ANNEX B

Oil and Gas UK

Friday 3 March 2017

Date and Time of Engagement	Friday 3 March 2017 15:45 – 16:45
Where	Fraser Suite Ardoe House Hotel, South Deeside Road, Blairs, Aberdeen AB12 5YP
Key Message	**The Scottish Government is committed to a sustainable future for the oil and gas sector in Scotland and to working in partnership to secure the total value added for the economy and the industry.**
Who	• Deirdre Michie, Chief Executive • Neil Michie, External Affairs Officer
What	Key Discussion Areas: *1.* Oil & Gas UK 's Business Outlook 2017 – providing an update on the headline messages and overview – *This report will be published on 7 March.* 2. Apprenticeship Levy 3. Business rates *(if time allows)* 4. Brexit *(if time allows)*
Why	Oil and Gas UK have written to Mr Wheelhouse, on a number of separate issues, and asked for this meeting with the Minister. The correspondence covered: • Support for the Decommissioning Challenge Fund, and to discuss coordinating with Oil & Gas UK work on decommissioning • Briefing on the decommissioning sector in the UKCS Support for the draft Energy Strategy
When	**15:45 – 16:45; Friday 3 March 2017**

Supporting Official	[REDACT] **Oil and Gas Unit** [REDACT]
Media Handling	**N/A**
Dress code	**Business attire**
Greeting Party and specific meeting point on arrival (if at a non SG Building)	**N/A**
Specific entrance car/parking arrangements	N/A.
Briefing Contents	**Annex A – Summary** **Annex B – Business Outlook 2017 – Headline Messages** **Annex C – Apprenticeship Levy** **Annex D – Decommissioning Challenge Fund** **Annex E– Decommissioning Summary** **Annex F – Oil and Gas FMQ - still to be added** **Annex G – Business Rates FMQ – still to be added**

ANNEX A

PURPOSE: Summary

Deirdre Michie met with the Permanent Secretary on 23 February. This was a positive meeting and reiterated strong messages of support for the sector.

On Tuesday 7th March Oil and Gas UK will publish their new Business Outlook report.

- This meeting will provide Oil and Gas UK with an opportunity on the headline figures within the report. – **headline messages are located in Annex B**
- The report will look at opportunities and risks facing the whole industry in 2017, both for exploration and production companies as well as the different areas of the supply chain.

Industry Update - North Sea Oil & Gas Sector Outlook

- The scale of job losses has been significant over the last two years – 120,000 jobs supported by the industry have been lost across the UK. The industry continues to support 330,000 jobs in the UK, with 124,500 of these based in Scotland.
- In response to the low oil price and downturn, the industry has worked to improve efficiency and reduce costs – operating costs are down by 45% from peak levels.
- While offshore production increased this year (due to significant investment over the past decade) – the outlook for investment and exploration in 2017 is challenging and this will impact on the supply chain.
- In recent months, there have been a number of high profile asset sales in the North Sea (e.g. Shell sale of £3bn assets to Chrysaor and BP sale of interests in Sullom Voe Terminal to EnQuest.) Both SG and OGUK have welcomed recent deals, which are seen as positive steps towards maximising economic recovery, by placing ‘the right assets in the right hands’.

UK Budget & SG Calls for Fiscal Reform

- Ahead of the last Autumn Statement, the Cabinet Secretary for Finance and Constitution wrote to the Chancellor (12 Nov) to outline three specific calls for fiscal / policy reform:
  - **Improve access to decommissioning tax relief**
  - **Urgent clarity on the use of loan guarantees**
  - **Measures to stimulate exploration**
- **These measures were not delivered in the 2016 Autumn Statement**. The SG will continue to work with industry to ensure that the policy environment supports the aim of Maximising Economic Recovery.
- **The intention is that the Cabinet Secretary for Finance will again write to the UK Chancellor ahead of the next UK Budget on 8 March**. Along with reiterating the priority measures called for ahead of the autumn statement, the letter will **-**
  - call on the UK to follow Scotland’s lead – in launching the Decommissiong Challenge Fund – and work with the Oil & Gas Authority and industry to also **consider funding for projects that could improve the capacity of Scottish sites for securing decommissioning, dismantling and disposal contracts.**

    - State that the **Scottish Government stands ready to work with the industry, the regulator and the UK Government to develop a 'sector deal'** for this crucial industry.

- **Both the SG and the Oil and Gas UK Fiscal calls are broadly aligned.**

OGUK March 2017 Budget Calls:

Industry has welcomed recent changes made by the UK Government to the fiscal regime, and the commitment of successive UK Governments to HM Treasury's Driving Investment Plan. However, the industry still faces an extremely challenging economic climate, with a lack of fresh investment linked to the global downturn and drilling in the UK at an all-time low.

The **Budget Representation** sent to the Chancellor had 3 key asks:

1. **Extend the scope of the Investment Allowance to a wider range of productive expenditure**
   The industry is facing severe capital constraints globally and this is amplified in mature regions, such as the UK. We propose extending the scope of the Investment Allowance to include all forms of expenditure that will benefit the integrity and longevity of North Sea assets, or improve the ultimate recovery of oil and gas. This would build on previous fiscal improvements to enhance the business environment in the UKCS.

2. **Enable transferable tax credit for decommissioning to facilitate asset trading**
   The Driving Investment Plan identified that current facets of the tax system make it harder to transfer assets which have significant near term exposure to decommissioning to new entrants backed by new investors. The asset transfer market has not materially improved in the last three years and assets are effectively 'stuck' with their historic owners, with potential new owners deterred from buying the asset. Among other issues, we believe that enabling tax credits to move with the asset would remove an obstacle to asset trading, keeping assets producing for longer and the Exchequer continuing to collect production taxes.

