THE ROLE OF EUROPEAN FUNDING IN REGENERATION

Background to EU funding

Introduction

493. Over the past 40 years funding from the institutions of the European Union (“EU funding”) has played a major role in supporting regeneration policy in Scotland. Throughout most of the period from 1973 to 2003, 346 large parts of Scotland qualified for the highest level of EU funding support to tackle areas of deprivation, market inequalities and the skills and educational attainment deficit caused by the deindustrialisation of the Scottish economy.

494. These factors, coupled with high levels of poverty, social exclusion, health inequalities and a large number of peripheral and remote communities has resulted in Scotland receiving one of the highest per-capita levels of EU funding over the last 30 to 40 years.

Scale of EU funding

495. In October 2013, the European Commission cleared the way for the approval of the EU’s budget for 2014 to 2020 (having already been approved by the European Parliament).

496. David Souter of the Scottish Government set out the scale of EU-funded work underway when he told us that the Scottish Government is monitoring 500 EU-funded projects. 347 On the level of EU funding delivered to Scotland for regeneration projects during the current EU budget period, he stated—

“We have delivered £84 million in grants in 13 local authority areas that are targeted under our urban regeneration priority, and that has unlocked expenditure of about £200 million. […] Scotland will receive something in the order of €700 million over the next six or seven years. There is no thematic criterion of urban regeneration in the new programmes; the European Commission has set out what the 11 themes will be and urban regeneration is not one of them, although some of the activity indicators would lend themselves to a wider, more holistic definition of regeneration that would include low-carbon interventions at local level and skills development. The best guess is that about €200 million will be available in the social inclusion and employability envelope, but we do not have precise figures for how that will play out for what could be termed as regeneration.” 348

346 The accession of ten new EU Member States in 2004, many of which were former Warsaw Pact countries in Eastern Europe with deindustrialising economies, saw a major shift in the focus of EU funding support for deprivation and inequality away from Western European regions to Eastern Europe.


EU funds in supporting regeneration

Outcomes to date

497. As part of our examination of the use of EU funding, we questioned witnesses on whether projects were successful in delivering outcomes that support regeneration. The Minister for Housing and Welfare, Margaret Burgess MSP, pointed to the strong focus in Scotland on utilising EU funding to tackle issues of social deprivation.349

498. David Souter acknowledged that EU funds could have been better used had a more strategic approach been adopted in the delivery arrangements and a more effective alignment between funding streams achieved. However, he informed us that is “a lesson learned from the current programme period that is informing [the Scottish Government] for the new one”.350

499. SLAED suggested that local authorities had successfully used EU structural funds in flexible ways to benefit communities, but they acknowledged an increased rigidity in access to EU funds in recent years. SLAED expressed the hope that new arrangements, once finalised, will improve the situation—

“Local authorities have been central to the success of the various structural fund programmes that have operated across Scotland and have used these funds effectively to support regeneration activity. The use of EU funds is targeted and adds to the complement of funds directed towards regeneration from local authority, other Government, private and other sources. Regeneration officers across local authorities have adopted creative means of channelling these funds to secure maximum benefit for their communities and there are many examples across the country where successful use of EU funds can be witnessed.

There has been increased concern in recent years over the increased rigidity in the access to EU funds and a fragmenting of effort that has arisen as a result. EU funds added to the complexity of the funding environment and a fragmenting of effort that resulted. It is hoped that the new EU programmes currently in preparation will be able to adopt a more strategic, longer term and more flexible approach, aligning themselves more fully with the mainstream resources available from Government. The arrangements for the targeting and access to these funds has not yet been finalised and will be an important consideration in the direction of future regeneration activity”.351

JESSICA and SPRUCE

500. In 2010, the Scottish Government launched the JESSICA fund. JESSICA is part of the Joint European Support for Sustainable Investment in City Areas. It is a £50 million fund, supported by the European Investment Bank, with £24 million

351 SLAED. Written submission, 25 September 2013.
being provided from European Regional Development funding (ERDF) Priority 3, and a further £26 million provided by the Scottish Government.

501. JESSICA supports a range of regeneration projects offering loans and equity investment to revenue generating projects in 13 local authority areas that are eligible for ERDF priority 3 funding.  

502. The Scottish Partnership for Regeneration in Urban Centres (SPRUCE) is supported by the JESSICA fund. SPRUCE provides funding for regeneration and energy efficiency projects within those targeted areas of Scotland.  

