INFRASTRUCTURE INVESTMENT BOARD
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Special Purpose Vehicles

1. Introduction

This guide is designed to help public sector policy makers and their property teams when they are considering whether a Special Purpose Vehicle (SPV) is the solution to particular property challenges that they face. It then addresses which type of SPV might best address particular situations and the issues of benefits and risks that need to be considered. Some brief case studies are included in **Annexe A**. The guide assumes no prior knowledge, and is designed for users to be able to skip over sections where the material is familiar.

1.1 Are there alternatives to SPVs?

There are two prior questions to address before pursuing the option of an SPV.

- What objective is to be achieved, and what purpose to be fulfilled?
- What options are available to achieve that objective or fulfil that purpose?

Alternative vehicles can include simply retaining the property task in the public sector holding body, strengthen the holding body by bringing in external expertise, or transfer it to another public sector body with more appropriate powers (e.g a local authority), selling the asset into the private sector to allow a private entity to deal with it . Only if these more straightforward solutions are inadequate is it worth undertaking the legal and financial set up costs of an SPV.

The motivation for setting up an SPV should be a positive one, and it should be demonstrable that the resources to be deployed will be repaid with commensurate benefits in achieving the objective(s). Care should be taken to ensure that SPV's are never used to circumvent the rules of propriety of the parent body, obligations under communities policy or to avoid the normal tax responsibilities of public sector bodies.

If the SPV option is to be pursued the two or more organisations need to be sure that they enjoy shared core values, complementary skills and assets needed to pursue common interest, that will be better progressed in partnership. Once this community of interest or shared objective is established informally the next step is to identify the best administrative or legal structure within which to deliver the shared purpose. It will also be important to consider the appetite for risk of the partners, the risks that will be assigned to the SPV, and how the contingent risk will be handled if the SPV encounters difficulties.

At the start there needs to be consideration as to how the SPV will manage projects using Prince 2 or other frameworks. There will be need to consider how the SPV's programmes and projects will be subject to peer review, perhaps using the Gateway Review process. Agreement of Procurement processes will be important.

1.2 What is an SPV?

A special purpose vehicle (SPV) is a separate legal entity, usually a limited company or a limited partnership designed to deal with narrowly focused, specific, or temporary objectives that are difficult for the parent body to achieve itself. An SPV can help deal with difficulties of access to capital or problems of structures unsuited to commercial decision making or the need to have a cohort of specialist professional expertise focussed solely on the task.

In the private sector, SPVs are often used by companies to isolate the main firm from financial risk. Thus the SPV can go into liquidation without threatening the whole group. It is a well understood tool of risk management. In the public sector it is more difficult to insulate the parent body which in the public mind still bears the reputational risk, and may remain the bearer of financial risk of last resort.

Sometimes an SPV owns a single asset and its associated property, planning, and building regulation rights. It can also own multiple assets. SPVs can work with land interests less than ownership**.** Scottish Government bodies have used SPVs in the past with some success, as have the UK Government and local authorities

A number of potential case studies have been identified in Annex A.

NHS Property Transaction Handbook guidance flowchart for property disposals is attached at **Annex B**.

1.3 Potential applications of Special Purpose Vehicles.

Special Purpose Vehicles have been used to achieve many varied ends.

They have been used by local authorities in particular to hold and manage portfolios of assets such as recreation facilities. SPVs and LABVs could be used to manage a public sector shopping facility or set of town centre assets to improve the urban realm. British Waterways (BW) has used them to manage and develop canal side assets to produce investment income and development gains to fund the main activities of BW.

SPVs are often used for the regeneration of areas where there are surplus public sector assets which can be redeveloped to pump prime the wider regeneration of a locality over a defined, long time period. These often work in partnership with the local authority to benefit from their compulsory purchase powers, and ensure they work in harmony with their planning and housing policies.

An SPV can be a single project as at Edinburgh Quay where British Waterways, now operating as Scottish Canals, and Miller Developments set up a Joint Venture Company to develop offices at Tollcross.

