

EAST RENFREWSHIRE COUNCIL

28 October 2015

Report by Chief Executive

REVISIONS TO PROCUREMENT ARRANGEMENTS FOR CAPITAL PROJECTS

PURPOSE OF REPORT

1. The purpose of this report is to advise Council of changes to the structure for procuring and delivering capital projects through the hub Design, Build, Finance and Maintain (“DBFM”) model as a result of the introduction of new European System of Accounts 2010 (“ESA10”) rules.

RECOMMENDATIONS

2. It is recommended that Council:

- (a) Approves the required amendments to the hub West Scotland Territory Partnering Agreement and Shareholders Agreement; and
- (b) Notes the potential impact on the Council’s ongoing Eastwood Health & Social Care and Barrhead High School projects and that further reports will be submitted for consideration once the position has been clarified.

BACKGROUND

3. In February 2012 the Council agreed to participate as a shareholder in the West hub Territory, a procurement vehicle supporting a long term programme of investment in community infrastructure for local authorities, NHS Boards and other public sector bodies, with these public bodies joining together to deliver assets more effectively through a single partner to offer continuous improvement and better value for money.

4. The Council is currently progressing two projects via hub: Eastwood Health & Care Centre, which is under construction and due to open in spring/early summer 2016 and Barrhead High School which is scheduled to reach financial close in the next few months and proceed to construction thereafter.

REVISED REQUIREMENTS

5. New European System of Accounts 2010 (“ESA10”) regulations came into force on September 2014, reinforcing the rules for classifying Design, Build, Finance and Maintain (“DBFM”) projects to the private sector for national accounting purposes. As a result, the Scottish Ministers have proposed a new delivery structure for all hub DBFM projects signed since 1 September 2014. These proposals have been submitted to the Office for National Statistics for consideration and, once approved, will require all hub participants to approve changes to their local Territory Partnering Agreements and Shareholder Agreements. Further details on the reasons for these changes are set out in Appendix 1.

6. The new rules must be applied to both of the Council's current projects as they are being delivered via DBFM arrangements, but the rules will not impact on the delivery of any other services or Design and Build Development Agreement ("DBDA") contracts progressed through hub.

7. Hub West Scotland is a joint venture known as a "hubco" with 60% of shares held by the private sector development partner (Wellspring), 30% of shares held by public sector participants and 10% of shares held by the Scottish Futures Trust. These arrangements will not be affected by the new rules.

8. For each DBFM project taken forward via Hub West Scotland a new special purpose vehicle (SPV) company is established to deliver the scheme. Under the original arrangements these would have been wholly owned subsidiaries of hubco, however this will not be permitted in future.

9. Under the revised arrangements the special purpose company (SPV) set up to deliver the project will be separate from the corporate hub structure and will be owned 60% by the private sector development partner, 20% by a newly-formed private sector national charity (Hub Community Foundation), 10% by the Scottish Futures Trust and the remaining 10% by the procuring public sector participant. Options for shareholders to invest sub debt in the project would also follow these percentage allocations.

10. The revised arrangements can be summarised in the table below:-

	Original Arrangements		Revised Arrangements	
	SPV owned by	Sub debt options	SPV owned by	Sub debt options
Private Sector Development Partner	60%	60%	60%	60%
Public Sector Participants	30%	30%	10%	10%
SFT	10%	10%	10%	10%
National Charity	0%	0%	20%	20%

11. The new national charity will be run by a board of trustees with the majority having an interest in the hub programme but being independent of both SFT and the private sector development partners. The charity's objectives will be the advancement of education and health, the provision of recreational facilities and the relief of those in need.

12. The introduction of the charity as a shareholder will reduce the scope for public sector participants to invest sub debt in these projects in future. In the early years, however, if the charity has insufficient funds to take up its options on subordinate lending, these undersubscribed options will be offered instead to the private sector development partner.

IMPACT ON EAST RENFREWSHIRE COUNCIL

13. No further schemes may progress to financial close until the new arrangements have been adopted by each hub Territory and reflected in its Territory Partnering Agreement and Shareholder Agreement. As such, all local participants in the West Scotland area must approve these changes before financial close can be reached on Barrhead High School or any other current projects. All local participants are now seeking to agree these amendments

promptly in order to minimise project delays and potential associated inflationary cost increases. At present, the best estimate is that the ESA10 issues will result in a delay of at least 3 months to this project. If this is the case, then the school would not be complete until spring 2017 rather than the previous expectation of around December 2016, however it should be noted that there is no certainty that the ESA10 issue will be concluded within the next 3 months.

