LANCASTER CITY COUNCIL

Promoting City, Coast & Countryside

LATE REPORT AND SUPPLEMENTARY INFORMATION

Cabinet

Tuesday, 5th June 2007

The following report was received too late to be included on the main agenda for this meeting and was marked 'to follow'. It is now enclosed, as follows:

Agenda Item Number	**Page**	**Title**	**Reason for Late Report**	**Officer Responsible For Late Report**
8	1 - 46	Storey Institute Centre For Creative Industries.	Information received after the publication of the Agenda.	Corporate Director (Regeneration).

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Agenda Item 8

CABINET

Lancaster & Morecambe Economic Development Zone
Storey Creative Industries Centre
5th June 2007

Report of Corporate Director (Regeneration)

PURPOSE OF REPORT

For Members to consider providing additional funding to proceed with the refurbishment of Storey Institute into a Centre for Creative Industries as part of the Lancaster & Morecambe Economic Development Zone, together with resolution of associated operational matters.

Key Decision	Y	Non-Key Decision		Referral from Cabinet Member	
Date Included in Forward Plan	April 2007				
This report is public					

RECOMMENDATIONS

1. **Members note the progress to date on the detailed design phase and the revenue business plan.**

2. **Should Members wish to proceed with the Storey project as outlined in the report:**

   i. **That Council be recommended to allocate an additional £200,000 to the Storey project and that the Capital Programme be updated accordingly.**

   ii. **That subject to Council agreeing to the allocation of additional funds and confirmation that the project meets existing grant funding conditions, the contract to deliver the capital scheme be let in accordance with Conlon Construction's tendered financial proposal.**

   iii. **That income received from Luneside Studios for the licence to occupy space in the Storey Institute be ring fenced for year 1 start up costs incurred by Storey Ltd**

   iv. **That Members recognise the need to provide financial cover estimated at £25,000 per annum to assist with any year 1 & 2 revenue shortfall (should the need arise) and that an earmarked reserve be created accordingly, in line with Cabinet's discretion to increase future years' spending projections as set out in the Medium Term Financial Strategy (MTFS)**

v. **That Members agree the terms of the lease and service level agreements as included at Appendices 2 and 3, including the lease being at a peppercorn rent, as a basis for negotiation between the Council and Storey Ltd, subject to agreement by the relevant Cabinet Member as an Individual Cabinet Member decision.**

vi. **That the Head of Financial Services be authorised to update the revenue budget for current and future years accordingly.**

3. **Should Members not wish to proceed with the Storey project as outlined in the report, then a further report be brought back to Cabinet on options for the disposal of the building.**

1.0 Introduction

A number of previous reports have been submitted to Cabinet concerning progress with development of the Storey Institute Creative Industries Centre project. Members should be aware that the project development has been ongoing for a number of years and the scope of the project has had to be changed as a result of difficulties in securing external funding from some sources, notably Heritage Lottery Fund.

The overall desired outcomes of the project have not changed over the project development period. In simple terms the project has always been based on:

- Restoration and conversion of the Storey Institute, a dilapidated and underused building in need of substantial investment in repair and maintenance
- Creation of a new Creative Industries Centre, operated by a new and independent not-for-profit company,
- Development of a financially sustainable business and cultural 'hub' that provides a base and resources to drive the development of the creative industries sector in the district

Within these desired outcomes the project has taken a variety of forms driven by the funding expectations experienced at particular points in the project's history. The project started out as an ambitious £7 million scheme. However, the realities of competing for scarce external funding has seen the project consistently scaled back in accordance with the prevailing financial situation. Gaining certainty on the funding package over 2006 was particularly difficult. Two major funding sources, Heritage Lottery Fund (HLF) and Lancashire County Developments (LCDL) had to be discounted. The bid to HLF failed and LCDL's investment conditions were thought, on balance, unattractive and unworkable in the context of an already challenging business plan.

A report to Cabinet on 10th October 2006 outlined a number of options for the Council, ranging from abandoning the project and selling the building on the open market, through to proceeding with a scaled back "contingency " scheme with a £3.5 million budget (which depended on a £500k capital contribution from the Council.

It was made clear to Cabinet in the October report that there would have to be significant revision of the capital costs and that this 'contingency' scheme would in itself be challenging to deliver in terms of maintaining a balance between capital cost and 'fit for purpose' viability.

Cabinet decided that it could not invest £500k in the project at that time due in part to wider pressures on the capital programme.

The decision led to a 'call-in' process. This resulted in a number of resolutions arising from a Cabinet meeting on 24th October 2006:

- *That funding drawn from the Industrial aid provision (£100k), SRB under spend (£150K), and estimated revenue savings arising from concessionary travel (£150K) and treasury management (£100K) are allocated to the Storey project to make up the current £500,000 shortfall in funding.*
- *That the Head of Financial Services be authorised to update the Revenue Budget and Capital Programme accordingly.*
- *That the above funding arrangements be reviewed as part of the 2007/08 budget process, in light of the updated revenue and capital position, and in recognition of the funding risks attached.*
- *That the terms of the lease are such that surpluses achieved in the running of the Storey project be used to provide for a development fund that could be used to complete elements of the project omitted from the current scheme and repay the Council's contribution to the project.*
- *That the terms of the lease allow for the Council to step in in the event of the business plan failing to achieve its financial and European funding targets, or in the event of additional capital costs being incurred over and above the £3.1m estimated to complete the contingency plan, to ensure any risk to the Council can be mitigated.*
- *That the terms of the lease be agreed between the board and officers before being brought back to cabinet for consideration."*

Cabinet agreed to the progression of the scaled back 'minimum' plan for the Storey project to use available resources from Arts Council, SRB, ERDF, and City Council. Significant progress has been made since then, both in terms of design of the capital scheme and also negotiations and discussions with the proposed operating company Storey Centre for Creative Industries Ltd (Storey Ltd). (Cabinet agreed the principle of handing the refurbished building over for operation by an independent, not for profit organisation (Storey Ltd) in February 2006).

A tight deadline is now being imposed on the Council in relation to ERDF and SRB funding, and it is now necessary for the Council to formally confirm its own commitment to implementing the current scheme and address issues that have arisen since the last report.

2.0 Proposal Details

Full details of the proposal concept and a range of material illustrating the main features of the design will be available at the meeting. The progression of this development proposal has overcome considerable constraints but the Council's and funders' general requirements are considered to have been met. Facilities within the building will include:

- 2800 sq m of refurbished floorspace
- A refurbished Storey Gallery
- A new 100-seat auditorium space and conference venue - the first purpose-built spoken word venue in the North-West
- New Media gallery space operated by Folly

- A new Tourist Information Centre, making full use of new technology and acting as a "hub" for the wider TIC network in the district
- Visitor hospitality facilities, including a bar/restaurant/café and toilets, and exhibition space

Economic outputs from the project include

- 129 jobs generated or safeguarded in the first three years, rising to 486 after 15 years
- 22 new creative businesses in the first three years
- A programme of creative business support

Once it becomes fully operational the building is expected to become fully self-financing, including generation of funding for future repair and maintenance of the buildings, creating a sustainable long-term future for the both the property and the activities of Storey Ltd.

Design and costs of capital works

The grant funding available for the project currently stands at £3,491,695. This figure comprises an original construction budget of around £3,100,000 with the remaining funds supporting fees, charges and grant to Storey Ltd.

The process of delivering the 'contingency' or minimum scheme involved making cutbacks in key structural areas from the more ambitious scheme which would have been delivered with HLF and LCDL funding contributions. A balance has had to be achieved between issues of time, cost and quality against:

- A strategic view of whether elements were essential requirements to a viable centre.
- The potential beneficial impact of individual elements to the proposed business plan and practical operation of the completed building.

Since the beginning of the year the project design team has attempted to ensure that the 'minimum' product would meet the aspirations of the Council and Storey Ltd (as end users) via a design workshop and close dialogue. Principal key design features agreed as necessary to provide the minimum viable scheme included:

- Retaining the separate café/restaurant and bar element rather than making a combined café/bar.
- Relocating the TIC to a different room on the Ground Floor
- Relocating reception to allow potential/flexibility for integration with the TIC
- Moving proposed Folly Gallery to first floor to create a new Arts hub alongside Storey Gallery and Litfest.

Design work was completed in March and all stakeholders agree that the project provides a viable proposition even under a minimum specification.

However, the contractor and Council's cost consultant advised that uncertainty had been introduced due to the increasing inflationary pressures on the prices estimated for the previous larger HLF/LCDL funded scheme on which the 'minimum' scheme was based. A formal market based re-costing exercise was therefore required before the contractor's suppliers could commit to price certainty on the current design.

Following this exercise the design team advised that the project could not be delivered to the quality, budget and contingencies anticipated without either wholesale reduction in fit out of key areas or progression of the scheme with no contingency sum.

The contractor and Council's cost consultant has advised that to maintain the optimum balance between price, quality and risk the overall capital budget should be increased from the original estimate of £3,100,000 to £3,248,000, a requirement for an additional £148,000. These current project costs assume a start on site date in late July 2007.

