

Meeting: Cabinet

Date: 24 August 2021

Wards Affected: Collaton St Mary

Report Title: Expansion of EFFECT Photonics onto Torbay Business Park

Cabinet Member Contact Details: Councillor Long, Cabinet Member for Economic Regeneration, Tourism and Housing, swithin.long@torbay.gov.uk

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1. Purpose of Report

- 1.1 To support the Council's ambition for a thriving economy in Torbay. Cabinet is asked to support, through the Growth Fund, the creation of a new Electronics & Photonics Production Park and build out the first unit for an anchor tenant.¹ The Levelling Up Fund (LUF) application and the outcome of that application will determine the scale of investment required.
- 1.2 Sector development work undertaken by TDA has encouraged growth in this sector most recently through the successful delivery of EPIC. Working closely with tenants and wider sector businesses has identified the pressing requirements for space for EFFECT Photonics and it is proposed that they will become the anchor tenant on this new development supporting both inward investors and Torbay's hi-tech businesses as they move from R&D into production and manufacturing.
- 1.3 This paper sets out two funding options for the Council. Option 1 is to provide the Council's match funding contribution committed as part of the LUF application process. Option 2 provides the funding for the EFFECT Photonics unit securing its significant anticipated economic benefits if the LUF bid is unsuccessful.
- 1.4 The delivery model proposed is for Torbay Council to acquire the land and build the property and subsequently lease to EFFECT Photonics. In return, Torbay Council will secure future jobs in the electronics and photonics sector, estimated to be 175 new jobs generating an additional £18M a year extra into the local economy. The Council will also receive rental income expected to be £286,000 per annum and business rates estimated to be £88,000² per annum.
- 1.5 The Council is asked to consider 2 financing options:

¹ Part of a £20M bid into govt submitted on 18th June. Decision expected in Autumn. This paper identifies the match funding required for the Electronics and Photonics Production Park. A further paper will follow setting out the Council's match funding commitment to the Brixham Fish Quay and Market Extension.

² Based on rateable value for Nissha Medical

- A successful LUF application resulting in a minimum of £683,759³ of match funding needed to support the project.
- An unsuccessful LUF application resulting in the full project cost of £4,754,300⁴ needed to support the project.

2. Reason for Proposal and its benefits

We want Torbay and its residents to thrive.

We want Torbay to be a place where we have turned the tide on poverty and tackled inequalities; where our children and older people will have high aspirations and where there are quality jobs, good pay and affordable housing for our residents.

2.1 The proposals in this report help us to deliver this ambition by supporting the delivery of the Economic Repositioning Plan as well as the recent Levelling Up Fund Application. In particular this will support the 'Thriving Economy' element of the Community and Corporate Plan through improved investment in economic growth, jobs and infrastructure within Torbay.

2.2 The reasons for the decision are to:

- Ensure match funding is available should Torbay be successful with the LUF application
- Ensure a local company, EFFECT Photonics, can continue to grow within Torbay, should the LUF application be unsuccessful.

2.3 Economic benefits are as follows:

EFFECT Photonics expects to create 175 new additional jobs that will generate local wages of £7.3M per year, and GVA of £18M per year. The average salary in this sector is £33,000 per annum, nearly 70% higher than Torbay's average salary⁵. GVA per worker in this sector is twice the Torbay average.

Most of the jobs will be in technician and engineering roles. All roles are expected to be full-time.

Whilst EFFECT Photonics has not struggled to fill most of the roles that it has created locally, their rapid growth is creating demand for skilled labour in this sector. South Devon College, with support from TDA and Hi-Tech Cluster, is developing a new training programme for the electronics and photonics sector and has recruited a Sector Skills lead for this area. In line with the sector pathway approach recommended in the Economic Repositioning Plan training will be provided for those who want to access jobs in the sector, and those already employed in the sector. This will help to ensure that there are suitably skilled local people available to fill the new jobs that are created, maximising the benefits within Torbay.

³ Subject to final costings

⁴ Subject to final costings

⁵ Annual Survey of Hours and Earnings, gross annual median workplace-based earnings, 2020

3. Recommendation(s) / Proposed Decision

That Cabinet be recommended:

If the Levelling Up Fund application is successful

- i. That delegated authority be given to the S151 officer in consultation with the Portfolio Holder to satisfy himself that the Growth Fund criteria are met, and that there is a robust business case, including an agreement for lease, to authorise allocation from the Growth Fund to match fund the construction of the building described in the report, being a minimum of £683,759.

If the Levelling Up Fund application is unsuccessful then:

- ii. That delegated authority be given to the S151 officer in consultation with the Portfolio Holder to satisfy himself that the Growth Fund criteria are met, and that there is a robust business case, including an agreement for lease, to authorise allocation from the Growth Fund to construct in totality the building described in the report.
- iii. That delegated authority be given to the Director of Asset Management, Investment and Housing in consultation with the Portfolio Holder to agree and finalise the detailed lease terms.

