NHS Scotland Revenue Finance Briefing Session
SGHD: Mike Baxter
SFT: James King, Viv Cockburn

18 April 2011
Welcome and Introduction

MIKE BAXTER
SCOTTISH GOVERNMENT HEALTH DIRECTORATE
Welcome and Introduction

• Introduce speakers

• Objectives for today
  • Raise awareness and understanding of the key issues
  • Gather issues from the Service
  • Outline development work required

• It is the Start of a journey !!!!

• Agenda for today
1. Welcome and Introduction
2. What are revenue funded projects?
3. hub DBFM contracts – how do these work?
4. How will projects be selected for the different funding structures?
5. Governance arrangements and business case processes?
6. What does this funding approach mean for your schemes?
Current funding environment, context and policy

- UK CSR Settlement – 36.5% real terms reduction in capital
- Demand for infrastructure investment increasing and high levels of commitment in the system
- Review of capital planning 2010 – preparing for the inevitable
- The mixed economy approach to public capital and revenue finance
- £2.5bn pipeline – a planned and sustainable approach to revenue financed investment
- A corporate approach across SG
QUESTIONS AND ANSWERS
What are revenue funded projects?

VIV COCKBURN
SCOTTISH FUTURES TRUST
What are revenue funded projects?

1. How do revenue funded projects work?
2. What revenue funded project structures are available?
3. How do revenue funded NPD projects work?
4. What are the differences between NPD projects and hub DBFM projects?
5. How will these projects be different to previous PFI/PPP models?
6. What services will be procured under revenue funded projects?
How do revenue funded projects work?

**Procuring Authority:**
- Pays monthly for the services over the contract period
- The monthly payment is subject to:
  - Performance deductions
  - Availability deductions
How do revenue funded projects work?

SPC Cost Profile

- Construction Costs
- Unitary Charge
- LCM, Financing, SPV Costs

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How do our projects become revenue funded?

Limited Capital Availability

Revenue projects ........... procurement of services

To be revenue must:
* Contract for provision of services
* Transfer 2 of 3 risks. **Must transfer construction risk and one of availability and demand**
What revenue funded project structures are available?

**NPD Projects**
- Separate projects...separate procurement
- Favour large scale acute projects or where projects not covered by hub OJEUs

**Hub DBFM**
- Utilises existing hub Private Sector Development Partners
- Favours community facilities/primary care
How do revenue funded NPD projects work?

**Funders**
- Senior Debt
- Sub-debt

**SPV**
- Design, Build, Finance & Maintain
- Construction Sub-Contract
- FM Sub-Contract

**NHS Board**

**Surpluses**

**Construction Company**

**Lifecycle/Hard FM Company**
## What revenue funded projects are available?

<table>
<thead>
<tr>
<th></th>
<th>NPD</th>
<th>Hub DBFM</th>
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</thead>
<tbody>
<tr>
<td><strong>Contract Structure</strong></td>
<td>Project Agreement for a design, build, finance and maintain contract</td>
<td>Project Agreement for a design, build, finance and maintain contract</td>
</tr>
<tr>
<td><strong>Principles</strong></td>
<td>Not for Profit Distribution Surpluses over the contract are returned to the procuring authority/SG</td>
<td>Delivered by hub partner. Sharing mechanism for surpluses.</td>
</tr>
<tr>
<td><strong>Ownership &amp; Funding</strong></td>
<td>No public ownership or funding of SPV</td>
<td>SPV – 100% owned by hubco. hubco is 40% owned by the public sector. Public funding up to 4% of SPV.</td>
</tr>
<tr>
<td><strong>Representation on Board</strong></td>
<td>Public Interest Director</td>
<td>2 Public sector directors</td>
</tr>
<tr>
<td><strong>Procurement Approach</strong></td>
<td>Competitive Dialogue</td>
<td>Partner already procured /in procurement / pre-procurement</td>
</tr>
</tbody>
</table>
Procuring NPD Revenue Funded Projects
........competitive dialogue
How will they be different to previous revenue funded projects?

### Contract
- Previously: NHS Scotland Standard Contract
- Now: hub DBFM/ NPD Standard Project Agreement
  - Consistent across sectors

### Services
- Previously: hard FM, LCM, catering, cleaning security etc...
- Now: hard fm & LCM. Narrower range

### SG Funding
- Previously: funded by NHS Boards
- Now: SG funding package consistent across sectors
What services will be procured?

