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Economy, Energy and Tourism Committee

Room M2.07

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Dear Mr Fraser,

I welcome the opportunity to appear before the EET Committee on the 9th of March 2016, following the session with Creative Scotland, Scottish Enterprise and Highlands and Islands Enterprise on the 10th of February.

I appreciate that the Committee and the wider screen sector have found the situation regarding the work to deliver enhanced studio facilities frustrating and I share the Committee's disappointment that our ambitions in this regard have yet to be realised despite the considerable efforts of the respective members of the Film Studio Delivery Group (FSDG).

We have been very clear however that we want to make this happen and are doing all that we can to find a way through some very complex territory, particularly in regard to state aid. As such, in the spirit of facilitating a productive session on the 9 March, I thought it would be helpful to set out some of the key issues and challenges to inform the discussion.

Background

The Scottish Government is working with Scottish Enterprise and Creative Scotland, as members of the FSDG, to support the delivery of enhanced studio infrastructure for Scotland. This has not been easy and you are aware that there have been ongoing negotiations with a private sector developer regarding a proposal for a permanent facility since January 2015. The FSDG has made significant efforts to progress this work and we are all committed to delivering a positive outcome.

The Committee has previously expressed concern and frustration at a perceived lack of timeframe or work-plan put in place by the FSDG for this project. I hope it's helpful to clarify that, as this is a private sector led project, the FSDG has not been in a position to dictate terms and timelines unilaterally. It is also important to note that the FSDG partners are *not procuring* a film studio. Rather, as we have stated from the outset, we welcome proposals that: are private sector owned and operated; meet the needs of industry; and would be financially viable *with the level of financial support that the public sector is able to provide under EU rules on state aid*.

Current studio provision

Within the Scottish Government and our partner bodies in the FSDG, we are looking at *new* studio provision from two perspectives.

Firstly, the on-going work to support the delivery of additional screen studio facilities in a public/private partnership. I am pleased to be able to let you know that the FSDG has secured agreement from our private sector partner to talk about this ongoing and commercially sensitive work in greater detail. As a result, I would be happy to elaborate on this as much as is appropriate at our meeting on the 9th of March. I am keen that Parliament and this Committee is briefed on this important matter, as soon as the private developer agrees that we can, but just for awareness there are plans to issue a news release and brief journalists on the negotiations to develop the new site.

Secondly, wholly private led initiatives such as the Pentlands proposal for a film and TV studio in Midlothian. The FSDG has not been approached for any public sector support with regards to this proposal. Scottish Enterprise has had regular contact with the Pentlands Studio team and are happy to talk further at any time regarding the project. The planning application for the Pentland Studio facility is currently at appeal with Planning and Environmental Division (DPEA). The Scottish Ministers have issued a recall direction in this case confirming that they will make the final decision on this appeal following submission of a report and recommendations from the DPEA reporter. As I am sure you will appreciate, it would not be appropriate for me to comment on the specifics of the planning proposal given that it will be the subject of a decision by Ministers later this year.

It is also worth noting that the FSDG supports *existing* studio provision in the form of temporary studio facilities in vacant industrial sites across Scotland such as Glasgow Clyde College and The Shed in Glasgow which were both used in the production of *World War Z*. Another example is Studio Alba in Stornoway which has been used by several clients including ITV, SSC Alba, MacTV, Tern Television with productions such as *Katie Morag* and several Gaelic programmes. Scotland already has a total of 118,000 square feet of converted stage space in use with TV drama production at Ward park and in Dumbarton. The Screen Commission is also marketing a total of 338,336 square feet of build space across Scotland's central belt, of which 173,095 square feet is currently in use by four productions. This demonstrates that we have an active industry at the moment and there is demand to expand it which is why we are looking at new studio facilities. Creative Scotland, as the lead body for film, are constantly updating the portfolio of suitable spaces for production and the latest availability can be found here:

<http://www.creativescotlandlocations.com/?a=31997>

Wider Support for Screen

I think it's also helpful to note that the studio, although critical to our collective ambitions for screen in Scotland, will not succeed without a wider suite of support and incentives in place. That is why the Scottish Government and Creative Scotland have worked collaboratively to develop ideas for new schemes such as the Screen Skills Fund, the Tax Credit Loan Facility and the Production Growth Fund. These

new funds bring a welcome additionality to the existing and on-going funding and support available from Creative Scotland. I hope to elaborate on some recent successes with regards to the Production Growth Fund for example, in due course.

State Aid Position

Separate to the issue of EU funding mechanisms, EU state aid legislation applies to the UK in relation to compliance with aid intensity levels or the proportion of public investment compared to private in a public/private partnership. Given the scale and nature of the facility, we would be competing at a UK and European level to attract productions and production funding, so the key principle underpinning state aid rules is to prevent distortion of the market. A company in receipt of public sector support gains an advantage over its competitors and so the amount of support that can be provided by the public sector is strictly limited. The level of support that the public sector can provide depends on the intended location and the size of the company.

It is agreed that market demand for a studio facility exists, particularly in relation to international high-end TV and film production, driven substantially by available UK tax credits. Nonetheless, a state aid compliant solution is challenging to achieve because the limited and volatile revenue stream available to studio developers is likely to require substantial public support (which may then exceed regional state aid thresholds).

