NHS Greater Glasgow & Clyde

Eastwood Health and Care Centre

And

Maryhill Health Centre

Project Bundling Paper

22 May 2014

Contents

1 Proposed Investment

This paper is presented on behalf of NHS Greater Glasgow and Clyde (NHS GGC) to set out the financial efficiencies through bundling the projects to develop a new Eastwood Health and Care Centre and a new Maryhill Health Centre.

These projects are proposed to be bundled into one contract to be provided by hub West Scotland as part of Scottish Governments approach to the delivery of new community infrastructure.

"Eastwood Health and Care Centre"

NHS Greater Glasgow & Clyde presented an Initial Agreement document, '**Proposed Eastwood Health and Care Centre**', to the Scottish Government Capital Investment Group (CIG) on 18 July 2012. It received approval on the 9th November 2012. Subsequently the Outline Business Case (OBC) received approval on 13th August 2013. The final stage of the process is presenting a Full Business Case (FBC) outlining the preferred option in detail for approval by CIG. It was considered by CIG in March 2014.

"Modernisation and redesign of primary and community health services for Maryhill"

NHS Greater Glasgow and Clyde presented an Initial Agreement document, 'Replacement Maryhill Health Centre', to the Scottish Government Capital Investment Group (CIG) in June 2012. It received approval on 9th November 2012. Subsequently the Outline Business Case (OBC) received approval on 13th August 2013. The Full Business case has now been prepared presented by CIG at their meeting in March 2014.

2 Financial Efficiencies through Bundling

The following financial efficiencies, in nominal terms, have been estimated through bundling the two projects. It is noted that there is added complexity of progressing two entirely independent construction sites under one project agreement.

Financial Efficiencies	2015/16	Project Lifetime
	£'000	£'000
Agency Fees	25	265
Due Diligence Costs	32	32
Financial Modelling	30	30
Sub hubco Management Fees	56.8	1,420.8
Input Costs	23	23
TOTAL SAVINGS	**166.8**	**1,770.8**

The savings are analysed in more detail below:

- Agency fees – savings of £10,000 per annum (£250,000 project lifetime) and £15,000 of fees saved during construction

- Due Diligence costs – Where appropriate fees with advisers have been established by hubco based on a bundled scheme. From discussions with hubco and based on the evidence provided, it is estimated that bundling the two schemes has resulted in savings in the region of £32,000 during development.

- Financial modelling – savings in operational model fees of £30,000 have been achieved as a result of the bundling of the two projects.

- sub hubco management fees – the bundling of project will lead to financial efficiencies as costs, especially labour costs, can be spread across the projects. The proforma management fee for each scheme was confirmed at £140,000 but at the New Project Request Stage, a management fee cap of £100,000 per scheme was agreed with sub hubco. As a result of bundling the two schemes, a combined fee of £143,168 was agreed. This equates to an annual saving in comparison to the NPR stage of £56,832 per annum or £1,420,800 over the project lifetime.

- Input Costs - hubco has identified circa £23,000 of net savings on construction costs as a result of bundling.

It should be noted that there is not anticipated to be any savings in the funding margins and fees for bundling the projects, due to the finance product that Aviva offers.

3 The Financial Case – Eastwood and Maryhill

The following sections summarises the bundled financial case for Eastwood and Maryhill Health Centre projects. This sets out the following key features:

- Revenue Costs and associated funding
- Capital Costs and associated funding
- Statement on overall affordability
- Financing and subordinated debt
- The financial model
- Risks

3.1 Revenue Costs and Funding

3.1.1 Revenue Costs and Associated Funding for the Project.

The table below summarises the recurring revenue cost with regard to the Eastwood and Maryhill Health Centre Schemes.

In addition to the revenue funding required for the Eastwood & Maryhill Health Centre schemes, capital investment will also be required for land purchase (including site investigations £1,295k), equipment (£1,131.1K) and sub debt investment (£515.5k). Details of all the capital and revenue elements of the project together with sources of funding are noted below;

Recurring Revenue Costs Table

First full year of operation	2015/16
Recurring Costs	**£'000**
Unitary Charge	**2,349.7**
Depreciation on Equipment	**113.1**
IFRS – Depreciation	**842.4**
HL&P , Rates Domestics etc	**500.6**
Client FM Costs	**43.7**
Total Recurring costs for Project	**3,849.5**

3.1.2 Unitary Charge.

The Unitary Charge (UC) is derived from both the hub West Scotland Stage 2 submission and the Annex D Financial Model Eastwood Maryhill v15 and represents the Predicted Maximum Unitary Charge of £2,349.7pa, based on a price base of April 2013.