3. **Ministerial dialogue with a view to improving access to finance**
   The oil and gas supply chain is also seeking support to improve access to finance for both their UK and international businesses. We believe that they would benefit from improved access to measures such as those available through the Government's UK Export Finance department and request further dialogue with Ministers to ensure that it is straightforward for industry to utilise such schemes.

Decommissioning & SG Decom Challenge Fund (DCF)

- On 8 February, the First Minister visited Aberdeen and launched a £5 million Decommissioning Challenge Fund (which will go live in financial year 2017/18).
- The DCF will support infrastructure upgrades and improvements at Scottish ports & harbours, or innovation in salvage and transport to port, to enable Scottish locations to secure onshore dismantling and disposal contracts

- This fund helps to deliver on the Programme for Government commitment that decommissioning is executed in a safe, environmentally sound and cost effective manner in order for the supply chain to gain competitive advantage.

The Scottish Energy Strategy and Climate Change Plan

- The draft Energy Strategy, published for consultation on the 24th January, sets out the SGs energy vision to 2050.
- The SG published the draft Climate Change Plan, on the 19th January setting out how we intend to meet the emission reduction targets in the period 2017-2032.
- Our draft Energy Strategy conveys a clear message to the oil and gas industry – the recovery of North Sea oil and gas as a highly regulated source of hydrocarbon fuels will continue to be a priority for this government for decades to come.

Apprenticeship Levy

- The Oil and Gas Sector are concerned that *"with less than 2% of companies across the UK falling into the scope of the levy, the size and complexity of companies in oil and gas means the industry is likely to be disproportionately affected by its introduction"*.
- The Levy is viewed as an additional tax on bottom line costs which could lead to companies looking at cutting costs in areas of their business.
- Industry argues that there remains a lack of clarity on how the Levy will operate in Scotland, particularly in terms of those employers operating across borders.
- At the EJTF meeting on 8 December, Deirdre and others sought clarity on the SG approach to the Apprenticeship Levy. **Scottish Government will update on Apprenticeship Levy at the next task force meeting on 22 March 2017.**

Key Lines

- During the consultation employers asked to see a more flexible approach and for Levy funds to be used to protect the development of the apprenticeship offering.
- The UK Government announced in November that the Scottish Government would receive £221m next year as a result of the levy
- This is not £221m of additional money coming to Scotland through the Apprenticeship Levy
- We estimate that the cost to the public sector in Scotland will be around £73 million per annum - when you take that into account the Scottish Government's spending powers are actually £30 million down as a result.
- All of the funds raised through the Apprenticeship Levy will be invested by Scottish Government in skills, training and workforce development to meet the needs to employers, the workforce, young people and Scotland's economy.
- That is why Minister for Employability and Training announced, as part of the budget, that we would introduce a Flexible Workforce Development Fund, to the tune of £10 million.
- The details on how the fund will operate as officials are being finalised, but this funding is committed.

Business Rates - SG Action:

1. The Draft Budget included a package of measures to reduce the overall business rates burden:

- reducing the poundage by 3.7% to 46.6p
- raising the eligibility threshold for 100% relief under Small Business Bonus Scheme, so that it lifts 100,000 properties out of rates completely
- raising the threshold for the large business supplement (which stays at 2.6p), so that fewer than 10% of businesses pay it

2. The 21 Feb announcement targeted additional support where it was most needed by applying a real-terms 12.5% cap on rates bill increases for:
   - nationwide hotels/pubs/restaurants/cafes
   - nationwide small-scale hydro
   - office space in Aberdeen city & shire
3. The cap for Aberdeen & Aberdeenshire offices targets support to the area most impacted by the oil & gas downturn.
4. Councils are free to provide further rates reductions to address any other local issues. SG is working in partnership with interested councils (including Aberdeen City & Aberdeenshire) to inform local decision-making.

On the 21 February announcement, Deirdre Michie, chief executive of **Oil and Gas UK, has commented**: *"We look forward to further details from the Scottish Government about how today's business rates announcements will support the oil and gas industry".*

UK Industrial Strategy and Brexit

- <u>Brexit</u> – OGUK statement (July 2016):
  - *"Brexit raises challenges and opportunities for governments, it is so important that we do not lose focus on the very real difficulties being felt by the sector at this time. Low levels of exploration and development activity on the UK Continental Shelf (UKCS) are of real concern; we need to ensure the basin continues to attract investment going forward. The UKG must continue to support the UKCS as being a competitive place in which to do business."*
- Previous informal feedback from OGUK indicated that some members also raised the issue of a potential second independence referendum as a cause of uncertainty.
- OGUK recently (1 Feb) held a Brexit event to explore the possible impacts of Brexit on the industry; this meeting will be an opportunity to hear the latest industry views.
- <u>UK Industrial Strategy</u> – in response to the Industrial Strategy Green Paper – OGUK are developing a case for a 'sector deal' for the oil and gas industry based on the ten pillars of the strategy. <u>A workshop will be held in mid-March and we encourage OGUK to work with Scottish Government to get the best deal for the sector.</u>

Annex B – Oil and Gas UK Business Review 2017

Business Outlook 2017 - Headline Messages

- The UK offshore oil and gas industry is now in better shape to compete for much-needed investment.

- Confidence is slowly returning to the UK Continental Shelf (UKCS) following an intensive two-year drive to improve efficiency, streamline costs and boost productivity, while maintaining focus on safe operations.

- Domestic oil and gas production continues to rise and unit costs are improving. This demonstrates that the basin is more resilient, and globally competitive, despite on-going lower commodity prices.

- Exploration and production companies may collectively see a return to positive cash-flow for the first time since 2013, provided costs are kept under control and commodity prices hold.
    - However, this is unlikely to translate immediately into reinvestment or increased activity.
    - The challenges for the basin ahead, particularly for companies in the supply chain, are still considerable.

