



Community
Woodlands
Association

**Submission in response to the Scottish Affairs Committee
consultation on a programme of comprehensive land reform in Scotland.**

**Community Woodlands Association
October 2013**

The Community Woodlands Association¹ (CWA) is very pleased to have the opportunity to submit a response to the open consultation on land reform in Scotland launched by the Scottish Affairs Committee in July 2013. We fully endorse the paper the Committee published to stimulate discussion “432:50 – toward a comprehensive land reform agenda” which presents an excellent summary of the issues around land reform in Scotland.

CWA was established in 2003 as the direct representative body of Scotland’s community woodland groups. We help community woodland groups across the country achieve their aspirations and potential, providing advice, assistance and information, facilitating networking and training, and representing and promoting community woodlands to the wider world.

The first community land buyout in Scotland was at Wooplaw Community Woodland in the Borders (1987), and there are now well over 200 community woodland groups across Scotland, responsible for the management of tens of thousands of hectares of woodland and open space. More than half of our members own their woods, the remainder lease or work in partnership with public and private sector landowners. Community woodlands are extremely diverse, embracing all woodland types from ancient semi-natural woods to extensive conifer plantations, and ranging from less than a hectare to over a thousand hectares in size. Likewise, the communities involved range from crofting townships in the far north and west to small towns and inner-city communities in the central belt.

Some of the larger groups employ staff to manage and develop their woods, while others are managed entirely by volunteers. Whilst the aims and objectives of individual groups vary according to local needs and aspirations, and the type and scale of the woodland managed, all are working to build sustainable, flourishing, creative, resilient and vibrant communities. Scotland’s community woodlands deliver a huge range of public benefits, across a suite of policy agendas, including:

- Economic development - increasing the value of forestry to local communities, creating jobs and developing local processing and markets for timber and other forest products;
- Health and wellbeing - providing wide-ranging opportunities for outdoor recreation, from informal paths and "all ability" facilities to mountain bike trails and orienteering courses;
- Education and Employability – hosting forest schools, providing learning opportunities for all and practical skills training for those seeking employment;
- Renewable energy - developing local supply chains and markets for woodfuel, to help reduce our dependence on fossil fuels and support sustainable forest management;
- Biodiversity & Conservation - restoring and expanding native woodlands, and carrying out habitat improvements within other forest types, to conserve and enhance Scotland’s biodiversity and contribute to climate change mitigation;
- Social inclusion - involving all sections of the community in planning and decision-making, and ensuring that the benefits of community woodlands are available to all.

In the past decade we have supported a great many of our member groups in their attempts to acquire land, from private and public sector landowners. Some are successful; almost all discover that the process of acquisition is onerous, bureaucratic and long-winded. Issues around valuation and financing have proved particularly difficult, in part at least as a consequence of the distorted market in and inflated price of land caused by the favourable tax and subsidy regime for landowners.

¹ <http://www.communitywoods.org/>

Responses to Specific Questions

We have provided brief answers to a number of questions, as below, and have attached, as annexes, three papers providing more detail on the specific aspects of the difficulties facing community bodies seeking to acquire assets, especially woodland.

1 How does Scotland compare to other countries in terms of the pattern of land ownership?

Official statistics on land ownership are conspicuous in their absence; however, there is a substantial body of academic research demonstrating that land ownership in Scotland is concentrated in very few hands, compared to our European neighbors.

In 2011, the Forestry Policy Group, of which CWA is a member, commissioned research² on forest ownership in Scotland. This demonstrated that that of the 67% of Scotland's forest area that is privately owned, 91% is owned either by landed estates or by investment owners, with 55% of the area owned by absentees.

2 What are the benefits and disadvantages of the current pattern of land ownership, and to what extent is this pattern sustained and reinforced by subsidy and taxation arrangements?

The current ownership pattern concentrates decision-making in the hands of relatively few individuals, a significant proportion of whom are disengaged from the consequences of their decisions: either wealthy enough to pursue their whims or simply uninterested in the land other than as an investment vehicle. At the same time the vast majority of those living and working in rural Scotland are effectively disenfranchised. This does not seem to be a sound basis for sustainable land management.

The land-ownership pattern is sustained and reinforced by subsidy and taxation arrangements in a number of ways:

- Subsidy and tax advantages inflate land values, which limits new entrants,
- The use of land as an investment vehicle rewards speculation and inhibits innovation,
- Subsidy and tax advantages ensure the price of land is divorced from its productive value, which rewards inertia and inhibits sustainable development.

3 Is the current system of land tenure in Scotland the most efficient model for food security?

No

Food security is an important strategic issue for all governments to consider, but the debate needs to be grounded in the realities of current and feasible agricultural production in Scotland. Unfortunately the food security "debate" has been largely hijacked by vested interests and presented as a justification for continued or increased levels of public subsidy.

