

The Highland Council

Resources Committee - 25 November 2015

Agenda Item	20
Report No	RES/111/15

Changes to the Structure of delivering Hub Design, Build, Finance and Maintain (DBFM) Projects

Report by Director of Finance

Summary

This report outlines changes to the hub Design, Build, Finance and Maintain (DBFM) delivery model that are required to reinforce the classification of these projects as private under ESA10 rules. The Committee is recommended to accept them and to consent to the hub Shareholders Agreement and the Territory Partnering Agreement being amended to accommodate these changes. As part of this recommendation Delegated Authority is requested to be given to the Chief Executive, Director of Finance and Director of Care and Learning to resolve any unforeseen detailed issues that may arise during the implementation of these changes.

The Committee is also advised that these changes to the hub DBFM delivery model will be retrospectively applied to the Council's Wick Campus DBFM project. These structural changes do not affect the costs, funding arrangements, contract terms and timetable for the Campus project.

1. Background

- 1.1 Changes need to be made to the structure for delivering hub Design, Build, Finance and Maintain (DBFM) projects in order to reinforce the classification of those projects to the private sector for national accounts purposes under European System of Accounts 2010 ('ESA 10') rules and the accompanying Manual of Government Deficit and Debt 2014 ('MGDD'). A new hub DBFM delivery structure has been approved by Scottish Ministers and must be applied to all DBFM projects signed since the introduction of ESA 10 on 1st September 2014.
- 1.2 As some Members may be aware, the 'ESA 10 issue' has resulted in delays to any further Scottish Government funding announcements through its NPD/Hub funding approach. This has had particular implications in relation to future investment in Easter Ross Schools, where it had been anticipated a funding announcement would have been made at the start of 2015. The changes outlined in this report, will assist with resolving these issues at a national level.
- 1.3 This report outlines the 4 key changes proposed to be made to the hub delivery structure and advises that these changes will require to be retrospectively applied to the Council's contract with Hub North Scotland (Wick) Ltd for the delivery of the Wick Campus which was signed on 19th December 2014.

2. Reasons for the Changes

- 2.1 Private classification of DBFM projects for national accounts purposes is required for Scottish Government to support projects from long term revenue budgets rather than capital budgets as they are constructed.

- 2.2 The rules under which the national accounts are compiled are set in Europe and under ESA 10, and supporting MGDD, changes have been made to the rules applicable to the classification of projects delivered under public private partnership structures such as hub DBFM.
- 2.3 In order to reinforce the required private classification under the revised rules, Scottish Futures Trust (SFT) has identified that:
- a) Any perception of public sector control over the delivery company (the sub hubco under the existing structure) must be avoided. This is achieved through the restructuring of that company as a stand-alone DBFM co.
 - b) Public sector financing of projects whether through subordinated debt or through capital contributions to projects must be limited in order to maintain clarity of risk transfer to the private sector delivery partner.

3. Details of the Changes

3.1 Changes to the Sub Hubco Delivery Company

- 3.1.1 The existing structure has the project delivery company as a fully owned subsidiary (a sub hubco) of the Hubco. Under the revised structure the procuring participant for a DBFM project will contract with a company that sits outside of the hubco corporate structure (a "DBFM Co") rather than with a sub hubco as at present.
- 3.1.2 The DBFM Co will be owned 60% by the private sector development partner, 20% by a newly formed private sector charity, 10% by SFT and 10% by the procuring participant. A majority of the DBFM Co directors will be appointed by the private sector developer partner and so the board of the DBFM Co will be under private sector control.
- 3.1.3 The shareholders in DBFM Co will have the right to invest subordinated debt in proportion to their shareholding.

3.2 Changes to arrangements for investing Subordinated Debt in projects

- 3.2.1 Under the existing arrangements Participants have the right to invest up to 30% subordinated debt in their own and in other participant's projects. Under the new structure this right to invest is limited so that participants have the right to invest 10% of subordinated debt in the DBFM Co delivering their own project.

3.3 Setting Up of a new Charity

- 3.3.1 A charity will be formed (currently referred to as the Hub Community Foundation ("HCF")) to assist and enhance the delivery of the wider community benefits that are connected with the activities of the hub programme.
- 3.3.2 HCF's purposes will be the advancement of education, the advancement of health, the provision of recreational facilities and the relief of those in need. It will be for the HCF's board of trustees to determine the causes that HCF will support and therefore the public benefit that HCF will deliver.

- 3.3.3 HCF will be established as a Scottish Charitable Incorporated Organisation and its Board of Trustees will comprise:
- a) 1 trustee appointed by SFT;
 - b) 1 trustee appointed by the 5 hub private sector development partners; and
 - c) A majority (3-5) of trustees who have an interest in the hub programme and its objectives but are independent of the public sector and the 5 private sector development partners.

3.3.4 HCF's members will be the SFT, the 5 private sector development partners and the independent trustees.

3.4 **Capital Contributions to DBFM Projects**

3.4.1 Under the existing arrangements Participants can make a capital contribution towards the capital costs of the DBFM project. This would reduce the amount of the Annual Service Payment payable by the participant over the term of the DBFM contract.

