Finance and Resources Committee

10.00am, Thursday 28 November 2013

Treasury Management Update re HubCo

Item number	7.5
Report number	
Wards	

Links

Coalition pledges	P30
Council outcomes	C025
Single Outcome Agreement	SO1

Alastair D Maclean

Director of Corporate Governance

Contact: Innes Edwards, Principal Finance Manager

E-mail: innes.edwards@edinburgh.gov.uk | Tel: 0131 469 6291

Executive summary

Treasury Policy Update re HubCo

Summary

The Council's Treasury Management activities are carried out in accordance with the Council's Treasury Policy Statement included as part of the Council's Annual Investment Strategy which was approved by Council on 18 March 2013. On 27 June 2013, the City of Edinburgh Council approved an amendment to the Council's Treasury Management Policy to permit investment in subordinated debt of projects delivered via the "HubCo" model, subject to an overall limit of £1m.

This report outlines the progress in the consideration of the subordinated debt as an investment.

Recommendations

It is recommended that the Committee:

1. notes the current position regarding the potential subordinated debt investment; and

2. remits the report to the Governance, Risk and Best Value Committee for their scrutiny.

Measures of success

The success of the Treasury Section can be measured by the out-performance of the Treasury Cash Fund against its benchmark and managing the Councils debt portfolio to minimise the cost to the Council while mitigating risk.

Financial impact

The Council's temporary investments have generated significant additional income for the Council.

Equalities impact

There are no adverse equality impacts arising from this report.

Sustainability impact

There are no adverse sustainability impacts arising from this report.

Consultation and engagement

Not applicable.

Background reading / external references

Report to Council 14 March 2013 – Annual Treasury Strategy 2013/14
Report to Council 27 June 2013 **-** Treasury Policy statement re HubCo

Report

Treasury Management Update re HubCo

1. Background

1.1 Arrangements for the Investment of the Council's Surplus Funds

1.1.1 Most of the Council's surplus funds are managed on pooled investment basis along with those of Lothian Pension Fund, Forth Estuary Transport Authority and other associated bodies as part of a Treasury Cash Fund. However, the Council also has some investments which do not form part of this pooled investment arrangement. These relate mainly to Investment Properties, loans to other organisations, and investment in or loans to Council Companies / Joint Ventures.

1.1.2 The Council's Treasury Management activities are carried out in accordance with the Council's Treasury Policy Statement included as part of the Council's Annual Investment Strategy which was approved by Council on 18 March 2013. On 27 June 2013, the City of Edinburgh Council approved an amendment to the Council's Treasury Management Policy to permit investment in subordinated debt of projects delivered via the "HubCo" model, subject to an overall limit of £1m.

2. Main report

2.1 Background to HubCo Projects

2.1.1 The hub model has been developed by the Scottish Futures Trust and is structured to give the potential to deliver a wide range of facilities to improve the provision of community services. Projects could include community health centres, dental surgeries, doctor surgeries, debt and citizens' advice facilities, employment advice and a range of other community services, primary and secondary schools and police and fire service facilities.

2.2 James Gillespie's Campus Project ('JGCP')

2.2.1 The delivery of the new secondary school element of the James Gillespie's Campus project is being delivered on a Design Build Finance and Maintain (DBFM) basis via the HubCo model. The previous report covers the model in more detail, but for information, Figure 1 below shows the contractual structure of the project.

