

REPORT TO: **EDUCATION COMMITTEE - 19 MARCH 2007**
POLICY AND RESOURCES COMMITTEE - 19 MARCH 2007

REPORT ON: **DUNDEE SCHOOLS PPP PROJECT - FINANCIAL CLOSE**

REPORT BY: **CHIEF EXECUTIVE AND DIRECTOR OF EDUCATION**

REPORT NO: **147 - 2007**

1.0 PURPOSE OF REPORT

1.1 This report updates the Committee as to the financial/commercial position achieved at Financial Close and outlines a procedure for dealing with contract variations during the construction phase of the project.

2.0 RECOMMENDATIONS

2.1 It is recommended that the Committee:

- i) note the contents of this report; and
- ii) approve the procedure outlined to deal with variations during the construction phase of the project.

3.0 FINANCIAL IMPLICATIONS

3.1 The financial closure achieved requires the Council to pay a first full year (2010/2011) Unitary Charge of £9,518,712 (including the estimated cost of energy), which compares favourably with the affordability target of £9,620,000 approved by the Education Committee on 20 November 2006. This full year Unitary Charge of £9,518,712 and the consequential savings will be reflected in future years' Revenue Budgets.

3.2 The Scottish Executive have now confirmed Level Playing Field support payable to the Council over the 30 years of the PPP Project (copy letter attached at Appendix 1). The grant profile shows that the Council will receive the grant that was included in the approved Final Business Case, this being £5.73m per annum from 2010/2011, but in addition will receive an additional £311,657 per annum for 27 years from 2010/2011 to reflect the underpayment in the phased opening years. The Head of Finance would propose internally investing this additional sum in order to fund the final year's (2037/38) Unitary Charge. This situation is financially more advantageous than originally predicted and will assist with meeting the Unitary Charge in future years.

3.3 In terms of any variations to the scheme required by the City Council, the Head of Finance has advised that she would wish to fund these from the capital receipts generated from the sale of surplus school sites.

4.0 SUSTAINABILITY POLICY IMPLICATIONS

- 4.1 This project will meet the Council's sustainability policy in the following areas - Compliance with Environmental Legislation, Energy and Water, and Built Environment.

5.0 EQUAL OPPORTUNITIES IMPLICATIONS

- 5.1 The revitalised teaching and learning environment in the new schools will help combat disadvantage and promote social inclusion by allowing learners to access the skills, knowledge and information needed to enable them to play a full part in society. The project will ensure that resources are used efficiently to open up opportunities for culture, leisure and recreation to the wider community as well as providing an up to date setting for day school education.

6.0 BACKGROUND

- 6.1 On 26 June 2006 the Education and Policy and Resources Committees noted the programme of events leading to financial close of the project and approved the Final Business Case setting out the main features of the proposed contract with Discovery Education. The Chief Executive was authorised to negotiate and agree the final terms of the contract and to carry out all other steps necessary to bring the project to financial close. A report on progress with the contract negotiations was made to the Education Committee on 20 November 2006.

7.0 CURRENT POSITION

- 7.1 Agreement on the key commercial terms was reached with Discovery Education PLC prior to Christmas 2006. However the task of finalising the detailed contract and bond documentation extended into February 2007 with the Project Agreement (Contract) being signed on Monday 19 February 2007, the bond launched on Wednesday 21 February 2007 and the flow of funds (Financial Close) taking place on 27 February 2007.
- 7.2 The Scottish Executive have confirmed their funding for the project in a letter dated 14 February 2007, a copy of which is attached at Appendix 1.

8.0 KEY FEATURES OF THE PPP PROJECT

- 8.1 The key features of the project were described in the Final Business Case which was approved by the Education and Policy and Resources Committees on 26 June 2006. A summary of the key features is listed below.
- 8.2 The full scope of the project approved by the Education Committee on 15 March 2004 is included in the finalised project scope.
- 8.3 As well as building the schools, Discovery Education will provide a range of facilities management services, including:

- Building repairs and maintenance;
- Security;
- Cleaning;
- Grounds maintenance;
- Energy management;
- Heavy equipment/fixed furniture;
- Caretaking/Janitorial Services;
- IT infrastructure;
- Telecommunications infrastructure; and
- Helpdesk.

8.4 Catering services, maintenance of grassed and planted areas, and soft janitorial services are excluded from the contract. Cleaning services will be provided by Tayside Contracts, acting as a sub-contractor to the main facilities management sub-contractor, Robertson Facilities Management.

