

Evidence Paper in advance of the Public Accounts Committee Scrutiny Session – 05.11.2018

Auditor General for Wales Report on Pinewood Studios

The purpose of this paper is to provide Written Evidence to the Public Accounts Committee on the Auditor General for Wales Report on Pinewood Studios. A timeline is attached at Annex 1.

Project Initiation

Officials initially approached the former CEO of Pinewood Shepperton plc in the summer of 2013 regarding potential investment into a new film and TV studio in Wales. This was in response to an ever increasing demand for studio space in the UK due to the high level of major inward investment feature films and high end TV drama, coming to the UK on the back of UK Tax incentives. This was backed by the British Screen Commission's call for more studio space in the regions to cope with the demand as London was becoming full. During discussions Pinewood proposed the creation of a £30m film and TV fund for Wales. The money was to be retained by the Welsh Government and Pinewood were to work with production companies to structure commercial deals that were considered suitable for Welsh Government investment. These deals were then to be presented to an independent panel of experts, who would have responsibility for providing advice to Welsh Government on whether to invest in the production. This was an opportunity for Wales to establish a sustainable commercial fund to reinvest into productions securing the long term future of the industry in Wales, sharing in the commercial success of productions at the same time as securing economic benefits of spend across the Welsh Film & TV supply chain. This was a unique opportunity for the Welsh Government to collaborate with one of the leading providers of studio and related services to the worldwide film and television industries. Officials saw the opportunity to market Wales' Film & TV industry on the back of a globally recognised brand via a sponsorship agreement.

Pinewood Collaboration Agreement

These discussions led to the development of the Collaboration Agreement which was a binding contract between the Welsh Government and Pinewood. The Collaboration Agreement commenced on the 1st March 2014 and had three main components:

- 1. A film and television studio facility*
- 2. A £30m Media Investment Budget, to provide a mix of flexible film and television finance.*
- 3. A sponsorship agreement*

Studio

Following an extensive search for appropriate sites for the studio, Pinewood Shepperton plc expressed a preference for Wentloog as the preferred site for the new facility. The new site was considered to be the best option due to its location, size and accessibility. Since opening in 2015 the studio has been home to several major drama productions and films to date, including Journeys End, Sherlock Season 4, The Bastard Executioner, The State and Showdogs. The facility is also home to key film and television supply chain companies such as Andy Dixon Facilities, Real SFX and Lubas Medical.

Media Investment Budget

For productions supported via the Media Investment Budget (MIB), the criteria to date has been that projects must undertake 50% of principal photography in Wales and spend a minimum of 35% of their budget on local below the line expenditure¹. However, this is combined with a requirement for all commercial funding to be compliant with the Market Economy Operator Principle (MEOP) and repaid in full, plus profit.

Pinewood's role was to develop commercial projects to a point whereby they were considered ready to apply to the MIB. The commerciality of projects applying for funding via this route is ratified by external media experts and then considered by a panel of media specialists. Any project not considered to be MEOP compliant would not be recommended for funding.

The specialist panel assesses the level and type of funding being requested and considers the probability of its potential to provide a return on investment, based on but not limited to, independent sales projections, how other projects of a similar genre have done in the market place and track record of the production team.

Under the original Collaboration Agreement, Pinewood brought forward nine projects through the MIB that were filmed in Wales.

We have had some particular successes, for example 'Their Finest' which has seen excellent box office takings and significant critical acclaim. Welsh Government has recouped all of its investment on this film. In addition, 'Journey's End', based on the famous play by R. C. Sherriff, released in Cinemas in the UK in March 2018 has received very favourable reviews and fared well at the box office. The Welsh Government has already recouped two thirds of its investment into the film.

Overall, each project supported by MIB has also spent a significant proportion of their budget locally; employing freelance crew and facilities companies in Wales. This expenditure is running in excess of £18m.

The very first project supported via the MIB 'Take Down' did not do so well. This was the very first project supported via the fund and provided some important lessons learned for Pinewood, Welsh Government Officials and the Media Investment Panel. In particular, it was considered that future projects should have a greater balance of private investment and therefore requiring a lesser contribution from Welsh Government, better value for money and more detail to be provided to assess potential recoupment.

Details of projects supported via the MIB under the Collaboration Agreement are detailed in the Wales Audit Office Report.