- **Lifecycle**
  - Sufficient service provision and risk transfer to meet ESA95 requirements

- **FF&E**
  - Ability to include other services but need to justify on VfM grounds

- **Reactive Maintenance**

- **Utilities (pass through)**
QUESTIONS AND ANSWERS
COFFEE BREAK
Hub DBFM Projects

JAMES KING
ASSOCIATE DIRECTOR
SCOTTISH FUTURES TRUST
Session Agenda

• Exclusivity

• Brief outline of hub structure

• Delivery of Value for Money and affordable projects under hub DBFM

• Process of procuring DBFM projects under hub

• Brief discussion in respect of hub DBFM Contract
hub Programme

“working together to build better buildings, for better Public Services, for communities across Scotland...”
Qualifying Projects

- All Participants - Identified Projects (those in the current TDP)

- NHS – >£3.5m capital value for primary or community health services in first 10 years of Hubco (different for South East, North and East Central hubcos)

- Joint NHS and Local Authority if >£3.5m value and lead participant is NHS (different for South East, North and East Central hubcos).
Exclusivity

• 10 years from Commencement of Territory Partnering Agreement (TPA)

• Provision of all On-going Partnering Services;

• Project Development Partnering Services for Qualifying Projects (i.e. bring forward proposals for these new projects);

• Project Services for Qualifying Projects that become “Approved Projects” i.e. if approved the project will then be procured via a “Project Agreement” (DB/DBFM) between the Participant and hubco (or a subhubco) who will then subcontract to Supply Chain.
hub – project development process

New Project Request
- Affordability Cap
- Brief
- Programme
- Preparatory work done?
- Novation options?
- agree comparators and adjustments for Project Development fee

Stage 1 Approval
- Agree affordability cap
- Agree comparators for elements/components of the new project and agree any adjustments.
- Pricing cap adjustments
  - Option Appraisal
  - Initial design & feasibility
  - Develop preferred option
  - VFM assessment

Stage 2 Approval
- Develop design
- Pre-planning Consultation
- Planning Consent
- Procure Contractor
- Confirm VfM
- Procure FM Contractor
- Procure Funding

Contract Finalisation
- Financial Close
- Conditions Precedent
- Documentation
- Resolving residual risks
- Arrange Finance
Delivery of Value for Money

• Value for Money at Project Level
  • Key part of both Stage 1 and Stage 2 submissions

• Method
  • Comparators
  • Taken from appropriate parts of pricing data
  • Benchmarks - Previous hub projects/other market data (e.g. BCIS indices)
  • Costs always shown on open book basis, showing steps taken at supply chain to get VFM and continuous improvement

• Market Testing
  • At Participant request
  • Procedure for agreeing evaluation, selection, tendering etc

• Value for Money at Pipeline Level
  • Driving improvements in design
  • Driving reduction in construction and hard FM costs
Partnering Services

Ongoing

- Develop Territory Delivery Plan with Participants
- Supply Chain Management
- Support TPB

Project Development

- New Project Development/Delivery (*hubco does not need to tender for work – no OJEU*)
- Supply Chain Selection
- Funding

Strategic Support

- Strategic Estate Planning – if requested
- Service Planning – if requested
Project Development PS - VfM

- Procurement costs & timescales
- Efficiency gains
- Supply chain management
- Competitive pricing & budgets

hub VfM
hubCo VfM
hub VfM - Procurement

- Procurement costs & timescale savings
  - minimum 100 day savings on OJEU process.
  - Relationship exists with hub co working alongside Participants
  - Early engagement of supply chain
  - Volume of projects through increases procurement savings.
  - Less procurement risk & cost
  - Procurement measured through KPI’s
hubCo VfM - Supply Chain Management

• Robust tiered approach
  - Tier 1, Tier 2 & Tier 3

• Contractors & consultants all signed up at FC

• Commitment to deliver and tied to KPI’s

• Members appointed on a competitive basis, inc cost, quality, partnering, etc

• Measures in contract for reviewing & refreshing
**Project Delivery - Overview**

**Territory Partnering Agreement**
- Contains process for hubco to develop proposals for New Projects at request of a Public Sector Participant
- Contains approvals process for New Project proposals developed by hubco
- Contains Template D&B Development Agreement and Template DBFM Agreement to be entered into once hubco’s proposals for a New Project have been approved

**D&B Development Agreement**
Design and Build contract entered into between the relevant Public Sector Participants (i.e. those procuring the facilities in question) and hubco on New Projects that are capital funded

**DBFM Agreement**
Design, Build, Finance and Maintain contract entered into between the relevant Public Sector Participants (i.e. those procuring the facilities in question) and Sub hubco on New Projects that are revenue funded. The expectation is that special purpose vehicles will be established by hubco (and wholly owned by hubco) for delivering DBFM projects.
Project Delivery – DBFM