8.5 The contract will run for a period of 30 years from the target completion date of the first school in 2008. The schools will revert to the Council following the expiry of the contract period.

8.6 The designs of all schools meet the Council's specifications and include the provision of full sprinkler and CCTV systems.

8.7 Community access to schools has been guaranteed through an extended core hours arrangement, with provision being included for all current users of the existing schools to continue to be able to use the new schools and also for the extended use of the schools by the community. In addition, the swimming and games facilities in the two secondary schools will be operated as sports centres.

8.8 The Standard Schools PPP Contract position and the current market norm is that all energy risk should be borne by the Council. However, as an incentive to operate the schools as efficiently as possible, a mechanism has been developed whereby the risk of consumption of electricity and gas above or below expected levels is shared equally by the Council and Discovery Education since both parties can influence consumption.

8.9 A payment mechanism has been negotiated which will incentivise Discovery Education to meet the quality of service specified in the contract, with financial deductions being made from contract payments if performance is not up to standard.

9.0 JOINT VENTURE

9.1 The Scottish Executive agreed in January 2004 to the Council inviting bidders to submit optional variant bids for the PPP Project whereby the Council would take an equity stake of no more than £25,000 in the PPP consortium.

9.2 Subsequently on 26 June 2006 the Education and Policy and Resources Committees agreed to the Council taking a 15% shareholding in Discovery Education PLC with an equity investment of £7,500 of "B" shares (which carry

no rights to dividends) and also to nominate the Depute Chief Executive (Finance) as a Director of Discovery Education PLC.

- 9.3 After being advised late in 2006 that, for reasons related to financial security, the PPP consortium was to be set up with a structure of 3 separate companies, it was necessary to obtain the approval of the Education and Policy and Resources Committees on 15 January 2007 to the Council's equity investment now being made in Discovery Education (Holdings) Limited and to the Depute Chief Executive (Finance) also being nominated as Director of Discovery Education (Holdings) Limited and of Discovery Education (Nominee) Limited.
- 9.4 In January 2007 it was also indicated that the "A" shareholders in Discovery Education (Robertson Capital Projects Limited and PFI Investors Limited [an associate company of Sir Robert Macalpine Limited]) were intending to increase their total equity investment to around £700,000 (albeit it was later revised to £466,500 just prior to financial close).
- 9.5 Although the additional equity investment technically dilutes the Council's shareholding in the PPP consortium, the consortium itself is financially stronger as a result of the investment. While the Council's shareholding could have been increased from £7,500 to £25,000, there was no advantage to be gained by incurring such additional expenditure since the key benefit to the Council of the joint venture arrangements is not related to the amount of the shareholding but rather to the fact that the Council will have a Director on the Boards of the joint venture companies.

10.0 AFFORDABILITY

- 10.1 The affordability of the PPP project was covered in detail in the Final Business Case which was approved by the Education and Policy and Resources Committees on 26 June 2006. It was also reported to the Education Committee on 20 November 2006, that since the first full year of operations under the contract will now be 2010/2011, the revised affordability target for that year would be £9,620,000.
- 10.2 Financial closure included the flotation of the bond to fund the project and the interest rate achieved was lower than had been previously projected. This saving in bond interest rate means that the first full year Unitary Charge (including the estimated cost of energy) will be £9,518,712, being £101,288 lower than the affordability target.
- 10.3 It will be noted from the Scottish Executive approval letter (Appendix 1) that although the total amount of Revenue Support Grant payable is based on the maximum amount previously indicated, i.e. £5.73m x 30 years, the profiling of the grant payment by the Scottish Executive will give the Council an additional £311,657 per annum for 27 years from 2010/2011 with a significant shortfall in funding in the final contract year. The Head of Finance will internally invest this additional £311,657 and this will provide sufficient funding to fund the final year's Unitary Charge in 2037/38.