¹ Below the line expenditure can be defined as all production costs excluding the creative talent – such as Actors, Director, Producers, and Writers from the other crew.

Sponsorship

The sponsorship was for Pinewood to promote Wales as a centre of excellence for film and high end TV drama, as part of their international offer. It is not comparable with any other sponsorship agreement that Welsh Government has entered into hitherto.

Having such a well known brand in Wales has helped to elevate Wales as a premier production location and has given Wales a global advantage over other regions.

Pinewood has worked closely with Welsh Government to bring other productions to Wales.

The return on investment for having the Pinewood brand linked to Wales and promotion in global markets is difficult to quantify. Whilst the success of the TV and film industry in Wales cannot be attributed to Pinewood alone, there is little doubt that their sales efforts and their brand have led to an increase in enquiries for film and TV in Wales.

Officials believe that the production expenditure for projects that Pinewood have brought to Wales via their sponsorship activities is in excess of £24m.

Issues with the Collaboration Agreement

Transparency

Officials wrote to Pinewood on 2nd November 2016 highlighting the need for full transparency in the information it provides to Welsh Government and Media Investment Panel about the extent of wider Pinewood Group involvement in productions. This was part of an agreement between both parties to work together to resolve any outstanding problems and continue to deliver great projects to Wales. Officials requested that for all projects we are provided with the full details of all benefits which Pinewood would accrue from the deal proposed within and across the Group. Pinewood did then provide Welsh Government with information regarding to any services they would be providing and the cost to the production for each project brought forward for consideration for MIB.

Perceived Conflict of interest

The lack of transparency referred to above gave rise to concern about Pinewood having a perceived advantage over other companies through its exclusive access to the MIB. Local companies had voiced these concerns, having been unsuccessful in securing work through productions brought in via this route.

As a result, we entered into further discussions with Pinewood, and procedures were tightened to provide additional assurance. The independently appointed Media Investment Panel considered potential conflicts of interest in projects brought forward by Pinewood Pictures, and sought to ensure the best deal possible for Wales in providing advice to Welsh Ministers.

To add to this, the Pinewood Studio facility, and the MIB, operated independently of each other and there were no conditions imposed to use Pinewood Studio Wales when accessing the MIB.

Contract Performance

Officials raised concerns with Pinewood in November 2016, about performance of the fund, with investment and returns falling significantly short of the original business plan.

Pinewood stated that this was mainly due to changes in the market place, but it was recognised that changes needed to be made and a new business plan was duly requested.

A new business plan was submitted, but did not meet Welsh Government's expectations and further negotiations commenced. In October 2016, Pinewood came under new ownership, followed by the appointment of a new Chairman and interim CEO, following the then Chief Executive's departure from the company in April 2017. The new Chairman and interim CEO took over responsibility for re-negotiating the terms of the Collaboration Agreement with officials. It was during this period that Pinewood made the decision to withdraw from third party fund management.

Reasons for move to new agreement

Pinewood's decision to withdraw from third party fund management across the board – not just in Wales - presented us with the opportunity to renegotiate the terms of our collaboration with Pinewood.

Whilst the full terms of our new agreement are in confidence, at Pinewood's request, this means that they remain fully committed to operating the studio in Wentloog, and are continuing to promote Wales internationally as a destination for high end TV and film production.

The success of the TV and film industry in Wales cannot be attributed to Pinewood alone, however, there is little doubt that its sales efforts and brand have led to an increase in enquiries for film and TV in Wales.

Therefore, it was considered by Welsh Government that retaining the Pinewood brand through a new three-year agreement, which would also generate commercial revenues through the studio, was a better value for money proposition than simply leaving the site empty, the costs of which would be significant to Welsh Government.

In addition, the new agreement can be terminated by the Welsh Government upon six months' notice at any time after the first anniversary of the agreement, 1st November 2018.

The Property

This modern industrial property which is located at Wentloog was built to a high standard by the former Welsh Development Agency in 1998. The property was later sold to the private sector and has largely remained in beneficial occupation ever since and up until its re-purchase by Welsh Government in 2014.

When acquiring or disposing of property, it is normal practice for a valuation report to be carried out to confirm that the transaction represents market value. Such reports comment on the condition of the building but do not extend to a full examination of the roof, unlike a full structural survey which would have looked at all aspects of the building. In this case, the purchase price paid by Welsh Government was less than the valuation provided by Welsh Government's property advisors and significantly below the Vendor's quoting price at the time.

