TEES VALLEY COMBINED AUTHORITY | TEES VALLEY MAYOR

Appendix D to this report is not for publication by virtue of paragraphs 3 of schedule 12A of the Local Government Act 1972

AGENDA ITEM 9

REPORT TO THE TEES VALLEY COMBINED AUTHORITY CABINET

25 OCTOBER 2019

REPORT OF STRATEGY & INVESTMENT PLANNING DIRECTOR

EDUCATION, EMPLOYMENT & SKILLS

THE NORTHERN SCHOOL OF ART, NEW MIDDLESBROUGH SITE/FACILITY

SUMMARY

This report considers the request from The Northern School of Art (the School) for investment to relocate its existing Further Education (FE) facility from Acklam in Middlesbrough to a town centre location, and in doing so to support its ambition to become a specialist University in Tees Valley.

The project involves the demolition and sale of the current site (which has reached the end of its economic life) and building 5,400sqm of specialist teaching space at a more central Middlesbrough location. This will not only safeguard the School's sustainability but also support its growth, deliver one of the recommendations from the Department for Education (DfE) Tees Valley Area Review (2016) to support specialist provision, unlock the School's potential to gain University status and also contribute to the wider regeneration of Middlesbrough and Tees Valley.

RECOMMENDATIONS

It is recommended that the Combined Authority Cabinet:

i. notes the request from the School for £14.5m of Combined Authority funding to support the £14.85m project as described in this report;

ii. based on the recommendations and conditions in this report and the funding appraisal, approves the request for £7.25m of non-repayable grant and up to a maximum of £7.25m repayable grant which has an initial repayment on sale of the existing site and further repayments if the agreed profit targets are met; and

iii. authorises the Combined Authority Chief Executive to take all necessary steps to negotiate and complete appropriate funding agreements with the School on the basis set out in this report, taking account of any issues arising as a result of meeting the appraisal conditions (detailed in Appendix 1).

DETAIL

Project Description

1. The School is the only specialist provider of post-16-degree level teaching in the creative sector in the North East and is a key asset in Tees Valley. It has received an Outstanding Ofsted rating since 2009 and a Teaching Excellence Framework (TEF) Gold rating for its undergraduate teaching. 80 % of its FE students go on to higher education (HE) and it has the best graduate satisfaction and employability rate in the North of England.

2. The DfE Tees Valley Area Review (2016) recommended that the School should continue its current successful model of delivery and should focus on quality provision in its specialism of art & design. It was also recognised as being financially viable as an independent college. The School secured its name change from the Cleveland College of Art and Design (CCAD) to the Northern School of Art from the Secretary of State in 2018.

3. The School currently operates from two sites, with HE provision delivered from its campus at the Innovation & Skills Quarter in Hartlepool and FE provision from its Acklam campus in Middlesbrough. This project aims to move the current FE facility from Acklam (where the building has reached the end of its economic life) into Middlesbrough town centre, to facilitate the growth of the School and contribute to the wider regeneration of the area.

4. In addition, the School has begun the process of seeking to transition to the HE sector in 2020 and has the ambition to become the second university in Tees Valley by 2025. To do this, the School must be able to demonstrate sustainability and meet the stringent financial viability test set by the Office for Students (OFS) to achieve sector transfer, which is the first step in this transition to University status. Its current FE facilities restricts its growth, but in addition the quality of the Acklam facilities is in any event a threat to the sustainability of the School.

5. The demographic changes anticipated in Tees Valley up to 2027 forecast growth in the numbers of 16-18-year olds of 13% (or 3,112 individuals). The biggest anticipated growth is in 16-year-olds at 15% (or 1,135 individuals). If the project is not delivered, a specialist key Tees Valley asset is at risk as it will become increasingly difficult to sustain the School (in terms of both FE and HE) without the opportunity to increase its student numbers.