As will be discussed, much of Scotland's land is owned and valued for non-productive purposes: it seems improbable therefore that this will deliver an efficient model for production.

² Forest Ownership in Scotland http://www.forestpolicygroup.org/Forest_Ownership_In_Scotland_Feb_2012.pdf

4 In particular, is the current land ownership pattern contributing to, or inhibiting, economic and community development? Is it socially just?

There is a widespread consensus, reflected in the Scottish Government's Land Use strategy, that the current ownership arrangements are not delivering sustainable development and the broad range of desired social, economic and environmental benefits.

We believe that the current land-ownership pattern inhibits economic and community development. In many cases community ownership of forests, land and other assets is motivated by a desire to turn round economic fortunes and bring about greater economic and community development.

5 Given mounting political interest in, or commitment to, a programme of land reform in Scotland, what form should this programme take?

We have identified 5 key elements of a successful land reform programme:

Information: detailed information on ownership patterns, covering both private and public sector, should be collated and made freely available. Summary management / development plans for all holdings above a given threshold should also be publicly available.

Legislation: a legal framework is required which further empowers communities with appropriate rights to purchase when that is in the public interest and even where there may not be a willing seller

Resourcing: a far-reaching and systemic re-evaluation and re-alignment of taxpayer support for rural land ownership is required, with an ethos on buying public benefits with public money, and incorporating significant commitments to support community ownership and management of land and assets.

Promotion: a Land Agency body is required to champion and promote the Land Reform Act and the wider Land Reform agenda. (see 9 below for more detail)

Commitment: the Land Reform agenda must be embraced and proactively supported at all levels of Government, with a commitment to change and the willpower to find solutions to issues, rather than looking for reasons to block community proposals (see comments on State Aid).

6 What sort of subsidies and grants are available to landed estate owners in Scotland? What are the advantages and disadvantages of the subsidy regime? In particular, are support payments being capitalized into land values and making these higher than they otherwise would be?

Landed estate owners have access to a wide range of subsidies and grants, both directly as payments made through the Common Agricultural Policy or indirectly as beneficiaries of subsidised fuel or state sponsored research. Additionally, landowners can profit from development opportunities, e.g. the current renewables boom, itself largely driven by government support.

Some grants and subsidies particularly those designed to “buy” public benefits for the nation, are available to all landowners, and we have no objection to private landowners receiving public funding to deliver such benefits (e.g. provision of recreation, conservation of cultural heritage, enhancement of biodiversity), however this is a relatively small proportion of the total flow from taxpayer to private landowners.

The largest single component of taxpayer funding comes in the form of Single Farm Payments, decoupled from production, and based on historic “entitlements”. These entitlements can be traded separately from the land to which they originally related, and continue to be payable even after abandonment of farming: it seems inconceivable to consider that the capitalisation of support payments does not contribute significantly to the on-going uplift in land values.

7 *How does the tax regime affect the way in which land is owned in Scotland? For instance, does it offer landed estate owners the opportunity to minimize the tax they pay, thereby increasing the value of land, adding to speculative interest (on the part of those looking for ways to minimize or avoid tax) and making it less likely that it will be made available to others?*

We believe that the favourable tax regime for private landownership in Scotland significantly affects patterns of ownership. The existence of a significant land and business management industry focused on supporting private owners to minimise tax liabilities, while maximising grants and subsidies from public funds, is compelling evidence of the role that the tax regime plays, and of its contribution to inflating land values.

8 *How easy is it for communities in Scotland to take ownership of land and other assets? Should it be made easier in the light of the substantial achievements of existing community ownership groups?*

CWA and others have provided substantial evidence to the Land Reform Review Group³ which set out a wide range of ways in which the process of achieving more community ownership could be made easier.

Our experience in supporting Community woodland groups suggests that despite the long and successful track record of established community woodlands e.g. at Wooplaw⁴ (1987) and Abriachan⁵ (1996), the process of acquiring woodlands has got more protracted and problematic over time, rather than easier.

In part this is because funding has become scarcer and more tightly regulated (see later comments on state aid etc.). It is also a consequence of increased regulatory scrutiny as elements of government seek to progressively define and constrain community organisations: it is clear that most of the pioneering (and now successful) community land or woodland buyouts would not be possible under current rules.

