WG funding conditions (see previous report which sets out advice on the terms and conditions attaching to the funding) and the Authorities potential liabilities if found to have breached the WG funding conditions - in terms of both claw back and jeopardising

future funding if the CCRCD fails to pass a gateway review because of such a breach. Here the position as regards compliance with all legislation, including procurement and state aid are key issues (please see the external advice for the detailed legal advice on these matters).

48. The Joint Working agreement provides powers to the Joint Cabinet to make Initial project investment decisions (authorised to commit up to £50 000 000 of the HMT contribution) on projects approved pursuant to (i) the terms of the Assurance framework and the (ii) Annual Business Plan. It is therefore important that the decision makers are content that point (i) and (ii) are satisfied before making the decision in respect of the Project.
49. The proposal involves expenditure of monies in excess of the HMT contribution that will have been received by the date the proposed expenditure is required. The question therefore arises how such shortfall in funding is being met? The intention of the JWA is clear that it is only the HMT contribution (up to £50 million) that can be committed ahead of the JWA business Plan being approved. At the time of writing these legal implications it is understood that it is proposed that one local Authority would take the lead and use its prudential borrowing powers to borrow the shortfall in funding required and subsequently be repaid from future tranches of HMT funding, once received. The condition to proceed with the Project will need to be conditional on such Authority making a decision to prudentially borrow the monies required and with the 9 remaining Authorities agreeing to enter into an appropriately worded agreement (back to back agreement) whereby they commit to make good their share of such funding, if for any reason future year HMT contribution is not received.
50. As will be appreciated the JWA Business Plan has yet to be agreed .The decision to approve the JWA Business Plan is a matter reserved to each Council and as a consequence there is a risk that the JWA Business Plan may not be agreed as we simply do not know what each council may decide. It should be appreciated that if the JWA Business Plan is not approved, the authorities will still be left with meeting the costs of the current Project to the extent that HMT funding does not cover the same or if, for whatever reason, the HMT funding is reclaimed or future years funding stopped. This point is further addressed in the Business Case at paragraph 4.12, which is understood to reflect the external legal advice received.
51. The external advice makes a number of recommendations in terms of conditions that should be attached to the proposed transaction, should a decision be taken to proceed. To point out the obvious these conditions should be applied if a decision is made to progress the Project.
52. These legal implication were written ahead of all external legal advice being finalised and may require to be supplemented once the Authority has had sight of the final advices.
53. In this case it is understood that there has been no consultation with stakeholders as regards the proposal, which may be a point of criticism that such stakeholders may raise
54. In considering this matter, regard should be had, amongst other matters, to:
 - (i) The Councils' duties under the Well-being of Future Generations (Wales) Act 2015 and;

- (ii) Public sector duties under the Equalities Act 2010 (including specific Welsh public sector duties). Pursuant to these legal duties Councils must in making decisions have due regard to the need to (1) eliminate unlawful discrimination, (2) advance equality of opportunity and (3) foster good relations on the basis of protected characteristics. Protected characteristics are: a. Age; b. Gender reassignment; c. Sex; d. Race – including ethnic or national origin, colour or nationality; e. Disability; f. Pregnancy and maternity; g. Marriage and civil partnership; h. Sexual orientation; i. Religion or belief – including lack of belief.

Equalities Impact Assessment.

55. Included above.

Reasons for Recommendations

56. To support the development of a Compound Semiconductor Industry Cluster in the region and in accordance with the Cardiff Capital Region Wider Investment Fund Assurance Framework provide the views of the Cardiff Capital Region Programme Board (contained in **Appendix 7**) in supporting this proposal.

RECOMMENDATIONS

Subject to the agreement of terms for the purchase of the specific facility:

- a) To enter into a Heads of Terms agreement for the purchase of a specific facility with finalisation of the transaction delayed until such time as the property is sold-on or at the cessation of the lease;
- b) In accordance with section 2.4 of the JWA, commit £37.9m of the HMT Contribution to the Wider Investment Fund for landlord works, building fit-out and ancillary works;
- c) To enter into a Heads of Terms agreement for an eleven-year lease, with an in-built stair-cased rental profile and flexible Option to Purchase;
- d) To support a further Heads of Terms that allows the head lessee, to enter into a sub-lease arrangement;
- e) To make a direct award for the development and fit-out of the facility;
- f) Establish a Special Purpose Vehicle to implement the proposal, the detail of which will be the subject of a further report.
- g) Prior to a Special Purpose Vehicle being established, to agree that for purposes of continuity, that Monmouthshire County Council continues to act as lead Authority.
- h) To accommodate this proposal will require an amendment to the Annual Business Plan 2017-2018 which will be reported back to the next meeting of the Regional Cabinet.

Sheila Davies
CCR Programme Director
25th April 2017

The following Appendices are attached:

Confidential Appendix 1:	Proposal to CCR City Deal – March 2017
Confidential Appendix 2:	Legal Observations - Pinsent Masons
Confidential Appendix 3(a):	Property Market Review – JLL
Confidential Appendix 3(b):	Property Feasibility Estimate - JLL
Confidential Appendix 4:	Due Diligence Report including an Economic Impact Assessment - KPMG
Confidential Appendix 5(a):	Establishing an SPV – Pinsent Masons
Confidential Appendix 5(b):	SPV Investment Issues – KPMG
Confidential Appendix 6(a):	Full Revised Proposal
Confidential Appendix 6(b):	Risk Register
Confidential Appendix 7:	Cardiff Capital Region Programme Board Observations Record

Background paper:

- Cardiff Capital Region City Deal Joint Working Agreement dated 1.3.17