

Kenneth Lawrie
Chief Executive
Midlothian Council
Buccleuch Street
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16th January 2013

Dear Kenneth

SCOTTISH GOVERNMENT FUNDING CONDITIONS FOR DELIVERING SCOTLAND'S SCHOOLS FOR THE FUTURE PROJECTS THROUGH REVENUE FINANCE USING THE NON PROFIT DISTRIBUTING (NPD) AND HUB DBFM MODELS

In the document 'Scotland's Spending Plans and Draft Budget 2011-12' published on 17 November 2010 the Scottish Government set out its commitment to deliver a £2.5 billion programme of revenue financed investment. The programme comprises priority projects across the transport, health, education and lifelong learning sectors.

The Scottish Government has agreed that a range of projects are to be funded through revenue finance using the NPD and hub DBFM models. Some projects within the Scotland's Schools for the Future (SSF) programme will be delivered using, where appropriate, the hub DBFM model, or, subject to the agreement of the Government, the alternative NPD model. Subject to meeting the guidance and funding conditions set out in this letter and demonstrating achievement of the SSF programme goals¹, appropriate revenue funding will be provided to procuring bodies to support delivery of those projects identified.

This letter sets out the key conditions and guidance for procuring bodies in the development and delivery of their projects, in relation to:

1. the anticipated scope, construction and building operating costs for the project;
2. the capacity and governance structures which the procuring body must put in place in order to deliver the project effectively;
3. requirements in terms of value for money assessment;
4. funding of preparatory and development costs; and

¹ which include efficient and effective procurement, cost efficiency and delivery of the nine School Estate Strategy principles. For further details regarding SSF programme goals please refer to the Scottish Futures Trust.

5. Scottish Government support for elements of the unitary charge.

The relevant guidance and conditions for the development of projects which are to be procured through the hub DBFM model are set out in the annexes below. As project owner, a procuring body is required to comply in full with the conditions and guidance set out in this letter in order to be eligible to receive revenue support for agreed projects.

Guidance and conditions for the development of projects which are to be procured through the alternative NPD model will be issued, on a project specific basis, if appropriate.

The final decision on the provision and level of unitary charge support for the project will be made by Scottish Ministers, subject to confirmation from both the procuring body and the Government that the project concerned is affordable and offers value for money.

The wider £2.5 billion investment programme is being supported by the Scottish Futures Trust (SFT). SFT are managing the SSF Programme on behalf of the Government. SFT provides a valuable centre of expertise and advice on the development, funding, structuring, procurement and management of these projects. Procuring bodies are therefore asked to continue to work closely with SFT throughout the ongoing development of their project. SFT's approval will be required at specific points, as detailed in the attached guidance, in order for the project to proceed to delivery. The relevant point of contact within SFT continues to be Gemma Gordon, Associate Director, Tel: 0131 510 0813, Mob: 07540 707 250, Email: gemma.gordon@scottishfuturestrust.org.uk.

You will be aware that your project was identified as one of the phase 3 projects which has the potential to be onsite within 12-18 months of the September 2012 announcement. It is important we direct and drive forward our collective efforts to strive to achieve this timescale. If an Authority cannot show that demonstrable effort has been undertaken towards this end, Scottish Government reserves the right to reallocate funds previously agreed for any individual school in the event that there is a material change in the circumstances that affect the timescale for delivery of that school.

I would be grateful for your indication at the earliest opportunity that you will work within the conditions and guidance set out in this letter. Please contact either Jonathan Moore (Head of School Infrastructure Unit) on 0131 244 1572 or Andy Dailly (School Infrastructure Unit) on 0131 244 7866 if you wish to discuss any aspect of this letter in more detail. I will of course be happy to discuss any aspect of this offer if you would find that helpful.

I am copying this letter to your Director of Education and Director of Finance.