- As a means to help the challenge of investment, Oil & Gas UK is asking HMT:
    - To extend the investment allowance to operational activities that are focused on maximising economic recovery.
    - To revise the tax treatment of decommissioning liability to facilitate the transfer of assets in the basin, and so stimulate additional investment.

- As companies continue to adjust to lower commodity prices, they remain focussed on near-term financial rebalancing and consolidating recent efficiency improvements.
    - Only a limited number of competitive opportunities are able to secure investment funding.
    - Investment in the UKCS is expected to continue to fall.
    - The wave of fresh capital investment seen in recent years is declining rapidly as fields currently in development come on-stream.

- Exploration remains at record lows and the basin urgently needs fresh capital to stimulate activity to unlock the UK's estimated remaining resource of up to 20 billion barrels of oil and gas.

- The impact on the supply chain has been particularly hard, with companies turning increasingly to overseas markets to offset the shortfall in domestic activity.

- There are indications however that the bottom of the cycle may have been reached and that business may at last begin to stabilise.
    - $4 billion worth of asset and corporate deals announced since January.
    - Share price of listed supply chain companies with a strong UK presence rose gently by 3%.
    - Approval for new capital investment could potentially rise this year with up to £1 billion of new field developments being sanctioned.

- Government's proposals for an Industrial Strategy must ensure that oil and gas remains at the heart of UK industrial policy, and ensure the competitiveness of the supply chain, by building resilience through diversification and exporting.

Key Statistics

Industry production:

- 5% rise in output to 1.73m boepd (630m boe pa) in 2016.
- Production has been rising since 2015, bucking a 15-year trend of decline.
- Production is expected to rise over the next two years, peaking at between 1.8 and 1.9m boped by 2018.
- By 2018, recent start-ups are expected to contribute more than 600,000 boepd – over one third of UKCS production.

Industry investment:

- Industry anticipates a total spend of just over £17 billion in the UK this year, around 20% lower than last year.
- Exploration remains at record lows and the basin urgently needs fresh capital to stimulate activity.
- $4 billion worth of asset and corporate deals announced since January.

Industry efficiency:

- Average unit operating costs have improved by half within two years, from $29.70/bbl to $15.30/bbl.
- Development costs for newly approved projects have reduced by more than 50% since 2013, reflecting costs trends as well as investment constraints.

Supply chain:

- Companies have seen an average 30% fall in revenues over the last two years.
- Export of goods and services are expected to be around £12 billion in 2017.
- Although overseas revenues have fallen by £4 billion since 2014, reflecting the contraction in global spend, they now account for 43% of supply chain revenues.

ANNEX C- Apprenticeship Levy

- The Autumn Budget Statement included details on the introduction of the UK wide Apprenticeship Levy in Apr 2017. It will be set at a rate of 0.5% of an employer's pay-bill and be paid on any pay-bill in excess of £3 million. HMT suggest that only 2% of UK employers will be eligible to pay.
- Minister for Employability and Training launched a short consultation on 13 Jul – 26 Aug seeking views on how we develop a distinct Scottish approach.
- The SG published response set out how the Levy will support skills, training and employment in Scotland, including:
    - continue to expand the number of Modern Apprenticeship opportunities as part of our planned growth to 30,000 new starts each year by 2020;
    - support measures to tackle structural unemployment issues;
    - continue to implement the Youth Employment Strategy'; and
    - establishment a new Flexible Workforce Development Fund
- The Oil and Gas Sector are concerned that *"with less than 2% of companies across the UK falling into the scope of the levy, the size and complexity of companies in oil and gas means the industry is likely to be disproportionately affected by its introduction"*.
- The Levy is viewed as an additional tax on bottom line costs which could lead to companies looking at cutting costs in areas of their business.
- Industry argues that there remains a lack of clarity on how the Levy will operate in Scotland, particularly in terms of those employers operating across borders.
- At the EJTF meeting on 8 December, Deirdre and others sought clarity on the SG approach to the Apprenticeship Levy. **Scottish Government will update on Apprenticeship Levy at the next task force meeting on 22 March 2017.**

Key Lines

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- The UK Government announced in November that the Scottish Government would receive £221m next year as a result of the levy
- This is not £221m of additional money coming to Scotland through the Apprenticeship Levy
- We estimate that the cost to the public sector in Scotland will be around £73 million per annum - when you take that into account the Scottish Government's spending powers are actually £30 million down as a result.
- All of the funds raised through the Apprenticeship Levy will be invested by Scottish Government in skills, training and workforce development to meet the needs to employers, the workforce, young people and Scotland's economy.
- That is why Minister for Employability and Training announced, as part of the budget, that we would introduce a Flexible Workforce Development Fund, to the tune of £10 million.
- The details on how the fund will operate as officials are being finalised, but this funding is committed.

ANNEX D - DECOMMISSIONING CHALLENGE FUND

- The Scottish Government will initially make available **£5 million in 2017/18** through the new Decommissioning Challenge Fund. The DCF could support infrastructure upgrades and improvements at Scottish ports & harbours, or innovation in salvage and transport to port, to enable Scottish locations to secure onshore dismantling and disposal contracts.

- This fund builds on **The Scottish Enterprise Decommissioning Action Plan** and industry feedback highlighting that Scottish companies have been successful in winning offshore decommissioning work, such as high value plugging and abandonment work, but that investment is required at Scotland's ports and harbours to increase our capture of dismantling and disposal contracts.

- The DCF will deliver a key **Programme for Government** commitment to ensuring that decommissioning is executed in a safe, environmentally sound and cost effective manner and supports the ambitions outlined in our Energy Strategy and Decommissioning Action Plan.

