

**LORN ARC - UPDATE REPORT AS AT 14 JULY 2017**

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**1. EXECUTIVE SUMMARY**

- 1.1 On 8 May 2014, Scottish Government ("SG") granted approval of the Lorn Arc Tax Incremental Financing ("TIF") Business Case, thereby awarding the Argyll & Bute Council Lorn Arc project (The "Project") TIF pilot status under the TIF pilot administration scheme. Selection of the Project as a pilot project provided SG and Scottish Futures Trust ("SFT") with an opportunity to assess how the TIF model might operate on a smaller scale project in a rural setting. This was regarded as an innovative approach to exploring a potential funding mechanism for a range of economic development and infra structure projects that otherwise could not be delivered within available funding. The Project consisted of 9 individual projects across various locations, namely: Barcaldine, Oban Airport, Dunbeg Corridor, and Oban town centre.

Unfortunately, due to a number of changes, such as changes in the wider economy and the follow on effects for business in Argyll & Bute, the business case, as originally envisaged, has proved unviable. A re-modelling exercise indicates that in all cases (best to worst case scenarios), there is a deficit over the 25 year TIF period for the full potential capital spend programme of £14.74m. Whilst the full programme has been assessed as financially unviable, it should be noted that the current level of approved drawdown (£1.388m. of which £0.785m has actually been drawn down and spent), is forecast as being capable of being paid from TIF income over the life of the project based on the current NDR assumptions.

- 1.2 Argyll & Bute Council submitted a letter (dated 3 February 2017), signed by the Leader of the Council and the Policy Lead for Sustainable Economic Growth, seeking confirmation from the SG of their willingness to engage with the Council to find alternative funding sources and/ or financing models for the delivery of the Lorn Arc programme and its associated social and economic outcomes. The Cabinet Secretary for Finance and the Constitution Derek MacKay replied (dated 26 February 2017), and confirmed that the affordability position of the Lorn Arc programme has been noted and advised that the SG remains committed to supporting Local Authorities and their use of innovative financing models to support inclusive growth.
- 1.3 At the March 2017 Policy & Resource Committee meeting, the Lorn Arc team was authorised to engage with SG and the SFT to progress alternative solutions for the delivery for the Lorn Arc programme, in line with the Ministerial comments noted above. The team met with SFT in March 2017 and a Council TIF Programme Board was subsequently held in April 2017.
- 1.4 The TIF Programme Board have noted that the likely solution for the programme would be the progression of a case for use of a growth model such as the Growth Accelerator or a Rural Growth Fund. Moving forward with an alternative funding model, however, requires a high degree of clarity and clear identification of the projects that would form the basis of that deal.
- 1.5 Individual projects are being progressed in different ways. A briefing meeting (on

Wednesday 9 August) for the Oban members included an overview of this. In addition to the detail within the main body of the paper, the updates provided at this meeting are included as appendices.

- 1.6 Budget: Detailed below is the current budget position for both the revenue and capital approved budget allocations.

<b>REVENUE</b>	<b>£000s</b>
Total approved funds	1,607
Total project spend to date June 2017	464
Balance	1,143
<b>CAPITAL</b>	<b>£000s</b>
Total borrowing approved	1,388
Total project spend to date June 2017	785
Balance	603

- 1.7 It is recommended that the Policy & Resources Committee:

1. Note the updates on the Lorn Arc programme provided in the paper and the attached Appendices A through to I.
2. Note the detail provided in para 4.4 of this report and endorse officers continuing to explore alternative funding models that will unlock the economic potential of Oban.
3. Agree that the remaining available drawdown of £90k can be used as a contingency fund for Project 1. Lorn/ Kirk Road and note that the Lorn Arc team will continue to manage Project 1. Lorn/ Kirk Road until the infrastructure (road and associated utilities) element of the project is delivered, and that once delivered, the project will be removed from the TIF programme.
4. Note and endorse that with regard to Project 3. Halfway House Roundabout, officers are working with the private sector on potential investment opportunities, and are presently awaiting feedback from private sector commercial agents.
5. Agree to the development of a Strategic Development Framework for Project 4. Oban South and a report coming back to members in the first quarter of 2018.
6. Agree to the development of an options appraisal for Project 5. North Pier Extension, which will be discussed with members in December.
7. Note that with regard to Project 9. Oban Airport Access and Enablement, the Lorn Arc team are working with a range of Council Services to enable the work on this project to be completed.