Yours sincerely,



Ian Mitchell
Deputy Director, Learning Directorate

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1. Anticipated scope, construction and building operating costs for the project

Conditions

- a) Revenue support will be provided to the procuring body from the Scottish Government up to a set level based on the project scope which has been agreed to be funded through Scotland's Schools for the Future Programme.
- b) Revenue support will be provided to the procuring body from the Scottish Government for a project which is procured using the standard form hub DBFM contract developed by SFT.
- c) Derogations from the standard hub DBFM contract will require sign off from SFT. Derogations will be signed off at key stages in the procurement process if they are assessed as being appropriate.
- d) Derogations which relate to the underlying principles of the standard form hub DBFM contract, as noted below, will require sign off from Scottish Ministers.
- e) Should the procuring body choose to expand the scope of the project beyond that agreed between the Scottish Government, SFT and the procuring body as being appropriate for the project, the procuring body will be required, subject to the guidance in Annex 5, to fully fund any resultant increase in unitary charge, including any inflationary impact over the term of the contract.
- f) Should the procuring body decrease the scope of the project below that agreed between Scottish Government, SFT and the procuring body, the level of revenue support provided by the Scottish Government will be commensurately reduced.
- g) In order for the project to enter procurement, the procuring body must satisfy both the Scottish Government and SFT that it has sought to minimise construction costs and operating costs within the agreed funded project scope and has undertaken a whole of life cost analysis.

Guidance

Underlying principles of the standard form hub DBFM contract

The underlying principles of the standard form hub DBFM contract are:

- returns to the private sector are capped; and
- surpluses are returned to the public sector.

2. Capacity and governance required to deliver the project effectively

Conditions

- a) **The procuring body is required to have in place a dedicated, qualified and sufficiently resourced project team to lead delivery of the project.**
- b) **The procuring body is required to have in place a Project Director (or equivalent) with recognised expertise in project management and delivering revenue financed projects.**
- c) **The procuring body is required to put in place a project governance structure, clearly linked to the governance arrangements of the organisation, which will ensure effective oversight and scrutiny, at a senior level, of the work of the project team and the development of the project.**
- d) **The project will be required to go through Key Stage Review and Post Project Evaluation, as directed by the Scottish Government, through the development phase until Financial Close is reached. The review process should be undertaken in full from the earliest applicable milestone. The project's Senior Responsible Officer (SRO) must take account of all recommendations. Successful completion of each Key Stage Review is required in order for the project to proceed to the next stage of delivery.**

Guidance

Project resourcing

The skills and experience of the Project Director (or equivalent) and the wider Project Team needed to deliver a successful revenue financed project are outlined as follows:

The Project Director (or equivalent) should have experience of comparable procurement of assets and long term services, ideally gained from senior involvement for the public sector in earlier revenue financed project(s).

The Project Director (or equivalent) should have the experience and expertise necessary to:

- take the lead role in managing the project from inception to Financial Close and beyond into the operational phase of the project; and
- provide clear leadership during the transition from the procurement phase to the delivery phase of the project.

The project team should be structured appropriately for the client role in the hub programme and should:

- have knowledge and experience of revenue financed procurement to be able to provide a challenge function to advisers and the private sector partner;
- operate as the public face of the project both internally and externally;
- have an understanding of the assets and services to be provided by the private sector partner under the proposed contractual structure;

- have the experience and expertise necessary to successfully manage and deliver the key phases in project procurement; and
- have the confidence and experience to lead detailed, wide-ranging and complex negotiations in relation to the technical, commercial and financial aspects of the project.

In addition to the expertise outlined above, the project team must have sound knowledge of these important aspects of procuring revenue financed projects:

- design;
- risk transfer;
- affordability;
- the payment mechanism, including penalty and default issues;
- funder issues;
- interfaces between the procuring body and the private sector partner and between the private sector partner and subcontractors;
- specification of hard facilities management (FM) services; and
- relevant employment regulations² where staff may be required to transfer from one employer to another.

Project and programme governance

Effective governance is vital to the success of individual projects and the investment programme as a whole. At project level, the procuring body is required to put in place a reporting and governance structure which will enable scrutiny and oversight at senior level within the procuring body. The exact form of this structure will be for the procuring body to determine: options include the creation of a specific project board which reports to a management board and/or Finance Committee, or a regular, detailed report from the project's Senior Responsible Officer (SRO) to a management board. The SRO must be an employee of the procuring body.

The Scottish Government has developed governance structures at programme level to enable scrutiny of progress across all Scotland's Schools for the Future projects. The procuring body will be expected to work within this structure and respond as appropriate to questions or recommendations that may arise at programme level.