As the AGW Report noted, the condition of the buildings at the time was observed and reported by the independent valuers as being in a generally reasonable state of repair commensurate with its age and use. No urgent or significant defects or items of repair were

noted within the valuation report which would be likely to give rise to substantial expenditure in the foreseeable future or which fall outside of the scope of a normal annual maintenance programme.

Shortly before Pinewood moved into the building, a number of water leaks became apparent, mainly in the vicinity of the rainwater gullies. The required roof repairs could have been restricted to these areas. Officials considered the options available and decided to implement a more comprehensive refurbishment scheme costing £979,000. This provided a coating for the entire roof and had the benefit of extending the life of the roof to more closely match the term of the lease. It was also considered that this option would minimise operational and reputational risks, assist with the ongoing management of the property and would make the property more saleable should Welsh Government seek to dispose of the property in the future.

It is almost impossible to accurately ascertain the cost of ongoing repairs to the roof because it would depend on how quickly the roof deteriorated in the future. At the time, officials established that circa 90% of the water ingress that the property was experiencing was due to deterioration of the lining of the gutter system. We may have been able to undertake isolated repairs to address the identified leaks at a cost of £15-20K. However, this option would not have guaranteed a watertight building going forward. The property was circa 16 years old. A roof system would usually be expected to have a life span of between 20 and 25 years, depending on the environment that it is exposed to. Consequently, further deterioration could reasonably be expected during the term of the proposed lease to Pinewood. If this deterioration was limited to the gutters more comprehensive works to reline the gutters could be implemented with an estimated cost of £100,000.

However, it is likely that in addition to the issue relating to the gutters there would be future problems with the roofing sheets that make up the majority of the roof. Isolated repairs of this type could be implemented on an as needed basis, but would be unlikely to fully resolve the issue.

Taking this type of reactive approach might have proved cheaper over time, but it would have meant more frequent maintenance and additional financial and reputational risks. For example if filming schedules were impacted or sets damaged due to ongoing water ingress productions could have been delayed with significant budget implications to the production companies.

The property was acquired in the open market with the purchase price taking into consideration the fact that the roof was a significant way through its expected life. The scheme undertaken significantly extends the life of the roof and includes a 20 year guarantee, which would be taken into consideration by a purchaser should Welsh Government seek to sell the property in the future.

On the matter of the listed farmhouse, the vendor was unwilling to sell the property without the buyer also acquiring the derelict Grade II listed house located adjacent to the main building. In purchasing the house, Welsh Government were under the usual statutory obligations to renovate the building accordingly. There is no set deadline for these renovations. The building or £360,000 renovation costs have not been re-evaluated since purchasing the building in 2014. Officials do not have an estimated sale value after refurbishment. There are no immediate plans to use the building. However, in renovating the building, it could become a valuable asset that can be leased or sold, either with or separate to the main building.

The Welsh Government was not provided with a schedule of works by Pinewood for its proposed £800,000 Tenant's contribution as this was not a condition of either the Collaboration Agreement or the Lease. This was a commitment made by Pinewood. These costs were not

included in the Agreement for Lease. The contribution was worded so that this would be provided over the term of the Lease.

The roof height at the studio has meant that productions requiring aerial shots have been precluded from use. As previously indicated, the search undertaken by both Pinewood and Welsh Government officials identified only two suitable sites for a potential studio based on Pinewood's specific requirements. Pinewood subsequently identified the former Energy Centre building at Wentloog as the better of the two shortlisted options. Pinewood recognised the limitations of the Wentloog building from the outset including the fact that productions that need to hang lighting from the ceiling will not be able to use the facilities due to the height and weight loading restrictions of the roof. Nevertheless, the Wentloog building still provided the best solution at that time for the company to operate from Wales.

There are workable rigging solutions to hanging lighting from the ceiling which makes the facility usable to all productions that can work to the height of the facility. The studio has been used for feature films *Showdogs* and *Journeys End*, and the TV series *Sherlock*, *Doctor Who* and Channel 4's *Jerusalem*, which demonstrates that it is still eminently usable as a studio facility by a broad range of productions.

There is still a huge shortage of studio space across the UK and in Wales. The Pinewood Wales facility has its market and is therefore an important asset for the industry here.