I can assure Committee members that there has been rigorous consideration of the issues in conjunction with the Scottish Government's own State Aid Unit and I hope that the information set out below provides some helpful context in terms of setting out some of the challenges we are currently negotiating.

The introduction of the General Block Exemption Regulation (GBER, effective on the 1st of July 2014) informed the development of our conclusions and the articles below may be of particular interest to Committee members:

Article 53 Aid for Cultural and Heritage Conservation

Under this article, eligible costs (including construction costs) can be supported if at least 80% of either the time or the space capacity per year is used for cultural purposes. The State Aid Unit enquired if it would be possible to use this article to justify the construction or adaptation of premises for film studio use. The informal view from the EU was that this is **not** the type of activity intended in this article and we have been forced to discount it as an option.

Article 54 Aid Schemes for Audio visual Works

Under this article "aid for film studio infrastructures shall not be eligible".

In the absence of specific provision within the GBER, the only state aid that can be offered is regional aid (thresholds reduced under the new GBER) and '*de minimis*' support, both of which (following the marketing exercise), have been found, to date, to be insufficient to bridge any "funding gap" and provide an acceptable commercial return to the private sector.

Market Economy Investor Principle (MEIP) now the Market Economy Operator Principle (MEOP)

It has been concluded that in a situation, including direct provision by the public sector, the public sector body would be acting as an "economic entity".

Any **publicly owned studio** would be considered to be a "commercial entity" and would need to operate as if it were a private sector enterprise. The Market Economy Operator Principle (MEOP) governs this. It is worth noting also that if the public sector has partial ownership of a business, they should receive the same returns as a private sector investor.

A fairly recent (July 2014) legal case found that Valencia Regional Government's support to the Ciudad de la Luz film studio complex in Valencia had broken rules on public sector support for film financing and studio space. The European Commission concluded that €265 million public funding granted by the Valencia Regional Government to the Ciudad de la Luz film studio complex was *not* provided on market conditions, and should be paid back by the beneficiary. The judgment included information on the level of return on investment that would be expected by a private sector developer (to reflect the risk involved). Scottish Enterprise undertook some work to model the business case for a new build studio complex and concluded that the return on investment would not achieve that specified in the Ciudad de la Luz judgment. Scale is not the issue, so even though our ambitions are more modest than the Ciudad de la Luz, we are still constrained by the judgment.

Scottish Enterprise has also undertaken work to model the business case to convert vacant industrial premises to studio facilities. There are very few sites available that meet the necessary size, height and noise requirements and which do not have internal supporting columns. However, it is worth noting that the return on investment has not reached the returns specified in the Ciudad de la Luz judgment.

Similarly, if the **public sector lends to a business** (in the absence of any commercial lenders) then the terms must be similar to those that a commercial lender would provide.

Other UK Studios

I am aware, of course, of developments across the UK which has seen Northern Ireland (North Foreshore and Titanic Studios), Wales (Pinewood) and the North of England (The Yorkshire Studios) achieve success with regards to the delivery of permanent screen facilities. We applaud them on the establishment of these state aid compliant studios, but it is worth emphasising that we are seeking to achieve the same optimum mix of investment and existing infrastructure which would enable similar developments to be delivered here. This has been the focus of considerable efforts. As far as we are aware, for example, the recent announcement in Belfast for the North Foreshore Development is a fully private sector led initiative, whilst the Titanic Studios are supported by public sector loans which are fully compatible with other products on commercial market. As I have already set out, this is a state of play which we also seek to replicate and I cannot emphasise enough that we are fully open to actively consider and support proposals that are state aid compliant and which deliver long-lasting benefits for the screen sector.

Thus far, the proposals we have solicited and those that have been brought to our attention have been considered and have not met those criteria.

Private Sector Investment

The FSDG has consistently sought to attract private sector interest both formally and informally. Scottish Enterprise has invited proposals from the private sector on three occasions, offering to provide financial support to the best proposal.

An example of this was in 2014 when EKOS published a feasibility study and options appraisal for a film studio (this study was refreshed in December 2015). Following this publication, a Market Development Brief was issued. The EKOS report was reported widely in the media in Scotland, the rest of the UK and overseas and highlighted the market opportunity for a studio development in Scotland.

A preferred project partner was identified from the Brief in 2014, outline heads of terms were agreed and we were very close to delivering, however the partner later withdrew from the process. For the reasons already outlined, we were unable to support any of the other proposals submitted but we made it clear that we remain open and welcome other proposals. As a result, we have appraised a number of proposals and commissioned financial and legal due diligence several times, but so far none of them have been viable with the level of support we are able to offer under state aid rules. For reasons of commercial confidentiality we cannot disclose the identity of any of the companies involved.

The FSDG continues to be open to interest from other parties and has recently received a new private-public proposal for a film studio elsewhere in the central belt, though this is at a very early stage of consideration. I will ensure the Committee is updated fully once the proposal is more developed. Conversations are also underway with several potential private sector investors in relation to other sites in

Scotland and the FSDG remains positive about collectively achieving a positive outcome.

I hope you find this useful.

FIONA HYSLOP