The Schools National Programme Board (NPB) has ultimate oversight of the Scotland's Schools for the Future programme. The NPB may therefore decide to scrutinise a project as part of the wider programme. Typically the NPB will provide this scrutiny early in the life of the project as appropriate. Where NPB makes specific recommendations in relation to the project, the SRO will be required to take account of those recommendations in taking forward the project.

Project assurance

Both the procuring body and the Scottish Government require assurance about the robustness of project management and the prospects for successful procurement, delivery and operation. Key Stage Review is an assurance tool which helps to ensure the successful delivery of major capital projects. The project will be required to undertake Key Stage Reviews as part of the hub DBFM procurement process. If an alternative procurement route

² Especially the Transfer of Undertakings Protection of Employment (TUPE) Regulations.

is used, an alternative assurance route will be directed by the Scottish Government, at specific points in the project development.

Key Stage Review provides a structured, independent 'due diligence' review of projects, supporting Project Managers and Sponsors at commercially critical procurement stages. Key Stage Reviews help to ensure that procuring authorities are sufficiently advanced in their project development and have put in place the necessary delivery arrangements and documentation in order to secure high quality, sustainable projects are delivered. They also ensure that authorities are adequately resourced to effectively and efficiently carry out the procurement, construction and operational stages of the projects. Key Stage Reviews are a formal requirement for all projects delivered through the hub DBFM model and will be conducted by SFT.

Contract Management

Where a shared service is in place for contract management, the procuring body should agree to participate in that service.

3. Requirements for value for money assessment

Conditions

In general, the procuring body will provide supporting analysis to the Scottish Government as requested. More specifically:

- a) The procuring body is required to meet the requirements of '*Value for Money - Supplementary Guidance for projects in £2.5bn Revenue Funded Investment Programme*³'.
- b) Revenue support will be capped based on an agreed capital value (including project development costs and construction phase SPV costs) supported at an agreed base date with an agreed construction inflation assumption⁴. Revenue support will also be provided for ongoing SPV costs subject to a cap.
- c) In advance of financial close, the procuring body is required to submit detailed costs and confirm that the project remains on track to deliver the Programme Goals.
- d) The procuring body and the Scottish Government must both confirm prior to Financial Close that the project is affordable in terms of both unitary charge and non-unitary charge costs.
- e) At Financial Close, Scottish Government will fix the revenue support based on the out-turn capital value of the project (including project development costs and construction phase SPV costs), the out-turn level of ongoing SPV costs and anticipated financing terms.

Guidance

Value for money – supplementary guidance

Procuring bodies should refer specifically to the Schools projects section of the supplementary guidance in relation to Schools projects (Section 4.3).

³ Publication can be accessed on SFT's website at:

http://www.scottishfuturetrust.org.uk/files/publications/Value_for_Money_Supplementary_Guidance_for_Revenue_Funded_Projects_-_October_2011.pdf

⁴ Revenue consequences of any upward movement in construction cost are likely to be the procuring body's account, although in exceptional cases with full justification, may be centrally funded.

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4. Funding of preparatory and development costs

Conditions

- a) **The procuring body (and where relevant, other participating public authorities), and Scottish Government are required to provide funding for the preparatory and development costs of the project in line with the proportions outlined below.**

Guidance

Four sets of preparatory and development costs have been identified as required in order to deliver the project through the hub DBFM model. These are:

1. **Public sector development costs** – which may include feasibility, planning, design and specialist advisory services. SG will not provide any contribution towards these costs upfront. SG will fund the equivalent of 66.7% [or 50%]⁵ of these costs, by making a contribution towards the unitary charge.
2. **Public sector advisory costs** – which may include legal, financial, technical (if additional to design costs) and insurance advice costs. SG will not provide any contribution towards these costs upfront. SG will fund the equivalent of 100% of these costs, subject to a cap, by making an additional contribution towards the unitary charge.
3. **Public sector enabling capital costs** – these are necessary to prepare the project for procurement (e.g. land purchase and preparatory works). SG will not provide any contribution towards these costs.
4. **Public sector enabling revenue costs** – which may include staffing costs or decant provision. SG will not provide any contribution towards these costs.