At the time of re-negotiation of the Collaboration Agreement it was considered important to retain the Pinewood brand in Wales and the facility as a studio. There are licensees in the studio who took a business decision to take office space at the site to be close to productions.

The demand for studio space in Wales is proven by the number of enquiries received for studio space and the number of studio visits undertaken by Wales Screen. Since July 2017, Wales Screen has received over 36 enquiries for studio space in Wales, with Pinewood being included in at least 30 of these requests.

In addition, there are economic benefits which arise from productions that use the site. For example, *Ravers*, which filmed at the site in 2018, reported a Welsh spend figure of £1m. We estimate that on average the Welsh spend from Productions using the studio could range between £5m and £10m per annum.

The suitability of the site has been further demonstrated by *The Crown* one of Netflix's key shows, using Pinewood Studio Wales as its production base for workshops and office space whilst filming parts of Season 2 on location across South East and North Wales. This sort of activity and the economic and cultural benefits it can bring to the area is very welcome; a number of local people have roles as actors and supporting cast in the drama. We are building a strong relationship with Netflix, with this being one of several productions that have filmed in Wales in recent months.

The Management Services Agreement

Welsh Government contracted with Pinewood under a new three year 'Management Services Agreement', which had two complementary parts:

- the sales and marketing of the studio; and
- its operation and management

Under the terms of the new agreement, Pinewood would continue to operate the studio on behalf of the Welsh Government. It should be noted that either party may terminate this

agreement at any time by giving 6 months' written notice to the other party to expire no earlier than 12 months after the commencement date.

The annual net cost to the Welsh Government of operating the management services agreement:

Annual studio running costs	890,000
Reimbursement of Pinewood production costs	216,000
Less: Projected studio revenues	(714,000)
Net annual operating cost before management fee	392,000
Plus: Management fee payable to Pinewood	[redacted]
Net annual operating cost	[redacted]

The annual studio revenue forecast of £714,000 was supplied to Welsh Government by Pinewood. The net operating cost totals in the above table assume that this figure is realistic. The reliability of the forecasts were tested and scrutinised by officials and also by independent property advisors.

At the time it was acknowledged that should a new agreement with Pinewood not go ahead, then the Welsh Government would incur annual property holding costs of around £890,000 (including VAT), and could expect only around £124,000 of annual income from the letting of office space. If these estimates were accurate, then the likely net annual cost to the Welsh Government under that alternative scenario would have been £766,000.

In addition, should the site not have been continued as a studio facility, the economy would not benefit from the additional revenues of productions using the studio. This is estimated to be between £5m and £10m per annum.

When the Minister for Culture, Tourism and Sport attended the Culture, Welsh Language Committee in July this year, it was stated that Pinewood was on track to achieve the forecast revenues for the first financial year of the new agreement.

Since that time projected revenues have dropped and the facility has been less busy than earlier in the year. This is not unusual for studio facilities, with demand being dependent on the right projects at the right time. Many of the projects that have filmed in Wales since July, have been location based projects rather than studio based projects. Wales still has a very healthy pipeline of projects looking to film in Wales over the next 12 months.

Pinewood Studio Wales is currently generating a sustainable annual income of circa £100,000 from the Media Hub Licences on the site. 17 key supply chain companies are located at the facility including Marigold Costumes Limited, Sgil Cymru Cyf, Alpha Grip (Cardiff) Limited, Movietech Camera Rentals Limited and Oh So Small Productions Limited.

The stages, production offices and workshops shop have generated circa £350,000 income from the start of the agreement to date.

More recently the facility has been home to the well known production 'The Crown' while they film on location across Wales for the forthcoming series. It has also recently been used by a Channel 4 production Jerusalem, Doctor Who and independent feature film Ravers, thereby continuing to demonstrate its suitability as a studio facility.

Should either party chose to terminate the agreement officials are confident there is enough demand for studio facilities across the UK to find another operator for the facility. The site is a popular commercial location with good links to the M4 Motorway and benefits from good quality office accommodation finished to a high standard. The lack of freehold opportunities within the market should enhance the property's appeal.