6. The critical success factors are:
    - Sustainable growth for the School;
    - Increased alignment of the curriculum to the needs of businesses;
    - Supporting and growing the supply of skilled individuals entering the creative sector;
    - Delivering a new facility that is visible, accessible and of appropriate specification for effective and future proof delivery of teaching in creative industry disciplines; and

- Supporting place regeneration in both Middlesbrough and Tees Valley.

7. The project has the potential to deliver additional net benefits of £24.8m of gross value added (GVA) to Tees Valley up to 2040/41. When set in the context of a £14.5m investment, this produces a Benefit Cost Ratio (BCR) of 1.7. If the School were to close due to its inability to grow and sustain its operations and ultimately achieve its ambition to become a university, the potential loss of benefits would be in the region of £117.6m of GVA, or a BCR loss of 6.24.

Assurance and Appraisal Outcome

8. In line with the Combined Authority's Assurance Framework (2018) a full business case was submitted by the School and a full appraisal has been undertaken in line with HM Treasury Green Book principles.

9. Appendix 1 provides a summary of the appraisal outcome for each section of the Green Book five-point business case, and the Authority's recommended conditions. It is recommended that authority is delegated to the Combined Authority Chief Executive and S73 Officer to sign off these conditions.

10. The business case and completed appraisal will be published on the Combined Authority's website in accordance with the Assurance Framework.

11. The Combined Authority funding will also be subject to its standard capital funding terms and conditions, which will include appropriate restrictions on the permitted use and disposal of funded assets.

Evidence of Need

12. The School's current FE campus at Acklam is not suitable for teaching in the creative sector in the 21st century: it lacks the scope for development as it is on a constrained site and it lacks the ability to cope with the projected growth in student numbers. The campus has evolved in a piecemeal fashion over the last 50 years, meaning that internal spaces are not configured to meet the current and future needs of the School. The infrastructure is now almost 60 years old and has reached the end of its economic life. The project will enable the School to be housed in more flexible, environmentally friendly and efficient accommodation, more in tune with a 21st century learning establishment with the high-quality reputation it currently holds.

13. The quality of the School's Middlesbrough estate is the worst of any college in the Tees Valley. Almost 90% of the estate remains in the lowest two national condition levels (Category III: less than ideal for the requirements; Category IV: use with extreme difficulty/not suitable). Without major investment, the condition of the estate will continue to deteriorate to the point where major investment will have to take place to rectify health and safety concerns. Such spending would inevitably come at the expense of investment in the teaching and student experience, with consequential quality and reputational risks.

14. The Green Lane campus is located in Acklam/Linthorpe, a residential suburb poorly served by public transport, which means the School has to make significant efforts to transport students in, with 9 subsidised bus routes reaching across the Tees Valley and out into County Durham and North Yorkshire. These traffic movements (together with staff travel) could be significantly reduced by the proposed move to a location well served by public transport, benefiting the environment and sustainability of those public transport links.

15. The School aims to transition to the HE sector and become the second university in the Tees Valley within the next 6 years, bringing significant benefit to the region. The first stage of this journey depends on the quality of provision, alongside strong governance, management and financial viability. The biggest threat to transition is the ongoing liability posed by the Middlesbrough campus and its potential impact on future financial viability. Becoming a Higher Education Institute (HEI), and university, will mean greater access to innovation and other forms of funding (such as the Creative Clusters programme and successors) that will bring wider benefits to the Tees Valley.

16. Funding had been earmarked for the School by the Learning and Skills Council (LSC) in 2008 but this was withdrawn when Government called a halt to the Building Colleges for the Future programme. The scale of the investment required, and the financial regulations the School must adhere to, mean that public support would be required for a project of this nature. There is no other capital fund for FE investment and the Government's expectation is that capital funds would be made available by Local Enterprise Partnerships (LEPs) or devolved authorities.

17. The School has undertaken a thorough options appraisal, considering further refurbishment of their existing premises and new build, and also a range of available sites and property options. A final independent assessment of options was undertaken by Cushman Wakefield, which resulted in the identification of the Denmark Street site in central Middlesbrough as the preferred option.