The UC will be subject to variation annually in line with the actual Retail Price Index (RPI) which is estimated at 2.5% pa in the financial model. The current financial model includes a level of partial indexation and this will be optimised prior to financial close. The financing elements of the UC are not costs that are subject to indexation.

3.1.3 Depreciation

Depreciation of £113.1k relates to capital equipment equating to £1.139.1m including VAT and is depreciated on a straight line basis over an assumed useful life of 10 years.

3.1.4 HL&P, Rates & Domestic Costs

HL&P costs are derived from existing Health Centre costs and a rate of £22.57/m2 has been used.

Rates figures of £17.69/m2 have been provided.

Domestic costs are derived from existing Health Centre costs and a rate of £20.38/m2 has been used.

3.1.5 Client FM Costs

A rate of £5.29/m2 has been provided by the Boards technical advisors, based on their knowledge of existing PPP contracts.

3.1.6 Costs with regard to Services provided in new Health Centre

Staffing and non-pay costs associated with the running of the health centre are not expected to increase with regard to the transfer of services to the new facility.

3.1.7 Recurring Funding Requirements – Unitary Charge (UC)

A letter from the Acting Director – General Health & Social Care and Chief Executive NHS Scotland issued on 22nd March 2011 stated that the Scottish Government had agreed to fund certain components of the Unitary Charge as follows:

100% of construction costs,

100% of private sector development costs

100% of Special Purpose Vehicle (SPV) running costs during the construction phase

100% of SPV running costs during operational phase

50% of lifecycle maintenance costs.

Based on the above percentages the element of the UC to be funded by SGHD is £2,051.0k which represents 87.3% of the total UC, leaving NHSGG&C to fund £214.7k (9.1%) and ERC the remaining £84.0 (3.6%). This split is detailed below.

UNITARY CHARGE	Unitary Charge £'000	SGHD Support %	SGHD Support £'000	NHSGGC Cost £'000	ERC Cost £'000
Capex including group 1 equipment, development & SPV Costs	1,963.7	100	1,963.7	0	0
Life cycle Costs	222.4	50	87.3	87.3	47.8
Hard FM	163.7	0	0	127.5	36.2
Total	**2,349.8**		**2,051.0**	**214.8**	**84.0**
			87.3%	**9.1%**	**3.6%**

3.1.8 Sources of NHSGG&C recurring revenue funding

The table below details the various streams of income and reinvestment of existing resource assumed for the project.

NHSGG&C Income & Reinvestment	£'000
Existing Revenue Funding – Depreciation	**120.3**
Existing Revenue Funding – HL&P, Rates & Domestic NHSGG&C	**391.6**
Existing Revenue Funding – HL&P, Rates & Domestic costs and GPs contribution	**249.0**
IFRS – Depreciation	**842.3**
Additional Revenue Funding via GPs	**111.2**
Sub-Total	**1,714.4**
East Renfrewshire Council running costs	**153.2**
East Renfrewshire Council unitary charge	**84.0**
Total Recurring Revenue Funding	**1,951.6**

Depreciation
Annual costs for depreciation outlined above relate to current building and capital equipment. The budget provision will transfer to the new facility.

H, L & P, Rates & Domestic
All heat, light & power, rates and domestic budget provision for current building will transfer to the new facility. This is reflected above in the two contributions being NHSGG&C and via GPs.

Additional Revenue Funding
This relates to indicative contributions from GPs within the new facility.

3.1.9 Summary of Revenue position:

Summary of Revenue position	£'000
SGHD Unitary Charge support	**2,051.0**
NHSGG&C recurring funding per above	**1,714.4**
NHSGGC funding from ERC per above	**237.2**
Total Recurring Revenue Funding	**4,002.6**

Recurring Revenue Costs	£,000
Total Unitary charge(service payments)	**2,265.8**
Depreciation on Equipment	**113.1**
IFRS – Depreciation	**842.3**
Facility running costs	**544.2**
ERC recurring costs	**237.2**
Total Recurring Revenue Costs	**4002.6**
Net Surplus/Deficit at FBC Stage	**0**

The above table demonstrates that at FBC submission, the project revenue funding is cost neutral.

3.2 Capital Costs & Funding

Although this project is intended to be funded as a DBFM project, i.e. revenue funded, there is still requirement for the project to incur capital expenditure. This is detailed below.