An SPV can be used for the disposal of a complex asset or series of assets. The NHS used a JV to dispose of Culduthel Hospital Inverness and shared receipts as houses were sold. It is one way of dealing with situations where receipts are deferred. Where there are a number of assets in the SPV, and particularly where there is more than one public body involved the question of how each asset is valued at entry, and how the receipts are divided up when the re-developed asset is sold is potentially complex, and needs a sound framework at the start to ensure the body can demonstrate it has achieved best value..

1.4 What Issues Might an SPV Address?

Governance – some bodies faced with a major disposal which may take several years to complete, may consider that the task is a distraction for senior management from core activity and prefer to move it to a specialised team with a single focus. An SPV may offer swifter decision making capability. Conversely some English Urban Development Corporations have SPVs face criticism of being less democratically accountable than their constituent councils.

A body may have clear lines of democratic accountability to a local authority or Minister. These lines of accountability can become less clear with an SPV that is a company whose board is accountable to ministers. Community interests approaching their MSPs and ministers may find themselves deflected to the SPV management on the grounds that their queries are 'operational' matters. This may help Ministers and the originating body focus on their core activities, but it can leave the public and local property interests feeling disempowered and that a democratic deficit has been created. SPVs may work better in regeneration areas where the community accepts a common goal (regeneration).

Some public bodies are constrained by legislation to undertake activity solely related to their service provision. In some cases direct investment in commercial development or engaging in highly speculative activities are not permitted, but disposal of assets on SPFM terms into an SPV which is empowered may get round this problem. If the asset has significant development value, the question of how that value is to be divided up between the public body and the SPV has to be decided up front so that the public body can demonstrate that it has achieved best value to its auditors.

Finance - a body may have an asset that needs investment in gaining planning consent, master-planning and enabling infrastructure to permit its disposal at the best price but lacks the remit, finance and or borrowing power to make the investment required to maximise the proceeds. NHS Health boards may find themselves in this situation.

Financial risk – a private sector company can substantially insulate itself from financial risk through an SPV, and this is recognised by creditors and bodies dealing with it. For the public sector the financial risk can still fall back on the parent, and the tax-payer or rate-payer in the last resort. It is important that this risk is assessed and responsibilities for the risks of the SPV getting into financial difficulty are allocated onto the appropriate risk register with a named owner when the SPV is being established.

Expertise – disposal of a major asset may need the engagement of specialist legal, planning, valuation and marketing skills in which a body may feel it lacks capacity.

Long Term Regeneration & Development – assembling sites, acquiring access rights, site preparation, installing infrastructure, gaining planning consents, master-planning and then phased disposal requires sustained management resources and a range of specialist skills over a number of years. An SPV can provide the expertise and continuity of purpose required to see an area development through. The disadvantage is that there can be significant wind up costs, and an exit strategy, perhaps passing responsibilities to the local authority should be developed at inception.

Value capture – often the public sector invests in infrastructure and development, but then sees much of the uplift in property values it has created benefitting other landowners. Sometimes if an SPV has access to the powers to acquire neighbouring properties or work in partnership with neighbouring landowners they can capture some of that planning gain for the public benefit.

Reputational Risk – an SPV allows the transfer of some risks away from the public body, although retention of some risk is inevitable for some public authorities. It is difficult for public bodies to transfer reputational risk, and ultimate financial responsibility if an SPV gets into difficulty.

2. Types of Joint Entity (SPV)

Local Asset Backed Vehicle – a distinct legal entity, often with equal public and private sector partners on the management board. Its aims are enshrined in a business plan, and it often has a defined life – often 10 but increasingly 20 years. LABVs are sometimes used by local authorities who put in a portfolio of assets and private sector partners who offer capital and development expertise. The RICS study in 2012 examined 14 LABVs in 2012 and identified 4 types:

- Management LABVs can be useful to bodies that hold assets for investment income like local authorities. The LABV can access additional finance and professional skills to actively manage and invest in the estate in the longer term to increase income, and enhance the capital value of the portfolio.

