

*Commercial in Confidence*

**Briefing for hub territories:  
Revised structure for  
Design Build Finance & Maintain Projects**

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**SCOTTISH  
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**Briefing for hub territories:**

**Revised structure for Design Build Finance & Maintain Projects**

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## 1. Introduction

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 (“ESA10”) 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 hub DBFM projects signed since the introduction of ESA10 (i.e. since 1 September 2014).

This briefing paper contains an overview of the new hub DBFM delivery structure (section 2) and the process for its implementation (section 3).

Until the new delivery structure is fully established, hub DBFM deals that are in a position to reach financial close will be able to do so under the existing hub DBFM delivery structure, on the understanding that they will transfer into the new structure once that is established. The transfer process is explained in section 3.

SFT has appointed Pinsent Masons LLP to advise on and prepare the legal documentation required to support the new DBFM delivery structure and to advise on the procurement law implications of making these structural changes. Pinsent Masons have produced advice on the changes, on which all public sector hub participants are entitled to rely (see annex 1).

It is important to note that the structural changes do not affect the joint venture arrangements at a hubco level. Each hubco will remain 60% private and 40% public (i.e. 30% public sector participants and 10% SFT) and the public sector will retain the board representation and involvement in the management and direction of hubco's affairs (including certain rights of veto) that have been at the heart of the hubco model from the outset. The changes will have no impact on the delivery of DBDA projects or other hubco partnering services (including hubco's development work in relation to DBFM projects) under the Territory Partnering Agreement.

## 2. Overview of the revised hub DBFM delivery structure

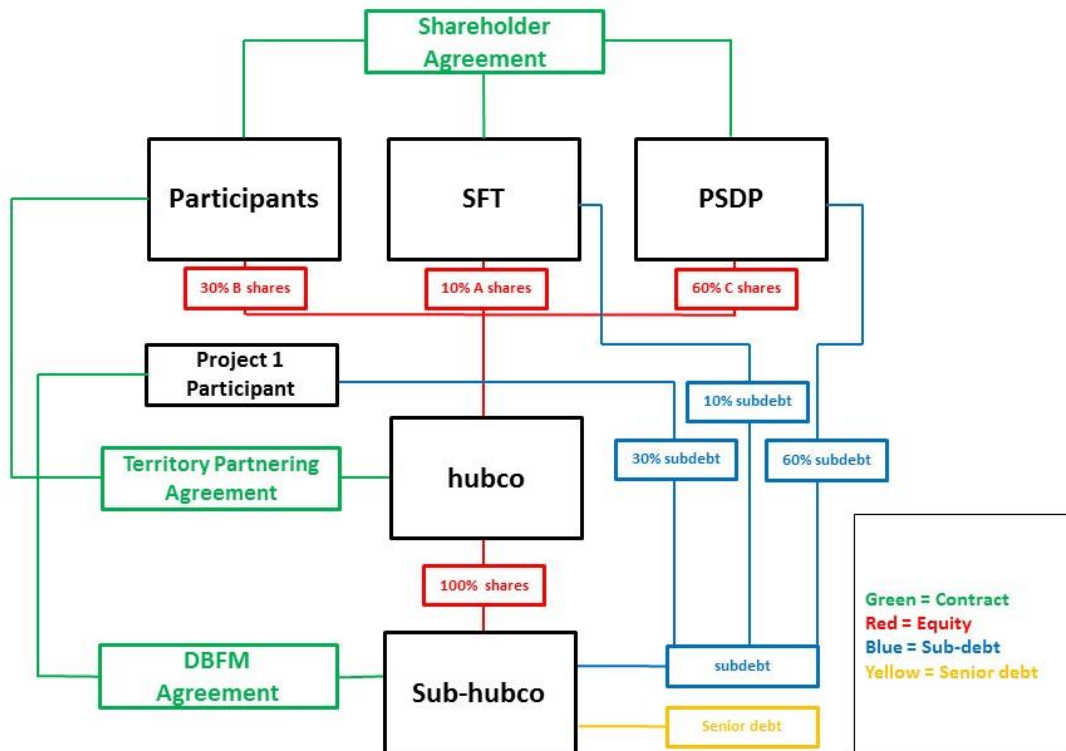
### 2.1. Establishing a DBFM Co

Maintaining the integrity of the hubco joint venture is important in light of the terms of the original hub procurements and the fact that the business of a hubco is wider than the delivery of DBFM projects. The changes are therefore limited to the structure for delivering hub DBFM projects.

