



Mutual Investment Model

Question and Answers for Local Authorities and Colleges

9 March 2017

Introduction

During the recent briefing meetings with Local Authorities and Colleges on the Mutual Investment Model, a number of questions were raised. These have been collated and answers provided.

Questions raised during the Local Authority/ College MIM meetings

1. Is the £500m ring fenced for education only buildings?

Welsh Ministers have committed to boosting the level of investment in the education estate by £500m; as a capital build value. This will be funded via revenue over a long-term period.

This is not a £500m pot of ring-fenced funding, but Ministers have made the commitment to provide the revenue to support Welsh Government's funding contribution to this additional investment.

The projects which fulfil the criteria of the 21st Century Schools and Education programme will be eligible to be considered as part of the MIM pipeline; although consideration must be given the specific schemes and whether they are more or less suited to this type of procurement route.

2. Why can't the revenue be used for LGBI as before?

The Local Government Borrowing Initiative (LGBI) enhanced the Band A programme to ensure schools could be delivered swiftly. We have reviewed the success of this funding instrument; both in education and highways.

The main challenge and risk with this type of instrument is the classification of the borrowing. The £340m provision from two LGBI schemes has provided a welcome boost to infrastructure in education and highways and we are also exploring a similar instrument for the Coastal Risk Management Programme (CRMP). We believe that this level of LGBI – that is, up to around £500m – is broadly sustainable.

HM Treasury – who have responsibility for government budgeting rules – are keeping a close eye on these types of funding instruments. Terminations of historic PFI deals across a small number of Local Authorities, when PFI Credits are still being paid, are also drawing attention. The current level of risk with the LGBI is manageable; however, we don't want this risk increasing and will not be pursuing further LGBI investments at this time.

3. What other revenue options have been considered?

As well as LGFI, or similar instruments, we have explored a range of different Public Private Partnership (PPP) arrangements. You may recall that in 2014, the then Minister for Finance and Government Business (Jane Hutt), announced that Welsh Government would be adopting the Non-profit Distributing (NPD) model to deliver the three PPP schemes. NPD has since been determined as unacceptable in classification terms and therefore the Welsh Government has devised a new 'off balance sheet' model – MIM.

Welsh Government will also have access to direct borrowing powers from 2018-19. However, Cabinet has committed to using these funds for development of the M4 relief road and, based on the funding profile and the annual limits of borrowing, this option is exhausted.

4. Outline the main differences between PPP,PFI,MIM

MIM and PFI are forms of private public partnerships (PPPs). The key differences between MIM and PFI are:

- *The Mutual Investment Model includes important obliging long-term provisions to secure community benefits; create apprenticeships and training places for Welsh workers and for sustainable development, in which the private partner to support delivery of the Well-being of Future Generations Act. It incorporates our commitment to an ethical employment code and allows us to maximise the benefits of our sustainable procurement practices.*
- *The model also enables the government to exert influence over the chosen private partner to ensure the public interest is protected. Where we invest in schemes this influence will be exercised by a Public Interest Director, an important advance on what has been secured in other public private partnership models. This ensures robust transparency in terms of access to Board-level information, alongside a range of reserved matters to protect public funds and the public interest.*
- *The MIM removes 'soft' services, such as cleaning and catering, from these contracts, which led to expensive, inflexible contracts and was a real bone of contention in the old PFI model;*
- *It embeds transparency – about costs and performance – and the requirement to review efficiency, effectiveness and performance every two years;*

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- *It removes equipment, which can be funded more efficiently from public capital; Under its terms, private sector partners will take on risks associated with building, financing and maintaining public infrastructure. But unlike historic PFI deals, our model allows the public sector to share in the profits. It also ensures transparency about costs and performance, with a requirement to review efficiency, effectiveness and performance every two years.*
5. Why is MIM value for money? WG need to provide justification for LA that this is value for money

Firstly, let's be clear that a lot more can be done on capital builds to deliver value for money. The current position is not a perfect example of value for money and we can work together to explore the different efficiencies which can be exploited to deliver a greater number of quality assets with the funding available.

That said, we need to ensure that any alternative approach is not disproportionately expensive. One of the important principles of a Public Private Partnership (PPP) is the long-term view and considering an asset not as an upfront build cost, but also about maximising the life of the asset.