18. Following the selection of the Denmark Street site, and during the preparation of the full business case, a further option emerged due to Durham University Stockton campus buildings becoming available. Although the site selection exercise had already been undertaken the unique and exceptional nature of academic buildings becoming available within Tees Valley led to their evaluation as a potential relocation solution. However, it was concluded that whilst each of the three campus buildings could potentially meet the space requirements of the School, the indicative costs of acquisition, reconfiguration and refurbishment were, at best, equivalent to a new build option, and potentially significantly higher. It was therefore concluded that the Durham University campus be discounted in the site selection process.

Strategic Fit and Benefits

19. The project contributes to four of the six priorities in the Strategic Economic Plan (SEP):

a. Education, Employment & Skills: improving the specialist FE college with a real opportunity for it to become a university, supporting a SEP priority sector in developing a skilled workforce;

b. Place: contributing to wider economic regeneration with a more central town centre location, and raising the reputation of Tees Valley both domestically and potentially internationally;

c. Culture & Tourism: through growth and capacity building in the creative sector; and

d. Business Growth: the statistics currently demonstrate approximately 35% business start-up for graduates, alongside a talent retention rate of approximately 70%. If the School achieves its ambition to become a university, this could see wider impact in business growth in this sector and beyond, through inward investment and indigenous growth.

20. The Higher Education and Research Act (2017) was intended to create a new regulatory framework for HE and increase competition and student choice. It established a new framework for the registration of new providers and a new route to gaining degree awarding powers (DAPs). In 2017 the School was encouraged by the Chief Executive of the Higher Education Funding Council for England (HEFCE - the then regulator) to seek both DAPs and its transfer to the HE sector, as this would bring benefits in terms of recruitment and profile.

21. The School is one of only two specialist art and design FE Colleges left in England (Hereford being the other). This is because since 1992 many art colleges have either merged with larger institutions or have made the transition to university/DAPs status.

22. The School's proposal therefore mirrors the successful strategy of other specialist art and design colleges, all of which claim to have experienced significant growth in student numbers since being awarded university status:

- Bournemouth and Poole College of Art, became the Arts University Bournemouth (AUB) in December 2012;
- Norfolk Institute of Art &, which became the Norwich University of the Arts - from January 2013;
- The Jacob Kramer College in Leeds became Leeds Arts University in August 2017; and
- Plymouth College of Art & Design became a HEI in 2014 and was awarded degree awarding powers (TDAP) in 2019, and is presently consulting on its name change, as a result of having gained university status.

23. As a result of becoming a university, the institutional profile will be raised domestically (bringing the potential for additional student recruitment), but also in terms of international reputation and student recruitment. In terms of UK undergraduate recruitment, Bournemouth, Norwich and Leeds saw art and design undergraduate acceptances increase by 21%, 12% and 24% respectively in the recruitment cycle immediately after they gained university status.

24. The School would expect its UK undergraduate recruitment to increase by approximately 20% in the first recruitment cycle following university status being granted, in addition to growth through the increase in numbers of young people. In addition, it will explore international links with appropriate institutions so that it will have an overseas recruitment initiative in place by the time it gains university status.

25. The School aims to increase its curriculum offer to support screen/digital/gaming industries by 2022 and to grow its FE student numbers from 500 to 730 by September 2027. This in turn will increase the number of students qualifying at Level 3 and moving on to HE or employment in the sector.

26. The projected demographic growth in 16-18-year olds is 13% (or 3,112) by 2027, with the greatest growth in 16-year olds at 15% (or 1,135). This level of growth in the Tees Valley (alongside the specialist nature of the School and its anticipated growth (230 students by 2027)) would suggest that the overall growth of the market should limit any potential displacement from other local colleges.

27. Currently the destination of students from the existing FE facility is as follows:

- 30% continue onto HE with the School;
- 30% go to other northern institutions - 10% Teesside University and similar to Sunderland, with a smaller proportion going to Leeds, Northumbria and York;
- 20% to HE institutions further afield; and
- 20% do not progress to HE.