Supporting Information

1. Introduction

Effect Photonics is an Anglo/Dutch company developing world leading products from their existing Torbay sites at Brixham Laboratory and EPIC. They develop and deliver highly integrated optical products based on Indium Phosphide (InP) which is the material of choice for creating efficient laser light sources, waveguides, modulators, and photodiodes used in optical communication systems throughout the world. They are experts in developing photonics components within a single chip and being able to produce these in volume with high yield at low cost. With this capability, EFFECT Photonics is addressing the need for low-cost solutions driven by the soaring demand for high bandwidth connections between data centres and back from mobile phone towers.

Two years ago, the company were supported by Torbay Council through an asset backed loan which enabled them to purchase vital manufacturing equipment. This allowed them to continue to develop their technology while moving to greater volume production to meet increasing global demand for their products. They have recently been awarded a £150,000 grant through the Heart of the Southwest LEP's ERDF Soft Landings Programme to support their continued growth in Torbay. Effect is developing products which are world leading and this growth is expected to support the creation of 175 new jobs in a key local sector where productivity levels and wage rates are higher than local averages supporting the area's economic repositioning.

EFFECT Photonics continue to be successful with ongoing investment funding and recently secured \$43M in round C series funding to develop single chip coherent optics and scale production. This year, they have expanded further taking lab and office space at the Electronics and Photonics Innovation Centre (EPIC) in addition to space at Brixham Laboratory. As a high growth company, they now want to expand further in order to scale up their manufacturing to meet customer demand. Through TDA, EFFECT Photonics is working with Midas to design and build a 26,004 sq. ft. facility at Torbay Business Park. This facility will include office, production and cleanroom space. Costs are currently estimated to be £4.75M (see Appendix 1).

EFFECT Photonics is only interested in a leasehold arrangement. On Torbay Business Park, neither the landowner nor the developer is interested in leasing the completed building; the landowner is looking to sell the land and the developer's business model is to sell the completed build. As with other units on this Business Park (Unit E, Nissha Medical), these developments have only occurred with intervention from the Council. Market failure is evidence with employment sites in Torbay. A study undertaken in 2019⁶ clearly identifies abnormal cost and infrastructure costs as reasons for market failure. This project would not happen without intervention from the Council.

The rent sought will be the higher of either a market rent or rent sufficient to cover the Council's borrowing costs. Based on the current budget estimates the starting point for negotiating is £286,000 per annum which is based on a gross internal area of 26,004 sq. ft. at a blended rental rate (across the entire building) of £11 p sq. ft. This is based on advice from a commercial property agent and represents a level at which the market would initially seek for a new building of this type. A rental at a figure substantially less than this figure would have the potential to negatively impact the open market by creating

⁶ Heart of the Southwest Employment Land Review, Hardisty Jones, 2019

low comparable evidence for future new builds thereby limiting market interest in increasing the supply of employment space, a key risk to achievement of the Council's economic growth objectives.

The rental figure is based on EFFECT Photonics entering into a 25-year full repairing and insuring lease on institutional terms. The lease would incorporate a provision for rent reviews every 5 years subject to an upward only rent review mechanism. It is anticipated that the Council would seek that the lease terms are guaranteed by the EFFECT parent company.

Early discussions with EFFECT Photonics have indicated that they would be looking for a break option at year 10 giving the Council 10 years term certain.

Economic Benefits

EFFECT Photonics expects to create 175 new additional jobs that will generate local wages of £7.3M per year, and GVA of £18M per year. The average salary in this sector is £33,000 per annum, nearly 70% higher than Torbay's average salary⁷. GVA per worker in this sector is twice the Torbay average.

Most of the jobs will be in technician and engineering roles. All roles are expected to be full-time.

Whilst EFFECT Photonics has not struggled to fill most of the roles that it has created locally, their rapid growth is creating demand for skilled labour in this sector. South Devon College, with support from TDA and Hi-Tech Cluster, is developing a new training programme for the electronics and photonics sector and has recruited a Sector Skills lead for this area. In line with the sector pathway approach recommended in the Economic Repositioning Plan training will be provided for those who want to access jobs in the sector, and those already employed in the sector. This will help to ensure that there are suitably skilled local people available to fill the new jobs that are created, maximising the benefits within Torbay.

2. Options under consideration

Please see **Part 2 CONFIDENTIAL** financial and commercial appendix.

3. Financial Opportunities and Implications

Torbay Council has committed to providing match funding for the LUF application; Torbay's contribution to this project is set out in option 1. Should Torbay's application be successful, the result will be a significant surplus for the Council. This surplus will help address the Council's anticipated financial challenges and would provide the opportunity to increase investment in complementary economic growth activity.