Council engineers have also indicated that it may be necessary for the Council to resolve a pressing highway issue as part of this contract. An independent report by consultant engineers has noted shearing movement in a retaining wall within the curtilage of the Storey Institute on Castle Hill. The report recommends a partial or complete reconstruction to ensure the long-term safety of highway vehicles and pedestrians. Correspondence from County Council states a view that maintenance is the responsibility of the City Council as owners of the Storey Institute and not the County as Highway Authority. This is arguable as the pavement level appears to have been raised, and the increased load on the top section of the wall has caused considerable movement of its top courses.

However, Storey Ltd cannot reasonably be left with this issue and responsibility/cost liability will not be resolved in the immediate future between City and County Council. The issue is in itself part of wider ongoing discussions between the City Council and Highway Authority over maintenance of bridges and structures. Therefore, without prejudice to future action against the Highway Authority it is recommended that the wall repair be brought into the Storey refurbishment contract. The contractor advises that a provisional sum of £50,000 be allocated for further investigation, design and mitigation.

Taking into account all the above, the project is now costed at around £200,000 over budget, a principally inflationary increase of around 6% from October and it is unlikely that further savings could be made without adding unsupportable risk into the capital project. No further matching funds can be identified. Although officers would continue to work on reducing capital costs and reviewing funding opportunities, it is considered that in order for the project to progress, the Council would need to make a further contribution to the scheme from its own resources.

Business Plan

The operating company Storey Creative Industries Centre (or Storey Ltd) would be responsible for all aspects of running the building, managing staff, tenancies and the catering/conference facilities. The Company would oversee the delivery of the creative/cultural programme within the building, and in conjunction with the regional Creative Industries network, provide dedicated business support mechanisms to the local Creative Industry sector. It also has to take ownership of the financial business plan and make key decisions on income resource allocation from the baseline case business plan provided by the City Council.

The company Board has already been heavily involved in refining the design of the building. The Board has created several sub groups and is fully aware of the need to create a detailed action plan to cover the next 18 months and beyond. Project management staff would support this planning and implementation process. However, critical to this side of the process is the early involvement of direct staffing support for Storey Ltd itself. A funding allowance of around £95,000 is included in the scheme to support the Storey Board in the 12 month period prior to the projected opening. The 12 month period is known within the project as ‘Year Minus One’, and funding would cover project management support costs, marketing, programme development advertising of key posts and other board development work.

Part of the building would be let under licence during the construction period to Luneside Studios. The terms of this negotiation are ongoing but it is assumed that the Council’s income from the licence would be reinvested in Storey Ltd as part of the Council’s support to Storey Ltd’s costs in building up to opening the facility. Cabinet are asked to confirm this arrangement. (The value of this licence is still being negotiated but is unlikely to exceed £10,000 pa).

A detailed 5 year business plan has been produced to show the viability of the scheme from opening. The ‘expenditure’ side may be viewed as pessimistic to some degree in that it is based on current core building costs. Staffing levels have been agreed by Storey Ltd as acceptable to meet their and the Council’s operational objectives. A summary is attached in Appendix 1. Estimated income streams to balance these costs are generated from:

- workspace rental income;
- catering and bar income;
- hiring out the rehearsal, workshop and meeting rooms, and the Litfest auditorium;
- hosting events and conferences
- Other project based income (as this is not guaranteed it is not included in current business plan projections)

Officers anticipate that, realistically, it will be challenging for Storey Ltd to overachieve against the income figures shown and it will be hard for the company to meet the ‘break even’ budget in the short term. Storey Ltd are confident in their business plan but Officers, in recognising the financial risks, would advise providing a ‘safety net’ of £25,000 per year, as an earmarked reserve. This would be available, to assist Storey Ltd with any year 1 and 2 revenue shortfall, should the need arise.

If Cabinet is minded to support the progression of the project, this ‘safety net’ could be facilitated through the discretion that Cabinet has (through the Medium Term Financial Strategy - MTFS) to increase future years’ budget projections by up to £50K per year. Any sums would also be reviewed as part of future years’ budget processes also – as would Storey Ltd’s financial position.

This would also secure/mitigate any reputational risk to the Council of an unmanageable deficit being built up by Storey Ltd in the early years of operation. .

3.0 Options and Options Analysis

Option analysis

Cabinet considered the arguments for and against proceeding with Storey Institute project in September and October last year. Essentially, the options/arguments remain as before and are summarised and updated as follows:

Option	Advantages	Disadvantages	Risks and Mitigation
1) Do nothing – Abandon the project and continue to operate Storey Institute as at present.	Avoids the risks associated with undertaking a complex, externally funded capital scheme and any risks associated with the ongoing operation of the CIC.	Immediate loss of almost £3 million of external funding from ACE and ERDF Leaves the Storey Institute in its dilapidated condition and in need of major repair and maintenance (estimated at over £2 million) The building is now unoccupied (apart from Oxford Archaeology) and there would be a substantial revenue deficit unless new tenants can be found Over £400,000 of public investment in the project development work will have been wasted. Design fees of around £70,000 will have to be funded by the Council plus 'highway' costs of around £50,000. Adverse impact on the Council's reputation with key partners. No contribution to overall Council 'vision' and economic development/regeneration objectives.	1) Leaves the Storey Institute in its dilapidated condition and in need of major repair and maintenance (estimated at over £2 million). 2) Risk of continuing revenue deficit if sufficient new tenants cannot be found 3) The main form of mitigation would be to move to option (2) below – sale of the building.
2) Abandon the project and attempt to sell the building to a private sector investor/developer	No cost to the Council's capital programme Generation of a possible capital receipt	(As for option 1): Loss of almost £3 million of external funding from ACE and ERDF (As for option 1): Over £400,000 of public investment in the project development work will have been	1) No certainty that a suitable purchaser could be found. In this case, the Council would be in the same position as for option 1, facing continued dilapidation of the building and escalating repair and maintenance bills 2) Risk that a private sector purchaser would be able to over-ride the covenant and change the use of the building to more

		abortive. Design fees of around £70,000 will have to be funded by the Council plus ‘highway’ costs of around £50,000. Possible adverse public reaction to the sale of the Storey Institute. No external funding available to support the private sector in developing a viable scheme.	profitable uses which are not in keeping with the original bequest to the City by Sir Thomas Storey.
3) (Preferred Option) Affirm the decision of October 2006 but increase council capital contribution by £200k and implement the scheme within acceptable quality and risk thresholds.	Secures a sustainable, long term future for one of Lancaster’s key heritage assets Can achieve the full range of economic development and regeneration benefits arising from this project Maximises the financial viability of the building Storey Ltd and provides the best opportunity for creation of a viable business. Avoids unsupportable quality/risk issues which would otherwise inevitable occur. Resolves a serious highway issue.	Requires the current council capital contribution to be increased to £550,000, with no provision for recovery. Commits the council to the risks associated with undertaking a complex, externally funded capital scheme with a third party operator. Lost opportunity to generate a possibly substantial capital receipt	1) Risk of overspend is inherent in a complex, externally funded, capital project. These have been mitigated by the use of the Partnering approach. The project team has worked on an open basis to secure a maximum market price for the build, within which the Council’s partner contractor Conlon Construction will be contractually obliged to deliver the scheme. The ‘partnering’ method of procurement is regarded by experts as the single most positive step a project can undertake to control capital cost risk. The risk of matters outside the contract impacting adversely on the agreed maximum price are/will be reduced by: • Early contractor involvement and commitment to partnering and ongoing value engineering against agreed work packages, provisional sums and identified risk items; • The quality of contract design documents and the upfront appreciation of end user needs/expectations; • Adequate risk contingency monies for unforeseen impacts; • Quality of the design team and their length of involvement and knowledge of the building; • Independent cost consultants employed on behalf of the Council The contractor is offering a ‘maximum’ price (equivalent to a tender figure) with a lower ‘target cost’ set as a performance indicator. It is the intention of the project team to drive towards this lower figure with any savings accrued returned to the project to assist in further mitigating potential risk items. Project costs

			and variations will also be monitored through the use of LAMP methodology and any risks of cost-over-run will be identified at the earliest practical stage so that appropriate action can be taken. In accordance with LAMP methodology, a full capital project Risk Log has been produced and is available as a background paper if required. 2) There are risks to the revenue costs of the completed building in handing it over to a not for profit organisation. These are quite complex issues and are outlined in the text below.

Discussion and Preferred Option

The issues surrounding the original proposed investment in the project by the City Council have been well rehearsed in previous reports, but can be summarised in the question: Does the benefit of maximising the capital funding available to the project outweigh the impact of doing nothing?

Should the Storey scheme be abandoned, and if the Council chooses to continue to run and operate the Storey building, the liability for running costs will fall back on the Council to generate. The Council may also have less rental income from tenants who have already left the Storey building as there is no guarantee they will return to a building that has not been maintained.