³ Andy Wightman has collated responses here: http://www.andywightman.com/?page_id=2024

⁴ <http://www.wooplaw.org.uk/>

⁵ <http://www.abriachan.org.uk/>

9 *Is there a case for establishing a Land Agency to facilitate both the expansion of community ownership and the creation of new, especially “starter”, tenancies on land acquired for this purpose?*

Yes

We believe a new Land Agency body is required to champion and promote the Land Reform Act and the wider Land Reform agenda. This Land Agency would assist and advise communities on the registration and acquisition processes, work with community bodies and land owners to manage negotiations and facilitate transfers, and advise ministers on issues of public interest and sustainable development.

Such a body would require a range of powers, including those to compel co-operation from landowners and community bodies, and to carry out compulsory purchases and subsequent transfers to communities. The new Land Agency could be developed from existing public bodies, or created new. Either way, it should seek to utilise the considerable existing expertise within both the public and community sectors.

Starter tenancies should include woodland crofts and smallholdings. We note that Forestry Commission Scotland has recently created starter farms on newly acquired land, but has declined to facilitate the creation of new woodland crofts on the National Forest Estate.

10 *How easy is it for land in public ownership to be transferred to communities and other private individuals, where that would be in the public interest? Should steps be taken to make it easier? For instance, should the UK and Scottish Governments compile a register showing land and assets for disposal? Should there be changes in the way in which such land and assets are valued? What UK Treasury rules are relevant to this area?*

Community woodlands have been at the forefront of community land and asset ownership, and over 100 woods of all types and sizes are now in community ownership. Despite this, transfers remain problematic, with the primary difficulties centred on financing and valuation.

In 2005 Forestry Commission Scotland (FCS) established the National Forest Land Scheme as a mechanism to facilitate community acquisition of assets. The scheme has much to recommend it, and it has been responsible for considerably more community acquisitions than the much more vaunted Community Right to Buy provisions of the Land Reform Act.

However the operation of the NFLS has been increasingly inhibited by financial issues. Essentially communities have found themselves caught between FCS, who insist that the Scottish Public Finance Manual demands that transactions are at full market value, and the Big Lottery Fund/Highlands & Islands Enterprise, who have argued first that they cannot fund the acquisition of assets from the public sector, and then that any such state funding is constrained by state aid rules and limited to 20% of the purchase price. Further details of NFLS valuation issues are contained in Annexes 1 & 2.

The transfer of public sector assets would be facilitated by provision of publicly available asset registers, and the replication of the National Forest Land Scheme across the public sector, and we believe these should be duties placed on each public authority. However, these measures will not

in themselves deliver substantial changes in ownership patterns unless the issues over financing are resolved.

We do not believe that Treasury rules need necessarily limit the ability to transfer land, however, the discretion permitted within the rules is not clearly understood throughout Government, and this militates against that discretion being used. Likewise, there is a pressing need to reconsider the principles of valuation, especially as the price that communities are expected to pay for assets is often unrelated to their productive value.

Often the assets that communities are seeking to acquire are more correctly described as liabilities, which the communities are taking on to rescue them from neglect or prevent closure of services and loss of amenity. Nonetheless, the asking price is usually inflated by some or all of the elements described previously which are irrelevant to public sector or community owners.

There is also a pressing need to clarify state aid rules, which are currently being used to impede community asset purchases, particularly of woodlands. Civil servants and local government officers need to be empowered to make appropriate appraisals of projects based on a thorough understanding of the regulations and a realistic view of the likelihood of challenge. A more thorough-going solution is to develop approved schemes for the activities of community based, non-profit distributing organisations, and to ensure that where possible they are covered by General Block Exemptions. Further details of the difficulties around state aids are contained in Annexe 3.

Annex I: Valuation for NFLS community acquisition:

The National Forest Land Scheme (NFLS) was introduced in 2005 by Forestry Commission Scotland to give community organisations, recognised non-governmental organisations (NGOs), and appropriate housing bodies the opportunity to buy or lease National Forest Land where they can provide increased public benefits. Community bodies must be appropriately constituted, and demonstrate that their proposals for management are consistent with sustainable development principles, are in the public interest and will deliver additional public benefits cf. FES management.

Notwithstanding the commitment to additional public benefit and the general alignment with the delivery of Scottish Government policy, acquisitions through the NFLS are required to be at “full market value”, and this has proved a significant obstacle to the effectiveness of the scheme.

Valuations are carried out, on a joint instruction basis, by the District Valuer, who may receive representations from both FCs and the community body, and then values the property on the basis of direct comparables. Because public assets are valued by comparison with private sector sales public bodies such as Forestry Commission Scotland, who are not direct recipients of single farm payment or tax advantages, will still benefit from any uplift in land prices.