3.4.2 Under the revised structure there will be no public sector capital contributions.

3.4.3 Local Authorities which had planned to make capital contributions to DBFM projects will not be able to do so and will have to make an increased contribution to Annual Service Payments in respect of the element of the capital cost it was intending to contribute. The "no better no worse" principle will apply and Local Authorities will not be expected to contribute additional financing costs above those they would have incurred had the capital contribution been supported by PWLB borrowing.

4. **Implications for The Highland Council**

4.1 The implications for the Council are two fold:

- I. The Council as a participant in Hub North Scotland Ltd needs to formally agree to these changes; and
- II. As the participant which commissioned the Wick Campus, the Council needs to be aware that these changes will be retrospectively applied to the Wick Campus.

4.2 **Implications as a Participant in Hub North Scotland Ltd**

4.2.1 The Council needs to formally agree to these changes and consent to the hub Shareholding Agreement and Territory Partnering Agreement being amended to incorporate these changes.

4.2.2 SFT have commissioned Pinsent Masons to draw up the documentation for these changes in each Territory and this work has already been completed.

4.2.3 In terms of any challenge to these changes under Procurement Law, SFT commissioned Pinsent Masons to review this risk and Pinsent's conclusion is that:

"We [Pinsent Masons] are of the view that there are strong arguments as to why the Variation should not be considered to constitute a material change and whilst there is a degree of risk associated with the Variation, in our view the

likelihood of success of a challenge on grounds of material change is relatively low. Further such risk could be mitigated by publication of a Veat Notice (subject to section 2.6.4(d)).” The Veat Notice has been sent to OJEU for publication.

- 4.2.4 Resolution of this ESA10 issue has been a major issue and blockage for the Scottish Government, SFT and Hubco in closing projects and developing new ones. The last projects to be closed, including the Wick Campus project, took place in December 2014 and closure of all other projects has been put on hold since then pending resolution of this ESA 10 issue.
- 4.2.5 At the time of writing 2 Participants in Hub North Scotland have yet to consider the proposals, all the other Participants have already agreed them.
- 4.2.6 It is recommended that the Council agrees to the changes outlined and consents to the hub Shareholder Agreement and Territory Partnering Agreements being amended to reflect these changes. As part of this approval, Delegated Authority is requested to be given to the Chief Executive, Director of Finance and Director of Care and Learning to resolve any currently unforeseen detailed issues which may arise during implementation of these changes.

4.3 Implications as Participant which commissioned the Wick Campus Project

- 4.3.1 The only change that will affect the Wick Campus project is the replacement of the current Sub Hubco – Hub North Scotland (Wick) Ltd – by a new DBFM Co. This will involve a restructuring of both the equity and subordinated debt investments and SFT advise that details will be discussed at individual project level with the relevant Participant. Accordingly after all the changes to the hub Shareholding agreement and Territory Partnering Agreement have been made SFT will contact the Council to implement the changes to the delivery model for the Wick Campus project.
- 4.3.2 At this stage it is unclear how the cost of changing project specific contract documents will be funded. SFT are currently working through the project documents on a contract to ascertain the cost of making the changes. After this analysis has been completed SFT will decide on the funding arrangements to be applied. Consequently any liability falling on this Council cannot be estimated until after the SFT decides on the funding approach to be adopted.
- 4.3.3 The project costs, funding arrangements and timetable are not affected by these structural changes. Similarly the terms Project Agreement between the Council and Hub North Scotland (Wick) Ltd (and its successor DBFM Co) will remain unaltered.

5. Implications

5.1 Resource

There may be a resource implication on the Council in that SFT has yet to decide on the funding arrangements to meet the cost of changing the contract documents for specific projects including the Wick Campus project.

5.2 Legal

There will be some legal work required to implement the changes to the contractual documents outlined in this report and this will be met from internal legal resources.

5.3 Risk

The risks to the Council are envisaged to be low as by agreeing to these changes the Council is complying with changes to national arrangements.

5.4 Equalities, Climate Change/Carbon Clever, Gaelic and Rural Implications

There are no relevant implications to highlight in this report.

Recommendations

The Committee is asked to:

- I. Note the Changes that are being made to the hub DBFM delivery model;
- II. Agree to their implementation of these changes;
- III. Consent to the hub Shareholders Agreement and the territory partnering Agreement being amended to accommodate these changes;
- IV. Agree that Delegated Authority be granted to the Chief Executive, Director of Finance and Director of Care and Learning to resolve any unforeseen detailed issues which may arise during the implementation of these changes;
- V. Note that these changes to the hub delivery model will be retrospectively applied to the Council's Wick Campus project but this does not affect the project costs, funding arrangements, contract terms or timetable for the project; and
- VI. Note there may be a resource implication on the Council as SFT has yet to decide on the funding arrangements to meet the cost of changing the contract documents for specific projects including the Wick Campus project.

Designation: Director of Finance
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