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**2. INTRODUCTION**

- 2.1 This report provides the Policy & Resources Committee with an update on progress in relation to the Lorn Arc TIF, and the latest budget position as at the end of June 2017.

**3. RECOMMENDATIONS**

- 3.1 It is recommended that the Policy & Resources Committee:
1. Note the updates on the Lorn Arc programme provided in the paper and the attached Appendices A through to I.
  2. Note the detail provided in para 4.4 of this report and endorse officers continuing to explore alternative funding models that will unlock the economic potential of Oban.
  3. Agree that the remaining available drawdown of £90k can be used as a contingency fund for Project 1. Lorn/ Kirk Road and note that the Lorn Arc team will continue to manage Project 1. Lorn/ Kirk Road until the infrastructure (road and associated utilities) element of the project is delivered, and that once delivered, the project will be removed from the TIF programme.
  4. Note and endorse that with regard to Project 3. Halfway House Roundabout, officers are working with the private sector on potential investment opportunities, and are presently awaiting feedback from private sector commercial agents.
  5. Agree to the development of a Strategic Development Framework for Project 4. Oban South and a report coming back to members in the first quarter of 2018.
  6. Agree to the development of an options appraisal for Project 5. North Pier Extension, which will be discussed with members in December.
  7. Note that with regard to Project 9. Oban Airport Access and Enablement, the Lorn Arc team are working with a range of Council Services to enable the work on this project to be completed.

**4. DETAILS**

- 4.1 On 8 May 2014, Scottish Government ("SG") granted approval of the Lorn Arc Tax Incremental Financing ("TIF") Business Case, thereby awarding the Argyll & Bute Council Lorn Arc project (The "Project") TIF pilot status under the TIF pilot administration scheme. Selection of the Project as a pilot project provided SG and Scottish Futures Trust ("SFT") with an opportunity to assess how the TIF model might operate on a smaller scale project in a rural setting. This was regarded as an innovative approach to exploring a potential funding mechanism for a range of economic development and infrastructure projects that otherwise could not be delivered within available funding. The Project consisted of 9 individual projects across various locations, namely: Barcaldine, Oban Airport, Dunbeg Corridor, and Oban town centre.

Unfortunately, due to a number of changes, such as changes in the wider economy and the follow on effects for business in Argyll & Bute, the business case as originally envisaged has proved unviable. The last TIF Executive meeting with SG and SFT took place on 5 December 2016, where the financial model update that took into account changes arising from a property market conditions review was reported. The Commercial Agent's (Ryden) report, taken together with the Council's own knowledge of the prevailing local market conditions, suggested that timing and magnitude of future development and the associated incremental Non Domestic Rates ("NDR") generation is unlikely to be forthcoming as anticipated in the 2013 Full Business Case ("FBC"). The result of this re-modelling exercise was that in all cases (best to worst case scenarios), there is a deficit over the 25 year TIF period for the full potential capital spend programme of £14.74m. This exercise demonstrates that, in the present form, the full TIF programme of £14.74m is not currently affordable, based on those current NDR assumptions.

Whilst the full programme has been assessed as financially unviable, it should be noted however, that the current level of approved drawdown (£1.388m, of which £0.785m has actually been drawn down and spent), is forecast as being capable of being repaid from TIF income over the life of the project based on the current NDR assumptions. It was reported in March 2017, that no one event or issue has led to the current affordability position, rather a combination of a number of factors such as change in property market assumptions, new business eligibility for the SG reliefs & exemptions in terms of NDR, and change in land ownership at the Barcaldine site. Key projects are still being progressed through various means and details are outlined below. Notwithstanding this progress the project team continues to take a cautious and prudent approach in terms of delivery and the drawdown of any further TIF debt will continue to be subject to affordability testing and internal governance processes as outlined in the Project Initiation Document ("PID").