A significant proportion of community acquisitions have been stimulated by FCS’s on-going disposals policy, under which communities have a time-limited opportunity to attempt to acquire properties determined by FCS to be surplus to requirements⁶ before they are placed on the open market. For most communities this is a once-in-a-generation opportunity to gain control of key local assets and resources and manage them for local benefit. Once the woodlands are sold into the private sector then the community has very little power to influence management objectives, or even to ensure that management takes place at all, and very little prospect of future acquisition: the Community Right to Buy provisions in the Land Reform Scotland Act are cumbersome, toothless and easily sidestepped by landowners.

Unfortunately, the disposals policy has coincided with a period of rapid inflation in the price of forest land. As one DV report notes:

Since 2008 there has been a general downturn in the property market as a whole. However, land and especially forestry properties have bucked the overall trend and have continued to increase in value throughout the period.⁷

This inflationary trend, and the extent to which land price is driven by non-productive values, has been illustrated by several recent NFLS valuations.

The Ross of Mull and Iona Development Group have applied to acquire Tioran forest on the Isle of Mull. All parties have acknowledged that there are significant obstacles to future forest management: notably disease, windblow, and limited transport infrastructure. Nonetheless, the Tioran valuation was £950,000 for 792ha, which equates to ~£1200/ha. This represents a very substantial uplift cf. the previous NFLS acquisition on Mull, in 2006, when the North West Mull Community Woodland Company acquired 691ha at Langamull and West Ardhru for £343,000, including legal fees (i.e. just under £500/ha).

The Maryculter Woodlands Trust applied in 2013 to acquire Kirkton of Maryculter wood, a 67ha property approximately 10km from Aberdeen, which was selected for disposal by FCS despite a well-established and active partnership with the community. Almost all the mature timber in the

⁶ Detailed criteria here: <http://www.forestry.gov.uk/website/forestry.nsf/byunique/infd-77cdu2>

⁷ From DV valuation of land at Kirkton of Maryculter Wood

wood has been felled in recent years, there are substantial areas which have yet to be restocked⁸, and there is no obvious development value in the wood. Nonetheless the DV valuation was £210,000: i.e. in excess of £3,000/ha.

The DV, in his report on Maryculter, notes:

*It is clear...that demand remains high for all types and qualities of woodland areas... The good level of demand is partly driven by the investment market where investors are struggling with the unpredictability of other types of investment such as commercial property, shares and banks. The unpredictability of other classes of investment makes land and trees seem a safer and more sought after option.*⁹

After enumerating some of the drawbacks of the site: poor productivity, access constraints, steep ground, archaeological features, the replanting obligation, he continues:

“However, despite these constraints and problems, the demand in the market place for woodland properties is such that many prospective purchasers would undoubtedly take a speculative approach and make an offer...”

At neither Tioran nor Maryculter does the valuation appear to reflect the productive capacity of the land or the potential of the woodland from a forestry perspective. The speculative nature of the forestry market is also well illustrated by the most recent NFLS application, by the Raasay Development Group, to buy 290ha of land on the island of Raasay, which have been valued at £400,000. The land is in two blocks: Inverarish 196.40 ha (50% stocked, 30% clearfelled), valued at £290,000, and Brochel 93.90 ha (almost completely clearfelled) £110,000.

The DV's report is very illuminating, and worth quoting at length:

The woodland areas on Raasay are remote and the ability to extract the timber is limited by the island's road network and the fact that a barge would be required to take the timber off the island. The majority of the standing timber at Inverarish is ready to be felled and this may well put off potential purchasers who would prefer a more constant income stream. It is my view that these factors alone would put off many potential purchasers. Being a small and sensitive island community, any purchaser from out with the island would need to work closely with the community for purposes of management and extraction of the timber. The close proximity of the main woodland areas to the village and the high levels of public access, all add complications and potential for conflict. The economic viability of extracting the timber to the mill is something that would need to be investigated thoroughly. We would expect that the rate per tonne of income would be considerably less than on mainland locations. This has certainly been the case on the Isle of Mull recently.

The land at Brochel has a limited value in forestry terms. It will be many years before any income is realised from the planting and natural regeneration. There is however a degree of hope value in respect of this land. There is at least one ruined building and an area down by the foreshore which could lend itself to the erection of a small bothy or log cabin for holiday use, subject to ascertaining the necessary planning consents. Similar types of properties have sold well on the market in recent years. The remote island location and outlook lend itself to this type of buyer. Even in cases where the planners give negative feedback as to the potential for development, purchasers will often still take the risk as a medium to longer term project.

⁸ Which will have to be undertaken by the purchaser at a cost of c. £50,000

⁹ From DV valuation of land at Kirkton of Maryculter Wood

After careful analysis, I expect that most purchasers would be deterred by the many factors outlined above. Despite this, if the purchase price was right some would take the risk and purchase the subjects in the hope of getting a return on their capital, or more likely, for the prospect of owning and enjoying a small estate property on a popular and attractive West Coast island.¹⁰

The DV could not be more clear: the price of this land bears no relation to its productive value, nor to its capacity to contribute to the sustainable development of the island and its community, but is driven by speculation and indulgence.

