

# HUB PROGRAMME DELIVERY OFFICE

## GUIDANCE NOTE 01/15

### Stage 2/Financial Close Approval - European System of Accounts (ESA10) Implications for DBFM Projects

**September 2015**

**Contents**

1. Overview.....	2
2. Implications Of Implementing This Guidance .....	3
3. Amendment To Stage 2 & Financial Payment Provisions .....	4

Appendix 1 - DBFM Agreement, Contract Schedule Matrix

## 1. Overview

### 1.1 Introduction

There are a number of hub DBFM projects that have been affected by the need to get clarity on how the relatively recent European System of Accounts (ESA10) rules and guidelines are being interpreted for PPP style projects. These rules, introduced in September 2014, affect the national accounts prepared by the Office for National Statistics (ONS). As such they also affect how projects are budgeted for by the UK Government. This means there is likely to be some further impact on the delivery timetable for Hub DBFM projects that are in the current pipeline. At this stage it is too early to know what that impact will be.

It is a requirement of Scottish Government (SG) and the Scottish Futures Trust (SFT) that notwithstanding the ongoing ESA10 issues, all affected Hub DBFM projects should continue in their development to Stage 2 approval and, insofar that it is practicable, complete all relevant activities to enable financial close on affected projects to be secured at the earliest opportunity following resolution of the ESA10 issue. In doing so Participants, their respective hubco and their associated supply chain of contractors, consultants and advisers are required to mitigate the impact of any delay and additional costs at all times..

In light of the above, the following guidance is designed to overcome the challenges Participants and hubco face in continuing to develop projects to a point such that they can proceed to financial close in the quickest and most efficient way on the back of a satisfactory ESA10 outcome.

This guidance note can be applied to NHS and Local Authority projects for DBFM forms of contract only. This guidance note provides:

1. For temporary derogation/relaxation to the payment provisions in the Territory Partnering Agreement (TPA) to enable appropriate payments to be made to hubco's on current DBFM projects affected by the ongoing ESA10 issue; and
2. The minimum requirements that SG and SFT expect to be concluded post Stage 2 approval to enable affected DBFM projects to progress to close in a timely manner post an ESA10 resolution.

Part 1 of this guidance note is time limited and the normal provisions as set out in the TPA will apply post an ESA10 resolution.

Following consultation with the appropriate SFT hub support director, the conditions attached can be amended on a project by project basis should unique project specific circumstances exist.

### 1.2 Current Stage 2 Approval and Hubco Payment Arrangements

The TPA Schedule Part 5 – Approval Process for New Projects sets out the process by which hubco is required to submit a Stage 2 submission for approval and the circumstances under which hubco is entitled to payment should the Participant not approve the Stage 2 submission within 60 Business Days.

In the absence of Participants adopting this guidance note, Participants' liability to pay the hubco Incurred Project Development Fee as set out in the TPA will still apply.

In most hub DBFM Projects the hubco Portion, outstanding Stage 2 fees and Financial Close SPV costs are capitalised in the Stage 2 financial model and paid out to hubco post financial close.

Complementing the above, SFT issued Guidance Note 4/14 which set out the scope for payment of an Interim Stage 2 payment on completion of a Stage E design. Participants are strongly encouraged to make such interim payments.

### 1.3 Revised Payment Arrangements

This guidance note outlines the recommended temporary amendments to the payment process from Stage 2 approval to financial close. The key proposals include:-

- Payments to hubco and their supply chain upon Stage 2 approval, and / or
- Post Stage 2 payments running up to financial close (FC) on approval of a compliant Stage 2 submission.

This guidance note outlines the options around a revised payment process, compliance with the TPA, funding requirements and how this could be implemented.