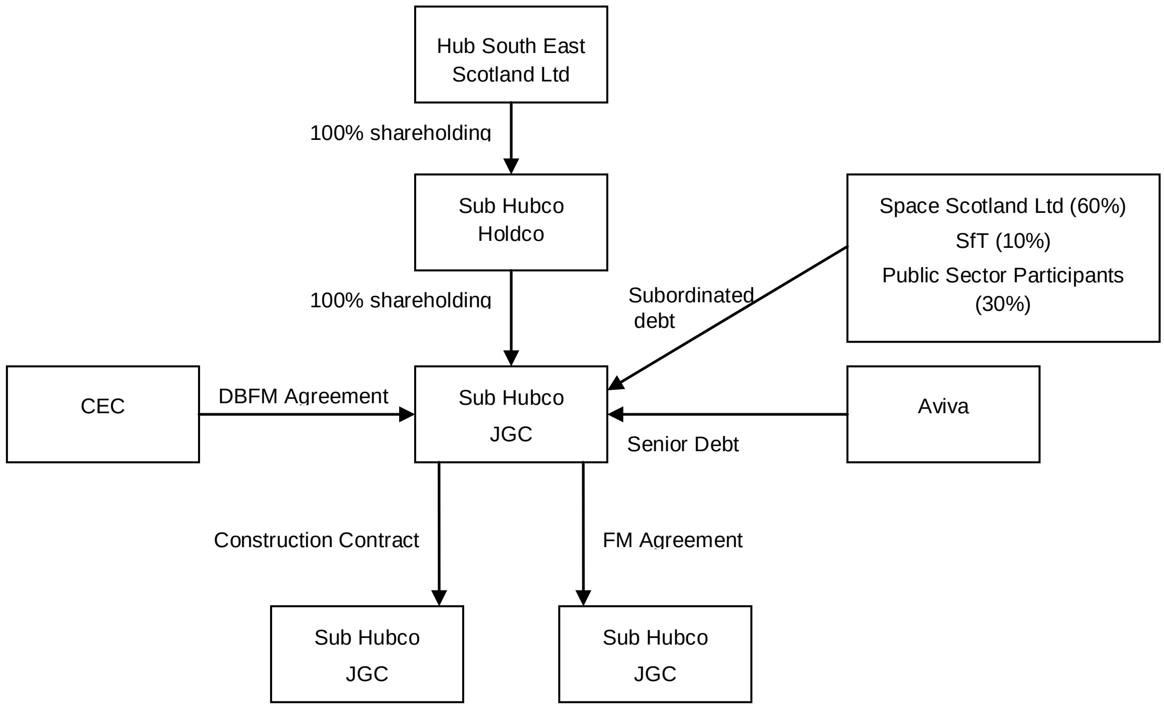

Figure 1 - Contractual Structure of HubCo

2.2.2 The commercial close regarding the JGCP DBFM contract has now been achieved and the works to deliver the new secondary school have commenced under and advance works agreement with financial close planned for 29 November 2013.

2.3 Changes to James Gillespie Campus Project Funding Model

2.3.1 In the previous report, it was stated that the funding will come from three main sources:

(a) capital contribution from CEC;

(b) senior debt, which is currently anticipated to be provided by Aviva; and

(c) subordinated debt provided by Space Scotland Ltd (the majority shareholder of HubCo and joint venture between Davis Langdon, Fulcrum infrastructure and Galliford Try) who will provide 60% of the sub debt requirement, SfT who will provide 10% and the Public Sector Participants of HubCo who have an option to provide the remaining 30%.

2.3.2 All of the Public Sector Participants in HubCo have the option to take up a share of the subordinated debt in each project. However, all the other Public Sector Participants in the JGCP DBFM project have intimated as expected that they will not be taking up their option to subscribe to the subordinated debt in this project. It is therefore open to CEC to fund 30% of the subordinated debt requirement should it wish to. Were CEC not to take up their option, it is understood that SFT would provide the remaining 30% of subordinated debt required.

2.3.3 Since the previous report, there has been a change agreed in the funding structure for the JGCP DBFM contract. Where a Council in Scotland is delivering two or more schools which are being funded through the Scottish Government's Scotland's Schools for the Future Programme, it has been agreed by the Scottish Government that the Council can consider a grouping based funding approach which allows the overall Scottish Government funding for these schools to be considered as a single funding package. This would allow the most advantageous overall funding arrangements for the schools within the package to be achieved while still delivering them through the Scotland's Schools for the Future Programme.