The Scottish Land Fund established by the Scottish Government in 2012 and delivered in partnership by the Big Lottery Fund and Highlands and Islands Enterprise is intended to support rural communities to become more resilient and sustainable through the ownership and management of land and land assets, and ought therefore to be able to assist in such acquisitions. However, the Scottish Land Fund considers these plantations to be “commercial forestry” and therefore (in their interpretation) state funding to facilitate a community purchase is constrained by EU state aid rules¹¹ and thus can only contribute to 20% of the asking price.

¹⁰ From DV valuation of land at Inverarish and Brochel, Raasay

¹¹ See annex 3 for more on state aid.

Annex 2: Valuation for NFLS community leasing:

The National Forest Land Scheme also gives properly constituted and eligible community bodies the opportunity to lease National Forest Estate land. As with purchase, this is to be at “full market value”, however, the assessment of this is problematic in the absence of a functioning market which might provide comparables.

FCS has therefore created a rental valuation methodology comprising two elements:

- an annual ground rent for the whole leased area, based on the capital value to the land, annualised using the Treasury discount rate;
- and timber payments, based on the value of the timber to be felled, making allowance for roading and restocking costs necessitated by harvesting, and any grant aid payable, and paid following harvesting.

The percentage of net timber income due to FCS will be on a sliding scale to reflect the increasing level of management input from the community over time. Minerals, development rights and commercial activities are normally excluded from the lease, but could be subject to separate negotiations if the community wished to secure these rights during the term of the lease. Sporting rights will be considered on a case-by-case basis, and reflected in the valuation if included.

As yet there have been very few ground rent valuations for leasing, but these, together with data from FCS accounts and previous valuations for purchase are sufficient to allow a broad comparison of community leasing with the one obvious comparable: the status quo¹².

FCS accounts¹³ reveal that Forest Enterprise Scotland just about breaks even as a standard UKWAS compliant forestry business¹⁴, and receives >£32M government grant (at 100% intervention rate) to deliver “additional public benefits”¹⁵.

In contrast, our estimate is that if the Scottish Government were to lease the entire National Forest Estate to community organisations through the NFLS, the Scottish Government (and thus the taxpayer) would be at least £40M per annum better off, possibly substantially more. This additional income would be comprised of a number of elements: broad brush estimates based on available information are listed below:

- Community bodies would be required pay in the range of £15M-£20M¹⁶ in ground rent to occupy the land and secure the right to harvest timber.

¹² Scottish Ministers own the National Forest Estate on behalf of the Scottish people, and contract Forest Enterprise Scotland (FES), which is designated as a public corporation for national accounting purposes, to manage it.

¹³ [http://www.forestry.gov.uk/pdf/ScotlandAccounts2012-13.pdf/\\$FILE/ScotlandAccounts2012-13.pdf](http://www.forestry.gov.uk/pdf/ScotlandAccounts2012-13.pdf/$FILE/ScotlandAccounts2012-13.pdf)

¹⁴ This is accounted for under the “Sustainable Forest Management” (SFM) budget heading which covers forest planning, timber operations, forest protection and maintenance (including deer management), management and development of the estate, and sufficient social and environmental activity to ensure continued UKWAS compliance. The apparent operating deficit in 2012-13 for net sustainable forest management was £36.3M, although this includes £31.3M for the value of felled timber: subtracting this reduces the deficit to £5.1M, which was apparently mainly due to the cost impact on impairments to the value of buildings (in 2011-2 the SFM budget had a £2.9M surplus).

¹⁵ These “additional benefits” are subdivided into “Communities, recreation and tourism” (net cost £13.0M), “Environment and heritage” (net cost £7.3M) and “Estate improvements” (net cost £12.4M) – in respect of which FCS received government grant of £32.7M. The published accounts do not break down expenditure under these budget headings, but they incorporate significant staff and organisational costs, as well as cash expenditure.

¹⁶ National Forest Estate covers c. 660kha. Valuations of ground rents to date range from £20-30/ha pa, which gives a range of £13.2-19.8M. Note, however that these valuations have been for properties designated surplus by FCS and are therefore likely to be below the mean value of the estate.