At a high level, the revision changes the special purpose company established to deliver each DBFM project from being a 100% owned subsidiary of hubCo to being directly owned 60% by the private sector development partner, 10% by the procuring participant, 10% by SFT and 20% by a newly established hub charity. The reasoning behind the changes is set out in section 4 and the structure is described in more detail below.

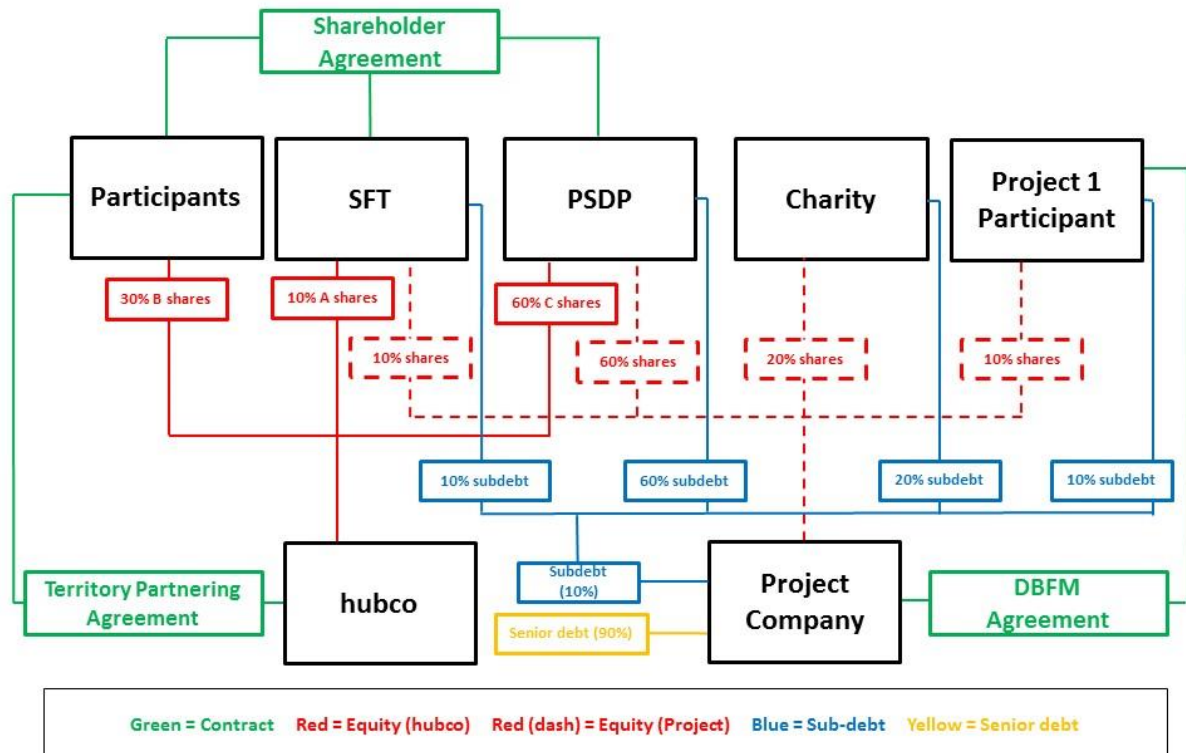
The existing hub DBFM delivery structure, in which a procuring participant will contract with a wholly-owned hubco subsidiary ("Sub-hubco") is set out in the following diagram:

### hub structure - current



This will be replaced with a revised delivery structure as illustrated in the following diagram:

## hub structure – ESA10 revision



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.

The DBFM Co will be owned 60% by the private sector development partner in the hub territory (PSDP), 20% by a newly-formed private sector charity (HCF - see section 2.2 below), 10% by SFT and 10% by the procuring participant.

Shares in the DBFM Co will be divided into the following classes - "A shares" held by SFT, "B shares" held by the procuring participant and the charity and "C shares" held by the PSDP.