Should Torbay be unsuccessful with the LUF application, the Council can still cover its borrowing costs in all of the loan scenarios – this does however assume no change in project costs and a rent in the region of £11 per sq. ft. is achieved. The working assumption is that negotiations will proceed on the basis that Council costs are at least covered.

The implication of not supporting both options is that if Torbay is unsuccessful with the funding application to Levelling Up Fund, Torbay Council will not be able to acquire the

⁷ Annual Survey of Hours and Earnings, gross annual median workplace-based earnings, 2020

land and building and lease to EFFECT Photonics. The result may put an end to the project locally and EFFECT Photonics may consider other locations outside of Torbay.

A further (estimated) £88,000 per annum will be generated through business rates.

It is possible that EFFECT Photonics may seek further loan funding from Torbay Council to build the Cleanroom required. If so, this will be the subject of a future report.

4. Legal Implications

The Council does not currently own the site, the use of the selected developer will be a condition of the land sale to the Council. On the basis of exclusive right the appointment of the developer by the Council will be exempt from the requirements of the Public Contracts Regulations 2015.”

5. Engagement and Consultation

TDA consulted with local stakeholders in February 2021 to understand the priority needs and opportunities in Torbay that would drive forward the economy. Virtual discussions have been held with Torbay Council, South Devon College, Torbay Business Forum, Torbay Hi Tech Cluster and Torquay, Paignton and Brixham Chambers. Amongst the priorities is the need to deliver employment land and support the growth of the hi-tech sector.

6. Purchasing or Hiring of Goods and/or Services

TDA will work with the Developer to establish and implement an Employment and Skill Plan creating training and job opportunities for local people, in line with Torbay’s Community Wealth Building ethos.

7. Tackling Climate Change

The growth of the electronics and photonics sector contributes to the Ten Point Plan for a Green Industrial Revolution⁸, through creating communications technologies that reduce the need to travel, are lower energy and more efficient.

We will explore with the Developer site specific energy saving measures.

8. Associated Risks

There are several risks associated with this investment.

- The project cost is an estimate and therefore could go up. This estimate is based on discussions between Midas and Effect Photonics, so this cost does have a degree of accuracy.
- Ensuring EFFECT Photonics has sufficient credit to meet the rental payments. A Dun and Bradstreet report has been included indicating the risk is low. The company has this year secured a \$43M Venture Fund (which will be used across the entire company) which does not yet appear on the balance sheet.
- EFFECT Photonics is seeking a lease with a 10-year break, and the loan period is 25 years so it might be necessary to re-let the building. There will be elements of this building that will be bespoke (e.g. Clean Room) but the expectation is that tenants for the Electronics and Production Park are likely to require such facilities.

⁸ <https://www.gov.uk/government/publications/the-ten-point-plan-for-a-green-industrial-revolution>

Alternatively, the Clean Room could be removed at the end of the tenancy to ensure a broader appeal across a range of sectors. In the instance that Torbay is successful with the LUF application, the Council could choose to borrow the money over a shorter time period. TDA will manage the process to ensure that the building is of a nature that would be attractive to the market as much as possible.

- Should the Council not agree to Option 2, there will be abortive costs associated with this project to the point we receive an outcome to the Levelling Up Fund application.
- Should the Council not agree to Option 2, EFFECT Photonics will need to be informed that support with this project will only be possible in the event of a successful Levelling Up Fund application. Therefore, should the application be unsuccessful, EFFECT Photonics may be forced to consider other locations outside of Torbay.
- The return on investment with Option 1 is very high as to possibly question whether government intervention is needed. The guidance is clear that projects provide a minimum of 10% match funding. With this project, the match funding contribution is 14%.

Equality Impacts

9.	Identify the potential positive and negative impacts on specific groups			
		Positive Impact	Negative Impact & Mitigating Actions	Neutral Impact
	Older or younger people			There is no differential impact
	People with caring Responsibilities			There is no differential impact
	People with a disability			There is no differential impact
	Women or men			There is no differential impact
	People who are black or from a minority ethnic background (BME) <i>(Please note Gypsies / Roma are within this community)</i>			There is no differential impact
	Religion or belief (including lack of belief)			There is no differential impact
	People who are lesbian, gay or bisexual			There is no differential impact
	People who are transgendered			There is no differential impact
	People who are in a marriage or civil partnership			There is no differential impact
	Women who are pregnant / on maternity leave			There is no differential impact

	Socio-economic impacts (Including impact on child poverty issues and deprivation)		There is no differential impact
	Public Health impacts (How will your proposal impact on the general health of the population of Torbay)		There is no differential impact
10..	Cumulative Council Impact (proposed changes elsewhere which might worsen the impacts identified above)	None	
11.	Cumulative Community Impacts (proposed changes within the wider community (inc the public sector) which might worsen the impacts identified above)	None	