- 4.2 Argyll & Bute Council submitted a letter (dated 3 February 2017), signed by the Leader of the Council and the Policy Lead for Sustainable Economic Development, seeking confirmation from the SG of their willingness to engage with the council to find alternative funding sources and/ or financing models for the delivery of the Lorn Arc programme and its associated social and economic outcomes. The Cabinet Secretary for Finance and the Constitution Derek MacKay replied (dated 26 February 2017), and confirmed that the affordability position of the Lorn Arc programme has been noted and advised that the SG remains committed to supporting Local Authorities and their use of innovative financing models to support inclusive growth. He also endorsed further exploration of viable alternative options that will deliver economic growth within the Lorn Arc area.
- 4.3 At the March 2017 Policy & Resource Committee meeting the Lorn Arc team was authorised to engage with SG and SFT to progress alternative solutions for the delivery for the Lorn Arc programme. The team met with SFT in March 2017 and a Council TIF Programme Board was subsequently held in April 2017.
- 4.4 The TIF Programme Board have noted that the likely solution for the programme would be the progression of a case for use of a growth model such as the Growth Accelerator or a Rural Growth Deal. Both options are similar in that they require the identification of economic outcomes (e.g. jobs, GVA etc.) resulting from public sector provision of infrastructure. Initial funding is generally provided by the Local Authority, at risk, and government funding is only released when pre-agreed outcomes are achieved. Growth Accelerators and Growth Deals differ from TIF programmes in that they do not rely on increased NDR to repay borrowing. The level of funding is certain provided the outcomes are achieved. If projects are clearly identified and defined ahead of discussions in relation to an Argyll wide Rural Growth Deal then it would be possible to seek develop a Growth

Accelerator business case for Oban to replace the TIF model. This, however, requires a high degree of clarity and clear identification of the projects that would form the basis of that deal. This is necessary in order to identify outcomes that could reasonably be expected to result from the investment, which represent an acceptable level of risk to the Council and which meet the aspirations of Scottish Government. The paragraphs below outline the position in relation to projects currently under consideration.

- 4.5 **North Pier Extension:** With the recent opening of the CHORD Transit Berthing Facility, the North Pier is becoming more tourist focused. As a result of this it is considered that an options appraisal for the future potential development of North Pier will be taken forward and presented to OLI members in December. Other locations in North Lorn will also be looked at to support the increased Lorn industrial demand which is more suited to a site outwith Oban town centre.
- 4.6 **South Oban Development Zone:** The original TIF business case did not identify a specific project in the south of Oban but made assumptions about the potential investment and returns. The view is that in terms of Oban South Development Zone, the development of a Strategic Development Framework is essential. This will capture 'Oban as a University Town' ("OaUT"). And is based on the fact that this initiative is likely to be integral to this project and the Council continues to have positive discussions with Highlands and Islands Enterprise ("HIE") and education partners in this regard. It should be noted that the OaUT initiative has a project team and steering group made up of a group of stakeholders, of which the Council is a member of each. A 5 year Action Plan is to be developed by the end of October 2017 and this is expected to identify infrastructure requirements which will need further investigation (including where necessary captured in the Local Development Plan 2 which is due for adoption in 2020). These may require public sector funding. Until the infrastructure requirements are identified it is not possible to factor any projects into a business case for an alternative funding mechanism.

In addition to the OaUT work, there are various other works ongoing by HIE (facilitation and construction of a new road which will release circa 5 acres of business land), Council Estate Services on potential uses of unused land, Council Road Services with a car parking study of Council owned car parks (potential car parking solution being explored), and development of the Roads Depot site that was demolished after a fire. An update to Strategic Development Framework will be reported to Members early 2018.

- 4.7 **Oban Airport:** An access road has been built as envisaged in the original TIF business case and further work has been ongoing to inform options for marketing and developing the site. Commercial Agents Ryden have recently completed a report assessing the property market and considering options for development of the site. In summary the report findings support through a public/ private joint venture, a phased development for a mixed use development, to offer some class 4 (office) and class 5/6 (industrial) space, while reserving land for future hotel and aircraft hangar phases. In the 2013 Full Business Case it was envisaged that the demand would come from class 4 (office) use. This did not materialize and this approach aligns with Private Sector interest already on the site where there is a higher demand for class 5/6 (industrial). A master plan is currently being prepared which, together with Council investment options for the Airport Business site, can be used to market the site for development on a joint venture basis. Proceeding on the basis of a joint venture would provide access to private capital, expertise and the sharing of risk. It is anticipated that the draft masterplan to cover Oban airport land holdings will be complete by the end of August. .