- They would then pay in the range of £15M-£20M¹⁷ in timber harvesting payments (NB, these payments are on a sliding scale, and would gradually decline over time)
- FCS/Scottish Government would continue to receive income e.g. from renewables installations. In 2012-13 this was £8.4M, and may be expected to increase with the on-going increased renewables capacity on the estate
- Community bodies would also pay a rental (to be agreed on a case by case basis) in respect of their own renewables installations, or any other substantial commercial developments.
- Community bodies would, no doubt, receive government grants to deliver “additional public benefits” (as and when such grants are available), however it seems unlikely that these would be payable at a 100% intervention rate, or that support would be available for staff and admin costs at such a high level.

It's difficult to escape the conclusion that **either** FES's management of the estate is woefully inadequate **or** the rentals being demanded of community bodies are extortionate.

We note also that the NFLS lease valuation process ascribes a “market value” to occupancy of the estate of £15M-£20M which does not appear in the FES accounts. If the Scottish Government is making the land available to FES at below market value then this would appear to constitute a state aid and (unless an approved scheme was in place) would breach EU competition rules.

¹⁷ Net timber income as reported in FES accounts was £34M, if deductions for restock (4,700ha in 2012-3) are estimated at £2-3k/ha, then timber payments in years 1-5 would be 80% of £19.9-24.6M, i.e. £15.92-19.68M

Annex 3¹⁸ State Aid

State Aid refers to forms of assistance from a public body, or publicly-funded body, given to selected undertakings (any entity which puts goods or services on the given market), which have the potential to distort competition and affect trade between member states of the European Union. These rules were designed to protect the operation of the free market and to facilitate a level playing field for major commercial interests with the capacity to trade across member states of the European Union; it seems unlikely that they were intended to inhibit the regeneration of some of our most disadvantaged communities or to restrict the growth and operation of locally based, not for profit social enterprises.

For an investment to be considered a state aid it must satisfy all of the following criteria: the support must be from state resources, confer a selective advantage, have the potential to distort competition, and affect trade between Member States. Where investments are assessed to be a state aid, support to an organisation is capped at 200,000 euro in a rolling three year period. Any additional investment beyond this *de minimis* level can only be made through approved schemes or under General Block Exemption regulations.

The *de minimis* regulations provide a useful mechanism to enable small scale state intervention where project appraisal indicates that all the criteria for state aid apply, however, blanket approval under *de minimis* is being used as a substitute for project appraisal against the state aid criteria. This approach is an attractive, risk-free option for civil servant and local government officers, but its cumulative effect is to severely constrain future development options for community bodies. The perception across the community sector is that civil servants and local government officers are taking an overly risk-averse approach which focuses on the potential problems rather than the pursuit of solutions. Our experience is that if officers see the slightest possibility of a State Aid issue they will treat it as an insuperable barrier, rather than carry out an appropriate and proportionate appraisal. There is growing evidence that Scottish officials are taking a much harsher line than their counterparts south of the border.

The current interpretation of the rules is impacting negatively across a raft of Scottish Government policy areas, including: 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.

State Aid rules: unfairly impacting on Community Organisations

Community organisations understand that they are subject to EU competition rules. However, the current interpretation (and in some cases misinterpretation) of those rules is unfairly impacting on their current and planned operations. There are a number of aspects to this impact.

(i) Community activity addresses market failure, rather than distorting functioning markets

A common feature of the activities of many community-based, non-profit distributing organisations is that they occur in response to market failure. To claim that market distortion results from public investment in circumstances where no viable market previously existed, misconstrues the fundamental principle which underpins state aid rules.

¹⁸ This annex reproduces, with only minor edits, a paper produced by the Scottish Community Alliance (of which CWA is a founder member) for submission to the Scottish Parliament Local Government and Regeneration Committee.

Example: Community transport

The bus industry was deregulated nearly 30 years ago with the intention that the industry should operate on a purely commercial for profit basis. Post-deregulation, bus companies were no longer expected to cross-subsidise loss-making routes from their profitable ones, leaving many parts of the country without an adequate public transport service. Community transport operators have emerged to address this market failure. The regulatory regime for community transport is lighter touch than that for commercial operators, with a system of special permits issued on the understanding that the service is not a commercial (for private profit) business. Notwithstanding this, and the fact that community transport only operates where a commercial operator is unable to deliver an effective and profitable service, local authority officers increasingly cite state aid rules as a reason not to provide the necessary support required to enable community transport projects to operate effectively.

(ii) Community development proposals are stymied by officers' mis-understanding of the state aid rules

The interpretation and application of state aid rules is a complex process, and those in public bodies charged with project appraisal may have only a limited understanding of the process. A frequent misconception is that a potential investment should be regarded as a state aid if one, or several of the criteria are met, rather than all.

Example: Aberfeldy Town Hall.