503. The Minister for Housing and Welfare set out the aim of SPRUCE in helping to deliver private sector investment for regeneration projects—

“We have been working to put in place the right conditions to implement our vision and to focus our funding on where it can make the most difference. The Scottish partnership for regeneration in urban centres—SPRUCE—is a loan fund that will leverage private sector investment into regeneration projects.”  

504. The Minister went on to highlight other benefits of SPRUCE funding. She pointed to SPRUCE’s role as a potential future income source for urban regeneration companies. The Minister also highlighted the community benefit that SPRUCE funded projects could deliver, and referred to two projects—

“….at Dundyvan, Coatbridge and Queen Street, Glasgow. The first is funding workshop space and the second a high end office complex. Strong community benefits clauses are included in each contract with a number of outcomes envisaged, including creation and sustaining of jobs, and training and development of young people.”  

505. Other witnesses however highlighted the difficulties that had arisen with JESSICA/SPRUCE funded projects. David Souter set out the difficulties experienced with JESSICA projects owing to the economic downturn and the dramatic changes resulting in private sector markets—

“When we designed the JESSICA fund, the intention was that it would fund projects that were happening in areas that needed regeneration. The shift in the market over the past four or five years has meant that those projects are simply not happening, and we have had to shift the focus of the investment to projects that, five years ago, would have been considered for bank finance. That is not necessarily a criticism of the JESSICA instrument, because it demonstrates that it is flexible enough to deal with different...
market conditions, but a frustration of mine is that it is not doing what I thought it was going to do at the start and unlocking investments in communities. I hope that, by the time the money starts to be repaid and comes back in, the market will have picked up and we will be able to have a revolving line of credit that can go out. That is probably the project in which I am most disappointed.”

506. Questions about the suitability of the JESSICA/SPRUCE funding model in delivering a community benefit were also reflected in the evidence we received from North Ayrshire Council. Pointing to the lack of delivery which market-based funding structures could achieve for small-scale community projects, the Council stated—

“The shift towards market-based delivery mechanisms such as Tax Incremental Finance, National Housing Trust, Business Improvement Districts and SPRUCE, part of Scotland’s Joint European Support for Sustainable Investment in City Areas (JESSICA) raises concerns that these loan based or speculative business models may not be viable for development projects within marginal areas where market failure is most evident, or for local organisations in disadvantaged communities. As an example, the SPRUCE fund will have a minimum £1m loan threshold, which is unlikely to be suitable for most small to medium community enterprises. Government funding should be flexible to reflect the differing market circumstances throughout Scotland.”

**LEADER funding**

507. Another issue which arose in the inquiry was the impediments placed on accessing regeneration funding, especially for small-scale projects, with regard to administrative burdens. Reference was made to the operation of the LEADER programme.

508. LEADER (links between activities developing the rural economy) is a bottom-up method of delivering support for rural development through the implementation of local development strategies. Its aim is to increase the capacity of rural community and business networks to build knowledge and skills, and encourage innovation and co-operation in order to tackle local development objectives. LEADER accounts for a minimum of 5% of the total Scottish Rural Development Programme (SRDP) allocation.

509. Several local authorities highlighted the importance of LEADER funding to delivering community capacity building in their areas. South Lanarkshire Council cited the ability of LEADER-funded projects to maximise return on investment—

“In our rural communities too the Council has worked in partnership with communities and other stakeholders to plan, implement and monitor...”

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regeneration activity through its EU funded LEADER programme. Managed by a Local Advisory Group, the majority of which are community representatives, a major element of spend under this grass roots programme has been in supporting local capacity building activity. This has allowed the capacity of groups and organisations within the rural area to grow, with the scale and complexity of projects now increasing, including the development of social economy enterprises to progress training and employment initiatives e.g. the Clydesdale Community Initiative which through an initial investment of £20k from LEADER has gone on to secure £1.9m funding for a new training and social economy facility.360

510. Highland Council highlighted that it operates a £16.5 million LEADER programme to which it contributed £5 million-worth of funding. The programme has supported 350 projects throughout the Highland area.361

511. While the benefits of the LEADER programme to community-based regeneration are clear, it is also apparent that a significant level of administrative resource was required to access funding from, and comply with, the LEADER programme’s requirements. Concern over the potential inability of community-based groups to cope with this was pointed out by Rory Dutton of the Development Trusts Association Scotland. He spoke of the administrative burden placed on local community groups by the requirements of the LEADER programme—

“… there is a big demand on community groups that are involved in LEADER-funded projects. The biggest issue with LEADER is to do with cash flow, because groups have to spend money and then seek reimbursement. That is a huge issue for organisations that have no capital reserves or regular incoming cash flow.”362

Community access to EU funds to support community-led regeneration

512. The obstacles to community-based groups gaining access to EU sources of funding was a recurring theme of the inquiry. Various witnesses expressed concerns about the ability of such groups to meet the administrative and resource burdens that come with EU-funded projects. This was especially true of the level of resources required to bid for EU funding, as well as the audit requirements for those groups in receipt of EU funding.