- Development LABVs can be used for single or multiple sites. Their aim is to take underused sites and through the application of specialist skills, and access to additional forms of finance take a development scheme from inception to conclusion.

- Town Centre regeneration LABVs can be used to deal with the particular complexities involved in regenerating town centres. These may rely on the parent public body for assistance with site assembly through their compulsory purchase powers, but offer access to the additional skills and finance needed to manage acquired assets, refurbish or demolish them and redevelop them in partnership with the many private property interests with investments in a town centre.

- Operational LABVs can cover a dispersed portfolio of assets that need managing to support a common aim, and perhaps provide an income stream. The inland waterways bodies have used these to access financial and skill resources to enhance the assets increase the value of canal side assets and help regeneration localities near the canals. Additionally these LABVs have enhanced operational assets directly involved in running the waterways and rail networks.

Local Investment Backed Vehicle – is a legal entity where properties do not initially transfer to the partnership but are subject to options which allow the LIBV to acquire them when they wish.

Joint Venture – a joint arrangement whereby the parties have joint control of the arrangement and both have rights to the assets and obligations for the liabilities relating to the arrangement. Most SPVs and LABVs are a form of JV.

Limited Liability Partnerships are a possible legal structure to consider and these have been used by the National Housing Trust.

3. Issues to be explored when establishing an SPV

- Public sector or private sector? There has been public sector SPVs where bodies with assets combine with organisations like local authorities or enterprise bodies which have compulsory purchase powers for site assembly, property expertise and access to finance. Some SPVs are joint public and private sector bodies which can benefit from private sector property expertise, finance and public sector powers. This decision on the composition of the SPV will affect the governance, the finance and how risk is managed.

- Governance/regulations. Scottish government bodies in the ‘trawl’ system under the Scottish Public Finance Manual (SPFM) circulate details of surplus properties as a first stage so other Ministers get a chance to express an interest in the site for their requirements. Most public bodies like local authorities will have mechanisms to ensure that they have no other internal requirements for the site before moving to the next stage of deciding which assets will enter the SPV.

- The Town Centre First Principle – is an initiative of the Scottish ministers to ensure that the economic and social health of Scotland's towns centres are considered when public bodies are reviewing the future of their assets in ways which affect their vitality "This principle puts the health of town centres at the heart of decision making and encourages vibrancy, equality and diversity." (External Advisory Group Sept 2012 resulting in the Action Plan announced by the Minister for Local Government and Planning on 9th July 2014, in agreement with COSLA).

- Community Empowerment – at the date of writing a new Bill is passing through the Scottish Parliament which is likely to offer additional powers to communities in respect of public sector assets. How SPVs and LABVs interact with communities, and observe the requirements of this emerging legislation will be important features of their governance.

- Town planning. Scottish ministers are head of the planning system and formulate the National Planning Framework, Scottish Planning Policy and various Circulars and guidance notes. Local planning authorities are the democratically accountable bodies involved in the structure plan, local development plan and the granting of planning consent. SPVs work within the planning framework, and it may be helpful to provide for the situation where it wishes to challenge a planning decision, and how that should be handled in the governance documents.

- 'Crichel Down' Rules It is important to consider whether any assets going into an SPV/LABV were acquired under compulsory purchase powers, or 'in the shadow 'thereof. 'In the shadow 'means that the acquiring body had access to compulsory powers but did not use them. If a central government body asset is in that category then the Crichel Down Rules in Scottish Planning Circular 5/2011 are mandatory and the property must be offered back to the dispossessed owner or their successors. If assets are placed into a SPV the consequences of whether these rules are applied, and when, need to be addressed. If the assets are offered back to the original owners or their successors when they pass into the SPV, the Crichel Down Rules may not apply when an asset leaves the SPV. It may be helpful to take legal advice at the point of transfer into the SPV to reduce the risk of subsequent legal challenge.