It's very difficult to compare like-for-like as the maintenance cost for assets varies across different projects. Nonetheless, when we take a benchmark for maintenance and lifecycle costs, the outcome gives an indication of the amount we should be paying under a PPP contract; as it is the same service delivered under a long-term contract.

One of the other important elements to factor in is the risk transfer. Under PPP, or MIM, contracts, a number of risks are transferred to the private party to bear. This comes with a price, but means the authority is not expected to rectify issues with the asset; such as a leak on the site which is causing damage. The transfer of risk must be considered as a value. All MIM schemes must undergo a Public Sector Comparator (PSC), which involves understanding where the value lies in a capital versus a PPP project.

6. Have the Wales Audit Office been involved and what are their views?

The ONS are responsible for the classification of government accounts in the UK. We have worked closely with the ONS (as well as Eurostat, the European PPP Expertise Centre (EPEC), and the Scottish and UK Governments) in developing the Mutual Investment Model. We formally consulted the ONS with our policy proposal, which culminated in an off balance sheet decision for the model. Specific schemes will also need to undergo this assessment; ensuring the project specific changes have not departed from acceptable parameters.

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The new assets will be on balance sheet from an IFRS perspective, but off balance sheet from an ESA2010 (national accounts) perspective.

The Wales Audit Office have not been involved in the MIM programme, although have been involved in considering expenditure on the Band A programme. It is anticipated that they will take a similar level of involvement in the Band B programme.

7. Why can't the money be used to buy out existing PFI contracts?

It's important to remember that this £500m represents a capital build value and is not a pot of money which the Welsh Government is looking to spend.

The Welsh Government is committed to investing in infrastructure to ensure economic growth and sustainability across Wales. The availability of capital funding in Wales has fallen substantially over recent years (21% from 2009-10 to 2019-20) and the MIM pipeline represents one of the instruments developed to provide additional investment.

This funding is not to terminate existing PFI contracts and they remain the responsibility of Local Authorities to manage (including funding the termination costs, if considered appropriate).

8. What is in the inflation rate?

We have put together a model which sets out the indicative cost. Part of the model (around 25%) has been inflated to reflect the cost of the maintenance and lifecycle services over the 25 yrs. of the contract. RPI (all items has been used as the inflation index).

9. Is there a financial model for authorities to understand indicative costs?

A financial model is being developed to enable authorities to consider the indicative costs of a MIM project, whether a primary or secondary school. This will be high level showing indicative costs based on varying intervention rates. As projects are developed the costs will be refined and detailed within the financial model inputs needed for the OBC. When authorities/colleges propose projects for MIM funding we will model the costs in detail with the relevant authority/college during the OBC development process.

10. Would having a scheme under MIM affect your capital allocation?

Programme funding will be prioritised and based on needs, such as condition and sufficiency. If you choose to fund a scheme through the Mutual Investment Model, it is likely that this will reduce your need for capital. However, if you choose not to use this form of funding, you will not be penalised through capital budget allocations.

11. Why can't authorities and WG come together to borrow money?

The Welsh Government is only shortly due to receive the power to borrow for infrastructure (above and beyond existing budgets). This £500m funding, which is due to rise to £1bn in 2019-20, has an annual draw down of £125m. Welsh Ministers have considered which schemes are suitable to be funded via the direct borrowing programme. The majority of the funding has been earmarked for the M4 relief road which is currently undergoing public consultation. Therefore, the Welsh Government does not have any capacity to borrow further at this time.

12. Will the intervention rate be the same across authorities?

Work is being undertaken to provide options in respect of the grant intervention rate for discussion by Senior Officials and decision by the Cabinet Secretary. At present, it is assumed that there will be two intervention rates: one for schemes funded using capital; and one for schemes using revenue. At present, it is not planned that grant intervention rates will vary between Local Authorities / Further Education Institutions, although consideration will be given to a rate that is affordable for all. This will be balanced with the need for investment.

13. How will the funding work for faith schools?

Faith Schools have a higher intervention rate than other schools and colleges in Wales, and are funded at 85% when using capital. This will be a consideration when work is undertaken to establish the grant intervention rate for capital and revenue projects.

In respect to Faith projects funded through the Mutual Investment Model, there are a number of additional issues to be considered, including land ownership etc. This will not preclude Faith schools from being included in the Mutual Investment Model batches however it will need to be examined to make sure that value for money is maintained.