A majority (most likely to be 3) of the DBFM Co directors will be appointed by the PSDP and so the board will be under private sector control.

The shareholders will have the right to invest subordinated debt in proportion to their % shareholdings (i.e. 60% PSDP, 20% charity, 10% procuring participant, 10% SFT).

The structure of the DBFM Co will be enshrined in its articles of association. Standard form DBFM Co articles of association have been produced and these will be mandatory across the hub programme (see annex 2).

## 2.2. The charity

A charity will be formed (referred to here as the “Hub Community Foundation” or “HCF”) to assist in and enhance the delivery of the wider community benefits that are connected with the activities of the hub programme. As set out below, the charity will be independently established and governed, what follows is a most likely description of it and its activities.

### *Charitable Purposes & Public Benefit*

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 is anticipated that it will further these ends through:

- investing in projects that provide new facilities for delivering education, healthcare and other community services (including taking equity and subordinated debt in DBFM Cos formed to design, build, finance and maintain projects through the hub programme); and
- supporting other charitable organisations and initiatives (e.g. apprenticeship schemes or third sector community service providers) with income it receives from its DBFM Co investments and other sources (see below).

It will be for HCF’s board of trustees to determine the causes that HCF will support and therefore the public benefit that HCF will deliver.

### *Governance, Trustees and Membership*

HCF will be established as a Scottish Charitable Incorporated Organisation (SCIO). Its board of trustees will comprise:

- 1 trustee appointed by SFT
- 1 trustee appointed by the 5 hub private sector development partners (“PSDPs”)
- a majority (3 to 5) of trustees who have an interest in the hub programme and its objectives but are independent of the public sector and the 5 PSDPs.

HCF’s members will be the SFT, the 5 PSDPs and the independent trustees.

### *Funding*

In the short term, funding for HCF's initial set-up, operating costs<sup>1</sup> and initial share capital investments in DBFM projects<sup>2</sup> will come from a membership subscription of £10,000 (to be agreed) from each of the 5 PSDPs and SFT. HCF is unlikely to have sufficient funds in the short term to take up its entitlement to 20% of the subordinated debt on each hub DBFM project. The right to invest is a valuable asset in itself which HCF may be able to use to generate income from the outset, and in the future it may find a way of being able to invest itself.

In the medium to long-term, HCF's income is expected to include:

- Dividends paid on share capital that HCF holds in the DBFM Cos. These are expected to be irregular distributions and towards the end of the life of projects.
- Interest on subordinated debt investments that HCF makes in DBFM Cos. These are expected to be regular annual distributions from the point of construction completion onwards.
- Fees received in return for passing on subordinated debt investment opportunities.
- Income from any subordinated debt investments that HCF sells on the secondary investment market.
- Donations that PSDPs, SFT and Participants may choose to make as part of their community benefits or wider corporate social responsibility programmes.

Early modelling indicates that once in a "steady state" HCF could credibly be in a position to generate funds in the order of £50,000 annually to apply towards its charitable purposes.

SFT has taken early steps to consider the structure of the charity and further discussion with OSCR will now be pursued to allow its establishment.

### **2.3. Capital contributions**

Under the revised hub DBFM structure there will be **no public sector capital contributions** (see Section 4).

**Health Boards** which had planned to make capital contributions to projects should discuss the revised arrangements with SFT and SGHSCD.

**Local Authorities** which had planned to make capital contributions to either projects undertaken with health partners or schools projects will not be able to do so. The project cost will be financed by hubco and the Local Authority will have to make an increased contribution to unitary charge payments in respect of the element of the capital cost it

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<sup>1</sup> In the short-term, operating costs will be low (in the order of £10,000) if, as expected, HCF does not employ any staff and trustees are unpaid. Trustees are likely to meet twice a year.

<sup>2</sup> As equity in hub DBFMs is typically "pin-point" (e.g. in the order of £100 per project) HCF would only require funds in the tens or low hundreds of pounds for share subscriptions in early projects.

was intending to contribute. The “no-better-no-worse” principle of the overall funding of schools through DBFM arrangements will apply and Local Authorities will not be expected to contribute additional financing costs above those they would have incurred had the capital contributions been supported by PWLB borrowing. Advance payment of design / development fees prior to financial close is not affected by this change. Detailed funding arrangements supporting this principle can be discussed with the SFT schools team.