This highlights the opportunity to increase the number of HE students who stay in Tees Valley and go on to HE here.

28. Paragraph 7 in this report identifies the potential economic impact of the project and the Combined Authority will continue to work closely with the School to finalise the objectives, outputs and performance reporting for inclusion in the funding agreement.

Funding

29. The total cost of the project is £14.8m, of which £7.25m is requested from the Combined Authority as a non-repayable grant and up to a maximum of £7.25m grant which is repayable if the agreed profit targets are met. The balance is the capital cost of purchasing the site and this will be paid by the School. *[Note: RIBA Stage 3 designs will be completed by 13th September, so we will update the report on receipt of these.]* The build cost is estimated to be around £1,900 to £2,500 per sqm, which is relatively low according to SFA FE cost models (July 2015).

30. To achieve university status, the School must remain financially stable and demonstrate future sustainability, whilst remaining competitive against much bigger organisations including specialist universities. This will require both capital investment and expenditure to attract more students from a wider geographical area.

31. Organisations contracting with the Education Skills Funding Agency (ESFA) are awarded a financial health grading from Inadequate, through to Requires Improvement, Good and Outstanding. At this point in time the School is sufficiently solvent and holds modest amounts of cash which are required as working capital and to ensure that the 'Good' financial health score is met. Its performance is good, but it cannot invest in further revenue or borrowing without breaching the ESFA's acceptable assessment levels.

32. The Combined Authority has explored six options with the School for the funding for the project:
1. 100% TVCA non-repayable grant;
2. The School provides increased capital investment;
3. TVCA loan paid back through income;
4. TVCA builds and owns the facility and rents it to the School;
5. TVCA grant 100% repayable based on meeting profit targets; and
6. TVCA grant, 50% repayable based on meeting profit targets (proposed option).

33. Option 1 was discounted as the Combined Authority would be the sole investor, taking 100% of the risk and not sharing any future upside receipts.

34. Option 2 is not possible as the School does not have access to any further capital. The School will commit any proceeds from the sale of the current FE site in Acklam which will repay some of the grant. The School is itself acquiring the Denmark Street site (currently a car park) from Middlesbrough Council.

35. Option 3 is not possible as the School cannot incur any further borrowing without breaching its banking covenants and reducing the School's financial health rating with the ESFA.

36. Option 4 - the School does not currently pay rent as it owns the facility, and its current strategy is to become financially viable and sustainable. The Board of Governors would find it difficult to authorise additional long-term expenditure as it would affect the ability of the School to grow and in turn achieve the ambitions for the project. The School cannot enter a long lease due to the impact on its balance sheet, which would reduce its financial health to an unacceptable rating from the ESFA, so only a short-term lease wold be possible, which in turn would not support the long-term funding of the project.

37. Option 5 was discounted, as a fully repayable grant would not be viable and the risk of non-repayment would be high. It is recognised that for a project of this scale some public intervention is required.

38. Option 6 is the proposed option, which is to commit a 50% non-repayable grant, and a 50% grant which is repayable if and when the agreed profit targets are met. This option recognises that public intervention is required to make a project of this scale viable, but also looks to share the risk and reward between the School and the Combined Authority. The School will repay the repayable element of the grant, provided it meets the agreed financial hurdles over the period for repayment under the funding agreement.

39. Repayment by the School will be dependent on it achieving its growth targets. It is proposed that the relevant repayment period begins 5 years after practical completion of the FE campus and ends 25 years after that practical completion date. Therefore, the repayment period would be 20 years from 2026 - 2046.

40. Repayment will be triggered when:

- The School makes a surplus based on its full business accounts for both the FE and HE provision;
- Up to 10% 'normal surplus' can be retained by the School to support future investment (as recommended by DfE);
- 50% of the surplus beyond this 10% is repaid to the Combined Authority, which will be determined and paid annually on an open book basis.