This situation points to an option, where in order to avoid high ongoing net running costs and a call on the capital programme, the City Council could choose to try and dispose of the building. This option also has other difficulties in terms of:

- Trying to sell a poor quality building in need of high investment with a restrictive covenant;
- A building within the Council's portfolio continuing to deteriorate;
- Popular community reaction against the council selling off a building to which it is a 'custodian'.

It does have the advantage, however, of generating a possible capital receipt, to help fund the capital programme.

Through inflationary pressures and a detailed market based testing exercise the £3.1 million budget is, unfortunately, considered to be insufficient to deliver the minimum viable scheme without unacceptable cost risk to the Council. The introduction of the recent highway issue introduces another element of cost/risk burden to the scheme. The council's cost consultant, working closely with the contractor, has clearly advised that to reduce high cost/core elements of the scheme (particularly building envelope and mechanical and electrical work) will lead to problems in the ability of the contractor's supply chain to deliver. There is no further benefit, in terms of price, to be gained from driving down the price offers from key subcontractors.

There may be small gains to be made on fit out elements, but the end user must be given a building that is fit for purpose as a minimum and which can generate income from day one. It is not feasible for the Council to deliver to Storey Ltd a simple 'shell' as may be expected under a standard commercial arrangement for premises or workspace. The project specified a minimum standard fit out allowance for key public areas such as the auditorium, bar, café and gallery spaces for optimum income generation. It will be 'false economy' to reduce allowances for items which will be key to the end building experience.

Therefore, the preferred option is Option 3 – additional capital funding to allow the minimum scheme to proceed.

Members should note that since October, design costs of around £70,000 have been incurred in revising and developing the scheme and these would have to be paid by the Council if the project did not proceed.

If members agree to the approval of additional £200,000 this will bring the Council's capital investment in the project to £550,000.

Risks/Benefits associated with the preferred option

Cabinet agreed the principle of handing the refurbished building over for operation by an independent, not for profit organisation (Storey Ltd) in February 2006. For the City Council, this is an innovative approach, and members will need to be aware of the specific risks and benefits that this approach presents.

Primarily, these relate to the risk that Storey Ltd fails to achieve the income targets in its business plan, and runs into financial difficulties, either at an early stage or later in its operational life. Should this lead to a change in the use or ownership of the building, this could potentially trigger clawback of the ERDF, SRB and Arts Council grant aid invested in the building.

Should Storey Ltd run into financial difficulty, the Council would be faced with three main options:

Option	Comments	Clawback risk
1) Provide short term revenue support to Storey Ltd to help it keep trading and recover	This would have to be judged on the circumstances at the time, including availability of funding within the Council's own budgets and an assessment of the strength of Storey Ltd's prospects for recovery.	Minimal, provided Storey Ltd continue to operate and let the workspace for grant eligible activities (ie small /medium businesses)
2) Repossess the building under the terms of the lease, and operate it directly, on similar lines to its recent operation, as flexible workspace with minimal staffing (eg caretaker/receptionist)	This effectively puts the Council back to where it is at present, but with a refurbished and repaired building with no immediate maintenance and repairs liability. There may be a short-term income deficit if the building is not fully occupied, but on past experience the building may be capable of running at break even or better.	Negotiations would have to be held with GO-NW to determine whether this would invalidate the use of the value of the building as an in-kind contribution in the capital scheme. Potentially, this could lead to clawback of part or all the ERDF grant. It is expected that GO-NW's primary concern would be to ensure that the building was continuing in the use for which grant was given (ie managed workspace) and that they would be supportive of the Councils' actions under this option.
3) Repossess the building under the terms of the lease and sell it to a third party at market value.	The building value would have been enhanced by the refurbishment scheme and would exceed the current £900k valuation, but cannot be quantified at present.	Clawback of both SRB, ACE and ERDF grant would be triggered. This would be offset by the receipt from sale of the property. It is not possible at this stage to say whether the receipt would meet or exceed the clawback amount.

Members should note that the risk of Storey Ltd's failure has been mitigated as far as possible by recruiting company directors of considerable quality and experience. A recruitment process facilitated by Business in the Arts North West (BIANW) appointed the members necessary to allow the company to legally discharge its responsibilities. Individual directors have considerable experience of running companies in both the profit and non-profit making sectors and there is particular expertise in workshop facility and marketing/events management. Project management staff will continue to support the company's planning and implementation process.

In broad terms this transfer of public assets for ownership and management by a social enterprise realises social, economic and community benefits in appropriate circumstances. Officers consider that the benefits of this type of management and ownership outweighs the risks and any opportunity costs. There are risks, but they can be minimised and managed – there is plenty of experience to draw on. All parties are working together in a business focussed approach which, while not the norm within the public sector, is an approach that works. The stake that Storey Ltd has in the building imposes a degree of financial and legal responsibility but also gives greater freedom to exploit the building's potential. There has been a rational and thorough consideration of the risks and officers consider this project to be a 'smart' investment of public funds and the council's own asset which has the potential to achieve high level outcomes.

4.0 VAT, Lease and Service Level Agreement

Members should be aware of the impact of certain resolutions made by Cabinet if it agrees to proceed with the capital scheme as outlined above.

Previous detailed VAT studies indicated that the preferred Management structure for the completed building would involve the development of an Independent third party trust/management company to take on a fully repairing and insuring lease and run the refurbished building. The creation of such a body ensured that VAT on the capital build cost incurred by the Council would be reclaimable if a lease was offered at a true 'peppercorn' and as 'non-business supply'. This approach eliminated the risk of Lancaster City Council exceeding its VAT threshold on 'non-statutory/essential' activity.

However, as noted in Section 1.0 Cabinet has resolved:

> *That the terms of the lease are such that surpluses achieved in the running of the Storey project be used to provide for a development fund that could be used to complete elements of the project omitted from the current scheme and repay the Council's contribution to the project.*

This resolution has a fundamental impact on the project approach and VAT risk. Informal advice from the HMRC is clear that the capital project's 'non-business' status would be invalidated by lease clauses that demand:

- A requirement for the repayment of any capital sum expended on the refurbishment
- A requirement to deliver the building back to the Council in an improved form
- A requirement to carry out, or make financial contributions towards, any arts/creative industries activities beyond those involved in meeting the Centre's own output objectives (though the Council can be specific about what those outputs are to be).

If Cabinet wishes to control or make use of the income generated during the period of the lease then it has to use an 'Option-to-Tax' route to be certain to reclaim VAT on the build costs. However, under this route a 'demonstrably commercial' rent must be set or the arrangement could be viewed as contrived and in contravention of anti-avoidance legislation. For certainty, then, the lease should be clearly either a 'commercial' or 'non-commercial' arrangement.

The main problem with a 'commercial' arrangement is that the business plan has been developed on the basis that there will be no rental liability on Storey Ltd. It is difficult to define what is commercial in terms of HMRC attitudes and the context of this project. If the Centre could obviously make £150k a year before rent and rent was set at £1k, then this would appear to look like a preferential, not commercial, arrangement. However, if the company is making very modest profits then £1k could be considered 'commercial'. There is also the risk of protracted negotiation between the company and the Council before this issue could be resolved. It is inevitable that a rent would have to be low making 'payback' relatively meaningless when compared to the Council's capital investment.

The Council is however able to exercise control through a number of elements in a 'non-commercial' approach that reduce the risk of non-performance of the company while giving VAT certainty. A 'peppercorn' lease is still able to define overall use of space and include the grant funder's use terms (Draft terms currently being discussed are attached in Appendix 2). It also allows the Council to 'step-in' in the event that Storey Ltd's business objects or terms of reference are altered to move the company from its current 'not for profit' status.

There is no VAT issue if the Council defines targets and actions through direct grant funding to Storey Ltd. In section 2.0 it was noted that some grant will be paid to Storey Ltd for project development purposes. Storey Ltd's access and use of these funds can be made conditional on specific achievements in terms of outputs and outcomes. A draft service Level Agreement is attached for information (Appendix 3).

In summary, Cabinet could commit to the arrangement with Storey Ltd as 'non business' under the broad lease and Service Level terms outlined and be confident that its own VAT position is secure and that an appropriate degree of control is being exercised over project outcomes. The apparent downside to this is that the Council would not be able to recover any of its capital contribution to the project, if Storey Ltd ever generated sufficient profits in future – but realistically there is little prospect of this situation occurring. (Members should also note, however, that recovery of the Council's contributions to the capital scheme could have led to complications with external funders, notably ERDF, as such repayments could be subject to clawback). This is different to the resolutions of Cabinet back in October, hence the re-consideration of this issue.

5.0 Conclusion

There is an opportunity to bring to fruition a development project that will contribute to the growth of the local economy by the provision of new employment generating workspace and supporting the Storey Ltd to become a powerful advocate for the creative industries sector in the district. This will require a significant financial contribution outside of the current Capital Investment framework and budgetary projections, however. Members are therefore asked to consider whether this scheme should proceed or not, under the terms outlined in the recommendations.