14. How are foundation schools treated?

Because of the different arrangements regarding the ownership of the asset and the ownership of the land, together with where the maintenance obligations sit, we will need to have specific legal wording in the standard contract and supporting documents to deal with the legal arrangements for foundation schools

15. Why is maintenance included?

It makes sense that we require the contractor who designs and builds the facility to maintain it as this will encourage the contractor to consider the whole life cost of the facility. Maintenance is a service that meets their skill set unlike something like cleaning or catering, for example.

The public sector will not start paying for the project until it is ready to move into the facilities and then the payment will be divided out over a long period. This means that the bank debt will not be fully paid back until the later end of the contract period. The bank will want to know that the facility has been maintained as per the service specification so that it gets its money repaid, without multiple deductions and that were something to go wrong, the facilities and the cost of the maintenance remaining would be attractive to other contractors so that the service would continue

16. What is the level of fees for professional services for this type of contract?

For each batch technical, financial, legal and insurance advisors will be required. When we have tranches of projects we can be more specific on what the level will be. Welsh Government has appointed legal and financial advisers for MIM projects and will shortly advertise for technical advisers. The intervention rate will include assessment of the costs associated with development of the OBC and procurement process. It is important that, when appointing and managing advisors, there is clarity in scope and requirements to ensure costs are minimised.

17. How will the fees be paid?

How the fees are afforded will be considered as part of the discussion on the intervention rate and what it will cover.

18. Will one SPV cover all authorities in a batch?

Yes, the successful bidder will form one SPV which will cover all the authorities in that batch

19. How will colleges and VAT be treated?

The Unitary Charge (payable by the relevant authority to the SPV) will be VAT at the prevailing rate (currently 20%). In calculating the Unitary Charge VAT implications will be assessed based on the costs being incurred by the SPV. The majority of VAT costs will be reclaimable, so will have limited impact on the Unitary Charge calculation (other than potentially some timing implications of when VAT is paid and when it is reclaimed).

The detailed treatment of costs, and relevant tax treatment will be incorporated into the detailed financial modelling undertaken within the OBC.

We are aware of the different VAT treatment for colleges and the cost of VAT will be included in the cost of the services (i.e. Design, Build, Finance and Maintain) for the colleges

20. What is the SPV set up and how much does it cost to run?

The SPV will be a new entity, set up specifically to deliver the batch of projects. This will be formed by the successful bidding consortia with WG having the option to invest in some of the equity. The SPV will be responsible for the delivery of the schools/colleges and their ongoing maintenance to the standard set out in the Project Agreement. There will be a cost associated with the management and governance of the SPV: for example resource costs, finance costs and directors costs and including costs associated with fulfilling statutory obligations (such as audit compliance). At this stage the SPV costs are not known. An assumed cost will be included within the OBC modelling so that the affordability implications can be addressed. Each bidder will include SPV costs, and associated resources, within their bid models. It is important that these costs are reviewed and negotiated during the competitive dialogue process to ensure that they fully reflect the work that the SPV will be undertaking throughout the contract life, and not over exaggerated.

21. Will it be possible to build buildings larger than a standard school and how will this be funded? i.e. child care provision

Yes, we want to actively encourage co-location of services and flexible use of assets. However, the 21st Century Schools and Education Programme funding will typically only cover the construction cost of the school / college

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rather than additional space.. Any projects included by an authority that includes additional space for other facilities would need to speak to budget holders in Welsh Government responsible for funding the additional facility. We suggest that you speak in the first instance to Kathryn Massey or Mark Williams who will put you in touch with the appropriate officer. Applications will be looked at on a case by case basis and where additional budgets are available e.g. for childcare, we will look to access available funding support.

22. Do we have to partner neighbouring authorities?

If an Authority/college proposed a batch of schemes (in the case of an authority and a high value scheme in the case of a college or an authority/college in the same area proposed schemes with a high value then that could be considered as a single tranche. It is more likely that we will need to involve more than one authority in a batch.

23. Could WG help broker decisions across boundaries?

WG would be willing to work with authorities where specific help was requested.

24. How are WG going to encourage cross boundary working?

Cross Boundary working already takes place, for example through the Waste Infrastructure Programme and Regional Consortia. Greater cross boundary working will be encouraged in the 21st Century Schools and Education Programme generally. However, this is particularly important in respect to the effective working of the Mutual Investment Model, which is more likely to require cross boundary working ensuring that batches are of sufficient size to be of appeal to the private sector.