Capital costs and associated Funding for the Project

Capital Costs	£'000
Land purchase & Fees	**1,295.0**
Site Demolitions	**500.0**
Group 2-5 equipment Including VAT (NHS)	**1,131.6**
Group 2-5 equipment Including VAT (ERC)	**271.1**
Sub debt Investment	**622.4**
Total Capital cost	**3820.1**
Sources of Funding	
NHSGG&C Formula Capital	**1,822.2**

NHSGG&C Capital Plan	**1,120.0**
ERC Capital	**877.9**
Total Sources of Funding	**3,820.1**

3.2.1 Land Purchase

A capital allocation for the land purchase of £1,295k, including the cost of survey fees, has been incorporated in NHSGG&C's 2013/14 capital plan.

3.2.2 Group 2-5 Equipment

An equipment list amounting to £1,402.7k including VAT has been collated for the Eastwood and Maryhill Projects, with NHS GG&C providing £1,131.6k and ERC providing £271.1k. The equipment list is currently being reviewed which will also incorporate any assumed equipment transfers.

3.2.3 Sub Debt Investment

In its letter dated 6th July 2012, the Scottish Government set out the requirement for NHS Boards in relation to investment of subordinated debt in hubco.

"each NHS Board with a direct interest in the project being finance will be required to commit to invest subordinated debt, up to a maximum of 30% of the total subdebt requirement (i.e. the same proportion as the local participant ownership of hubco)".

The full 30% (£622.3k) investment has now been agreed between the participants. The value of investment at FBC stage is £515.5k for which NHSGG&C has made provision in its capital programme. ERC will contribute the remaining £106.8k.

3.2.4 Non Recurring Revenue Costs

There will be non-recurring revenue costs of £213.2k in terms of advisers' fees. These non-recurring revenue expenses have been recognised in the Board's Financial Plans.

3.2.5 Disposals of Current Health Centres

The FBC's are predicated on the basis that the existing Health Centres, which are not fit for purpose, will be disposed of once the new facilities become available. There will be a non-recurring impairment cost to reflect the rundown of the facilities. The Net Book Values as at 31st March 2013 are £2,938.8m. Following the disposals, any resultant capital receipt will be accounted for in line with the recommendations contained in CEL32(2010)

3.2.6 Overall Affordability

The current financial implications of the project in both capital and revenue terms as presented above confirm the projects affordability.

3.3 Financing & Subordinated Debt

3.3.1 hubco's Financing Approach

hub West Scotland will finance the project through a combination of senior debt, subordinated debt and equity. The finance will be drawn down through a sub-hubco special purpose vehicle that will be set-up for the two projects.

The senior debt facility will be provided by Aviva, the remaining balance will be provided by hWS' shareholders in the form of subordinated debt (i.e. loan notes whose repayment terms are subordinate to that of the senior facility) and pin-point equity. It is currently intended that the subordinated debt will be provided to the sub-hubco directly by the relevant Member.

3.3.2 Current Finance Assumptions

The table below details the current finance requirements from the different sources, as detailed in the financial model submitted with hubco's Stage 2 submission.

	£'000
Senior Debt (£000)	20,687
Sub debt (£000)	2,074
Equity (£000)	0.01
Capital Contribution (£000)	5,611
Total Funding	28,372

The financing requirement will be settled at financial close as part of the financial model optimisation process.

3.3.3 Subordinated Debt

In its letter dated 6th July 2012, the Scottish Government set out the requirement for NHS Boards in relation to investment of subordinated debt in hubco:

" each NHS Board with a direct interest in the project being financed will be required to commit to invest subordinated debt, up to the maximum of 30% of the total sub debt requirement (i.e. the same proportion as the local participant ownership of hubco)".

Therefore our expectation is that subordinated debt will be provided in the following proportions: 60% private sector partners, 24.85% NHS Greater Glasgow & Clyde, 5.15% East Renfrewshire Council and 10% Scottish Futures Trust.

The value of the required subdebt investment is as follows:

	NHS GG&C	ERC	SFT	hubco	Total
Proportion of subdebt	24.85%	5.15%	10%	60%	100%
£ subdebt	515,488	106,781	207,423	1,244,538	£2,074,230

NHS Greater Glasgow & Clyde confirms that it has made provision for this investment within its capital programme.

It is assumed the sub-ordinated debt will be invested at financial close, and therefore there would be no senior debt bridging facility.