- Finance - disposal and best price. Considerable thought needs to be given as to how the public body recovers the value of its asset, and can demonstrate to auditors and the public that it has obtained best value. Public bodies are required to achieve best price for their assets, and disposal at less than market value or market rent constitutes a 'gift' and for central government requires Ministerial sign off and notification to the Parliament. With assets which have 'hope value' (the likelihood of achieving a higher planning consent and disposal price) the norm is that either planning consent is obtained prior to marketing, or the asset is sold 'subject to planning' and the ultimate price reflects the enhanced planning consent achieved by the successful buyer. However with an SPV the asset may be put into the vehicle before the planning situation is clear and the public body faces two dilemmas. The first is that the book value may be higher than the existing use value so it faces impairment in the accounts. Secondly it is delegating its duty to achieve best price through an enhanced planning consent to another body. When the asset is disposed of disaggregating the value owing to the public body may be difficult to demonstrate. This is particularly true if it has been enhanced by investment by the SPV in planning, master planning, infrastructure investment and marketing. Apportioning value objectively and transparently is difficult. If the site has been sub-divided, reduced or enlarged in size, or has been enhanced by the acquisition of additional interests, the problem of disaggregation is compounded.

- Capital receipts are often already identified by public bodies as supporting approved projects. Those not so designated are accrued to central finance to support overall capital programmes. Some finance structures provide mechanisms for retention of any revenue income (profit on disposal) to the holding body. Disparities can arise when establishing what the final disposal price/revenue/profit is against a book value.

- Regulations on Capital Accounting need to be given considerable thought. Financial rules are regularly updated. Different bodies and partners within SPVs may work to different conventions. European Accounting Standard ESA10 governs the Scottish Public Sector and advice will need to be taken on how the SPV is classified for EAS purposes as this may influence its accounting and VAT treatment.

- Classification – with PPP and Non Profit Distributing projects specialist legal and procurement advice will be needed on how the EU will classify the entity at a very early stage.

- IFRS - International Financial Reporting Standards set out how SPVs are handled under the standard IAS 27 and it will have to be decided if these govern Scottish Government and Scottish public bodies SPVs.

- Public or private audits. It will be important to establish whether audit of the SPV will be undertaken by Audit Scotland or private sector auditors, and to whether public or private sector accounting conventions will be used.

- Financial risk? As with any company or independently financed body an SPV can get into financial difficulty. This can occur if its costs exceed its income and it runs at a loss. This may happen in the early stages when costs are high, but there is little or no income from the assets. Also if the body has borrowed commercially and the assets constituting the lender's security drop in value, the loan to value ratio falls jeopardising the loan. Then the lender may make a cash call or failing a satisfactory solution take over the assets. This occurred with some SPVs during the recession of 2009. By their nature SPVs and LABVs are dealing with market risk, so it is important to decide exactly how big the maximum risk exposure is and where the ultimate responsibility for dealing with it lies. This is often with the parent public sector body so it is essential that the contingency is put into their risk register with a named risk owner.

- The legal costs of establishing the SPV, putting a property in to an SPV, transfers of various legal rights on asset disposal and the eventual winding up of the SPV will need to be very carefully planned for.
- Intellectual property – most SPV's have a finite life and it is sensible for the public bodies involved to ensure at the outset that all the intellectual property, titles, leases, licences, contracts, plans, records, IT equipment, vehicles, funds revert back to or contracts are novated to the public authority.
- Value Added Tax liabilities vary between public bodies and with the private sector. Advice needs to be obtained early on in the establishment process as to what the VAT treatment of its transactions in and out of the SPV will be.
- Presentational Risk – while one objective of establishing an SPV is to externalise some risk, public sector property is very visible and often sits within a web of interacting policies These include planning policy, heritage, sustainability, maximisation of receipts, and community empowerment. How this risk is to be handled should be settled at inception.
- Policy conflict - consideration needs to be given as to how policy conflicts that the SPV encounters are prioritised and resolved. The actions of SPVs can also interfere with powerful interests who can use statutory processes to delay or frustrate the actions of an SPV and generate adverse publicity. It is vital in the establishment of the governance of the SPV, that there is representation of those who are familiar with public sector policies to mitigate these difficulties. Clear ownership of the presentational risk in the risk register is vital.
- The public sector director assumes the duties and responsibilities of a company director, which will be different from the responsibilities he/she has experienced to date. The director will be taking on personal risk, in a way that does not arise in the main-stream public sector. Consideration will have to be given to appropriate training, and also to Personal Indemnity Insurance.