Bad Wolf

Pinewood executives told WAO that the opening of a new film and TV production studio by Bad Wolf Studios (Wales) Ltd in Trident Park, Cardiff, in May 2017 had a detrimental impact on the occupancy of Pinewood Studio Wales. Pinewood argued that the number of enquiries they received for it had fallen as a consequence, although demand for Pinewood studios within the UK remains strong. Wolf Studios Wales, Trident Park, is currently full and is not in competition with Pinewood. Wales Screen promotes all facilities in Wales equally and there is sufficient demand for studio space in Wales for both Pinewood Studio Wales and Wolf Studios Wales to operate alongside each other. Bad Wolf has its own slate of productions worth circa £300m and to date Wolf Studios Wales has only been home to Bad Wolf Productions. Recent productions include:

- Deborah Harkness' All Souls Trilogy, the first of which is A Discovery of Witches, The first season was filmed in Wolf Studios Wales and on location in Wales. Bad Wolf will look to adapt all three books in the series for television. The first series is expected to generate £10m in Welsh Spend. This is currently on being aired on Sky.
- Phillip Pullman's His Dark Materials, an adaptation of the contemporary classic trilogy of novels for the BBC. The production currently filming in stages at Wolf Studios and on location in Wales its expected to spend £15m in Wales. The series is likely to run over five seasons, with eight episodes in each and filming is due to begin shortly.

South Wales has a cluster of studio facilities and there is always room for competition when growing a successful film and television industry. Pinewood was happy to recognise this.

In advance of Welsh Government entering into any studio deal with Bad Wolf, the then Chief Executive of Pinewood confirmed in writing by email that they were content for us to proceed in supporting Bad Wolf with a studio facility.

Conclusion

The importance of studio infrastructure has been a key part of our strategy for the Sector and is critical to the development of the film and television industry in Wales. The Pinewood deal was instrumental in taking the industry in Wales to the next level, raising our profile and making Wales the place to bring productions, outside of London.

These arrangements have brought significant value to the industry, but there have also been a number of lessons learned within the Sector Team and across Welsh Government as a whole.

Timeline

02/10/2013	Pinewood Chief Executive writes to officials regarding preferred site at Wentloog
30/01/2014	Pinewood submit Collaboration Agreement Business Plan
07/02/2014	Legal completion of the purchase of the Property by Welsh Ministers from Vendors (Standard Life).
01/03/2014	Commencement of Collaboration Agreement
04/2014	Set up Media Investment Panel
19/05/2014	Approval of 1 st project under MIB "Take Down" May 2014.
02/06/2014	Production Finance Agreement executed for the film <i>Take Down</i>
16/07/2014	Agreement to Lease signed by the Welsh Government and Pinewood Studio Wales Ltd
12/01/2015	Lease Commencement Date
01/2015	First Production begins at Pinewood Studios Wales
16/03/2015	First Minister visits Pinewood Studios Wales
20/01/2016	Officials send note to Cabinet Secretary regarding issues relating to the Media Investment Budget performance.
28/04/2016	Property Leadership Team recommendation of Central Roofing Bid
08/2016	Concerns by Creative Industries Sector Panel and Media Investment Panel about Media Investment Budget Performance
22/08/2016	Further note to Cabinet Secretary - Issues with Media Investment Budget.
23/10/2016	Lease Agreement Signed
02/11/2016	Officials issue letter to Chief Executive, Pinewood regarding issues with the Media Investment Budget. Ongoing dialogue on these matters until 23 rd January 2017.
12/01/2017	Rent Commencement Date
23/01/2017	Officials write to Chief Executive, Pinewood regarding the requirement to make changes to the MIB. Further dialogue commences on proposed changes to the MIB until April, when Chief Executive departs Pinewood.
30/03/2017	Wolf Studios Wales project approved
31/03/2017	Agreement from Chief Executive of Pinewood to proceed with Bad Wolf studio
04/2017	Change of management at Pinewood as Chief Executive departs and interim Chief Executive takes over. A new period of negotiation starts with the interim Chief Executive.
16/08/2017	Pinewood make the decision to withdraw from third

	party fund management
11/09/2017	Cabinet Secretary for Economy and Infrastructure meets with Pinewood's interim CEO to discuss the future relationship
29/09/2017	Property Leadership Team noted the Pinewood Operator Agreement
31/10/2017	Termination of Original Collaboration Agreement and Lease
01/11/2017	Commencement of New Management Services Agreement
12/06/2018	Wales Audit Office – facts only report into the Welsh Government's relationship with Pinewood