14. Under the new arrangements it will no longer be possible for Councils to inject capital contributions into revenue funded projects as had been planned for Barrhead High School. Consideration is currently being given to whether certain capital works relating to the pavilion, pitch and skatepark could be progressed under a separate contract to avoid this restriction or whether the project should be fully funded through hub with the Council making an increased annual revenue contribution.

15. The contract agreement for Eastwood Health & Care Centre was signed in October 2014 and therefore also falls under the new arrangements. As such, the project shareholding and subordinated debt investments will have to be restructured. Under the new arrangements, only the main contracting public sector participant has the right to take up the 10% shareholding and sub debt investment option in a scheme. In the Eastwood Health & Care Centre project the Health Board is the main public sector participant and the Council's sub debt investment of £97,113.45 may therefore have to be refunded to us. A further report will be submitted once clarification has been provided by SFT on this point.

FINANCE AND EFFICIENCY

16. The new rules impacting on DBFM projects require the Council to review its capital and revenue funding strategy for Barrhead High School and will also result in fewer subdebt investment opportunities for the Council in jointly procured hub schemes in future.

CONSULTATION

17. Consultation has taken place with hub West Scotland, West hub Territory Partnership, SFT, Legal Services and Property & Related Services in recent months.

PARTNERSHIP WORKING

18. The Council's involvement in hub West Scotland entails close partnership working with local Councils and other public sector participants, together with hub West Scotland and the local private sector development partner, Wellspring.

IMPLICATIONS OF REPORT

19. The report highlights the property and legal impacts of the new arrangements. There are no other implications for the Council in terms of staffing, IT, equalities or sustainability.

CONCLUSION

20. This report sets out the requirement for revised arrangements to be agreed for hub DBFM schemes and advises of the funding implications for the Council's two current hub DBFM projects.

RECOMMENDATIONS

21. It is recommended that Council:

- (a) Approves the required amendments to the hub West Scotland Territory Partnering Agreement and Shareholders Agreement; and
- (b) Notes the potential impact on the Council's ongoing Eastwood Health & Social Care and Barrhead High School projects and that further reports will be submitted for consideration once the position has been clarified.

Margaret McCrossan, Head of Accountancy (0141 577 3035)

Contact Details:

Report Author: Margaret McCrossan, Head of Accountancy

Telephone: 0141 577 3035 Email: margaret.mccrossan@eastrenfrewshire.gov.uk

BACKGROUND PAPERS: Reports to Council on 27 June 2012 & 11 September 2013 by Director of Finance on West hub Territory Partnering Board and on Opportunity to Invest in Hub Schemes.

KEY WORDS

A report advising on revised arrangements for hub DBFM schemes

Key words: DBFM, ESA10, hub West Scotland, shareholder, subordinate lender, Scottish Futures Trust.

APPENDIX 1

REASONING FOR CHANGES TO HUB DBFM ARRANGEMENTS

The classification of DBFM projects as private sector projects for national accounts purposes is required to allow the Scottish Government to support projects from long-term revenue budgets rather than capital budgets as they are constructed. The projects are then reported on the private sector's balance sheet rather than on the Government's balance sheet.

The rules under which the national accounts are compiled are set in Europe by Eurostat. Under their revised ESA10 rules and supporting Manual for Government Deficit and Debt (MGDD), changes have been made to the rules applicable to the classification of projects delivered under public private partnership structures such as hub DBFM.

In order to reinforce the required private sector classification under the revised rules, Scottish Futures Trust has identified that:-

- a) any perception of public sector control over the delivery company (the special purpose vehicle or SPV) must be avoided. This is achieved through the restructuring of that company as a stand-alone DBFM company separate from the local Hub territory companies.
- b) public sector financing of projects whether through capital contributions or investment of sub debt must be limited in order to maintain clarity of risk-transfer to the private sector delivery partner. To implement this:-
 - i. public sector bodies should no longer make any capital contribution to these projects;
 - ii. public sector participants and SFT will have the option to invest a maximum of only 20% of sub debt into such projects. The private sector development partner may invest 60% of sub debt and a new national charity will have the option to invest the remaining 20%.

The revised arrangements must be approved by the Office for National Statistics before being implemented.