4. **GOVERNANCE.** Current policies and legislative issues

It is important to consider the issues around public sector governance. What drives projects forward within the public sector is not always the same as within the private sector, although integral to both is profit - for private shareholders and best value - for public tax payers.

Community Empowerment and obligations to community interests

Moving an asset into an SPV is a disposal and a public body should consider and engage with community interests in accordance with the Community Empowerment Bill. Community bodies may want to acquire by lease, purchase or licence some or all of the asset and organisations need to consider the degree to which those aspirations can be fulfilled. Community interest need to be considered when the SPV disposes of assets and this can be at less than market value when considering wider public benefits within the principles of best value.

Running the SPV company

- Public sector directors. – One way for public bodies to maintain good governance and accountability is to appoint one or more directors to the SPV company board. This requires thought as most senior public sector staff are not recruited or motivated to spend some years in a property related company. Neither are they necessarily equipped for this specialised work. This question of appointing such directors needs to be addressed.

  Internal Dispute Resolution - How will disagreements be resolved both between public body and SPV and also within an SPV with multiple partners, and multiple properties? Mechanisms for resolving disagreements will be important as the stakeholders may be divided e.g. quick, certain sale at a lower price/higher price with a riskier scheme; or undertaking a planning appeal. It may be necessary to consider External Dispute Resolution. The Scottish Government is committed to businesses using the Arbitration Centre and would necessarily expect public bodies and any of its associated bodies to do likewise. Mediation may be useful first step with some form of arbitration as a backstop commensurate with the value involved in the dispute. Particular care needs to be taken with disagreements and appeals within the planning system as Scottish ministers are the head of it and promulgate the National Planning Framework and Scottish Planning Policy, and local planning authorities are the democratically accountable body responsible for structure plans, local development plans and granting planning consent.

- Receipt retention - can the SPV retain and reinvest some of the receipts e.g. in the infrastructure needed to open up subsequent sites for development? The SPV would be acting as a developer. Do the governance arrangements allow a public body to be a member of an SPV involved in such speculative development and divert some of its receipts when this is not its prime purpose?

- Out of Area activity The geographical remit of the SPV needs to be made clear in the governing articles. Where the geographical remit of the SPV varies from that of some of its partners the question of what happens if proceeds from a body's assets are used out of area for infrastructure investment and what happens where a profit or loss is made outside a public body's area? These issues would need to be agreed/considered if this was to be the case. For example the City of Edinburgh Council's body EDI worked in other council areas.

- Transparency & propriety – a big multi-property SPV will naturally attract developers' attentions because it may control the flow of a significant amount of developable residential land in a locality. The SPV must show that it is acting at arm's length and giving a wide range of interests a fair chance to bid. It must not behave anti-competitively. Similarly in the apportionment of consultancy, legal and estate agency work it will have to demonstrate the same standards of propriety and fairness as the parent body.