513. David Souter of the Scottish Government acknowledged the challenges faced by small-scale community groups when confronted with the realities of accessing EU-funded projects—

“I fully recognise the difficulties that small community groups in particular face in building sometimes very complicated funding packages to draw down ERDF and ESF. Since I moved into looking at the European social

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360 South Lanarkshire Council. Written submission, paragraph 3.10.
fund, which involves more local organisations, one of the things that has frustrated me is that we require organisations to spend a disproportionate amount of time building funding packages and drawing funding from the strategic agencies that are responsible for delivering the policy. Part of the thinking for the new programme is that we should try to declutter things, remove that requirement, and lift the audit burden that currently sits with community groups and put it at a level of groups that are better resourced to deal with.\footnote{Scottish Parliament Local Government and Regeneration Committee. \textit{Official Report}, 26 June 2013, Col 2420.}

514. A consequence of this situation is the requirement for community groups generally to engage with EU sources of funding through public bodies such as local authorities.\footnote{Scottish Parliament Local Government and Regeneration Committee. \textit{Official Report (David Souter, Scottish Government)}, 26 June 2013, Col 2414.} Despite the best efforts of many local authorities and public bodies to make this as painless a process as possible, the resource-heavy nature of applying and administering EU-funded schemes often acts as a disincentive to small-scale groups in seeking funds in this way.

515. Surprisingly however, such disincentives are not restricted to small community-based groups. The difficulties of the administrative burden associated with EU funding also acted as a disincentive to organisations as large as Scottish Enterprise. It stated—

“We would look to maximise the available European money. Although this happens only rarely, there can come a point below which there is little benefit, because of the staff resources and input that are required to achieve what can be quite a small outcome.”\footnote{Scottish Parliament Local Government and Regeneration Committee. \textit{Official Report}, 25 September 2013, Col 2657.}

516. The level of administrative burdens posed by EU-funded projects in Scotland was contrasted with the experience elsewhere in Europe. In its evidence to the inquiry the Royal Institute of Chartered Surveyors (RICS) commented that—

“Best practice of empowerment can be found in continental Europe where the municipality fully collaborates with community organisations. The operational structures provide a balance of community and municipal input which is geared to achieving the right outcomes.”\footnote{RICS Scotland, written submission paragraph 9.}

517. When asked what might prevent the Scottish Government from taking a more proactive role in assisting groups and organisations to determine how best to access EU-funded schemes, David Souter stated—

“I suppose that there is nothing to prevent that. I could say that it is resources or that it is not really our role, but there is nothing to prevent our going out and talking to a community group to evaluate a project.”\footnote{Scottish Parliament Local Government and Regeneration Committee. \textit{Official Report}, 26 June 2013, Col 2419.}
518. Referring to the actions the Scottish Government could undertake to address the disincentive caused by the burdens associated with EU-funded schemes, David Souter accepted that—

“The trick for us over the next year between now and the start of the new programme will be to identify the niche for structural funds instead of trying, as at the moment, to spread them across a lot of different activities. By identifying that, we can decide whether the funds are more appropriate to certain activities and less appropriate to others and we can start to declutter the landscape.”368

519. He went on to acknowledge that achieving this, along with getting EU funds aligned correctly, would provide long-term assurance to many community groups that funding would be available for three or four years. He considered that Community Planning Partnerships have a role to play in achieve this as—

“…one of the advantages of working or leveraging funds through community planning partnerships is that community groups can directly access that funding instead of being required to build funding packages and then come to us.”369

520. There appears to be a top-down approach to prioritising the use of EU funding in Scotland. This may be largely as a result of what could be seen as the heavy bureaucratic audit burden that securing funding involves. We are not convinced, having heard the potential barriers this represents, that the right balance has been struck. Regardless of opinion on whether the audit trail for EU funds is always proportionate and appropriate, we see no great evidence that the Scottish Government, local authorities, CPPs or other public agencies are engaging effectively with communities on how best to access and utilise EU funds to support their needs.

