

REPORT TO: POLICY & RESOURCES COMMITTEE – 8 DECEMBER 2014

REPORT ON: INVESTMENT IN EAST CENTRAL HUBCO (BALDRAGON ACADEMY)

REPORT BY: DIRECTOR OF CORPORATE SERVICES

REPORT NO: 439-2014

1 PURPOSE OF REPORT

This report outlines the investment opportunity for the Council to invest in the East Central HubCo project to replace Baldragon Academy. The report considers both the benefits and potential risks associated with investments of this nature and make a recommendation on investment decision subject to acceptable outcome of due diligence currently being undertaken.

2 RECOMMENDATION

It is recommended that:

- The risks and benefits of the investment outlined in this report are noted.
- The Director of Corporate Services be authorised to determine the extent of investment by the Council up to an estimated maximum of £822,000 for a period of up to 25 years subject to due diligence.
- The Committee note that the Director of Corporate Services will report back following completion of any investment.

3 FINANCIAL IMPLICATIONS

The investment in subordinated debt is for a term of up to 25 years. This investment would achieve a stable rate of return of no less than 10.0% per annum for the period of investment and will be funded from the Council's reserves. When compared with the current maximum return on 1 year market investments of 1% and in line with the expected anticipated minimum and maximum levels of investment available on the Baldragon project, the differences in the year 1 returns are as follows:

| DBFM Annual Investment Return Analysis In Current Circumstances | | | | |
|------------------------------------------------------------------------|---------|-----------------------------------------------|------------------------------------------------|------------------------------------------------|
| | | 1 Year Market Deposit Rate | DBFM Minimum Project Return | Difference In Return Achievable |
| | | 1% | 10% | |
| Minimum Investment | 594,000 | 5,940 | 59,400 | 53,460 |
| Maximum Investment | 822,000 | 8,220 | 82,200 | 73,980 |

Following consultation with Council Treasury Advisors, it is acknowledged that the standard treasury return achievable will be expected to rise in line with the Bank Rate increases. However, based on historical trends and the current economic outlook, it is not expected that the Bank Rate will average more than 5% over this 25 year period.

4 BACKGROUND

As a participant authority and shareholder within the East Central HubCo (a private limited company established by the Scottish Government, under the direction of the Scottish Futures Trust for the purpose of achieving improved local infrastructure), Dundee City Council have the opportunity of investing in the Design, Build, Finance and Maintenance (DBFM) infrastructure project to replace Baldragon Academy (Report 200-2014, Policy and Resources Committee 19th May, 2014 Article IV refers).

In accordance with the HubCo shareholders agreement, Dundee City Council is invited to invest what is termed “subordinated debt” in the Sub HubCo (a separate subsidiary private limited company established as the special purpose vehicle for individual projects).

The Council's current Treasury Management Strategy (Report 122-2014, Policy and Resources Committee 10th March, 2014, Article IX refers) allows investment in subordinated debt within its scope in the Council's current approved list of permitted investments.

5 INVESTMENT PARTICULARS

5.1 Investment Structure

The Sub HubCo will be funded by the following structure:

- 90% “senior debt” already provided by the banking sector. The status of this debt as having principal creditor status in event of winding up.
- 10% “subordinated debt” funded by HubCo shareholders proportionate to their shareholding. Subordinate debt follows senior debt in terms of payment priority, and in the event of winding up will only be repaid after full repayment of senior debt and only to extent of availability of funds. It is however important to note that holders of subordinate debt have no liability for debts beyond their initial investment.
- <0.1% “pinpoint equity” to ensure identical ownership of the sub-hubco to that of the HubCo:
 - **Private Sector 60%**
Amber Blue (consortium of Robertson Group Ltd., International Public Partnerships Ltd. and Forth Holdings Ltd)
 - **Public Sector 30%**
The 17 public sector bodies within the East Central region
 - **Scottish Futures Trust 10%**

Public Sector Participants can invest not only in their own projects but also those of others in the East Central Territory as each investment opportunity is offered to all participants in equal proportion. If a participant does not wish to contribute then their portion is offered to the other participants, however any individual investment is limited to 3% of overall debt financing.

Any remaining uncommitted public sector subordinated debt is offered in the first instance to the Scottish Futures Trust, and then to Amber Blue, the private sector consortium within the HubCo.

5.2 Term and Return of Investment

The investment has a 25 year time horizon with the principal being repaid at the end of the period. The rate of return of the subordinated debt will not be less than 10% payable to the Council bi-annually. There is also a small proportion of dividend receivable from the Sub HubCo shareholding, however it is not anticipated that the overall blended return would exceed 10.5% per Annum. The cost of the funding will be provided for in the Unitary Charge

payable by the procuring public body (Dundee City Council in the case of the Baldragon project) to the Sub HubCo.

5.3 Investment Opportunity

Although there are a number of projects within the East Central HubCo plan, the only Dundee City Council project currently being undertaken through a DBFM approach is the replacement of Baldragon Academy which will require an investment of between £594,000 and £822,000 depending on the level of funding received from the Scottish Government towards the capital cost of Baldragon.

6 **ISSUES FOR CONSIDERATION**

Due to the nature of the investment, the Council will not have the benefit of the ratings agencies' perspective when determining the relative risks and benefits of the investment. In order to assess matters or issues which require to be taken into account when considering making subordinated debt investments in East Central Hubco DBFM projects an extensive due diligence exercise is being undertaken by an independent third party (Caledonian Economics Ltd) and any investment decision would be on the proviso that the information received in their report as a result of this exercise is acceptable.

There are a number of risks that require consideration prior to investment decision. These are summarised below and will be addressed in the due diligence exercise being undertaken by Caledonian Economics Ltd.

- Scope and duration of investment.
- Governance and conflict of interest
- Investment risks including performance of project and Sub-Hubco, contract termination and liquidity
- Legal and financial status of Sub-Hubco, including any potential risk from change of ownership
- Practicalities of making the investment, including timing, availability and source(s) of funds
- Investment returns, including opportunity to sell investments
- Merit of agreeing cap on size of individual investments and/or total exposure to all sub-debt investments

7 **POLICY IMPLICATIONS**

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

There are no major issues.

8 **CONSULTATIONS**

The Chief Executive and Head of Democratic and Legal Services have been consulted in the preparation of this report.

9 **BACKGROUND PAPERS**

None.

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES

01 DECEMBER 2014