Design, Build, Finance & Maintain Agreement

Lead Participant

Sub-hubco

Sub Contracts

Hubco 100% Sub-hubco Equity

Construction Contractor

FM Contractor

Sub-debt Provision

Shareholdings

A Scottish Futures Trust (10%)

Public Sector Participants (30%)

- All Participants up to pro rata maximum - there is no requirement to take the full (or any) amount.
- If one or more participants decide not to exercise their sub-debt option, remaining options offered pro-rata to interested participants.
- If none or only some of the participants exercise their sub-debt options - for any remaining sub-debt, SFT have the option to take any remaining sub-debt up.
- If SFT do not wish to take up any remaining sub-debt, it will be offered to the PSDP.

B

C Private Sector Development Partner (60%)
Lead Participant

- Where there are joint projects, the TPA envisages that only the Lead Participant will enter into the DBFM;
- Joint Working Arrangements – not pre-determined;
- Key areas to cover will be:
  - liability for payment to hubco under DBFM, VAT;
  - issues that require joint consent/issues that Lead Participant can agree unilaterally;
  - reliance by non-Lead Participants on hubco (and supply chain)
DBFM Contractual Overview

- Once a New DBFM Project is approved a project-specific “subhubco” (wholly owned by Hubco) will enter into the DBFM with the Lead Participant procuring that New Project;
- DBFM Based on Standard health PPP contract with revisals e.g.;
  - Authority takes unforeseen capex change in law risk during operational period
  - IRR cap and collar
  - Other adjustments to reflect current market position and provisions for Local Authorities
- In terms of DBFM, where hubco is to secure funding, these contracts are known and acceptable to commercial funders in the projects market;
- Project specific provisions require to be negotiated on a project by project basis.
QUESTIONS AND ANSWERS
MORNING SESSION WASH UP
LUNCH
How will projects be selected for the different funding structures?

MIKE BAXTER
SCOTTISH GOVERNMENT HEALTH DIRECTORATE
High level analysis – programme level

Three stage process

1. High level analysis based on existing value for money guidance referred to in the Scottish Capital Investment Manual (SCIM) based on review of existing capital plans

2. More detailed assessment of suitability based on characteristics, scope and scale of projects

3. Business case process as per existing approvals process
Opportunities for developing projects

CSR Period – funding for legal commitments and formula – assumption of no capital for new developments

Hub is a programme based approach to development – not all projects currently identified

Review of scope and nature of those projects unsuitable as currently configured

Ultimately needs not wants – links to service strategy and supported by robust Property and Asset Management Strategies (PAMS)
Deciding between hub DBFM or Stand alone NPD

Is it within the scope of the hub procurement?

Scale – too small – too big?

Stand alone NPD – min £20m

Opportunities for bundling/ batching via hub
QUESTIONS AND ANSWERS
Governance arrangements and business case processes

MIKE BAXTER
JAMES KING
VIV COCKBURN
1. General issues

2. External reviews (Gateway Reviews and Key Stage Reviews)

3. Approvals processes (NPD & hub)

4. Business case processes

5. How will hub DBFM’s and NPD projects be assessed for vfm?

6. How will hub DBFM’s and NPD projects be assessed for affordability purposes?
General Issues

Not operating in vacuum – we have processes in place to deal with revenue financed projects – gives us a good foundation on which to build

Changes needed to respond to provision of funding and degree of challenge exerted

Clarity of roles and responsibilities – integrated processes essential

Degree of local challenge vital – needs not wants

Central challenge will be much stronger on aspects of proposals – capital requirements in particular
Validation Process

• All projects subject to review and validation
• Existing processes will continue – Gateway Reviews and KSRs
• Additional verification and examination – for example, components of revenue support
### What are the key validation stages?

<table>
<thead>
<tr>
<th>Stage</th>
<th>Description</th>
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<tbody>
<tr>
<td>1. Pre-NPR Review</td>
<td>Participants issues New Project Request</td>
</tr>
<tr>
<td>2. Pre-Stage 1 Approval Review</td>
<td>Hubco reviews New Project Request, Hubco Stage 1 Submission, Stage 1 Participant Approval</td>
</tr>
<tr>
<td>3. Pre-Close Review</td>
<td>Hubco Stage 2 Development, Stage 2 Submission, Stage 2 Participant Approval, CIG Approval, Conclude Project Agreement</td>
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<tr>
<td>4. Post Project Review(s)</td>
<td>PPE/POE, Post Project Evaluation</td>
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**Notes:**
- NHS Projects: Preparation & Strategic Planning
- Initial Agreement: Project included in TDP
- Standard Business Case: Full Business Case, CIG Approval
- Outline Business Case: Hubco Stage 1 Submission, Stage 1 Participant Approval
- Full Business Case: Hubco Stage 2 Development, Stage 2 Submission, Stage 2 Participant Approval, CIG Approval
- Hubco Stage 2: Conclude Project Agreement
- Completion: PPE/POE, Post Project Evaluation
# Business Case process