- The DCF will support infrastructure upgrades and innovation in salvage and transport methods at Scottish ports and harbours.

- There is potential for this fund to be expanded in future years to support larger scale projects at Scottish ports. We will engage with industry, local authorities and stakeholders to explore opportunities

- Applications to the DCF will be open to all locations, based on clear application criteria. This will help address any potential concerns about providing funding to one location over another. This will promote a strategic approach that enables ports with existing features or natural advantages to make a case for funding based on the relative merits.

- We will engage with industry/stakeholders to publicise and develop the scheme. The DFC will align with cost reduction efforts related to decommissioning activities led by the Oil and Gas Authority (OGA) and the Oil & Gas Technology Centre (OGTC)

- Decommissioning at Scottish Ports in line with the principals of a circular economy, would promote reuse of material over recycling and disposal where possible. The circular economy provides opportunities to reduce the energy intensity and emissions from decommissioning structures, but also provides opportunities to support the Scottish economy through potential new job and business opportunities, and cost savings for manufacturing that may use decommissioned material.

ANNEX E: DECOMMISSIONING SUMMARY

Key Facts:

- Decommissioning is a growing, nascent market, where £1.1 billion was spent on decommissioning activity on the UKCS in 2015; £2 billion is expected across 2017.
- Decommissioning in the North Sea represents a £17.6 bn opportunity over the next decade - with over 50% of this market to be found in the Central North Sea.
- Wood Mackenzie (Nov 2016) estimate total decommissioning spend will amount to £53 billion from 2017 onwards, where £24 billion (or 45%) is liable by the UKG via tax relief.

Key themes evident from decommissioning projects awarded to date:

- **The Scottish supply chain has been successful in securing contracts for certain aspects of high-value decommissioning work**, such as: "operator project management"; "well plugging and abandonment (P&A)"; "facility running"; and "facilities/pipelines making safe". These activities account for a significant proportion of overall decommissioning costs, for example well P&A accounts for 47 per cent of the total cost.
- **The highly visible onshore disposal and dismantling accounts for around 1 to 2 per cent of overall decommissioning costs**, and topside and substructure removal accounts for around 15 per cent, however there are limited options for capturing this work in Scotland. There are no locations in Scotland or the UK that currently have the required specifications to accept a Heavy Lift Vessel (HLV). However, with 82 per cent of projects still in the early stages of planning, this remains a significant future economic opportunity, particularly at a local level.
- **In the short to medium term Well P&A is the major decommissioning activity in terms of expenditure** (peaking in the late 2020's) but Topside removal/Onshore disposal activity will become more significant (again) by the late 2020's – indicating that there is some time to build capacity in this area before this transition. Opportunities may exist for collaboration and efficient use of resources particularly where clusters of fields may are being decommissioned at the same time.

<u>Examples of Scottish companies winning business in the decommissioning market:</u>

- The Brent Delta decommissioning services contract was awarded in 2010 to Wood Group PSN, an Aberdeen-based company. 100 companies with Aberdeen postcode involved in Brent / current project management phase support around 1,500 jobs.
- With regards to Well P&A Scotland has a strong presence of international drilling and well services companies such as Archer, KCA Deutag, Schlumberger, Halliburton and Weatherford who are Tier 1 suppliers for such products and services.
- A number of smaller supply chain companies also successful in securing contracts – e.g. Sparrows won decom contracts for BP's Miller field.

<u>There is a key challenges to the Scottish Supply Chain, particularly in onshore dismantling and disposal</u>

- A number of Scottish ports already deal with smaller modules and subsea related decommissioning (Aberdeen, Dundee, Montrose, Rosyth, Peterhead and Wick have all been involved in small scale work for the past 20 years).

- Water depth and quay restrictions mean that currently no port in Scotland can directly take a heavy lift vessel alongside – the alternative is barge transfer in sheltered water (Lerwick, Nigg & Invergordon have potential to support larger scale projects involving barge transfers).

<u>Decommissioning as part of the Circular Economy.</u>

- Reuse of energy infrastructure, including from oil and gas decommissioning, is one of four priority sectors in our circular economy strategy - 'Making Things Last'.
- Zero Waste Scotland is working closely with Decom North Sea to help Scottish companies understand and exploit the opportunities for reuse of high value oil and gas equipment and components.
- Specialist support for SMEs to develop and introduce innovative reuse and remanufacturing business models is available through the Circular Economy Service and Circular Economy Investment Fund. Support from academia for companies of all sizes to overcome technical reuse, repair and remanufacturing challenges is available through the Scottish Institute for Remanufacture.
- Generally industry estimates that upwards of 85% of decommissioning spend currently takes place within the UK, and Scotland enjoys a global leadership position in subsea engineering and is a world renowned hub with the potential for strong growth in international markets.

Annex F – Oil and Gas FMQ

First Minister launched a £5 million Decommissioning Challenge Fund (DCF) to provide opportunities for the Scottish supply chain to benefit from oil and gas decommissioning, 8 Feb

- The DCF will support infrastructure upgrades and innovation in salvage and transport methods at Scotland's ports and harbours.
- It will also encourage engineering scoping work at key sites to build business cases that will attract further private investment.
- The DCF will deliver a key **Programme for Government** commitment to ensuring that decommissioning is executed in a safe, environmentally sound and cost effective manner and supports the **ambitions outlined in our draft Energy Strategy and Scottish Enterprise's Decommissioning Action Plan**.

GMB have criticised DCF money as a "drop in the ocean" on GMS (9 Feb); and argue (20 Feb) that Scotland is a "decade behind" in preparing for decommissioning.