RELATIONSHIP TO POLICY FRAMEWORK

Corporate Plan - The project contributes towards the following Strategic Objectives Corporate Plan Priority 4 – "To lead the regeneration of our district

The capital financing position of the project falls outside of the Council's approved Capital Investment Strategy, however. That is why Cabinet would need to make recommendations on to Council, should it wish the project to proceed.

CONCLUSION OF IMPACT ASSESSMENT
(including Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing)

Diversity – The proposal aims to provide a wider range of employment opportunities to residents of the area.
Human rights – No adverse impact.
Community Safety – No adverse impact.
Sustainability – The proposal looks to support development, which will lead to local employment opportunities.

FINANCIAL IMPLICATIONS

CAPITAL

In line with the Council's Capital Investment Strategy, funding of the increase of £200,000 in the capital cost of the scheme will require approval by Council. The basic options are:

- use of prudential (unsupported) borrowing,
- additional use of revenue funding, and
- reductions elsewhere within the Capital Programme.

The outline implications of each are as follows. These would be assessed in greater detail for any subsequent report to Council.

- Including both interest and repayment of principal, the costs of borrowing would be between £17-20K per annum over the 25 year term of the project.

  Cabinet may be aware that following additional grant funding being obtained for the Luneside Scheme, there is almost £0.5M of 'unused' prudential borrowing, the costs of which have been provided within the revenue budget. Nonetheless, if Members choose to allocate any of this borrowing to the Storey project, there will be borrowing costs incurred as outlined – these would be avoided if the scheme did not progress.

- With the use of revenue funding, then compensating savings would need to be found, which could impact directly on the achievement of other objectives or priorities. Alternatively, if additional revenue reserves could be identified, there could still be a loss in investment interest of around £12,000 per annum.

- Reductions elsewhere within the Capital Programme would also impact directly on the achievement of other identified objectives and priorities.

REVENUE

The latest financial projections, as prepared by the Board of Storey Limited, have been reviewed in detail. In summary:

- adequate provision is made for expenditure, including levels of staffing sufficient to support the operation of the Centre,
- the one amendment that has been identified is that allowance should be made for irrecoverable VAT, estimated at approximately £15,000 pa, (note- this concerns Storey Limited's ability to recover VAT and is a separate matter to the VAT implications of the project for the Council, which are dealt with below,)
- there are remaining risks around two of the three main income streams, as follows:
  - ♦ lettings of creative space – targets are attainable, but challenging, with material risk of non-achievement, and
  - ♦ casual lettings of auditorium, etc – high risk of non-achievement,
  - ♦ the Board has identified a number of potential additional income streams which can be reasonably expected to mitigate these.

Taken together, these indicate that there is a material level of risk that financial targets will not be met, and that Storey Limited will require financial support during its early years of operation. Should this be the case then there are a number of potential sources of such support, but direct support by the Council may very well be needed and so some provision should be made for this at an early stage.

There are no net cost savings arising directly from the project to cover this. A number of possible other savings and additional income have been identified, but these are not yet definite. However, the key issue now is that, if approval is to be given to the progression of the scheme, the need for this provision is recognised and this is reflected in the recommendations. This could be provided through the existing flexibility and discretion that Cabinet has to increase future years' budget forecasts, as outlined in the report. Further detailed consideration would also be included within the 2008-09 budget process.

The recommended minimum level for such provision is £25,000 per annum for the first two years.

Storey Limited has a good prospect of its operations being self-financing by no later than the fifth year, but the possibility that it will require financial support, even if at a reduced level, into the fifth year and beyond, cannot be ruled out entirely, and Members would need to accept this residual risk. Should the performance of Storey Ltd be considerably poorer than anticipated, the Council would need to consider alternatives as set out in the report - such as stepping in as landlord and assuming control of the building, or agreeing a revised plan with some further initial short term revenue support - if there was convincing case that this would achieve a sustainable future for the Centre in the longer term.

Given the ongoing revenue position, as set out above, there is, unfortunately, no real prospect of Storey Limited being in a position to make the repayment of the Council's contribution to the capital cost, as was previously envisaged. Members should also note, however, that recovery of the Council's contributions to the capital scheme could have led to complications with external funders, notably ERDF, as such repayments could be subject to clawback.

Other revenue implications to note are as follows:

Luneside Studios: The recommendations provide for this income, estimated in the region of up to £10,000 pa to be used to help with Storey's start up costs. This has not previously been budgeted for, and so would not have any net impact on the Council.

Storey Gallery: At present the City Council provides grant funding to this organisation, which leases premises within Storey Institute. Once the Centre has opened, its rent payable will increase but it is assumed that the level of City Council grant funding will remain at current levels.

ASSET MANAGEMENT

The Council's principal contribution to the project, i.e. the commitment of a key asset with an estimated market value of £900,000, remains unchanged.

GRANT FUNDING

In the light of the changes made to the project, compared to the original proposals, clarification is being sought in order to ensure that these developments have had no impact on the validity of the existing grant funding approvals. This is for completeness and to ensure that the Council's interests are safeguarded, rather than because there is perceived to be an immediate problem. Should any difficulty be encountered then this would be referred to Cabinet.

VAT

A number of complexities in respect of VAT have been addressed.

In summary, in order to recover the VAT incurred on the capital project (a sum in excess of £500,000), and avoid rendering certain other amounts irrecoverable, the Council must either:

- charge Storey Limited only a peppercorn rent and classify the arrangement as 'non-business, or
- charge Storey Limited a 'commercial rent' and opt to charge VAT on this amount.

The latest advice from HM Revenue and Customs has indicated that, in this instance, a commercial level of rent could be a relatively low amount, eg £1,000 pa, which would not, in itself, jeopardise Storey Limited's financial viability.

The key distinction is that if the Council wished to require Storey Limited to either:

- make repayments of the Council's contribution to the capital scheme,
- carry out further development works to the building
- use its resources to contribute to the Council's activities beyond the operation of the Centre and its objectives, or
- provide the Council with any form of service, other than at full market price,

then the 'non-business' option would be invalidated and a 'commercial rent' would have to be charged.

If the Council does not wish to make any such requirement (and see above comments on the likelihood of the Business Plan being able to support them), then the 'non-business' route (i.e. based on a peppercorn rent) is the less complicated and the more appropriate of the two.

Should Members wish to pursue the option of disposing of the property instead of completing the project, then more work would be required to firm up options and likely disposal values. In essence though, the more development constraints etc. that Members wished to attach to the building, the lower the likely sale proceeds.

SECTION 151 OFFICER'S COMMENTS

The report provides up to date information on the estimated costs, together with financial and other associated risks attached to the project, based on contract prices and a more robust appraisal of the business plan. It also includes available indicative information on the implications for disposal of the property, although more work would be required to assess detailed options for this and this is reflected in the recommendations.

In essence the report sets out a clear choice for Members, i.e. whether to identify and allocate further capital and revenue funding to allow the scheme to progress, or whether to pursue disposal of the property. Each of these options would help support different objectives under the Corporate Plan – it is a question as to which one should take priority.

In reaching a decision, the s151 Officer would advise Cabinet to have regard to the financial outlook of the Council, in particular:

- capital prospects, including the need to generate capital receipts to fund the existing programme, as well as yet unquantified capital pressures such as those in relation to the wider accommodation review.

- Revenue prospects and the need (and scope) to make ongoing revenue savings if Council Tax / MTFS targets are to be achieved. This also includes consideration of prospects for Government funding, in line with the Comprehensive Spending Review.

The completion of the project would add further pressures to the Council's financial position. If Members wish the project to go ahead, therefore, the s151 would advise that Members need to be satisfied that they can achieve sufficient income and / or savings in order to deliver a balanced capital programme and revenue budget for the future.

The current Capital Investment Strategy, which was approved by Council in March, basically provides for any extra capital resources (such as from additional land sales or from unused prudential borrowing) to be 'set aside to cover any potential funding difficulties attached to the forecast capital receipts assumptions. It will not be used to support new or additional capital investment'. Should Cabinet wish the project to proceed, the extra investment required would be contra to the Strategy, hence the reason why referral on to full Council would be required.

LEGAL IMPLICATIONS

Legal Services have been consulted and will advise on the form of lease and service level agreement to satisfy the requirements for this proposed scheme

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments.