### 3. Implementation

#### 3.1. Consents and amendments to hub documentation

Consents and amendments to the hub Shareholder Agreements and Territory Partnering Agreements are required to enable procuring Participants to enter into DBFM agreements with DBFM Cos rather than (as currently envisaged in the documentation) only with wholly-owned subsidiaries of the hubcos (Sub-hubcos).

Pinsent Masons have produced the documentation for these changes in each territory and the changes are explained in their advice note.

SFT and the hub Territory Programme Directors will work with individual participants and hubcos to ascertain the governance processes that each participant and private sector partners will need to follow in order to approve and sign the required documentation.

In parallel with this, the set-up of HCF will be progressed with OSCR.

#### 3.2. Way forward for immediate projects

Projects that are ready to reach financial close before the TPA and SHA amendments have been formally documented and HCF established, will be able to proceed under the existing DBFM delivery structure, but on the understanding that they will transfer into the new structure once that is established.

For these projects, the procuring participant will enter into a DBFM agreement with a wholly-owned hubco subsidiary (a Sub-hubco), however the structure of the deal will otherwise be aligned as closely as possible to the revised structure so that the transfer into the revised structure can be made as easily as possible:

- projects will sign up to the new standard form DBFM agreement (with DBFM Co rather than Sub-hubco terminology)
- there will be no public sector capital contributions
- the DBFM Co will in the short term be a wholly-owned hubco subsidiary
- the public sector's subordinated debt will be taken up by SFT (10%) and the procuring participant (10%).
- the PSDP will take up its 60% share of subordinated debt and will have the right to take up the remaining 20%.

Once the charity is established, hubco will sell its equity in the DBFM Co to the PSDP (60%), charity (20%), procuring participant (10%) and SFT (10%). This transfer process is in fact provided for in the current hub documentation and will consents under the Shareholders and Territory Partnering Agreements.

Deals that have already signed since the introduction of ESA10 (i.e. since 1 September 2014) will also be transferred into the revised structure. For these projects, this will

involve a restructuring of both the equity and subordinated debt investments and details will be discussed with the individual projects.

### **3.3. Way forward for future projects**

Once the Shareholder Agreement and Territory Partnering Agreement changes have been documented and HCF established, DBFM projects will proceed to financial close under the revised DBFM delivery structure.

### **3.4. Procurement – VEAT Notices**

Pinsent Masons recommend that each territory publish a Voluntary Ex Ante Transparency Notice ("VEAT Notice") in the Official Journal of the European Union, advising the market of the intention to change the hub DBFM delivery structure and, in doing so, mitigating the risk of any procurement challenge. The VEAT Notices will not describe the changes in detail and of themselves will neither change the structure nor commit any party to agree to change the structure. The sooner the VEAT Notices are published, however, the sooner hub DBFM projects will be able to move forward. VEAT Notices have therefore been prepared and will be issued by SFT on behalf of each hub Territory Programme Board immediately.

Technically the immediate hub DBFM projects will be signed under the existing structure and later transferred (as is allowed for under the existing structure) and they are therefore not within the scope of the "change". Given that the VEAT notice adds market transparency and clarifies the position for the whole programme going forward, however, it is anticipated that these projects will wait until expiry of the 10-day VEAT period before signing.

#### 4. Reasoning for Changes

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.

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 classification under the revised rules, 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 capital contributions must be limited in order to maintain clarity of risk-transfer to the private sector delivery partner. To implement this:
  - i. the complete removal of any capital contribution to projects through the construction phase, or on construction completion is the cleanest approach and will be adopted across the programme;
  - ii. subordinated debt investment will align with the shareholding in the revised structure. SFT will hold 10% and the procuring Participant 10%. The PSDP will hold 60% and the charity will have rights to 20%. The PSDP will have the opportunity to take up any of the 20% allocated to the charity which it does not take up.

**Annex 1: Pinsent Masons Advice**

(Refer to separate document)

**Annex 2: Revised Standard Form DBFM Agreement**

(Refer to separate document – to follow)

**Annex 3: Standard Form DBFM Co Articles of Association**

(Refer to separate document)