A Labour Conference Motion: called on UK & Scottish Governments to agree a co-investment plan to support the industry by taking a public stake to protect vital offshore infrastructure, 25 Feb 17

- The Scottish Government has received no direct tax from production in the North Sea, while the UK Government has received £330 billion from the UK continental shelf and more than £20 billion from the Brent field alone.
- We have long called for reform to the fiscal regime, including improved access to decommissioning tax relief, protecting critical pieces of infrastructure and greater support for exploration.
- The Scottish Government has repeatedly demanded action from UK Ministers, who retain the key economic levers, to ensure the industry, and its workforce, have the future they deserve.

Top Lines

- The **North Sea still holds significant potential with up to 20 billion boe remaining,** but the industry highlights that further action is needed to encourage investment.
- We are under no illusions about the challenges facing the sector, but welcome the fact that the 2016 Economic Report shows that production increased in 2015 by 10.4%, **with a reduction in average operating costs by 45%** - reflecting the significant investment in recent years and the efforts by industry to reduce costs and increase efficiency.
- **The new £5 million Decommissioning Challenge Fund recognises that decommissioning is an emerging, but growing, activity in the North Sea**, with £17.6 billion expected to be spent in the North Sea over the next decade.
- **The key economic and fiscal levers remain with the UK Government**. The Scottish Government remains committed to the oil and gas industry during these challenging times.
- The **Energy Jobs Taskforce (EJTF) is supporting Scotland's oil and gas sector** - bringing together key partners to maximise employment opportunities for those in the industry.

The Scottish Government remains committed to maintaining domestic oil and gas exploration and production, and maximising economic recovery.

- This is clearly articulated, for the first time, within the context of our draft climate change objectives.

- The £5m Decommissioning Challenge Fund builds on the Programme for Government commitment to identify investment opportunities, with a view to improving capacity at Scottish ports, increasing the economic return to Scotland from a variety of removal, disposal and dismantling activities.
- Scottish Enterprise's **Decommissioning Action Plan** sets out a vision of how the Scottish supply chain can maximise the value that is obtained from the forecast spend of £17.6 billion on decommissioning between 2016 and 2025 (OGUK 2016).
- **Decommissioning presents a great economic opportunity for Scotland and our supply chain is already securing a significant amount of work.**
- The Scottish Government have already invested in infrastructure to support decommissioning activity in Scotland - demonstrated through **£2.4m public funding to develop the Dales Voe quay in Shetland**
- OGUK has described the Decommissioning Challenge Fund as "encouraging news" for supply chain companies.
- The UK Government retains control of oil and gas but has failed to provide an equivalent support mechanism for decommissioning in the North Sea.
- **The Scottish Government will make further funds available in future years once business cases have been developed to support larger scale projects.**

The Scottish Government is committed to providing certainty and stability on the long-term treatment of decommissioning tax relief

- It will continue to engage with the industry on future reforms. Post-independence decommissioning relief will be provided in the manner and at the rate currently provided through the current fiscal regime.
- Responsibility for decommissioning tax relief will be the subject of a negotiation between the Westminster and Scottish Governments.
- Successive Westminster governments have accrued around £330 billion in tax receipts (2015/16 prices) from oil and gas production.
- The Scottish Government will seek a commensurate contribution to meeting the costs of decommissioning from Westminster. However, the outcome of these negotiations will have no impact on the value of relief received by operators.
- The Scottish Government will also seek to maximise the economic benefits to Scotland of the decommissioning process, including maximising the substantial opportunities for our supply chain overseas.
- The real risk to the North Sea's future comes from the lack of support from the UK Government – despite repeated Scottish Government calls for greater support to encourage increased investment and stimulate activity and exploration.

Oil & Gas UK published their Economic Report 2016 on 27 September, it highlights the challenging conditions in the industry, including a fall in total UK employment supported by the industry of 27% from a peak of 450,000 in 2014 to the current 330,000 jobs.

- I heard first-hand from the OGUK Board, the efforts the industry is undertaking to improve efficiencies and lower costs - demonstrated by the 45% reduction in the cost of producing a barrel of oil since 2014.
- The UKCS is expected to generate a free cash flow deficit of £2.7 billion in 2016 - **an improvement from the £4.2 billion seen in 2015 due to a reduction in expenditure**.
- The report also highlights the continued downward trend in exploration and investment, with capital investment expected to fall to £9 billion in 2016, of which only £100 million is in new projects.

- **Industry still view a significant potential within the UKCS**. Gary Haywood, INEOS views the North Sea as a *"great opportunity"* especially with the low oil price environment, Energy Voice, 29 Sept 16.

It also points to the positive impact of efficiency measures, and highlights production increases:

- Average unit operating costs are expected to be around $16/boe, driven by cost efficiencies and increases in production, with production increasing in 2015 by 10.4% with 602m boe produced (UKCS).

<u>We launched a £12 million Transition Training Fund (TTF) to support individuals and help the sector retain talent on 1 February 2016</u>.

- The fund, now in operation for a year, will **operate for three years**. Latest figures show **more than 1,600 people have had applications approved from the fund**.
- Training programmes procured by the TTF will also **create around 340 employment opportunities across Scotland**, and **the latest tranche supporting 425 opportunities**.
- The TTF augments the work of the Energy Jobs Taskforce - already providing support through **PACE** and other measures such as the **Adopt an Apprentice initiative**.
- It is important that the TTF continues to address tangible economic opportunities, rather than simply offering speculative training - on this basis, the funding has already surpassed its initial aim of supporting over 1,000 participants each year.