Variations

- 10.4 It will be recalled that it has previously been indicated to Committee that the eventual level of the Unitary Charge would not be fixed until the last day of construction since construction phase contract variations may also be funded from the Unitary Charge.
- 10.5 Although as much work as possible was undertaken prior to Financial Close to progress the design and construction details of the project, it is inevitable that with such a large construction undertaking (especially over 8 sites), construction phase contract variations will be unavoidable. Indeed, it is normal practice for traditional construction contracts of this scale and at this stage to include a contingency provision of 2.5% of the construction value. However, since the risks under the PPP contract are already allocated between the Council and Discovery Education, it is anticipated that the cost of variations to be met by the Council will be significantly under this level. Examples of typical variations include:
- asbestos removal (following Type 3 intrusive surveys)
 - changes to accommodation requirements
 - transfer of existing fixed equipment to new schools
 - additional school requirements (to be funded from DSM budgets)
- 10.6 Where a variation requires to be met by the Council, the Project Agreement permits the cost of the variation to be paid either as a lump sum or through an adjustment to the Unitary Charge. The latter course would involve the issue of a variation bond and the adjustment of the computer model which calculates the Unitary Charge. Both of these actions will incur additional costs for the Council and accordingly it would be the intention wherever possible to only issue a variation bond when the cost of a variation or a group of variations reaches a pre-determined capital value (still to be finally agreed).
- 10.7 On the other hand, it must be accepted that funding the cost of variations via the Unitary Charge will always be more costly than meeting the cost directly from the Council's own resources, particularly since the project already attracts the maximum amount of Revenue Support Grant from the Scottish Executive. Accordingly, where Council revenue or capital resources permit, it would be advantageous for the cost of variations to be met from identified Council budgets.
- 10.8 In light of the above, the following procedure is proposed for dealing with variations during the construction phase:
- all variations will require the approval of the PPP Project Manager or in his absence the Depute Chief Executive (Finance);
 - all individual variations costing above £50,000 will also require the approval of the Chief Executive or in his absence the Depute Chief Executive (Finance);

- variations will be paid by lump sum and these will be met from the capital receipts generated from the sale of surplus school sites or, where applicable, from school DSM budgets; and
- all variations will be reported retrospectively to the Education Committee for information.

Tayside Contracts

- 10.9 In concluding the financial agreement with Discovery Education, it was necessary to accept that the Council should meet via the Unitary Charge the cost of the Single Status Job Evaluation exercise on Tayside Contracts' cleaning sub-contract with Robertson Facilities Management. Once the evaluation is concluded, Tayside Contracts will recalculate their sub-contract price and agree the revised figure with the Council before passing it to Robertson Facilities Management/Discovery Education for inclusion in the Unitary Charge. The revised price will be subject to validation and verification of the actual costs incurred.

11.0 PROJECT PROGRAMME

- 11.1 The construction dates included in the Project Agreement are:

School	Target Start Date	Target Completion Date
Craigowl PS	March 2007	April 2008
Claypotts Castle PS	March 2007	April 2008
Downfield PS	March 2007	April 2008
St Andrew's RC PS	March 2007	April 2008
Grove Academy	April 2007	October 2009
St Paul's RC Academy	April 2007	November 2008
Fintry PS	February 2008	March 2009
Rowantree PS	March 2008	April 2009

- 11.2 It will have been noted that, although the advance works approved by the Education and Policy and Resources Committees on 26 June 2006 and underwritten by the Council covered only asbestos removal, demolition works and site preparation at 3 primary sites, the construction contractors have remained on site and carried out further works at their own risk.

11.3 Accordingly, assuming that there are no unforeseen difficulties, it is possible that the completion dates for the first phase of primaries may be earlier than indicated above. However, the Council is under no obligation to accept the schools until the dates indicated above.

12.0 CONCLUSION

12.1 Negotiations with Discovery Education PLC have now been concluded and Financial Close achieved.

12.2 This report updates the Committee as to the financial/commercial position achieved at Financial Close.

12.3 The report also proposes a procedure for dealing with contract variations during the construction phase of the project.

13.0 CONSULTATION

13.1 The Depute Chief Executive (Finance) and the Depute Chief Executive (Support Services) were consulted in the preparation of this report.

14.0 BACKGROUND PAPERS

14.1 None

Alex Stephen
Chief Executive

12 March 2007

Anne Wilson
Director of Education

12 March 2007



SCOTTISH EXECUTIVE

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Our ref:

14 February 2007

Dear Mr Stephen,

DUNDEE CITY COUNCIL SCHOOLS PPP PROJECT

I refer to my letter of 22 December 2003 conveying a conditional offer of revenue support at £5.73 million per annum for 30 years (equating to an overall capped amount of £171.9 million) for your school buildings PPP project. This letter provides confirmation of formal funding approval for the project. In considering this matter we have had regard to the Full Business Case and addendum received on 30 June 2006 and 5 December 2006 respectively, the Project Agreement dated 8 December 2006, and the letter from your external auditors, Audit Scotland, dated 22 August 2006.