BACKGROUND PAPERS Previous report to Cabinet dated 05 September 2006 and Cabinet meeting resolutions from 24th October.	**Contact Officer:** Paul Rogers **Telephone:** 01524 582334 **E-mail:** progers@lancaster.gov.uk

Appendix 1

Summary of Expenditure Income Projections

Year 'minus one' (Pre Opening)	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	TOTAL
GRANT INCOME	£81,005	£833	£833	£833	£833	£0	£833	£6,833	£833	£833	£833	£833	£95,339
EXPENDITURE	£14,091	£8,291	£2,291	£2,541	£3,866	£3,866	£5,691	£7,441	£8,441	£14,791	£8,043	£15,991	£95,339

Year One (Opening Sep 08)						Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	TOTAL
INCOME						**£19,648**	**£19,648**	**£19,648**	**£19,648**	**£19,648**	**£19,648**	**£19,648**	**£137,533**
EXPENDITURE						**£19,712**	**£19,712**	**£19,712**	**£19,712**	**£19,712**	**£19,712**	**£19,258**	**£137,533**
												SURPLUS	**£0**

Year Two	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	TOTAL
INCOME	£21,860	£21,860	£21,860	£21,860	£21,860	£21,860	£21,860	£21,860	£21,860	£21,860	£21,860	£21,860	£262,316
EXPENDITURE	£21,757	£21,757	£21,757	£21,757	£21,757	£21,757	£21,757	£21,757	£21,757	£21,757	£21,757	£22,989	£262,316
												SURPLUS	**£0**

Year Three	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	TOTAL
INCOME	£24,688	£24,688	£24,688	£24,688	£24,688	£24,688	£24,688	£24,688	£24,688	£24,688	£24,688	£24,688	£296,255
EXPENDITURE	£24,626	£24,626	£24,626	£24,626	£24,626	£24,626	£24,626	£24,626	£24,626	£24,626	£24,626	£25,373	£296,255
												SURPLUS	**£0**

Year Four	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	TOTAL
INCOME	£27,429	£27,429	£27,429	£27,429	£27,429	£27,429	£27,429	£27,429	£27,429	£27,429	£27,429	£27,429	£329,143
EXPENDITURE	£27,242	£27,242	£27,242	£27,242	£27,242	£27,242	£27,242	£27,242	£27,242	£27,242	£27,242	£29,479	£329,144
												SURPLUS	**£0**

Year Five	Apr-12	May-12	Jun-12	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13	Feb-13	Mar-13	TOTAL
INCOME	£27,767	£27,767	£27,767	£27,767	£27,767	£27,767	£27,767	£27,767	£27,767	£27,767	£27,767	£27,767	£333,198
EXPENDITURE	£27,597	£27,597	£27,597	£27,597	£27,597	£27,597	£27,597	£27,597	£27,597	£27,597	£27,597	£29,632	£333,198
												SURPLUS	**£0**

Example Expenditure Profile (Year 3)

	Cost P/A			Cost P/A			Cost P/A
Staffing costs			**Building and Maintenance (cont.)**			**Office Running costs (cont.)**	
			On going general repairs	3,000		General office expenses	4,200
Centre Manager	39,306		Cleaning contract - whole building	23,870		Telephone, printing, stationary	4,947
Assistant Centre Manager	21,197		Window cleaning	2,546		Professional (legal & accounts)	2,596
Receptionist	30,618		Security Servicing	1,061		Marketing	5,000
Caretaker	17,664		Fire servicing	1,591		Web site maintenance	6, 365
Other staff costs (temp/recruitment etc)	3,819		IT servicing	2,575		***Office sub total***	***23,108***
Staffing sub total	***112,604***		Heating servicing	2,122		**Allowances**	
Building and Maintenance			Lift Servicing	2,122		Contingency for bad debt @ 2.5% of total income	7,406
Storey Ltd. Business Rates	17,345		Boiler servicing	2,060		Contingency I.e. reserves @ 10% of income	25,162
Water services	7,426		Grounds Maintenance	2,060		Sinking Fund for major repairs @ 4.5% of income	11,323
Heat Light & Power	30,900		Refuse collection	2,122		***Allowances sub total***	**50,804**
Insurance	15,914		***Building Sub Total***	***116,652***		**Total all 'Expenditure'**	**296,255**

Example Income Profile (Year 3)	Annual Income	Monthly Income
Event Income	£64,747	£5,396
Service charges @ 80% occupancy	£101,862	£8,488
Rents @ 80% occupancy	£129,646	£10,804
Total all income	**£296,255**	**£24,688**

Assumptions made to support Storey five-year revenue budget

Year minus one

It is assumed that the Board will receive £95k to assist them with pre opening costs from various external sources including cash for marketing from the City Council.

The Board is presently drafting a comprehensive pre opening Action Plan, which includes plans to:

1. Hire a Capital Project Commissioning Manager who will act as a temporary "Centre Manager". This post will be contracted to a "consultant" at a cost of about £31.5k plus VAT. The consultant will work closely with LCC staff and the Design Team to ensure that all systems such as fire/security/ICT, the design of bespoke areas and the catering facility are fit for purpose. The consultant will be the main point of contact for potential tenants.

2. Design and deliver a marketing plan, to include the creation of a WEB site (an audience development plan, the development of a booking system, the Building Sites Initiative, BillBoard, leaflets and later an advertising campaign). In addition, the plan will include a launch event.

3. Set up financial systems.

4. Staff recruitment. It is assumed that permanent manager will be recruited and in post by July 2008. The remaining staff will be in post shortly before opening.

5. Draft a Business Plan (a draft business plan must be submitted to ACE NW within 6 months of opening i.e. March 2009).

6. Draft applications for external funding.

7. Develop the business support services.

Assumptions that apply to all Years (one to five)

Services Charges

This version of the Business Plan charges a straight £6 per sq. ft. to each tenant as a service charge.

Rental income

1. Rent will vary between tenants. It is assumed that the existing Resident Art Organisations will pay a total of £12 per sq. ft. (rent and service charge). Therefore by charging £6 per sq. ft. service charge the rent to Folly, Storey Gallery and Litfest will be £6 per sq. ft.

2. Rents to other tenants are calculated likewise e.g. all existing vacant space (except the catering unit) will start at a rent of £8 per sq. ft. (£14 per sq. ft. in total).

3. The current Business Plan assumes an income from the catering unit of £16 per sq. ft. (a rent of £10 and service charge of £6).

4. The TIC will occupy rooms on the ground floor and space for storage (to be agreed) at a rent of £8 per sq ft and a service charge of £6 per sq ft. Also that the TIC rooms will be refurbished with NWRDA/LCC funds.

5. That Luneside Studios would continue the occupation of the Old Folly Annex and pay £10,000 per year.

6. It is assumed the occupancy level of "current" vacant space will be 60% early in year one. This will require that 15 workspaces are rented out early in the first year.

7. It is assumed that occupancy levels will increase at 10% per year to a maximum of 80% of "current" vacancies.

Other issues

1. At present it is assumed that VAT would not be charged to tenants.

2. That all tenants would pay their own business rates.

3. That the all Centre staffed (one Centre Manager, an Assistance Manager, two receptionists and one caretaker) are all paid 11% on costs. With the Centre Manager receiving a 3% pension.

4. That all non-staff expenditure on running costs, such as heat and light etc. would be very similar to existing costs and is therefore based upon existing centre costs and/or costs of similar serviced office accommodation.

5. Bad debt contingency is set at 2.5% of event income & 2.5% of rent from vacant space.

6. That inflation will be 3% pa and in the current Business Plan has been applied to expenditure only.

Specific notes on Year 0ne (From September 08 to March 09 only)

It is assumed:

1. The centre will open late August/early September 2008 staffed with a centre manager, supported by 4 staff.

2. It is assumed that the TIC will contribute towards the staffing of the reception area (details to be agreed).

3. That the old lecture theatre, the room opposite the theatre, the little gallery, old folly and the whole of the fourth floor would not be refurbished until after year 5 and therefore would not generate a ***regular*** rental income.

4. That occupancy levels (mainly the third floor) will quickly reach 60%.

5. That the catering unit will generate an income from day one.

6. That revenue from "events" e.g. conferences, meetings, weddings etc. would be low until the restored centre was established.

7. That Storey Ltd. not being a registered charity would be liable for business rates.

8. That Storey Ltd. would need to create provision for a working reserve (it is good practice to run any business with at least 6 months reserves), a provision for bad debt and a sinking fund for longer-term major repairs/restoration work.

Year One - Assumptions per budget line

1. Salaries
   - Centre Manager starts on £32,500 plus 3% pension
   - Assistant Manager starts at £18,000
   - Receptionists *2 start on £13,000
   - Caretaker starts at £15,000

2. On costs are set at 11%

3. A provision for other staff costs is set at £300 per month to cover recruitment, training and temporary staff

4. It is assumed that all business support services to clients will be delivered by external agencies.

5. Storey will pay business rates at c. £16k per year – this figure was supplied by LCC Property services.

6. All building and maintenance costs were estimated using current running costs of Storey, experience of LCC staff running other business support centre e.g. City Lab.