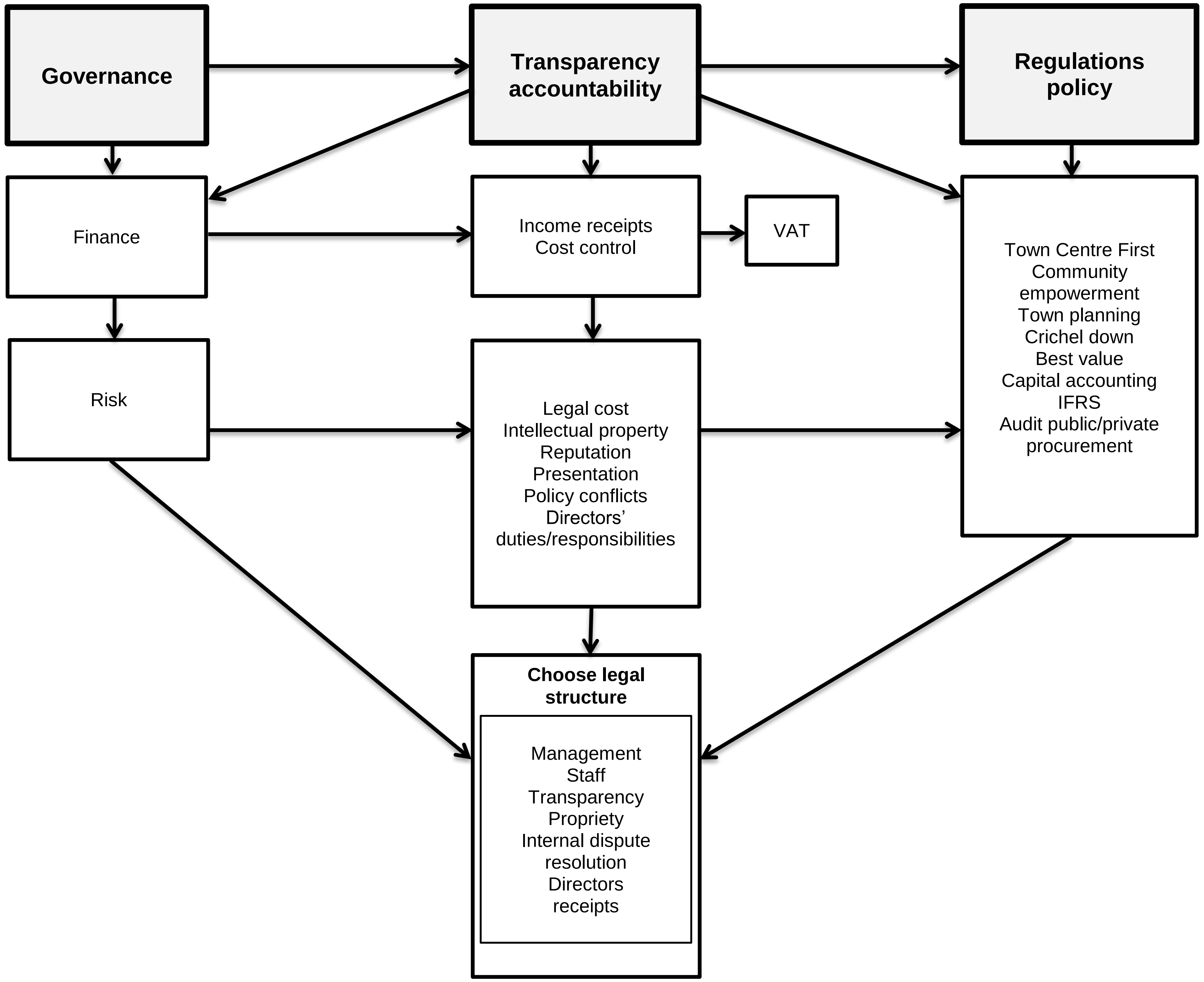
- Staff – if public sector staff transfer into the SPV clear Human Resources advice needs to be taken about the terms of service and any rights of return that may exist on wind up.

- Management - who manages the property pending planning applications and sale and bears the costs of security, empty rates repairs and the risks of occupiers' liability, fire, vandalism, or the injury of intruders? These responsibilities need to be clearly allocated.

- Policy commitments and legislation – The Government is committed to policies and practices that fall within the boundaries of democratically accountable politics and public responsibility. There is expectation that all public bodies are now committed to the agendas of land reform, community planning principles, place based decision making, the town centre first policy and single outcome agreements. An SPV to which the public body is entering needs to have clear policy as well as commercial guidance to avoid criticism that the SPV is a non-transparent way of avoiding rules of financial propriety and policy commitment.

- SPV procurement. Is it bound by public sector Procurement Guidelines or is it private sector? How will requirements of EU procurement rules and principles of diversity and living wage be dealt with? Is the establishment of the SPV effectively a procurement of a property service that needs tendering? The SPV partners will need a clear understanding of the procurement environment it which it works.