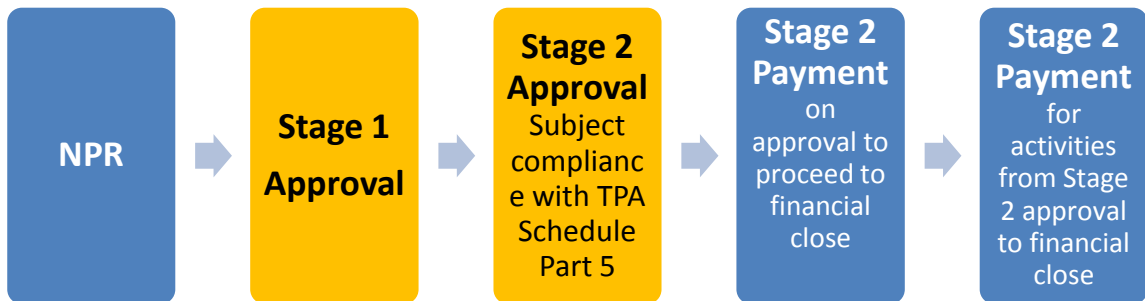


Diagram 1:- Key Changes To the proposed Payment Process for DBFM Projects

## 2. Funding To Implement This Guidance

### 2.1 Identifying Capital to Implement This Guidance

Prior to the implementation of this guidance the lead Participant should ensure adequate capital funds are available to meet the obligations and payment terms detailed within this guidance.

***Any payments made under the terms of this guidance are entirely separate to any capital contributions Participants had been expecting to make. On projects where Participants had planned to inject a capital contribution to support the project, in principle, these capital contributions will still be required. As previously advised however, it is expected that capital contributions will not be***

permitted under the new DBFM co structure. This guidance note is not intended to deal with options for the replacement of capital contributions.

*There may be project specific circumstances where some Participants will be considering paying non-refundable pre-financial close costs or paying for enabling/site preparation works using their allocated capital contribution. In these specific circumstances, Participants should consult with the appropriate SFT hub support director to ensure compliance with any funding or ESA10 requirements.*

To ensure no double counting, any agreed Stage 2 fee payments, Interim SPV Financial Close cost or any hubco Portion paid in advance of financial close shall be deducted from the capitalised costs in the Stage 2 financial model and the Stage 2 financial model shall be re-run to reflect the revised capital requirement.

*For projects that are fully funded by SG where Participants are not making any contribution to the capital cost of the facilities (typically Health Board DBFM projects), any agreed Stage 2 fee payments, Interim SPV Financial Close costs or any hubco Portion paid in advance will be drawn down at financial close and repaid in full to the Participant.*

Where the lead Participant is contracting in partnership with other Participants, all Participants shall agree their respective liability to pay such costs in advance of implementing this guidance note.

Prior to instructing this guidance the lead Participant should obtain a capped value for all payments within their Affordability Cap.

### 3. Proposed Amendment to Approved Stage 2 & Financial Close Provisions

#### 3.1 Current Position – Stage 2 submission onwards

All project development and hubco costs assuming an approved compliant Stage 2 submission up to the point of financial close, are currently cash-flowed by the relevant hubco and their supply chain and reimbursed in full as a single payment/drawdown at financial close. **Payments made by Participants during Stage 1 and Stage 2 are deducted from the reimbursement to hubco.** These costs typically include outstanding Stage 2 fees, SPV Financial Close costs and the hubco Portion incurred post Stage 1 approval (assuming no interim Stage 2 payment has been made in accordance with Guidance Note 4/14).

These costs can be significant in terms of value, typically around 8% of the overall project costs and given the ongoing impact of ESA10, unlikely to be sustainable in terms of hubco and their supply chain's ability to cash-flow these development costs indefinitely.

#### 3.2 Revised Payment Provision

To resolve the payment challenges facing hubco, this guidance note sets out temporary amendments to the payment provisions by Participants within the hub process based on the following two options:

**Option 1** - Suspending the on-going development. The project and payment of outstanding Stage 2 fees and 40% of the hubco Portion following the conclusion of the pre Stage 2 KSR and written Stage 2 approval by the Participant; and/or

**Option 2** - Progressing the project post KSR and Stage 2 approval with payment of outstanding Stage 2 fees and appropriate Interim SPV Financial Close costs as well as 80% of the hubco Portion on the conclusion of all project documentation as set out in Appendix 1 to this guidance note.

Ideally, projects should progress in accordance with Option 2 above.

Where Participants elect, in discussion with hubco, to follow Option 1 and suspend the project at Stage 2 approval, the payments set out in Option 1 should be made by Participants to hubco within 10 business days following:

- Confirmation by the Participant's advisers that the Stage 2 submission is in accordance with the minimum requirements set out in the TPA, NPR and the formal acceptance of the Stage 1 submission;
- The Stage 2 submission including a complete and checked (but not audited) Stage 2 financial model based on the target financial close date assuming the ESA10 issue did not exist;
- The pre-Stage 2 KSR process having been signed off by both the Primary and Secondary Reviewer as well as the Participant's Project Sponsor;
- Formal written acceptance of a compliant Stage 2 submission by the Participant having been issued ; and
- Written receipt from hubco of their commitment to pay their supply chain amounts properly due within 10 business days of receipt of such payments from the Participant.