7. Office running costs are those needed to support the Centre staff group.

8. Professional fees are low as it assumed Board members will contribute in kind revenue costs.

Appendix 2

SCHEDULE OF TERMS AND CONDITIONS

FOR LETTING AT STOREY INSTITUTE

Landlord:	Lancaster City Council Town Hall Lancaster LA1 1PJ
Tenant:	Storey Creative Industries Centre
Premises:	Land and buildings known as the Storey Institute, Meeting House Lane, Lancaster and shown edged black on the attached plan.
Term:	From the date the City Council is granted hand over of the Premises from the contractor (a date to be determined) for a term of 25 years.
Rent:	One peppercorn if demanded.
Rates:	The Tenant will be responsible for business rates.
Insurance:	The Landlord will insure the building against fire and special perils, and shall recoup the premium from the Tenant
Existing Lettings:	This Lease is subject to several letting or occupational agreements which the Tenant must honour and take on the responsibility of the City Council where applicable. See Schedule 1.
Repair and Maintenance:	The premises are to be let on a full repairing lease This means that the Tenant is responsible for the premises and all additions thereto, including windows, window frames, glass, (including stained glass), door, door frames, locks fastenings, landlord’s fixtures and fittings, (including monuments and statutes), all walls, roof, main timbers, sanitary and water apparatus, all drains, soil and other pipes, eaves, gutters, cables and wires, in good and tenantable repair, and to decorate and paint the interior and exterior of the premises to the reasonable satisfaction of the Head of Property Services
Assignment/Subletting:	There is an absolute bar against assigning this lease.

The Tenant is not to sublet the premises without the written consent of the City Council, except sublettings of parts of the building for a term of less than 5 years. Such consent not to be unreasonably withheld.

Sublettings can only be granted to small and medium-sized enterprises (SME's).

The definition of an SME that is applied by all funders of the scheme and has been agreed by the UK government and the European Commission is:

Companies classified as small and medium-sized enterprises (SME's) are officially defined by the EU as having fewer than 250 employees. In addition, they can have an annual turnover of up to50 million euro, or a balance sheet total of no more than 43 million euros. This definition is important when figuring out which companies can benefit from EU programmes aimed at SME's, and from certain policies such as SME-specific competition rules. In reality, 99% of businesses in the European Union are small and medium-sized enterprises. It is noted that it is expected that the Storey CIC project will usually service "micro-businesses" i.e. with 10 or less employees.

Permitted Use: The Premises is to be uses for Creative Industries.

The UK Government Department of Culture, Media & Sport (DCMS) defines the Creative Industries as:

Those industries which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property.

The DCMS creative industries categories consists of production in the following sectors: Adverting, Broadcast network talent, Design, Journalism, Film, Fine Art, Game Development, Craft, Music, Performing Arts, Publishing, Software Development & Computer Services.

The use has also to comply with the restrictive covenant on the Council's ownership (in brief the building is to be used for science, art, technical and industrial education, along with art, science, literature & history. Religious and political meetings are prohibited).

Alterations:	The Tenant is not to make any alterations or modifications to the accommodation without the written approval of the Landlord (such consent not to be unreasonably withheld).
Fees:	The Tenant is to bear the City Council's legal costs of drawing up the lease.
Requirements of the Funders:	The Tenant must comply with the requirements of the funders. These requirements are detailed in Schedule 2.
Monitoring:	The Tenant must allow Lancaster City Council staff and the monitoring/audit staff of all funders free access to the building and Storey Creative Industries Centre's records and any and all times.
Other Terms:	Other terms shall be in accordance with the City Council's standard form of contract.

SCHEDULE 1

Agreement relating to the Tasting Garden with Art Transpennine

Between Lancaster City Council and Art Transpennine Limited of 74, The Headrow, Leeds. LS1 3AA.

The Company commissioned artwork, which is located within the garden at the Storey Institute.

Term of 10 years from 23rd May, 1998.

Agreement with Lancaster University for cabling within the Building

To be attached

Agreement with Seeds Savers for use and care of the Tasting Garden

To be attached

SCHEDULE 2

Requirements set down by the Funders of the Scheme

A. European Regional Development Fund (ERDF)

In summary the following European Commission requirements apply:

STRUCTURAL FUND REGULATIONS

Council Regulations 1260/99 (General Regulations) and 1685/2000 (Eligibility) apply to this project. Other Regulations produced under relevant Articles in 1260/99 and notified by the Commission from time to time may also apply to this project.

EUROPEAN COMMUNITY STATE AID RULES

The European Commission has considerable powers to monitor, control and restrict the forms and levels of aid given by all Member States to their industries. The principles underlying State Aid are set out in Article 88(3) of the EEC Treaty. Detailed guidance on State Aid rules can be found in "European Community State Aids: Guidance for all Departments and Agencies" published by DTI in March 1999 and the various frameworks and guidelines issued by the Commission on the application of the rules. All State Aid (other than those covered by de minimis provisions – see below) must be notified to and approved by the Commission in advance of implementation, otherwise it is illegal.

COMMUNITY PUBLICITY REQUIREMENTS

Commemorative plaques A permanent commemorative plaque shall replace the billboard, where the infrastructure project is accessible to the general public (e.g. congress centres, airports, stations, etc.). Such plaques must include the Community emblem, mention the EU's contribution and may mention the Fund concerned, (e.g. ERDF). In the case of physical investments in commercial business premises, commemorative plaques shall be installed for a period of a year.

MONITORING

Article 38 of EC Regulation 1260/1999 sets out the general provisions for financial control.

The City Council takes responsibility in the first instance for financial control of ERDF assistance. The measures taken shall include:

(a) verifying that management and control arrangements for individual projects have been set up and are being implemented in such a way as to ensure that Community funds are being used efficiently and correctly;

(b) carrying out on-the-spot checks, including sample checks, on the operations financed by ERDF funds and on management control systems;

(c) ensuring that all assistance is managed in accordance with all the applicable Community rules and the funds are used in accordance with the principle of sound financial management.

B. Arts Council

In relation to ownership and use, Art Council has stated that as a condition of their funding, the Tenant must advise that funding provider (and the city Council) if it wants to make any significant changes to the activities or use which differ from those detailed in the "Permitted Use" clause. The Arts Council may alter or withdraw the grant it has given if it considers the change in planned activity to be unreasonable. Therefore, the Tenant must not go ahead with any changed activity prior to receiving written consent to this change from the City Council and the Arts Council.

Should the Tenant:

(a) significantly change the activity for which the Arts Council granted funding without prior written approval from the Arts Council and the City Council or

(b) not use the Premises for the purpose the grant funding was awarded

then the City Council may be requested to pay back the grant to the Arts Council and the Arts Council will stop any further payments.

The Tenant must indemnify the City Council against this and ensure that this does not happen.

C. Single Regeneration Budget (SRB)

All or part of the grant is to be repaid to the SRB by the Landlord if:

1. There is a substantial change to the scheme which the Regional Development Agency (RDA) (funding body for SRB) has not approved, or any attempt is made to transfer or assign any rights, interests or obligations created under the funding agreement letter or substitute any person in respect of any such rights, interests or obligations, without the written agreement in advance of RDAs;

2. The Tenant or any other member of the Partnership fails to comply with the terms and conditions of the funding agreement letter.

3. A charge is taken on an asset financed wholly or partly from grant monies, without the written agreement in advance from the RDA;

4. SRB grant has not been used for the purpose for which it was given;

5. Any European Community obligation which restricts the payment of grant or limits the amount of grant payable under the State Aid rules is breached (in addition to State Aid rules);

6. Any other European Community obligation, which applies to the Partnership, to any project or to the Scheme, is not complied with;

7. A decision of the Commission of the European Communities requires repayment of all or part of the grant or a reduction in the amount of grant.

Appendix 3

LANCASTER CITY COUNCIL

DRAFT SERVICE LEVEL AGREEMENT

BETWEEN

LANCASTER CITY COUNCIL – ECONOMIC DEVELOPMENT & TOURISM DEPARTMENT (REGENERATION)

- and -

Storey Centre for Creative Industries (Storey Ltd)

PARTIES

This is an agreement between Lancaster City Council (hereinafter called "the Council") and Storey Centre for Creative Industries (hereinafter called "Storey Ltd.")

Lancaster City Council agrees funding for the provision of services by Storey Ltd., as set out in Parts 1-4 of this Agreement.

CONTENTS:

PART 1 - GENERAL CONDITIONS

1.1 OBJECT OF AGREEMENT

To operate the Storey Creative Industries Centre and provide services as set out in Parts 1-4 of this Agreement.

To recognise, represent and act as a voice for the Creative Industries sector within Lancaster & Morecambe District and local communities (see also Service Objectives and Specifications see Part 2).

The Council wishes to support the services of Storey Ltd. as by doing so, it will achieve a number of its corporate objectives (see also Service Objectives and Specifications see Part 2)

1.2 PERIOD OF THE AGREEMENT

The agreement will commence on 1st July 2007 and continue until March 31st 2012 a period of five years and nine months and could continue on an annual basis after that unless it is terminated under 1.15.

1.3 THE PARTIES' OBLIGATIONS

Storey Ltd. agrees to provide the services specified in Part 2 of this agreement (Service Objectives and Specifications).

The Council agrees to make the grant payments specified in Part 3 of this agreement (Financial and resourcing arrangements).

1.4 STATUS OF AGREEMENT

It is not the intention of either party that this Agreement shall be legally binding. However, the Council reserves the right to reclaim the funding provided if it is not used for the purposes set out in this Agreement.

1.5 STATUS OF SERVICE PROVIDER

In carrying out this agreement, Storey Ltd. is acting in its own right as a not for profit organisation.