<table>
<thead>
<tr>
<th>Initial Agreement</th>
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<tr>
<td>• case for change</td>
<td>• validation of work to generate OBC</td>
</tr>
<tr>
<td>• part of the planned programme</td>
<td>• assessment of organisational capacity &amp; skills</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Outline Business Case</th>
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<tbody>
<tr>
<td>• authority to procure</td>
<td>• setting the funding parameters</td>
</tr>
<tr>
<td>• procurement strategy</td>
<td>• procurement strategy</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Full Business Case</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• the deal on the table</td>
<td>• formal agreement of funding</td>
</tr>
<tr>
<td>• authority to conclude the deal</td>
<td>• authority to conclude the deal</td>
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</table>
Development work to adapt existing processes

Four Stage approach to development

1. Review role, membership and operation of CIG to ensure consistent with SG objectives and revised funding arrangements and allow full assessment to be conducted as part of one process

2. Develop Standard checklists of questions to be addressed on a consistent basis in cases (for each procurement type and approval stage)

3. Update SCIM guidance to reflect changes and develop standard templates for business cases and presentation of evidence within them

4. Training and Development
How do we assess value for money?

**Programme Level:**
- Comparison of procurement routes

**Project Level:**
- Economic Appraisal
- Needs not wants
- Competitive Process
How do we assess affordability of NPD Programme?

- **Project Level**
  - SGHD, SFC, Transport Scotland, SG Schools

- **Portfolio Level**
  - SFT / SG Capital & Risk

- **Programme Level**
  - SFT / SG Capital & Risk

- Close scrutiny of cost drivers
- Funding terms & competitions
- Support capped & then fixed
QUESTIONS AND ANSWERS
What does this funding approach mean for your schemes?

MIKE BAXTER
VIV COCKBURN
What does this funding approach mean for your projects?

1. How will projects be supported with central funding?

2. SG Funding Principles – SGHD letter of 22 March 2011

3. What is funded and what is not?

4. Identified capital requirements

5. SFT role
How will projects be supported with central funding?

Pipeline to be finalised and agreed – market and pipeline management nationally will be vital to support effective delivery

Funding based on set of principles agreed by Ministers. These are set out in letter from Derek Feeley to Chief Executives – 22 March 2011

Dynamics of funding mean SG and Boards have interest in minimising impact of different expenditure components in projects i.e. capital expenditure v hard FM/lifecycle

Clear responsibilities on Boards for delivery and effective client function
Letter of 22\textsuperscript{nd} March - Key issues

• Standard contract and adherence to it

• Capacity and governance

• Value for money and business cases

• Preparatory work and development costs

• What is funded and what is not

• SFT Role
Outline Business Case stage:

- The procuring body is required to submit an Outline Business Case (OBC) to the Scottish Government, with a shadow bid model, which demonstrates how the project will deliver value for money in quantitative and qualitative terms. The OBC must be in line with Green Book guidance, the Scottish Public Finance Manual and appropriate sector specific guidance as outlined in Section 4.

- Before the project can enter procurement, the Outline Business Case must be approved by the procuring body and ultimately Scottish Ministers. SFT will have an oversight role and will provide comment to Scottish Ministers prior to their formal approval.

- The procuring body and the Scottish Government must both confirm at OBC stage that the project is affordable in terms of both unitary charge and non-unitary charge costs.

- Approval of the OBC will cap the revenue support based on agreed capital value supported at an agreed base date with an agreed construction inflation assumption and agreed centrally provided financing assumptions.\[1\]

\[1\] Revenue consequences of any upward movement in construction cost or timing after this date are likely to be the Authority’s account, although in exceptional cases with a full justification in the Final Business Case, may be centrally funded.
Full Business Case

After the procuring body has selected a preferred bidder but in advance of financial close, the procuring body is required to submit a Full Business Case (FBC) to the Scottish Government, with detailed costings which confirms that, following a competitive procurement process, the project offers value for money in both quantitative and qualitative terms. The FBC must be in line with Green Book guidance, the Scottish Public Finance Manual and appropriate sector specific guidance as outlined in Section 4.

Before the project can reach financial close the Full Business Case must be approved by the procuring body and ultimately Scottish Ministers. SFT will have an oversight role and will provide comment to Scottish Ministers prior to their formal approval.