41. There is a risk of non-payback, and benchmarking with other institutions and financial modelling has been undertaken to assess the likelihood of return. The School has modelled its financial position into the 2040s, to assess its ability to generate an adequate level of surplus and cash for investment, and the likelihood of repaying the contingent grant element in full (based on the assumption that its growth plans come to fruition). The School also examined the financial performance of key comparator institutions over a decade (Norwich University of the Arts, the Arts University Bournemouth, Leeds Arts University and Plymouth College of Art). ***(Data available in Appendix D – Commercially Sensitive Information, Number 4 Table 5.8)***

42. In summary the likelihood range of repayment is estimated to be a minimum return of £1.87m by 2046 up to a maximum return of £7.25m by 2042. If performance exceeds expectations, full repayment of £7.25m could be made by 2039.

43. If the School's growth plans do not come to fruition, leading to the closure of the School, the Combined Authority will have a legal charge over the asset.

FINANCIAL IMPLICATIONS

44. Assuming the recommendations set out above are agreed, the financial implications are that the Combined Authority would commit £14.5m of capital funding to the project, of which £7.25m is potentially repayable. This funding will come from the £15m Education, Employment & Skills capital allocation in the Investment Plan.

45. This funding will be subject to appropriate technical due diligence as required by the Tees Valley Assurance Framework.

LEGAL IMPLICATIONS

46. Approval is subject to the conditions set out in the appraisal, which include a condition that satisfactory state aid legal advice is received, and the repayment triggers being met, set out in paragraph [37].

47. Any funding will be subject to standard Combined Authority terms and conditions. In addition, special conditions will be included to ensure that any issues raised by the appraisal and due diligence are appropriately addressed.

RISK ASSESSMENT

48. The key risks in relation to this request for Combined Authority funding are as follows:

Risk	**Proposed Mitigation**
Grant is not repaid	• Due to the contingent repayment basis this is a recognised risk. However, the risk of this will be monitored closely and detailed management accounts will be provided to the Combined Authority twice a year in line with ESFA submissions; • If the project fails and the School ceases to exist, the Combined Authority will have a charge over the asset; and • Our standard quarterly claims and monitoring procedure will identify any potential issues early.
Cost overruns	• Cost certainty will increase as the project progresses through the RIBA Stages (current costs are based on Stage 3); • Currently a 7% contingency is built in to the budget, which will be reviewed at each stage; • The sale proceeds of the current site have been identified to cover any cost overruns, but the repayable contingent grant will not go above £7.25m; • The track record of the School in terms of capital project delivery is good; and • Our standard quarterly claims and monitoring procedure will identify any potential issues early.

Risk	Proposed Mitigation
The School does not gain University Status	• Practical completion must be achieved for the facility to open in September 2021, therefore early contractor engagement and strong project management will be in place. • The track record of the School in terms of capital project delivery is good; • The quality of provision is high and its financial viability good and has been consistent for years, therefore the risk is mitigated; and • We will continue to work closely with the School to work through each stage of this process.
The student numbers do not increase as forecast	• Joint project marketing and communication plan with the School, the Combined Authority and MBC; • Monitor local and national demographic data annually; and • Our standard quarterly claims and monitoring procedure will identify any potential issues early.
The funding of FE education changes resulting in an impact on revenue	• Monitor policy closely to pre-empt and plan for any potential issues.

CONSULTATION AND COMMUNICATION

49. Extensive consultation was undertaken leading to the project becoming a priority in the Investment Plan as approved in January 2019.

50. Further consultation has been undertaken with Tees Valley Management Group and Tees Valley Chief Executives.

51. A joint marketing and communication plan with the School, the Combined Authority and Middlesbrough Council will be agreed and implemented.

EQUALITY & DIVERSITY

52. There are no direct equality and diversity implications arising from this report. Equality and diversity requirements will be embedded into the design and construction requirements for the new facility.

LOCAL ENTERPRISE PARTNERSHIP

53. This report has been considered at the LEP meeting in advance of it coming forward to Cabinet.

Name of Contact Officer: Sarah Walker
Post Title: Project Development Manager
Telephone Number: 01642 526057
Email Address: sarah.walker@teesvalley-ca.gov.uk