<u>The Energy Jobs Taskforce (EJTF) remains focused on supporting those affected today but, at the same time, is looking to the future to lay foundations for a vibrant industry for decades to come</u>

- **The taskforce has met 12 times,** with the most recent meeting taking place on 8 December.
- The PACE programme has focused significant efforts in the North East **– PACE job events aimed at the oil and gas industry have been attended by 3500 people to date.**
- The Elevator Fresh Start programme has supported **the creation of 49 new businesses in the north east of Scotland**, originating from original contact at PACE events.
- From March 2015 to April 2016**, Scottish Enterprise has engaged directly with over 700 oil and gas companies via 29 events**. These include workshops and programmes and 4 industry networking events

<u>We have also provided a further £12.5 million to support innovation and business resilience</u>

- This included £10 million of SE funding to **help firms reduce risks associated with carrying out research & development. To date** around 78 innovation projects with a total project value of around £16 million having benefitted from **around £7 million** of Scottish Government support so far.
- £2.5 million was set aside for **business resilience reviews,** providing targeted support from industry experts, **with over £2.5 million committed investment so far**.
- SE & HIE are providing practical assistance to the supply chain and have run **6 Resilience in Oil and Gas Events**, welcoming 217 delegates from 144 companies, to hear from experts on strategy, operations, finance and market resilience

The key economic and fiscal levers remain with the UK Government, and further support is required

- The Chancellor has provided no substantive measures to support to the oil and gas sector in the **Autumn Statement.**
- A letter on 12 November 2016 from the Cabinet Secretary for Finance and Constitution to the Chancellor contained **three specific asks ahead of the Autumn Statement.**
- These proposals were focused around increasing activity in late-life assets to ensure their full potential is realised, protecting critical pieces of infrastructure, and driving forward much needed new investment in the North Sea. **These asks were not addressed in the Autumn Statement**.
- It is clear that without greater investment and activity we risk losing vital capacity and skills that will support production and ensure we maximise economic recovery from the North Sea.

  The recent measures announced on 23 Nov do not address the short term challenges facing the industry.

The Scottish Government has provided £125 million through the Aberdeen City Deal and a further £254 million of additional investment to help sustain Aberdeen as one of the world's leading cities for investment and business.

- On 21 November, the Scottish Government, UK Government, Aberdeen City Council, Aberdeenshire Council and Opportunity North East signed the Aberdeen City Region Deal. **The signing of the Aberdeen City Region Deal** and the release of funding allows the deal to move on to the delivery stage and make proposals a reality.
- The terms of the deal commit both the UK Government and Scottish Government to jointly investing up to £250m over the next decade.
- At the heart of the Aberdeen City deal is the Aberdeen **Oil & Gas Technology Centre.** This will be a new, world class centre to support innovation of the oil and gas industry in the North East, the rest of Scotland and across the whole of the UK.

Our draft Energy Strategy conveys a clear message to the oil and gas industry – the recovery of North Sea oil and gas as a highly regulated source of hydrocarbon fuels will continue to be a priority for this government for decades to come.

- Over the past five decades**, North Sea production** has established an industry that has generated over £330 billion in tax revenue and currently supports around 124,500 jobs in Scotland.
- Unlike the UK Government's Industrial Strategy – which only mentions oil and gas twice – our draft Energy Strategy is clear that the **oil and gas sector will continue to play a key role** in our transition to a low carbon economy.
- The sector provides high-value employment, the engineering and technical bedrock for our transition from fossil fuels, and stable supply of our energy demands for decades to come.
- Around **three quarters of total energy consumption in Scotland is supplied by oil and gas**.
- As a result of advances in technology, many of which are developed here in Scotland, new and innovative ways of using hydrocarbons are emerging. This will be a continuing opportunity for decades to come with new energy sources and technologies such as Hydrogen and CCS having the potential to substantially reduce the cost of decarbonisation.
- To sustain the industry into the future, maximise the economic benefit for Scotland – the Strategy will promote efficiencies, encourage innovation, reduce energy wasted in transportation and continue to minimise the environmental impact of the industry.

ISSUE: MINISTERIAL STATEMENT, 21 FEB

- 12.5% real-terms cap on bill increase for:
  - hotels & pubs; restaurants & cafes (benefits 8,500 properties);
  - offices in Aberdeen and Aberdeenshire (benefits 1,000 properties)
  - small-scale hydro (up to 1 MW) (benefits 100 properties)
- Expanding current relief up to 100% for qualifying community renewables projects, by lowering the eligibility threshold related to community profit-share from 1 MW to 0.5 MW
- New 50% relief for district heating schemes.
- Total estimated cost £44.6m, funded by revised approach to addressing the NDR pool deficit.

DRAFT BUDGET 2017-18 proposals

	Scotland		**England**	
	2016-17	**2017-18**	**2016-17**	**2017-18**
poundage (pence)	48.4	46.6	48.4	46.6
large business supplement (pence)	2.6	2.6	1.3	1.3
LBS threshold (rateable value)	£35k	£51k	£18k / £25.5k London	£51k
small business 100% relief – upper threshold (rateable value)	£10k	£15k	£6k	£12k
small business <100% relief (rateable value)	50% to £12k 25% to £18k	25% up to £18k	tapers to 0% at £12k	…0% at £15k

THE REVALUATION

- All non-domestic premises (subject to exemptions e.g. agriculture) have their property value reassessed by the independent Assessors. The SG has no locus to intervene. SG does have control over the tax rate (poundage) and reliefs.
- Assessors published draft revaluations online in December, subject to change in March. **All ratepayers have until 30 September to appeal their revaluation.**
- SG will publish an analytical report on the impact of revaluation in due course.

TRANSITIONAL RELIEF (TR)

- Revenue-neutral premise: largest bill increases and decreases phased in after revaluation so acts as a cross business subsidy, although past schemes have always required Gov subsidy to balance.
- SG consulted in 2016: published analysis showed 32 of 52 respondents supported TR (i.e. a small sample, given over 200,000 properties in valuation roll).
- English legislation requires TR for every revaluation. Scotland last applied it for 2005 revaluation.