Diagrammatic aide memoire – issues to explore and consider when choosing an SPV



Potential Case Studies

A. Single Property SPVs

A.1 Culduthel Hospital site (Disposal) - Single Property SPV

The disposal of Culduthel Hospital for NHS Highland many years ago resulted in an SPV which was a partnership between the NHS Health and the Tulloch Group in Inverness. The main features were that the developer submitted a bid comprising an upfront price, and subsequent payments per house built and the mechanism suggested for achieving that was an SPV with Culduthel Hospital as the sole asset and the 2 parties were Tulloch and NHS Highland. It was easy to appraise the bids for the hospital. The agreement was subject to a deadlock. It was developed out in 2/3 years.

A.2 Edinburgh Quay, Tollcross (Development)

A JV between British Waterways, now operating as Scottish Canals, and Miller Group to redevelop a site at the Tollcross canal basin for office and retail development around a working and developing canal basin.

B. Multiple Property or Long Term SPVs.

B.1 BIGG Regeneration Limited Partnership

To enable Scottish Canals to work with proven experts to deliver regeneration schemes along the canal network in Scotland and enhance income earning assets, in 2012, Scottish Canals and the Igloo Regeneration Partnership formed a Limited Partnership, BIGG Regeneration Limited Partnership as a special purpose vehicle to acquire, develop, manage and trade properties in Scotland, with a current focus in the Port Dundas area of Glasgow.

B.2 the EDI Group Limited (Participates in SPVs)

EDI is a property development/investment business. Est. 1988 by City of Edinburgh Council, it is an arm's length private company, owned by the council. It has managed property assets, developed land and property alone or through joint ventures such as Edinburgh Waterfront with developers, landowners, local authorities & public sector bodies. Current projects include Brunstane & Newcraighall, Market Street and Fountainbridge in Edinburgh. It undertakes regeneration and with the Council, works in Craigmillar through PARC Craigmillar Ltd, (Urban Regeneration Company) and at Edinburgh Waterfront.

B.3 Waterfront Edinburgh (Development)

This was a JV in which Edinburgh Council contributed about £16m of property assets, and the SG via the local enterprise company put in around £16m capital, with a view to regenerating the area in phases, disposing of the improved assets and ploughing the development profit back into the next phase as traditional public sector 'pump priming'. However the JV improved assets where the benefits accrued to the private sector, so in the recession it was one of 6 struggling Edinburgh council bodies quietly folded into EDI, which itself survived by selling assets to stay solvent.

B.4 Torbay (Town Centre Regeneration)

Torbay Council and McAlpine & Deeley Freed. GDV c. £500m, to regenerate town centre for commercial/residential uses. Phase 1 - 5 sites; Phase 2 - 4 sites.

B.5 Space Northwest (Management)

Northwest RDA and Ashtenne. Management and development of a portfolio of assets (industrial units, offices, business parks) in Merseyside and Cumbria. GDV c. £140m.

C. NHS Property Services

A limited company owned by the Department of Health took ownership of c. 3,600 NHS facilities in April 2013. After the Health and Social Care Act 2012, Strategic Health Authorities (SHAs) and Primary Care Trusts (PCTs) in England were abolished and replaced with GP led commissioning consortia in April 2013. All properties owned by the SHAs /PCTs not passed to the commissioning groups were transferred to NHS Property Services which now manages, maintains and develops the properties for the DoH.

This is more like an arm's length holding company like EDI, which might procure and work with SPV partners.

It has required additional funding and has been the subject of an NAO Report,

References:

1. RICS, (2012), ***Local Asset Backed Vehicles – a success story or an unproven concept?***

2. Scottish Public Finance Manual

www.**scotland**.gov.uk/Topics/Government/**Finance**/spfm

3. NHS Scotland Property Transactions Handbook

www.pcpd.scot.**nhs**.uk/PropTrans/PTHome.htm

4. Scottish Planning Circular 5/2011, the Crichel Down Rules

Disposal Procedures (sale or lease) - Flowchart