2.3.4 Consideration has therefore been given to the overall funding structure for the JGCP DBFM contract and the project to deliver a new Boroughmuir High School, both of which are being part funded through the Scottish Government's Scotland's Schools for the Future Programme. It has been agreed that the most effective funding model is to take the revenue funding which the Scottish Government will be providing towards the new Boroughmuir High School project and apply this to the JGCP DBFM contract thus making this entirely revenue funded. This then allows the capital contribution which the Council had intended to make to the JGCP DBFM contract, to be transferred to the new Boroughmuir High School project. The effect of this is that the new Boroughmuir High School project will now be delivered as a capital project through a more traditional procurement route and not as a DBFM contract. These changes in the funding structure do not have any effect on either the anticipated timescale for delivery or the overall cost of the JGCP DBFM contract. A full report will be brought to Council in December 2013 relating to the overall budget for the Boroughmuir High School project within which the advantages of the change in funding structure will be explained in more detail.

2.3.5 The change to the funding arrangements have meant that there is a higher level of senior and subordinated debt for the JGCP DBFM contract and that the ratio of senior to subordinated debt has also changed. While the final financial model to still be agreed, it is likely that total subordinated debt requirement will be in the region of £3.1m and this would mean that any investment by CEC would therefore to be approximately £0.94m within the £1m limit approved for subordinated debt associated with HubCo projects. The coupon on the debt is likely to be around 10%.

2.3.6 The revised arrangements grouping the two projects together as a funding package within the Scottish Government's Scotland's Schools for the Future Programme means that there will no longer be any subordinated debt associated with the Boroughmuir HS project.

2.4 Sub-HubCo Subordinated Debt as an Investment

2.4.1 As the previous report annotated, there are a number of reasons which can be put forward in favour of public sector investment in the Sub-HubCo, including that:

- it strengthens the partnership between the public and private sector by allowing the public sector participants to act as minority equity co-investor in hub projects;
- it will provide an incentive for both public and private sectors to achieve success together, by each having financial investment at risk in the Sub-HubCo. The public sector is sharing, proportionate to its investment, in the risks and rewards that are otherwise retained wholly by the private sector. This gives both public and private sector partners an interest in

seeing the Sub-HubCo succeed, which for the public sector shareholding means returns which can be re-invested into local services;

- the interest rate provides a relatively high rate of return over a long term period; and
- the investor rights in Sub-HubCo provide increased transparency to the investor in management of the project.

2.4.2 There is however, no requirement for the Council to take up the option to invest in the subordinated debt as part of the project, as SFT has confirmed it will take up any shortfall and the decision should therefore be taken on investment grounds. Subordinated debt is risk capital and as such is at risk in the event of any credit event facing Sub-HubCo. Furthermore, the subordinated debt is by its nature subordinated to the senior debt and will rank behind senior debt in the event of any credit event.

2.4.3 While the Council has approved, in principle, investment in the subordinated debt, as with any investment made by the Council, further due diligence in undertaken before an individual investment is or is not made. In particular, in this case the Council are seeking clarity and comfort on:

- the timing of the Council's investment in terms of other funding sources;
- confirmation that the investment is subject to limited recourse so that the Council is not committed to further funds over and above the agreed investment ;
- how construction risk is being managed; and
- the circumstances in which the interest or principal repayments might be at risk.

2.4.4 The Council has taken external advice on the draft legal agreements and is presently in discussion over the bullet points above. A final decision on whether or not to commit funds to this investment is therefore still dependent on the outcome of those discussions.

3. Recommendations

3.1 It is recommended that the Committee:

3.1.1 notes the current position regarding the potential subordinated debt investment; and

3.1.2 remits the report to the Governance, Risk and Best Value Committee for their scrutiny.

Alastair D Maclean

Director of Corporate Governance

Links

Coalition pledges	P30 - Continue to Maintain a sound financial position including long-term financial planning

Council outcomes	C025 - The Council has efficient and effective services that deliver on objectives
Single Outcome Agreement	SO1 - Edinburgh's Economy Delivers increased investment, jobs and opportunities for all
Appendices	None