The masterplan document being produced by the Lorn Arc team looks at the development potential for all of the land out-with the current Airport operational boundary (this goes beyond the area originally identified in the TIF business case) which is predominantly

within Council ownership (there are small pockets of ground owned by third parties). The focus of the masterplan is on various, currently unused, areas of ground owned by the Council, which, if developed responsibly, are a potential source of both revenue generation for the Council and socio-economic uplift for the wider community. This masterplan packages these land parcels into 'sites' and then explores their development potential and the measures needed to realise / explore further this development potential.

Further detailed development of options and discussions on the path forward will take place between Development and Infrastructure Services and Customer Services to determine our development strategy for the site, which will build upon the assessment of market and planning potential, appraised values and will recommend a way forward for the Council. Through Business Days, OLI Members will be kept updated on this process as it develops.

- 4.8 **Dunbeg Lorn/ Kirk Road:** Council Housing officers previously submitted an expression of interest to SG for up to £1.75m in grant funding to upgrade the Dunbeg Lorn/ Kirk Road under the SG Housing Infrastructure Fund ("HIF"). This grant funding has been earmarked for the project by SG but requires a detailed application with associated costings to the SG HIF. The Council Invitation to Tender was placed on Public Contracts Scotland on 23 June 2017, and contractor replies received 7 July 2017. The replies are presently being evaluated for Preferred Contractor and the intent is to have the final HIF application costs to SG mid-September 2017. Subject to a successful grant application, and to allow alignment with HIE and the Public Utility companies, forecast construction would start January 2017, with completion mid-2018. SG have requested under the Lorn/ Kirk Road HIF application for the Council to submit as part of the grant application package, what the Council contribution will be. It is proposed, in principle that the design and survey costs of £0.148m are the Councils contribution. SG have also informed the Council that the HIF would be provided in the same way as a Housing Association Grant, so we could not apply for any more than the contract value, or apply for any contingency. It is also proposed in principle, that if during project execution a requirement for contingency such as compensation events occurs, the remaining available drawdown of £0.09m of the approved £0.238m is available for use. It should be noted that the current level of approved drawdown (£1.388m. of which £0.785m has actually been drawn down and spent), is forecast as being capable of being paid from TIF income over the life of the project based on the current NDR assumptions.

As the potential SG HIF will fund the construction of the Lorn/ Kirk Road only to the turn for the existing housing estates, and not to the European Marine Science Park which is a further circa 170m of road, Council Officers communicated to HIE that there would be the potential of considerable savings to HIE if they were able to have an approved design and use the same works contractor as the Council. HIE are therefore presently looking at funding options for their design and construction.

The Lorn Arc team have the Project Management lead throughout the SG HIF application process and the construction works until the project is delivered. After the project is delivered and adopted by the Councils Roads Officers, the project can be withdrawn from the TIF programme and taken forward by appropriate council officers, HIE in relation to their own section of the road, and housing developers.

- 4.9 **Dunbeg Halfway House Roundabout:** The developer planning a large scale luxury hotel and spa resort at the Dunbeg/ Halfway House site has recently renewed the planning permission in principle approval for the roundabout and is seeking to renew planning consent for its own development, which signals a positive intention from the developer. In addition, a commercial area sub-committee of the Dunbeg Working Group which is chaired by Link Group, met on Monday 7 August 2017. Participants included

representatives of the Council, the developer, Link Groups Construction Consultants MacLeod's and their Commercial Consultants Colliers. The meeting was positive and the Council reconfirmed its willingness to invest circa £2m, as soon as the private sector responded in a way that lets us proceed i.e. evidence that sufficient NDR income that will repay the Councils borrowing will be forthcoming. Assuming it is viable, officers will progress the project to construct the roundabout, which would provide access to the hotel site to the east and a small commercial site to the west (road access to potential housing sites would not be eligible for the TIF programme funding).