Perth and Kinross Council were initially supportive of Locus Breadalbane's plans to develop the Town Hall and were prepared to lease the building at a discounted rate on a trial basis to give the group an opportunity to test out various commercial ideas. However, officers became concerned about the potential state aid implications of plans for a café. Their assessment was flawed on two fronts: the potential to give a selective advantage is only one of the criteria which must all be met for an investment to qualify as state aid. Secondly, the proposed level of support from Perth and Kinross Council through a discounted rent would fall well short of the *de minimis* level of 200,000 euros.

(iii) The blanket use of de minimis provisions is inhibiting the ability of Community Anchor Organisations to deliver community-led regeneration.

The Scottish Government's regeneration strategy highlights the important role that community anchor organisations (CAO) have within community led regeneration. CAOs are multi-purpose organisations that become involved in a wide range of activities within their communities. The benefits of such an approach are widely recognised. Such multi-purpose community bodies are particularly vulnerable to the blanket use of *de minimis* provisions, because while the appraisal of state aid is (or should be) made at the project level, the *de minimis* allowance is cumulative, and calculated at the organisational level, so investment in each of the disparate activities of a Community Organisation (and any wholly owned trading subsidiaries) is aggregated together.

Some funding streams (e.g. Scottish Government Enterprise Growth Fund and Enterprise Ready Fund) do not carry out any appraisal of individual projects, and automatically classifying all their awards as State Aids, with all investments made under *de minimis* provisions, or through General Block Exemptions. This effectively excludes many of the most active and successful Community Anchors from applying.

Example: Mull and Iona Community Trust

The Mull and Iona Community Trust is a well-established Community Anchor Organisation which engages in a wide range of activity for the benefit of the island communities the Trust represents, both residents and businesses. The following list provides an illustration of the range of work

being undertaken by MICT in recent months and the public funding that had been received in support:

- CARES Loan (£38000) for a community owned renewable energy project which should be converted to grant if the project does not proceed. At which point it would be treated as part of *de minimis* state aid.
- Hydro Grant from HIE (£13700) for a community owned renewable energy project. The surpluses from Garmony will be distributed by a committee and MICT will not necessarily receive income from this.
- Talent Scotland Salary (£1151) for a placement of an under-graduate to assist with marketing of MICT work across the islands of Mull and Iona.
- Argyll Energy Audit (£14810) for a consortium of islands to pay a consultant to carryout research and to produce a report on the consumption and production of energy on the islands to determine how by electrification of energy (e.g. changing from a diesel car to an electric car) might help alleviate problems with the National Grid.
- Data Loggers (£4658) for equipment to monitor the flow of electricity to/from the island to help understand current situation and to monitor future changes with new generation projects and electrification of other energy sources.
- Broadband Seed Corn Fund (£2400) for market research and mapping of broadband speeds around the islands on behalf of the island community.
- CARES Loan (£105000) for a second community owned renewable energy project and which would qualify as *de minimis* if converted to a grant.
- Anaerobic Digestion (£10000) for a project which aims to assist all businesses on Mull producing organic waste streams to reduce disposal costs.
- Energy Advisor (£57752) for to employ a person to provide a service to residents and businesses on Mull and Iona.

While all these projects are unrelated to each other, for the purposes of *de minimis* calculation the cumulative total is greater than the 200,000 euro limit and therefore the board of MICT are being forced into having to take a view as to whether they can continue to take on new projects or wait until the three year qualifying period has lapsed. The current definition of *de minimis* level is stifling ambition and preventing progress on the very sort of project which Scottish Government is actively encouraging development trusts to take on.

Example: Kilfinan Community Forest Company

Kilfinan Community Forest Company acquired part of Kilfinan Forest, near Tighnabruaich, Argyll, through the National Forest Land Scheme and are pursuing a wide range of projects to develop the forest. Investment in several of these projects has been approved under *de minimis* provisions. KCFC investigated the potential for renewable energy projects, including an application for a CARES preplanning loan. Usually if a renewable energy project does not proceed, the loan can be written off as a grant, but in this case (because KCFC are deemed to have reached their *de minimis* threshold as a result of declaring previous public support received for unrelated projects) it must be repaid with interest.

The CARES loan-writeoff provision was intended to de-risk community investigation of renewable energy proposals: unlike commercial companies who can factor a percentage of “failures” into their business planning, community groups usually only have one or two possibilities for development. The limits to write-off now represent a serious disincentive to future community renewables as it requires the community body to take on a potential liability with the risk of having no obvious means of repaying the debt.