Empty property relief unchanged

	Empty non-industrial property	Empty industrial property
Scotland from 2013-14	100% for 3 months, then 10%	100% indefinitely
Scotland from 2016-17	50% for 3 months, then 10%	100% for 6 months, then 10%
England	100% for 3 months, then 0%	100% for 6 months, then 0%

NDR INCOME / POOL

07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17	
1,928	1,924	2,010	2,138	2,251	2,347	2,367	2,511	tbc	tbc	*NB. 2015-16 data will publish Feb 2017*
	-0.2%	*4.3%*	*10.9%*	*16.8%*	*21.7%*	*22.8%*	*30.2%*	tbc	tbc	

- Conservatives cite SPICe 42% rise in collected NDR from 2007-08 to 2014-15. However, SG published collected NDR (table above): up 30% from 2007-08 to 2014-15; in line with England.
- Draft Budget shows (distributable) NDR dropping from £2,768.5m for 2016-17 to £2,605.8m for 2017-18. It does not reveal the fact that collected NDR is rising.

SG Non-Domestic Rating Account ("The NDR Pool") *[data to 2015-16 published; 2016-17 data will publish in Dec 2017]*

(£m)	2013-14	2014-15	2015-16	est. 2016-17	est. 2017-18 (Draft Budget)	
Contributions	2,500.9	2,554.0	2,573.8	2,802.1	2,816.2	*NB. figures differ from above stats due to prior-year adjustments etc*
Distributable Amount	2,513.0	2,780.6	2,788.5	2,768.5	2,665.8	
Yearly Balance	-12.1	-226.6	-214.7	33.6	150.4	
Cumulative Balance	152.7	-73.9	-288.6	-255.0	-104.6	

ISSUE: DAILY MAIL, 2 Feb 2017, '*Rates Hike to hit NHS'*

Selected <u>provisional</u> revaluations (public sector)

Property	2016 rateable value	Provisional 2017 rateable value
Edinburgh Royal Infirmary	£5.59m	£5.51m
Forth Valley Hospital	£5,04m	£7.55m

Glasgow, Queen Elizabeth Hospital	£15.0m	£22.59m
Aberdeen Royal	£6.3m	£6.93m
Glasgow Royal	£4.6m	£4.84m
Dundee, Ninewells	£4.58m	£4.53m
Aberdeenshire Council HQ	£2.4m	£2.54m
Aberdeen City Council HQ	£2.59m	£2.93m
Edinburgh City Council HQ	£3.12m	£2.60m
Edinburgh City Chamber	£1.05m	£0.93m
Glasgow City Chamber	£1.08m	£1.34m

Overall revaluation uplift for hospitals is around 10-11%, with individual valuations going up and down.

ISSUE: P&J, 27 Feb, '*Why parents could be forced to turn back on work to look after kids… Because of business rates*'

- Nurseries average rateable values are increasing by around 30%.
- P&J reports "Linda Pirrie, manager of three Croft Nurseries in Stonehaven, said that parents would have to pay more as she will have to stump up an extra £38,000".
  - In fact, the 3 nurseries' total rateable value is increasing from £74k to £111.5k, with rates bill increasing from £35.8k to £52.0k (up £16.1k or 45%).
- Reports "Graham Mogford owns the Bridges Nurseries in Westhill and Bridge of Don and is facing an increase in the rateable value on each of his properties from £65,000 to £112,000".
  - In fact, the 2 nurseries' total rateable value is increasing from £111.5k to £195.5k, with rates bill increasing from £56.9k to £96.2k (up £39.3k or 69%).
- Reports a "£44 million package to ease the burden on outfits feeling the squeeze from the oil and gas slump".
  - In fact, the £44.6m package comprised £4.8m for Aberdeen/shire offices; £2.7m for renewables; and £37.1m for hotels (& other accommodation), pubs, restaurants, cafes.

Reports Cllr Willie Young "called on Holyrood to give the same priority to the north-east as it had to the struggling steel industry".

<u>Top Lines</u>

- No restaurant, pub, hotel or café will see their bills increase by more than 12.5%;
- Additional support for the North East economy in light of the Oil and Gas downturn, capping bill increases at 12.5% for offices in Aberdeen and Aberdeenshire
- Expanded renewables relief as committed to in the Draft Budget
- As Mr Mackay set out on 21 Feb, updating the profiles of the Scottish Government's contribution required to bring the NDR pool into balance has provided the flexibility to meet the additional cost of these measures.
- The measures for hotels/pubs and offices will apply for 2017-18 and we will consider what further future support is required in light of the Barclay review when it reports this summer.
- We have freed councils to use their powers to introduce local rates relief schemes to address any other local issues.

The Draft Budget sets out a highly competitive business rates regime.

- **Over 70% of Scottish properties will pay the same or less in 2017-18 than they do currently.**
- We are cutting the poundage, extending the Small Business Bonus Scheme, and focusing the Large Business Supplement only on the very biggest businesses.
- More than half of rateable properties will pay nothing for 2017-18 [due to the Small Business Bonus and other reliefs].
- An external review (led by Ken Barclay) is exploring how business rates can better reflect economic conditions and support growth. We will respond quickly when it concludes in the summer.
- In 2017 all commercial premises will have their property value reassessed by the independent Assessor. The Scottish Government has no locus to intervene in this process.
- The Scottish Government will publish an analytical report on the impact of revaluation in due course.
- All ratepayers have a right of appeal against the independent Assessors determination of rateable value. This is free to do in Scotland, unlike in England where charges are proposed from 2017-18.