State aid regulations

521. Another recurring theme with regard to EU funding for regeneration was the operation of state aid rules. These concerns were best summarised by the Scottish Community Alliance (SCA)—

“State aid rules were designed to protect the operation of the free market across member states of the European Union. State aid is defined as being financial support from Government or other publicly funded bodies that distorts competition or gives an unfair commercial advantage to the recipient. These rules were put in place to facilitate a level playing field for major commercial interests with the capacity to trade across member states. It is highly unlikely however, that it was ever imagined that these same rules could seriously hamper the regeneration of some of the most disadvantaged communities and restrict the growth of locally based, not for profit social enterprises. But yet that is what is happening and as a result,

state aid rules are impacting negatively across a raft of Scottish Government policy areas e.g. public service reform and the implementation of Christie Review recommendations, regeneration and community empowerment, land reform, rural transport networks, food and energy security and the localised reduction, reuse and recycling of waste.\(^{370}\)

522. SCA went on to outline several examples of where they consider that the strict and disproportionate interpretation of state aid rules have impacted negatively on community-led regeneration projects.\(^{371}\) It summarised those impacts as follows—

- Hindering the development of community transport projects which are required to address ‘market failure’ in the provision of commercially-based transport. This is not a ‘distortion’ of the market, which state aid rules seeks to prevent, but rather a response to address the failure of the market.

- The misconception that public sector investment falls within state aid rules if one or more of the state aid criteria are met, when in fact all the criteria must be met. Some public funding streams automatically apply state aid rules, restricting access. An example is the Mull and Iona Community Trust (MICT), which has nine community projects underway in receipt of public funds.

- Although all MICT’s projects are unrelated to each other, for the purposes of state aid \textit{de minimus} calculation, their cumulative total is greater than the €200,000 limit. Therefore MICT is being forced to consider whether it can continue to take on new projects or wait until the three-year qualifying period has lapsed. The definition of \textit{de minimis} level is stifling ambition and preventing progress on the very project that the Scottish Government is actively encouraging development trusts to take on.

- State aid rules are applied on projects with thresholds lower than the €200,000 euro \textit{de minimis} threshold (e.g. Aberfeldy Town Hall project).

- The appraisal of state aid limits is calculated at organisational level. For community anchor organisations (CAOs) that have numerous strands of activity, this approach has a cumulative effective that limits their access to EU funds.

- The application of state aid rules in Scotland is also inhibiting the operation of community land ownership, especially in relation to the Scottish Land Fund. An example was cited of the purchase of a forest as a community forest where HIE funding was not available because of a determination that the purchase constituted the development of a new asset for state aid rules (namely the standing timber), as opposed to the transfer of assets to a community organisation. This is not the case with

\(^{370}\) Scottish Community Alliance. Written supplementary submission.

\(^{371}\) Ibid.
the applications of state aid rules in England and has led to the loss of EU-funding offers as a result of the inability to draw down matched funding.

- There is no independent appeals within the UK for state aid decisions. Obtaining an opinion from the European Commission is practically impossible for small projects, and in any case the national state aid teams that made the decision in the first place would have to be involved.

523. Several of the concerns raised by the SCA were supported by the evidence we received from the BIG Lottery. BIG Lottery highlighted sustainability, in the context of state aid regulations—

“In order to achieve sustainability, many of the community-owned assets we support through GCA require to generate income, sometimes by establishing themselves as social enterprises and carrying out very low key, small scale, limited and localised ‘trading’ in goods and services. In assessing such applications, BIG has to carefully check that any public funding we supply through our grants will not contravene European Union competition law (or state aid). … BIG does not believe that the state aid regulations were put in place to stifle the small scale community ‘enterprises’ that many community asset ownership projects so badly need to help them be sustainable.”

524. Eric Samuel of the BIG Lottery clarified in his evidence to how state aid rules are applied in Scotland—

“The issue seems to be arising more and more nowadays. In our case, it stems from when we try to get projects to think about how they will become financially viable towards the end of their grant, as I explained earlier. One obvious way in which they can do that is by engaging in fairly low-level, low-key trading activity. However, the word “trading” triggers all sorts of problems as far as state aid is concerned. It can also cause us problems when funding also comes from another organisation. We might take one view of state aid and another funder could take an opposite view of state aid—that happens and creates problems. It has been a particular issue for the Scottish land fund as far as forestry projects are concerned.”