1.6 MANAGEMENT

Responsibility for the management of Storey Ltd. is vested in its Board of Trustees, the membership and operation of which is laid down by a constitution of Storey Ltd.

1.7 PARTIES' REPRESENTATIVES

The Council and Storey Ltd. will each appoint a contact officer.

The role of the Council's contact officer is to:

- Be the initial point of contact within the Council for Storey Ltd.
- Inform Storey Ltd. of any issues which may have an effect on the implementation of the service provision in this agreement
- Provide information, advice and support to Storey Ltd. as reasonably required
- Set up quarterly monitoring meetings with Storey Ltd. contact officer to consider the information set out in Part 4 of this agreement
- Inform Storey Ltd. of any change in the Council's contact officer
- Monitor and audit outputs as specified in Part 2

The role of the Storey Ltd. contact officer is to provide the information required in Part 4 of this agreement and to inform the council's contact officer, in writing, if there is:

- a proposal by Storey Ltd. to change or reduce the services set out in Part 2 of this agreement;
- any amount to be taken into account under 3.2b (this must be notified by 1st February for the following financial year)
- a major change to the Storey Ltd. financial budget;
- a change to the Storey Ltd. constitution; or
- a change in the Storey Ltd. contact officer.
- To provide on request output information and any other information required by Council staff or auditors of external funding agencies

The parties' contact officers will be the (   ) for the Council and (   ) for Storey

Ltd. (Insert Job Title)

1.8 CONFIDENTIALITY

The Council accepts that some of the services Storey Ltd. offers are confidential and that all matters raised by individuals are kept confidential.

The Council expects that Storey Ltd. will not share the contents of this Service Level Agreement with anyone who is not either a member of the Board of Trustees and who is not an employee of Storey Ltd.

1.9 STAFFING

Storey Ltd. will be responsible for recruiting and training all staff and volunteers
Storey Ltd. will be responsible for managing all staff and volunteers

1.10 HEALTH AND SAFETY

The Storey Ltd. shall have regard to the requirements of the Health and Safety at Work Act, 1974 and any other Acts, Regulations, Directives or Orders etc about health and safety, including:

- Normal operating procedures(Copy needs to be supplied to the Council)
- Emergency operating procedures(Copy needs to be supplied to the Council)
- Activity Risk Assessments
- Child Projection Policy (Copy needs to be supplied to the Council)
- Staff qualifications (including all staff CRB checked at enhanced level)
- Suitable staff to client ratios on and off site
- Lone working – Risk assessments in place (including a response plan, who to contact)
- Safe operational methods (e.g. restricted access to kitchen etc)

1.11 INSURANCES

The Storey Ltd. will provide proof of adequate public liability insurance to cover such liabilities as may arise in the course of the services provided by Storey Ltd.

1.12 DISPUTE RESOLUTION

If either party considers the other to be in breach of their duties under this agreement or has a grievance about some aspect of the agreement's operation, the parties shall make every effort to resolve the issue through joint discussions.

Where this fails:

the party wishing to make the complaint should provide the other with written details, including proposals for resolving it;

a written response should be sent to the initiating party within 14 days;

if the response is not considered to resolve the issue, the initiating party may request in writing to the contact officer a meeting of the authorised signatories (or their successor);

where possible the meeting should be held within 14 days of the contact officer receiving the request;

If either party is dissatisfied with the outcome as notified to it in writing within seven days of the meeting, arbitration can be requested and this will take place with a mutually acceptable external party.

1.13 REVIEW

This agreement may require amendments in the light of experience of implementing its terms. Any amendments will need to be negotiated and agreed in writing by both parties.

The mechanism used for determining the grant set out in Part 3 cannot be the subject of an amendment under a).

An annual review of the level of services specified in Part 2 can be requested by either party, and a meeting held as soon as practicable after this.

Any amendment to the service specification under c) will need to be negotiated and agreed in writing by both parties, as would any amount to be taken into account under Part 3).

1.14 RENEWAL

This entire agreement shall be subject to a formal review beginning in January 2008 with the aim of establishing the conditions applying for the period commencing 1st April 2008.

1.15 TERMINATION

The agreement can be terminated by either party giving the other party six months notice in writing

Notice can be served if delivered, posted or faxed to the contact officer

PART 2 - SERVICE OBJECTIVES AND SPECIFICATIONS

2.1 PRINCIPLES UNDER WHICH THE SERVICES ARE PROVIDED

By working in partnership with the Storey Ltd., the Council will move towards achieving a number of its corporate objectives.

- To stimulate private investment.
- To achieve substantial area-wide environmental improvements in key locations.
- To provide new and refurbished business accommodation suitable for high growth and ICT businesses.
- To stimulate the creation new jobs and safeguard existing jobs
- To ensure that 15% of the new jobs created within the EDZ are accessed by residents of Communities in Need
- To support sustainable communities
- *Cultural Services Objectives to be added*

To contribute to a level of funding to assist the revenue “set up” costs (pre opening period from July 2007 to September 2008) associated with operating and providing services at Storey Creative Industries Centre

2.2 SERVICES FUNDED UNDER THIS AGREEMENT

1. Storey Ltd. to be responsible for providing the management function at the Storey Creative Industries Centre

2. Storey Ltd. to deal with all issues relating to the running of the Storey Creative Industries Centre including keeping the building clean and tidy, dealing with bookings and other enquires, stock control and replacement of consumable items (at no further cost to the Council) etc.

3. Storey Ltd. to provide a staffing structure to operate and provide services at the Storey Creative Industries Centre

4. Storey Ltd. to provide a minimum of 1,000sqm of work and office space for Small to Medium Enterprises SMEs belonging to the Creative Industries sector (see below for definitions of an SME and the Creative Industries). It is recognised that the minimum of 1,000 sqm will only be achieved once the third floor has been opened and refrublished

5. Storey Ltd. to provided a minimum of 209 sqm of gallery space i.e. the existing main gallery on the first floor

6. With the remaining space Storey to provide (at its discretion) other services to support client businesses and the wider community within the limitations set by the covenant and restrictions imposed by the external funders

7. Storey Ltd. to provide, in partnership with other business support agencies, a business support and advice service for all SMEs belonging to the Creative Industries sector, giving priority to businesses based within the Lancaster & Morecambe District

8. Storey Ltd. must ensure that all business support, direct or indirect, does not breach EU State Aids regulations (see below for details)

9. Storey Ltd. to deliver agreed outputs detailed in the grant Offer Letters of the European Union EU, Arts Council of England ACE NW and North West Regional Development Agency NWRDA (see below for details)

10. Storey Ltd. to promote and provide (with a range of art & cultural partners) a varied programme of art based activities and events for the whole community: Within the limitations placed on the building by its covenant and whilst ensuring all barriers to access are removed (see below for definitions)

11. Storey Ltd. to provide accommodation (at a fair and agreed rent) for the Lancaster City Tourism Information Centre TIC, which will act as a sub-regional TIC Hub

12. Storey Ltd. to promote and encourage suitable local clubs, groups and organisations to use Storey Creative Industries Centre

13. Storey Ltd. to work in partnership with relevant City Council Services in promoting and providing joint initiatives e.g. business support and art and cultural initiatives

14. Storey Ltd. may provide other support services for all clients using the Centre such as access to catering facilities

15. Storey Ltd. may develop and provide a range of commercially based services in order to generate additional income: Within the limitations placed on the building by its covenant and those impose by external funders

16. Storey Ltd. to actively seek external funding to expand the services provided at Storey Creative Industries Centre and to work towards making Storey Creative Industries Centre sustainable

17. Storey Ltd. to be keep detailed records for monitoring, evaluation and audit purposes. The records and the manner they are kept must be acceptable to the City Council and all external funding agencies for both the capital build and any future revenue activity e.g. the European Union, Arts Council of England NW, North West Regional Development Agency and lottery funding.

18. Storey Ltd. to be responsible for ensuring that State Aids rules are adhered to i.e. that a client SME does not receive more aid than allowed under EU law. Due to the nature of this project it is important that a record is made of all aid received by a client SME over the previous two years. In addition, that a record is kept of all support given to an SME, whether direct (cash) or indirect (an in-kind contribution/goods or services e.g. business advice) by Storey Ltd over the following third year. Please see below for details

19. Storey Ltd. should constantly press the case for improvements to the Storey Creative Industries Centre and services provided at the centre

20. Storey Ltd. should reinvest any surpluses back into the Centre for the benefit of all its stakeholders

21. Storey Ltd. should at all times allow a plaque(s) of an acceptable size to be placed in a prominent position (visible by users at the reception area) which acknowledges the contribution made to the Centre by all funding agencies. Each agencies should be represented equally in terms of size, position and visibility (see below for details)

2.3 DEFINITIONS OF TERMS USED ABOVE

<u>Definition of a Small to Medium Enterprise SME</u>

The definition of an SME that is applied by all funders of the scheme and has been agreed by the UK government and the European Commission is:

Companies classified as small and medium-sized enterprises (SME’s) are officially defined by the EU as having fewer than 250 employees. In addition, they can have an annual turnover of up to 50 million euro, or a balance sheet total of no more than 43 million euros. This definition is important when figuring out which companies can benefit from EU programmes aimed at SME’s, and from certain policies such as SME-specific competition rules.