The procuring body and the Scottish Government must both confirm at FBC stage that the project is affordable in terms of both unitary charge and non-unitary charge costs.

Approval of the FBC will fix Scottish Government revenue support based on the out-turn capital value of the project; anticipated financing terms; and maintenance and life cycle costs at an agreed base date.
### What is funded centrally and what is not?

#### Revenue Support: Where fixed within the procurement process

<table>
<thead>
<tr>
<th>KSR Stages</th>
<th>OBC</th>
<th>OJEU – Bid Receipt</th>
<th>IFT – Final Tender Evaluation</th>
<th>PB – Financial Close</th>
<th>Post FC</th>
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<tbody>
<tr>
<td><strong>Components of Funding Support</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction Costs – 100% funded</td>
<td>OBC ✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Sector Development Costs – 100% funded</td>
<td></td>
<td></td>
<td></td>
<td>✓ FBC</td>
<td></td>
</tr>
<tr>
<td>Financing Interest &amp; Fees – 100% funded</td>
<td></td>
<td></td>
<td></td>
<td>✓ FC</td>
<td></td>
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<tr>
<td>SPV Running Costs – construction – 100% funded</td>
<td></td>
<td></td>
<td></td>
<td>✓ FBC</td>
<td></td>
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<tr>
<td>SPV Running Costs – operation – 100% funded</td>
<td></td>
<td></td>
<td></td>
<td>✓ FBC</td>
<td></td>
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<tr>
<td>Lifecycle Maintenance Costs – 50% funded</td>
<td>OBC ✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Funding Support Fixed: Financing Cost: interest rates at financial close</td>
<td></td>
<td></td>
<td></td>
<td>✓ FC</td>
<td>✓ PB</td>
</tr>
<tr>
<td>All other costs at PB appointment</td>
<td></td>
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- ✓ Revenue Support Capped
- ✓ Revenue Support Fixed
Dealing with capital requirements

Capital expenditure required to support projects not covered within NPD contracts or hub DBFM e.g. enabling works, equipment

Timing and value has to be explicit to support planning at national level

Capital requirements for such projects will require to be bid for as part of SR processes

LDP’s need to be explicit about such requirements
SFT Role

Programme Level
Standard contracts, affordability, ESA95, vfm, assurance & approvals, market interface

Portfolio Level
Revenue support confirmation, assurance and approvals, progress reporting/monitoring

Project Level
Governance, business case development, assurance and approvals, procurement process support, contract derogations
<table>
<thead>
<tr>
<th>Work streams</th>
<th>Programme</th>
<th>Portfolio</th>
<th>Project</th>
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<tbody>
<tr>
<td><strong>Contract, NPD principles</strong></td>
<td>Develop standard contract &amp; NPD/hub DBFM principles</td>
<td>-</td>
<td>Approve project specific changes</td>
</tr>
<tr>
<td><strong>ESA95</strong></td>
<td>Programme clearances</td>
<td>-</td>
<td>Review Project clearances</td>
</tr>
<tr>
<td><strong>Affordability</strong></td>
<td>Monitor and provide updates on programme affordability</td>
<td>-</td>
<td>Track project affordability implications on programme</td>
</tr>
<tr>
<td><strong>VfM</strong></td>
<td>Support development of vfm guidance</td>
<td>-</td>
<td>KSR – challenge vfm implications</td>
</tr>
<tr>
<td><strong>Revenue Support</strong></td>
<td>Assist in developing methodology</td>
<td>Verify RS claimed and support Portfolio</td>
<td>Verify RS claimed</td>
</tr>
<tr>
<td><strong>Assurance &amp; Approvals Process</strong></td>
<td>Develop assurance &amp; approvals approach</td>
<td>Key Stage Reviews</td>
<td>Key Stage Reviews</td>
</tr>
<tr>
<td><strong>Project Governance</strong></td>
<td>-</td>
<td>-</td>
<td>Share best practice. May include SFT representation on Project Board</td>
</tr>
<tr>
<td><strong>Business Case Development</strong></td>
<td>-</td>
<td>-</td>
<td>Support as required by Portfolio</td>
</tr>
<tr>
<td><strong>Procurement Process Support</strong></td>
<td>-</td>
<td>-</td>
<td>Share best practice and provide support as agreed</td>
</tr>
<tr>
<td><strong>Progress Reporting</strong></td>
<td>Timescales, budgets, issues arising</td>
<td>Timescales, budgets, issues arising</td>
<td>-</td>
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</table>
QUESTIONS AND ANSWERS
SCOTTISH FUTURES TRUST

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