525. SCA suggested the Scottish Government take the following action to address state aid issues—

- Improve the appraisal process, training/guidance for officials – empower them to interpret the rules flexibly and proportionately whilst complying with rules;

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• Develop some community development schemes that fall within general block exemptions (similar to schemes already supporting commercial business), and

• Introduce an appeals process and/or an ombudsman for state aid rule decisions.

526. Angus Hardie of the SCA made a plea for the Scottish Government and other public authorities to address the significant impediments caused to regeneration by state aid rules—

“We need to try to get a grip of state aid and put the issue to bed one way or another, either by getting an exemption certificate for the regeneration industry or by drilling through the issue and sorting it out. State aid trips us up all over the place—in renewable energy, in forestry and in asset transfer. The issue is constantly present. As we have heard from lottery colleagues, state aid is often the big barrier to so much that they could do, so we need just to sort it out. I think that the threat often does not exist, but is used as a kind of bogeyman that nobody is prepared to lay to one side. That is my big plea to the committee.”

527. HIE drew our attention to a practice in relation to state aid rules which it describes as ‘duck and cover’. This approach sees the sponsoring organisation focus principally on the problems - real or perceived - weighing most heavily on the decision with a view to safety as opposed to seeking a solution that allows projects to proceed that are primarily for the benefit of the community.

528. As is the case with accessing EU funds, there is considered to be an administrative burden associated with compliance with state aid rules and ‘spiralling due diligence costs’ from commercial lenders.

529. We put our concerns on the impediments of state aid rules to the Minister. She responded—

“We are considering setting up a group that will include the Scottish Government state aid department, Highlands and Islands Enterprise and the Scottish Community Alliance to examine ways in which we can best advise community groups on state aid. It is a complex matter, and not only for community groups. We are looking at ways to ensure that the regulations do not inhibit community groups, and that they are not just turned down with the words “state aid”, which puts them off. I would not

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375 Highlands and Islands Enterprise. Written submission, 11 September 2013.
want to see that happening. We are aware that there is an issue and we are trying to see what we can do to assist.\textsuperscript{377}

EU ISSUES: OUR RECOMMENDATIONS

530. This section sets out our recommendations on the issues covered under the EU issues theme.

531. In the light of the evidence from Scottish Enterprise and others of the difficulty of obtaining European funding that, we recommend in the short term, that the Scottish Government identifies and implements intermediary activity to aid delivery of these funds to community groups and, for the longer term, makes representations to the EU.

\textbf{JESSICA}

532. We note the proposed benefits of the JESSICA fund and recommend that the Scottish Government report annually on outcomes, both economic and social, from the previous financial year, and identifying its targets for the coming financial year.

\textbf{State Aid Rules}

533. We are concerned to learn of the difficulties raised in respect of the state aid regulations in some cases leading to the abandonment of regeneration schemes. We consider the approach to date has been overly risk adverse. Much of it appeared to be driven by a ‘safety first’ approach by the supporting organisations. In the short term, we recommend the Scottish Government issue robust advice indicating that the regulations are not aimed at community-led regeneration.

534. Particularly, if a sponsoring organisation does require to take a view on state aid rules, it should consider whether there is a \textit{likelihood} of a breach of state aid rule occurring in respect of an application for funding. If so, it should seek to determine what the outcome might in terms of granting funding. Following this a judgement should be made at senior level of the sponsoring organisation.

535. In the medium term we encourage HIE to publish the material it holds in respect of state aid rules so that it can be accessed and shared with those groups who require advice on state aid rules.

536. The Committee urges the Scottish Government to quickly establish a state aid advisory committee with representatives of Highland and Islands Enterprise and the Scottish Community Alliance. One role of such a committee would be to issue advice to sponsoring organisations in terms of applications for funding by community groups and organisations.

537. However, we urge the Scottish Government to build on this proposal and inquiry to develop a and comprehensive and coordinated response to

the difficulties experienced in the regeneration sector by the state aid rules regime.

538. We recommend the Scottish Government implement the actions proposed by Scottish Community Alliance, which we have outlined in paragraph 521 of this report.

539. We urge the Scottish Government to consider expanding the membership of the proposed state aid advisory committee to include SLAED and/or representatives of local authorities from outside the HIE area. It is clear from the evidence we have received that impediments to maximising the regeneration potential of communities across the country is a Scotland-wide problem.