Please note:
In reality, 99% of businesses in the European Union are small and medium-sized enterprises. It is noted that it is expected that the Storey CIC project will usually service “micro-businesses” i.e. with 10 or less employees.

Definition of the creative industries.

The UK Government Department of Culture, Media & Sport (DCMS) defines the Creative Industries as:

Those industries which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property.

The DCMS creative industries categories consists of production in the following sectors: Adverting, Broadcast network talent, Design, Journalism, Film, Fine Art, Game Development, Craft, Music, Performing Arts, Publishing, Software Development & Computer Services.

European State Aids Rules

The European Commission has considerable powers to monitor, control and restrict the forms and levels of aid given by all Member States to their industries. The principles underlying State Aid are set out in Article 88(3) of the EEC Treaty (basically State Aid law is anti competition law). Detailed guidance on State Aid rules can be found in the DTI "The State Aid Guide: Guidance for state aid practitioners" published by DTI in October 2006, a copy can be downloaded from the following WEB site:
HYPERLINK http://www.dti.gov.uk/bbf/state-aid/,
http://www.dti.gov.uk/bbf/state-aid/,
.

A more recent document issued by the EU can be found at:

http://ec.europa.eu/comm/competition/state_aid/studies_reports/vademecum_on_rules_2007_en.pdf.

A summary of State Aids relating to SMEs:

State Aid at the level of the SME. There is no aid to th
he SMEs provided that it is shown that they are charged the market rate for the services provided (or where there is some divergence between actual and market rents this will be "de minimis").

At the level of the users (the SMEs benefiting from aid), the measure (aid support) would constitute state aid within the meaning of Article 87(1) EC Treaty, except in so far as the de-minimis ceiling of €200,000 per aid recipient I(per

SME) is not exceeded over a period of three years … .

This means an SME can receive aid to the value of €200,000 within a three year period. It is therefore important that all previous aid and aid granted is recorded and should not exceed this limit.

The EU has a list of what constitutes aid, a few common examples are:

- State grants
- Provision of goods or services – free or at reduced cost
- Consultancy advice – free or at reduced cost
- Free advertising/marketing support
- Rents free or at less than market cost

Outputs

For all business support, job related and increase in sales outputs and results etc. need to be achieved by March 2012.

The European Union ERDF outputs are:

Premises Provided (sq m)	3,008
New Jobs Created	74
Of which, from under represented groups	33
Jobs Safeguarded	46
Of which, from under represented groups	18
Increased Sales	2,050,000

Net Additional Jobs	39
Net Jobs safeguarded	29.5
Net additional Value added	1,400,000
Net Value added safeguarded	637,875

The Arts Council of England outputs are:

Please note that ACE NW does not detail outputs as other funders but lists general activity/actions and "deliverables". Within the revised contract ACE NW states:

"The Storey will not be an arts centre. The centre will promote contemporary culture, visual arts and language … It will be an incubator for creative industries providing enterprise support for both resident and non-resident enterprises. The building will provide workspace, exhibition and sale space for the creative industries. The building will provide new conference/auditorium for up to 100 people

A post construction deliverable (6 months after reopening) will be an up to date 3 year business plan.

The North West Regional Development SRB outputs are:

Area of new/improved business floor space	2879 sq m
Number of buildings improved or brought back into use	2
New Business Start ups	15
Number of full-time equivalent permanent jobs created	4
Number of full-time equivalent permanent jobs safeguarded	29.5

<u>The Convenant</u>

The use has also to comply with the restrictive covenant on the Council's ownership (in brief the building is to be used for science, art, technical and industrial education, along with art, science, literature & history. Religious and political meetings are prohibited).

<u>Barriers to Access</u>

In order to ensure that no stakeholder group or individual citizen is excluded from the Centre, its events or the services it supplies, potential barriers to access should be over come. The Centre has to becomes as "inclusive" as possible to as wide an audience as possible; taking care that the following areas (the list is not exclusive) are covered:

Organisational barriers e.g. image, opening hours
Physical barriers e.g. mobility issues, the elderly and the young
Sensory barriers e.g. visual and hearing issues
Intellectual barriers e.g. people with learning difficulties
Social and cultural barriers e.g. image and language
Financial barriers e.g. free or cheap access is available to people on low incomes.

Please note: Storey Ltd. should consider developing its own Access Policy and Plan

<u>Acknowledging contributions from various agencies</u>

For all funders a permanent commemorative plaque shall replace the billboard (erected outside the building during the construction phase) where the infrastructure project is accessible to the general public. Such plaques must include the correct logo/emblem, mentioning if necessary the correct wording.

For example the EU emblem is the European Flag (using the colours pantone blue and yellow) with the wording “This Project was Part Financed by the European Union - European Regional Development Fund”. Examples of the logs to be used are (acceptable official alternatives can be used):

2.4 MEANS OF ACCESSING THE SERVICE

Storey Ltd. should ensure that an adequate marketing campaign is maintained and where possible local and regional media is used to promote the centre and its services.

2.5 SERVICE DEVELOPMENT AND IMPROVEMENT

The "partners" (Lancaster City Council’s Regeneration Services and the Storey Ltd.) will work together for the joint aim of enhanced service development and improvement.

2.6 USER FEEDBACK AND INVOLVEMENT

The Storey Ltd. will operate a procedure for representations and complaints about the service (copy needs to be supplied to the Council).

The Board of Trustees is to be constituted in such a way as to encourage representation from as wide a range of people.

PART 3 - FINANCIAL AND RESOURCING ARRANGEMENTS

Note: Initial start up costs will be provided in advance for the first year prior to opening only

For the financial year beginning April 2007, the Council has agreed that the grant to be paid to the Storey Ltd. shall be £(to be agreed) and used to fund:

- A Capital Project Commissioning Manager
- Staffing (to be employed shortly before the centre opening during the summer of 2008)
- Basic office equipment for centre staff
- Materials

- Marketing and promotion (including the building sites initiative)

- A limited programme of activities including the provision of an opening event

For the financial year beginning April 2007, Storey Ltd. must provide the Council with a pricing policy to include:-

- Details of an acceptable procurement procedure
- Commercial fees and charges and what this covers and to who that would apply to
- Discounted fees and charges and what this covers and to who that would apply
- Income targets
- Fund raising/Accessing external funding

Any grant(s) for potential future years will be determined and agreed by both partners as part of the review process and will need to be applied for separately from this SLA. It is expected that such grant applications will be for specific “projects” associated with measurable outputs and will not be used to cover the core costs of Storey Ltd.

Storey Ltd. agrees to submit, to the Council in each year of this Agreement, a copy of its audited accounts.

PART 4 - MONITORING & PERFORMANCE ARRANGEMENTS

Regeneration Service’s will monitor and evaluate the implementation of the Service Level Agreement and how it performs against corporate objectives.

Each year a full Budget proposal shall be submitted to the appropriate Review Board in time for consideration as part of the Budget process.

Storey Ltd. will provide a copy of the Annual Report to the council and an invitation for the council's contact officer to its Annual General Meeting.

Storey Ltd. will provide information reasonably required by the council, subject to those requirements not being in breach of clients' confidentiality. Information will not be required more frequently than at quarterly intervals

These monitoring arrangements can be amended by agreement between the council and Storey Ltd. to reflect changes in service practice, for example data collection.

Regeneration Services expect that registers of attendance at events, appropriate records of business support, records of jobs created and safe guarded and increase in sales will be produced, using forms agreed by both parties

Storey Ltd. will allow access to all parts of the building and all records associated with outputs and external project financial information to monitoring and audit staff from the City Council and external funding bodies. Normally prior notice in writing will be given but Storey Ltd. should be aware that external funding programme audit staff can, if they wish, visit the centre without prior notice.

Regeneration Services expect that the contact officer for Storey Ltd. will attend regular meetings and if they can not attend then they will send a representative

Regeneration Services expect that if any services are stopped they will be informed immediately

Regeneration Services expect that all activities will be linked to meeting the aims the Council's Corporate Plan and Regeneration Services Business Plan

PART 5 - DECLARATION

On behalf of Lancaster City Council I confirm that I have read the agreement as set out above and the council will comply with the terms and conditions contained within

Signed…………
Date:……………………………………

Name of authorised signatory for Lancaster City Council :…………
.

Position:…………
.

Address to which communications relating to this agreement should be sent:

Head of Regeneration Services,
Lancaster City Council,
Town Hall,
Morecambe
LA4 5AF

On behalf of the Storey Ltd. I confirm that I have read the agreement as set out above and the Storey Ltd. will comply with the terms and conditions contained within

Signed …………
Date:……………………………………

Name of authorised signatory the Storey Ltd.

…………
……………………………………..

Position:…………
.

Address of Storey Ltd.:

Storey Ltd.
Storey Insitute
Meeting House Lane
Lancaster
LA1 1YQ

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