(vi) *Misplaced concerns about “market distortion” are severely limiting the expansion of community land ownership*

The Scottish Land Fund was established to support rural communities to become more resilient and sustainable through the ownership and management of land and land assets, however the over-zealous application of state aid rules is inhibiting the operation of the fund. When communities acquire woodlands (e.g. through Forestry Commission Scotland’s National Forest Land Scheme), what occurs is a transfer of assets, not the creation of new assets. Trees do not grow any faster under community ownership, so the volume available for harvest and thus the volume that can enter the timber market is unchanged by any transfer of ownership. It has been suggested by officials that simply establishing a new market actor is itself a market distortion. We note that the UK Government is preparing to transfer the entire English Public Forest Estate (with a market value of hundreds of millions of pounds) to a new Public Corporation, apparently without any State Aid concerns.

Example: Aigas Community Forest

Aigas Community Forest (ACF) was established by the community in and around Lower Strathglass in 2009 in response to Forestry Commission Scotland’s (FCS) intention to sell Aigas Forest (c. 260 ha) which had been deemed surplus to requirement. ACF’s application to buy the forest to deliver a wide range of economic, social and environmental benefits was approved in December 2009, but their attempts to raise the necessary funding have been repeatedly thwarted, most recently on the grounds of state aid and concerns over “market distortion”. ACF are one of a number of community organisations with approved NFLS applications who are unable to progress until this issue is resolved.

(v) *Interaction between public funding for the community sector and other public funding/incentive mechanisms.*

Funding bodies, particularly if operating either side of the Scottish border, do not appear to prioritise that State Aid compatibility runs across their respective programmes. This has been particularly problematic in the field of renewable energy in relation to the UK Government’s Feed in Tariff, which was declared a State Aid (even though a parallel mechanism, the Renewables Obligation, was not) and automatically incompatible with any form of public funding for ‘purchase and installation costs’ of energy generating plant. Uncertainty around the basis of the State Aid decision, and the interpretation of ‘purchase and installation costs’ has delayed a number of community projects and led to a loss of public (including UK Government) funding which has inhibited the development of individual projects and the sector as a whole. For example, the Isle of Gigha Heritage Trust lost a grant offer of over £250,000 from the ERDF.

(vi) *The burden of working with the State Aid rules can be substantial for community groups*

Whilst it is the responsibility of the awarding organisation to inform the recipient that aid is being awarded through the *de minimis* provision, it is the responsibility of the recipient organisation to maintain a current rolling total of the amount of such assistance received from all sources over a 3 year period, and to inform sources of possible further aid, should the threshold be likely to be breached. This can represent a substantial administrative burden, not least because the threshold is expressed in Euros, and different awards will have different exchange rates applied. Community organisations generally have high standards of governance and these liabilities are taken seriously, and often discourage a group from pursuing a project even when funding is available- or because of the risk it will prevent them from pursuing other projects.

We note that local authorities and some public agencies, who are eligible to apply to public funds such as LEADER, have been able to sidestep this stage of State Aid appraisal by refusing to provide details of previous funding, on the grounds that their organisations don’t keep comprehensive

records. The complexity of State Aid issues and the need to ensure compliance in order to receive commercial finance has contributed to spiralling 'due diligence' costs from commercial lenders. These are effectively an overhead that the community must include in its project costs, but as they can reach six figures for sub-million pound projects, they represent a significant financial burden and mean that projects must be over a certain minimum size to access this form of finance.

(vii) There is no recourse to a formal appeals process.

Within the UK there isn't an independent appeals process for State Aid decisions, and obtaining an opinion from the European Commission is practically impossible for small projects (and would in any case need to involve the national State Aid teams that would have made the decision in the first place).

Government Actions

There is no single solution the state aid problem, however there are a number of straightforward actions which the Government can undertake which would greatly mitigate its impact on the community sector

(i) Improved appraisal of state aid

Government should set a positive tone, making it clear that state aid should not be seen as an insurmountable barrier or a pretext for refusal, and should also ensure that all those charged with state aid appraisal are appropriately trained and supported to do so.

Civil servants and local government officers need to be empowered to make appropriate appraisals of projects based on a thorough understanding of the regulations and a realistic view of the likelihood of challenge.

(ii) Develop approved schemes for community based activity

A more thorough-going solution is to develop approved schemes for the activities of community based, non-profit distributing organisations, and to ensure that where possible they are covered by General Block Exemptions.

Design and notification of approved schemes would have to be taken forward on a sector-by-sector basis, and it is unlikely that they could ever provide total coverage, however they would greatly improve the situation. Such schemes are part of the normal support infrastructure for almost all commercial business sectors; without similar support the community sector will never develop to any significant scale.

(iii) Access to an appeals process

It would be beneficial to establish an independent (non-governmental) ombudsman for State Aid, with responsibility for managing an independent appeals process. This would also give comfort to those who administer the system and promote a more confident approach within the sector.