When we speak with authorities and colleges we would like your views on which authorities/ colleges you already have experience of working with.

25. What resources will be available and how will resources be funded before the start of Band B?

We will provide specialist resources from Welsh Government to assist in project development in respect of the Mutual Investment Model. Firstly to work with authorities / colleges who need more information about the MIM approach and how much it would cost and secondly, during the scoping of the tranches of projects. This support will continue throughout the OBC, and procurement. We have not yet decided what resources will be available centrally post contract signature

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26. Who will sign the contract?

There are various options for this and we will seek your views. There could be a lead authority / college which signs the contract. The lead authority/college would then have separate agreements with the other authorities/colleges in their tranche. This type of arrangement has been adopted in the residual waste programme. There could be a single contract which is signed by all authorities/ and colleges.

27. What is the incentive to use the model?

The indicative demand for investment in the educational sector is likely to far exceed the available capital budget. This means that Local Authority and Further Education projects will need to be prioritised, based primarily on condition, sufficiency etc.

The funding available via the Mutual Investment Model offers an opportunity to increase investment in the sector. The incentive to use the investment is twofold: It provides an opportunity to fund additional work during the Band B Period, which would otherwise be put on hold pending funding availability; and due to the way it is funded, it spreads the cost of investment over a longer period, reducing the impact on capital budgets.

28. Will there be any capital available for Highways work? – could effect education budgets.

In terms of funding for roads as part of school projects, the same eligibility rules apply to MIM schemes, as they do to the wider 21st Century Schools and Education Programme.

Capital funding has been made available to the Cabinet Secretary for Economy and Infrastructure – who has responsibility for roads – and the priorities for this funding have been set out. It is worth noting there is a highways project – dualling of the A465 at sections 5 & 6 – within the MIM pipeline.

29. How are the ongoing contract management costs funded?

We would expect authorities and colleges which receive MIM funding to budget for contract management costs. No decision has been made as to how contract management will be organised. This is something which we would like your view on. Economies of scale could be realised by having one contract management team to manage the tranches of projects receiving MIM funding, for example or you could manage each tranche separately. It is

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important that there is a properly skilled contract management team in place in order that the public sector receives the services which they are paying for through the MIM contract.

30. How will the money be paid to authorities?

Whilst we do need to further consider this point, given the specific nature for which the funding is being provided and as Local Authorities will be under contract to make the Unitary Charge payments in return for availability of the assets, it would seem most appropriate for funding to be transferred via a special grant.

We are happy to discuss this further with Local Authorities.

31. Could the money be paid by special grant rather than in settlement?

See above.

32. Concerns about future accounting procedures, how will this be mitigated?

We can not control changes which might occur due to future accounting processes, we can only comply with the rules which are in place at the time in which we are developing the scheme and up to contract signature. Under the current arrangements, we have received confirmation that the approach we have taken for the MIM as enshrined in the standard documents we have developed have received an off balance sheet classification for the Welsh Government.

The new Mutual Investment Model has been carefully designed to promote the public interest and protect the public pound. We have worked closely with statisticians at Eurostat and the Office for National Statistics and with experts at the European Investment Bank for more than a year to secure this model and to make sure it delivers the benefits for Wales.

33. Where is there a similar model to MIM for visits, information?

The MIM model has been specially created for Welsh Government therefore the contract documents are specific to MIM. There are examples of PPP projects in Wales where a design, build, finance and service model has been used. For example, in Scotland the Non Profit Distributing Model (NPD) approach was used although the model included the letting of some soft services such as cleaning, in the contract, but you can see the buildings which

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were built and their condition. In both the republic of Ireland and Northern Ireland there are schools / college which have used the PPP model. Again these include “soft services”. In England, the Priority Schools programme has used this approach to procure new buildings – the schemes are under construction at the moment. Under the Priority Schools Programme, the Education Funding Agency procured centrally on behalf of schools – unlike Wales, England has Free Schools and Academies.

34. If authorities and colleges are interested in applying for funding through MIM, we can arrange for a Q and A session with stakeholders who have used the PPP model and visit the facilities. It is fair to say that it will depend on what specification we write for the services as to what we will get back in terms of services and facilities.

Should you have any further questions or queries on the Mutual Investment Model please contact one of the team below.

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