4.10 **Programme Risks:** Following the November 2016 financial model update, and issues arising since in terms of project delivery timeframes, the majority of the risks are deemed high around the complexity of the funding model, and lack of private investment. All of which are regularly monitored with movements reported to Members, the TIF Executive and TIF Programme Board. In terms of Project Risks, Dunbeg Lorn/ Kirk Road Improvements is deemed to be a medium risk, due to the potential of securing SG HIF funding.

4.11 **Financial Model Summary Output:** The financial model calculates the affordability of the Programme over the life of the TIF Agreement. Amendments to timescales, cost of the TIF investment, projected increases in NDR and their timing, cost of borrowing and inflation can all change the output of the programme financial model.

As reported in March 2017, the Commercial Agent's (Ryden) report, taken together with Argyll & Bute Council's own knowledge of the prevailing local market conditions, suggested that the timing and magnitude of future development and the associated incremental NDR generation is unlikely to be forthcoming as anticipated in the 2013 FBC. The result of this re-modelling exercise was that in all cases (best to worst case scenarios), there was a deficit over the 25 year TIF period for the full potential capital spend programme of £14.74m. This exercise demonstrates that, in the present form, the full TIF programme of £14.74m is not currently affordable, based on those NDR assumptions. It should be noted however, that the current level of approved drawdown (£1.388m, of which £0.785m has actually been drawn and spent), is forecast as being capable of being repaid from TIF income over the life of the project based on current NDR assumptions.

4.12 **Budget:** Detailed below is the current budget position for both the revenue and capital approved budget allocations.

<b>REVENUE</b>	<b>£000s</b>
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## 5. CONCLUSION

5.1 The team's current focus for delivery of projects in the Oban area is the Dunbeg corridor, which would see development of the Halfwayhouse roundabout (potentially via current TIF arrangements), Lorn Road/ Kirk Road development (via SG's Housing Investment Fund), and the Oban Airport Business Park (via a potential public private joint venture) that will be informed by market reports, development options and a masterplan covering

Oban Airport land holdings. The team is also taking forward a Strategic Development Framework in association with Project 4 – Oban South with the intention to report back to Members in the first quarter of 2018.

In view of progress to date and reported changing market conditions, the team continue to review projects to analyse the potential of them being delivered under current TIF arrangements (with an initial focus on the Dunbeg corridor and commercial/ leisure development, which this would unlock). However, work continues to explore all potential projects which could deliver economic and social benefits for the Lorn Arc area and this exploratory work will be undertaken with cognisance of the work that is ongoing with regards to the Rural Growth Deal.

If projects are clearly identified, and fully defined, ahead of discussions in relation to an Argyll wide Rural Growth Deal then it would be possible to seek to develop a Growth Accelerator business case for Oban to replace the TIF model. This would require Scottish Ministerial approval.

## **6. IMPLICATIONS**

- 6.1 **Policy** - The delivery of this project fits with the Council's Corporate Plan, Local Outcomes Improvement Plan, Economic Development Action Plans (EDAPS) and approved Local Development Plan. The economic outcomes from this project will contribute to the Scottish Government's National Economic Strategy.
- 6.2 **Financial** - Note affordability of NDR uplift, also alternative funding sources being pursued, and that the current level of approved drawdown (£1.388m, of which £0.785m has actually been drawn down and spent), is forecast as being capable of being repaid from TIF income over the life of the project under current NDR assumptions.
- 6.3 **Legal** - Each project will have differing legal requirements; this will be laid out in each project's PID. No legal issues at Programme level.
- 6.4 **HR** - None.
- 6.5 **Equal Opportunities** - There are no equal opportunities implications.
- 6.6 **Risk** - As outlined in 4.10.
- 6.7 **Customer Service** - There are no customer service implications.

**Executive Director Development and Infrastructure Services:** Pippa Milne.

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11th August 2017

For further information - please contact:

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## **APPENDICES**

Appendix A – Tax Incremental Financing Overview

Appendix B – Project 1. Lorn Kirk Road



Appendix C – Project 2. Dunbeg Gateway Features  
Appendix D – Project 3. Halfway House Roundabout  
Appendix E – Project 4. Oban South  
Appendix F – Project 5. North Pier Extension  
Appendix G – Project 6. North Pier Streetscape  
Appendix H – Projects 7 & 8. Barcaldine Access Improvements / O&M Investments  
Appendix I – Project 9. Oban Airport Access and Enablement