Our Draft Budget demonstrates our commitment to competitive business rates

- The rates poundage will drop 3.7% from 48.4p for 2016-17 to 46.6p for 2017-18.
- We are maintaining the best support for small ratepayers in the UK.
- The Small Business Bonus has saved business over £1.2 billion cumulatively since 2008.
- The Small Business Bonus eligibility threshold for 100% rates relief will increase to a rateable value of £15,000, lifting 100,000 properties out of rates altogether.
- The Small Business Bonus will provide maximum support of £6,990 per business [100% relief for £15k rateable value at 46.6p poundage].Properties with rateable value up to £18,000 can still get 25% relief, as is the case currently [so long as ratepayer's cumulative rateable value is no more than £35k].
- **We are excluding 8,000 businesses from the large business supplement**, and limiting it to fewer than 10% of properties [around 20,000].
- **We are raising the threshold for the large business supplement from a rateable value of £35,000 to £51,000** [matching England].

QUOTE
Colin Borland, Federation of Small Businesses: *The sensible measures announced today should provide some comfort for Scotland's vital tourism and hospitality industries. Targeted help for the economy of the north east will also be welcomed by local firms." 21 Feb 2017*

QUOTE
James Bream, Aberdeen Chamber of Commerce: *"I think we can say the Scottish Government have listened to the chamber and its members, and actually we would expect to see real benefits over the next year to the businesses in the region." (Reporting Scotland 21 Feb)*

QUOTE
Marc Crothall Scottish Tourism Alliance*: "For us, a sector that employs two hundred and ten thousand people and has nigh on twenty thousand businesses, this is a really, really big*

result, there's never been such an issue that has caused such a concern for so many, and it's across the whole country." (STV News 21 Feb)

QUOTE

Andy Willox, Federation of Small Businesses: *"By giving full rates relief to 100,000 Scottish firms, the government has lifted the prospects of smaller businesses facing a tough 2017." 15 Dec 2016*

We will continue to fund a package of rates relief worth over £600 million

- We are not proposing transitional relief, as it would burden many smaller ratepayers (and benefit a few large utility companies).
- We will match the Chancellor's expanded rural relief [from 50% to 100%] and, subject to confirmation of detail, new relief for new broadband fibre infrastructure.
- We will expand renewables relief and confirm detail in due course.
- **Empty property relief will continue unchanged for 2017**
- Empty relief balances the incentive for landlords to occupy property, with a reasonable period of time to help manage vacancies.
- 'New Start' relief supports new-build development; and 'Fresh Start' relief supports re-use of certain long-term empty property.
- **Councils can also now apply further rates reductions** under the Community Empowerment Act. [Perth & Kinross is using the power to support town centres]

We continue to discuss Draft Budget proposals with stakeholders ahead of final decisions

- Ministers continue to engage a range of stakeholders including Aberdeen & Grampian Chambers of Commerce, Aberdeen City Council and Aberdeenshire Council.
- Rating valuation is undertaken by independent Assessors, funded by local councils, not the Scottish Government.
- Individual business rate payers can, of course, appeal their valuation if they feel it is incorrect.
- Each council retains all the business rates revenue it collects, and it is for councils to apply rates reductions, on top of existing statutory reliefs, as they see fit.
- Taking next year's local government finance settlement plus the other sources of income available to councils through reforms to council tax and funding for Social Care, the overall increase in spending power to support local authority services amounts to £241 million or 2.3 per cent.
- Aberdeen Council's share will see increased spending power of £7m in 2017-18, not a decrease.
- The Scottish Government is delivering a huge amount for Aberdeen and the North-east. We are delivering our share of the Aberdeen City Deal plus an additional £254 million investment announced alongside it. We are also investing £745 million in the Aberdeen Western Peripheral Route.

Almost two in every five nurseries [approx. 37%] received rates relief via Small Business Bonus in 2015

Approximately 60% of hotels (3,200 premises) received rates relief via Small Business Bonus in 2015

- 49% of hotels paid no rates at all.
- In total Small Business Bonus Scheme provided nearly £6 million of relief to the hotel sector.

We have made changes since Draft Budget to our estimated profile of non-domestic rates income [at Budget Bill Stage 1]

- This reflects updated projections of the Scottish Government contribution required to bring the non-domestic rates pool into balance.
- This revision takes place alongside evolving revaluation information from the Assessors - which is on-going ahead of new valuation rolls being produced in mid-March.
- The revision will have no impact on our competitive package of business rates measures already announced, which will be delivered in full.
- The distributable amount for 2017-18 will be confirmed in the Local Government Finance Order, which will be debated by Parliament before the end of March.

HOW MUCH IS THIS COSTING AND WHERE IS THE MONEY COMING FROM?

- As we laid out at Stage 1 of the Budget, we are continuing to update the profile of the Scottish Government contribution required to bring the non-domestic rates pool into balance. This process has allowed us to meet the estimated cost of the additional support package announced today of £44.6 million

Script

The NDR system works by accounting for all business rate receipts in a single account – the "NDR pool".

It is normal for it to run at of a surplus or a deficit (due to the nature of estimating) but, across years, action is taken to bring it into balance. We are budgeting to bring the pool back into balance over the next two years. Any shortfall in income must be matched by additional funding from the Scottish Budget.

The scale of that investment depends, in part, on the estimates of how much NDR will raise. In a revaluation year, this estimate continues to be refined as the revaluation approaches completion in March.

This process of refinement together with reprofiling over the next 2 years to bring the pool back into balance has allowed us to reduce how much funding the SG needs to contribute next year. Essentially, we are able to inject less funding in 2017/18 and still bring the pool into balance over 2 years.

This does not change how much is raised from NDR, nor does it change any company's business rates bill or change the amount of funding councils receive.

What it does allow is for sufficient funding to be freed to meet the estimated costs of the new reliefs package announced by Derek Mackay on Tuesday.