⁵ 66.7% for secondary school projects; 50% for primary school projects
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5. Scottish Government support for elements of the unitary charge

Conditions

- a) In order to be eligible for Scottish Government revenue support the project must be assessed, by the procuring body, under relevant Eurostat (ESA95) guidance as falling outside the public sector for national accounts purposes.
- b) In order to secure revenue support, the procuring body must satisfy both the Scottish Government and SFT that it has sought to minimise capital and operating costs within the agreed project scope and has undertaken a whole life cost analysis which demonstrates this.
- c) The procuring body is required to fully fund the unitary charge elements relating to Hard FM (facilities management) costs and lifecycle maintenance costs.
- d) Projects will only receive Scottish Government revenue support upon successful completion of construction and commencement of operations subject to any specific arrangements made regarding phased commencement of operations.

Guidance

ESA95

Guidance on the assessment of ESA95 will be provided by the Scottish Futures Trust.

Components of the unitary charge

The unitary charge is the amount of money paid by the public sector procuring body to the private sector consortium over the duration of the contract. Unitary charge payments begin once the project is fully operational or individual phases have been completed. The total unitary charge payment will comprise some or all of these components:

1. Construction costs
2. Private sector development costs (including staffing, advisory and lenders' advisers' fees)
3. Financing interest (which is necessary to fund the project through construction)
4. Financing fees
5. Running costs for the project's Special Purpose Vehicle (SPV) during construction, including insurance costs and management fees
6. SPV running costs during operations, including insurance costs and management fees
7. Lifecycle maintenance costs
8. Hard facilities maintenance (FM) costs

For clarity, the following cost elements are outwith the scope of the hub DBFM contract or are a pass through cost, and accordingly are a direct cost to the public body:

9. Soft FM costs, including cleaning, catering, grounds maintenance and security
10. Utilities including gas and electricity costs and rates

11. Equipment costs not included in the overall construction cost

Components of the unitary charge to be supported by the Scottish Government

Subject to the procuring body meeting the other conditions outlined in this letter, and the satisfactory commencement of operations on the project, the Scottish Government will commit to provide the procuring body with revenue support for the following elements of the unitary charge:

- 66.7% [or 50%]⁶ of construction costs (subject to the agreed scope of the project);
- 100% of private sector development costs (subject to an agreed cap);
- 100% of financing interest and financing fees, which relate to the proportion of the construction costs being supported by SG (at prevailing Financial Close rates);
- 100% of SPV running costs during the construction phase (subject to an agreed cap); and
- 100% of SPV running costs during the operational phase (subject to an agreed cap).

Components of the unitary charge to be supported by the procuring body

The procuring body is required to support the following elements of the unitary charge:

- 100% of Hard FM (facilities management) costs; and
- 100% of lifecycle maintenance costs.

It is assumed that the procuring body will exercise the option to inject their contribution towards construction costs as a capital contribution, subject to meeting the provisions of ESA95. If the procuring body is restricted from injecting a proportion of the construction costs as a capital contribution, resulting in the use of project finance, the Government will consider, on a case by case basis, whether to make a contribution to some or all of the differential cost of borrowing between PWLB and the project financing terms.

Any alternative project structure (e.g. no capital contribution) will require to be agreed by the Scottish Government. The associated contribution towards the unitary charge from Scottish Government would be agreed on a project specific basis.

The procuring body will be required to fully fund additional cost components for soft FM services, utilities costs and equipment costs (not included in the overall construction cost). It is assumed that these costs are outwith the scope of the hub DBFM contract or are a pass through cost.

Determining the value of SG revenue support and the procuring body's contribution

As part of the early project development process, the procuring body will be required to prepare anticipated project costs and financial cashflows. This information should provide projections of the various cost components of the project and should be completed in a format provided by SFT.

Later in the project development process, the financial model will be required to be made available to SFT in order that value for money can be examined.

⁶ 66.7% for secondary school projects; 50% for primary school projects
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At Financial Close, financing rates are determined and the total unitary charge payment is set, subject to inflation, for the term of the contract. The financial model, which forms the basis of Financial Close, will be used to determine the individual components of the unitary charge, and therefore finalise the respective revenue contributions from each of the relevant parties. The Scottish Governments support will be fixed based on the financing terms achieved in the market and will be subject only to annual inflation of an agreed percentage of the unitary charge by an agreed index.