Revenue Support

The amount of support calculated as due to the Council will be included in the sum allocated to the Council as its entitlement to Aggregate External Finance, in the same way as for conventional loan charges at present. This additional support will then be reflected in the total amount of Revenue Support Grant (RSG) allocated to the Council. As noted in SEED Circular 8/2001, payment of RSG in general is governed by Schedule 12 of the Local Government Finance Act 1992. RSG is unhypothecated: it is paid in general support of the Council's overall budget, forming only one part of the total resources available to the Council.

I can confirm that the PPP Revenue Support for this project will be as shown in the attached schedule. The notional PPP Revenue Support was calculated using the financial information in the form signed by the Director of Finance dated 12 February 2007. The result showed the need for funding higher than the capped annual rate offered in December 2003 and therefore the overall project cap of £5.73 million x 30 (ie £171.9 million) has been applied. A summary of the PPP Revenue Support payments in each financial year is attached.

Revenue Support payments in financial years 2007-08 to 2009-10 inclusive will be adjusted to reflect the phased delivery of the project. Additional payments will be made in financial years 2010-11 to 2036-37 inclusive in order to balance the part payments at the start of the contract.

1.



These amounts of PPP Revenue Support are based on a broadly commercial rate of 8.0631%, this being the prevailing rate at the date of this letter. This rate will be reviewed and the PPP Revenue Support recalculated if the Project Agreement is signed after 31 March 2007.

As indicated in SEED Circular 8/2001, the Scottish Executive reserves the right to rescind the support for a project where a project for which contracts have been entered into fails to proceed, for whatever reason, and to review payments if subsequent changes in the contract or in the contracted payments call into doubt the continuing validity of the original assumptions made in the calculation.

I am copying this letter to Anne Wilson and to Sandy Rosie, Director of the Financial Partnerships Unit, here.

Yours sincerely



COLIN M REEVES



DUNDEE CITY COUNCIL SCHOOLS PPP PROJECT

Financial year ending	Contract year	Redetermined payment (£)	Baseline payment (£)	Spread payment (£)	Total payment (£)
31 March 2008	1	117,449	0	0	117,449
31 March 2009	2	2,555,436	549,603	0	3,105,039
31 March 2010	3	810,630	4,942,155	0	5,552,785
31 March 2011	4	0	5,730,000	311,657	6,041,657
31 March 2012	5	0	5,730,000	311,657	6,041,657
31 March 2013	6	0	5,730,000	311,657	6,041,657
31 March 2014	7	0	5,730,000	311,657	6,041,657
31 March 2015	8	0	5,730,000	311,657	6,041,657
31 March 2016	9	0	5,730,000	311,657	6,041,657
31 March 2017	10	0	5,730,000	311,657	6,041,657
31 March 2018	11	0	5,730,000	311,657	6,041,657
31 March 2019	12	0	5,730,000	311,657	6,041,657
31 March 2020	13	0	5,730,000	311,657	6,041,657
31 March 2021	14	0	5,730,000	311,657	6,041,657
31 March 2022	15	0	5,730,000	311,657	6,041,657
31 March 2023	16	0	5,730,000	311,657	6,041,657
31 March 2024	17	0	5,730,000	311,657	6,041,657
31 March 2025	18	0	5,730,000	311,657	6,041,657
31 March 2026	19	0	5,730,000	311,657	6,041,657
31 March 2027	20	0	5,730,000	311,657	6,041,657
31 March 2028	21	0	5,730,000	311,657	6,041,657
31 March 2029	22	0	5,730,000	311,657	6,041,657
31 March 2030	23	0	5,730,000	311,657	6,041,657
31 March 2031	24	0	5,730,000	311,657	6,041,657
31 March 2032	25	0	5,730,000	311,657	6,041,657
31 March 2033	26	0	5,730,000	311,657	6,041,657
31 March 2034	27	0	5,730,000	311,657	6,041,657
31 March 2035	28	0	5,730,000	311,657	6,041,657
31 March 2036	29	0	5,730,000	311,657	6,041,657
31 March 2037	30	0	5,730,000	311,645	6,041,645
Sub-totals		£3,283,515	£160,201,758	Total RSG	£171,900,000

Notes:

Redetermined payments are lump sum payments at the end of the financial year, relating to schools which have opened during that financial year.

Baseline payments are paid throughout the financial year, and relate to a full year's service delivery for schools.

Spread payments are paid throughout the financial year during those years when all schools are open, and reflect the underspend incurred in the phased opening years.