Where Participants elect, in agreement with hubco, to progress in accordance with Option 2, the Interim SPV Financial Close costs shall be capped at the amounts set out in the Stage 2 submission financial proforma's as (typically funder and SPV professional advisor fees). In addition, no payments shall be made until the following conditions, in addition to those set out above, are discharged to the satisfaction of both the Participant's Project Director and the SFT hub support director:

- The Project Agreement and associated Schedules are completed in accordance with the requirements of Appendix 1 ***in so far as it is practical recognising that each project may have specific circumstances***; and
- Hubco's principle sub-contracts and ancillary documents mirror the requirements of Appendix 1 in so far as it is practical.

Upon payment of the Stage 2 Fee and or the Interim SPV Financial Close costs, all of the design development and supporting information shall become the property of the Participant.

## 1. Appendix 1 - DBFM Agreement, Contract Schedule Matrix

Financial Close Steps which can progress and which will not need to be re-visited due to delay in progressing to FC. Detailed below are aspects of the Project Agreement which should be developed post Stage 2 approval should the Participant elect to follow Option 2 set out above.

Schedule Part	Section	Description	Can it be developed/concluded?	Comment
		Project Agreement (the front end excluding schedules)	Partly	The majority of the PA can be developed and ready to be concluded in the run up to FC.
1		Definitions	Yes	
2		Completions Documents	No	
3		Key Personnel	No	
4		Funder's Direct Agreement	No	Pro-forma can be ready.
5		Land Matters	Yes	
6		Construction Matters	Partly	
	1	Statutory Approvals	Planning – yes Building Control & Warrant - partly	Full planning permission should be in place with an agreed list of planning conditions from the planning authority.  The initial building warrant application should have been lodged and a building warrant strategy should have been concluded with building control.
	2	Health & Safety during Construction	Yes	
	3	Authority's Construction Requirements (ACRs)	Yes	
	4	Contractor's Proposals	Yes	

Schedule Part	Section	Description	Can it be developed/concluded?	Comment
	5	Reviewable Design Data (RDD)	Yes	
	6	Room Data Sheets (RDS)	Yes	
	7	Thermal & Energy Testing	Yes	
	8	Quality Process	Yes	
	9	Change Protocol (during construction)	Yes	
7		Programme	Partly	Programme logic can be developed with the start date inserted once known.
8		Review Procedure	Yes	
9		Collateral Agreements		Templates can be prepared. Executed once the timetable is known.
10		Outline Commissioning Programme	Yes	The steps, processes etc. can be developed with only the Completion Date to be concluded.
11		Equipment	Yes	
12		FM Services		
		- Service Level Specification	Yes	
		- Method Statements	Yes	
		- Service Level Quality Plan	Yes	
13		Independent Tester Contract	Yes	But with execution deferred until actual FC date.
14		Payment Mechanism	Yes	Form and functionality can be developed with

Schedule Part	Section	Description	Can it be developed/concluded?	Comment
				only the final figures to be inserted.
15		Insurance Requirements	Partly	Templates can be concluded but it is recognised that hubco can't enter into insurance contracts until FC.
16		Change Protocol – Service Period	Yes	
17		Compensation on Termination	Yes	
18		Handback Procedures	Yes	
19		Records Provision	Yes	
20		Disputes Resolution Procedure	Yes	
21		DBFMCo Set Up	No	Completed in run up to FC. But the SPV need not be incorporated.
22		Certificates	Yes	
23		Re-financing	No	Final figures to be inserted once the funding documents are completed.
24		Employee Information (TUPE)	No	Will only be known when the timescales are concluded.
25		Insurance Proceeds Account	No	Completed in run up to FC.
26		Commercially Sensitive Information	Yes	
		Funder DD		



Schedule Part	Section	Description	Can it be developed/concluded?	Comment
		- Technical review	No	Needs to be in the lead up to FC.
		- Legal Adviser work	No	As above
		- Financial Model Audit	No	As above