3.4 Financial Model

The financial model at Stage 2 has been prepared on the basis that Maryhill and Eastwood are bundled together but enables sufficient transparency over the costs relating to each scheme so as to ensure that the model's consistency with the affordability analysis can be monitored and clarity over those savings in relation to bundling are obtained. The key inputs and outputs of financial model are detailed below:

Output	Maryhill
Capital Expenditure (capex & development costs	£26,674k
Total Annual Service Payment	£66,789k
Nominal project return	7.19%
Nominal blended equity return	10.50%
Gearing	90.89%
All-in cost of debt (including 0.5% buffer)	5.11%
Minimum ADSCR[1]	1.150
Minimum LLCR[2]	1.158

The all-in cost of senior debt includes an estimated swap rate of 2.96%, margin of 1.9% and an interest rate buffer of 0.25%. The buffer protects against interest rate rises in the period to financial close. The current (22nd May 2014) Aviva 6% 2028 Gilt is 3.02%, therefore with the interest rate buffer included, the debt is covered.

There is a difference of £24.5k between the Stage 2 capital expenditure of £26,674k and the financial model due to irrecoverable VAT. The financial model has been audited and reviewed by the Financial Advisors as part of the funder's due diligence process.

3.5 Risks

The unitary charge payment will not be confirmed until financial close. The risk that this will vary due to changes in the funding market (funding terms or interest rates) sits with NHS GG&C. This is mitigated by the funding mechanism for the Scottish Government revenue funding whereby Scottish Government's funding will vary depending on the funding package achieved at financial closed.

[1] Annual Debt Service Cover Ratio: The ratio between operating cash flow and debt service during any one-year period. This ratio is used to determine a project's debt capacity and is a key area for the lender achieving security over the project

[2] The LLCR is defined as the ratio of the net present value of cash flow available for debt service for the outstanding life of the debt to the outstanding debt amount and another area for the lender achieving security over the project

A separate, but linked, risk is the risk that the preferred funder will withdraw its offer or that funding will be otherwise unavailable at terms which are affordable. This will be monitored by means of ongoing review of the funding market by NHS GG&C's financial advisers and periodic updates from hubco and their funders of the deliverable funding terms (through the Funding Report). This will incorporate review of the preferred lender's commitment to the project as well. This will allow any remedial action to be taken as early in the process as possible, should this be required. Hubco's financial model currently includes a small buffer in terms of the interest rate which also helps mitigate against this price risk adversely impacting on the affordability position.

At financial close, the agreed unitary charge figure will be partially subject to indexation, linked to the Retail Prices Index. This risk will remain with NHS GG&C over the contract's life for those elements for which NHS GG&C has responsibility (100% hard FM, 50% lifecycle). NHS GG&C will address this risk through its committed funds allocated to the project.

The affordability analysis incorporates that funding will be sought from GP practices who are relocating to the new health centre. This funding will not be committed over the full 25 year period and as such is not guaranteed over the project's life. This reflects NHS GG&C's responsibility for the demand risk around the new facility.

The project team will continue to monitor these risks and assess their potential impact throughout the period to financial close.

4 Bundled Programme

The programme for the projects is currently anticipated as follows:

Eastwood Health & Care Centre - Project Phases

CIG Meeting for FBC	**11 March 2014**
Financial Close	**28 May 2014**
Start on site	**12 May 2014**
Completion date	**October 2015**
Services Commencement	**September 2015**

Maryhill Health Centre- Project Phases

CIG Meeting for FBC	**11 March 2014**
Financial Close	**28 May 2014**
Start on site	**12 May 2014**

Completion date	**July 2015**
Services Commencement	**July 2015**

The clear similarity of intended timescales compliment the financial benefits detailed above and align fully with the proposed to bundling of the Eastwood and Maryhill projects.

5 Conclusion

NHS GGC & East Renfrewshire CHCP have~~s~~ carried out a complete, evidence based review and analysis of the existing and future health requirements of the current users of health facilities in the Eastwood area of East Renfrewshire and Maryhill in Glasgow. The Outline Business Case and the Full Business Case represents the collective input of the CHCP/CHP, the Clinical and Community Staff at existing health facilities, their advisors and a wide variety of consultees and stakeholders.

The current facilities for patients, staff and visitors in the current sites area are inadequate. The facilities do not comply with various statutory requirements including Disability Discrimination Access (DDA). The existing buildings currently fail to meet modern healthcare standards, in terms of functional requirements, special needs, and compliance with current clinical guidance, fire regulations and infection control measures. Accommodation tends to be cramped and is characterised by inadequate GP consulting rooms, limited community staff accommodation and overcrowded/ noisy waiting areas. Furthermore, there is a significant backlog in maintenance. The plant and equipment are well beyond their design life, and hence are inefficient in terms of energy use and carbon footprint.

Benefits of Bundling

This paper clearly demonstrates the significant efficiencies that result from bundling the two facilities and as a result this is the recommended approach as reflected in the Business Cases.