

HERTFORDSHIRE COUNTY COUNCIL
CABINET
MONDAY 18 DECEMBER 2017 AT 2:00PM

<u>Agenda Item</u> <u>No:</u> 9
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**SALE OF THE AUTHORITY'S SHARE OF HERTFORDSHIRE SCHOOLS'
BUILDING PARTNERSHIP**

Report of the Director of Resources

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Executive Member: David Williams, Leader of the Council (as responsible for the Resources, Property and the Economy portfolio)

1. Purpose of report

1.1 To enable Cabinet to consider the Council's options in relation to its future shareholding in the companies associated with the Hertfordshire Building Schools for the Future ("BSF") programme, including a proposal for the sale of the County Council's share of such companies. The relevant companies being:

- Hertfordshire Schools Building Partnership Limited, a private limited company registered in England (registered number 07431413) (the "LEP"); and
- Hertfordshire Schools Building Partnership Phase 1 Holdings Limited, a private limited company registered in England (registered number 07431404) (being "HoldCo") which is the 100% owner of Hertfordshire Schools Building Partnership Phase 1 Ltd a private limited company registered in England (registered number 07434218) (being "ProjCo" and, together with the LEP and HoldCo, the "companies").

2. Summary

2.1 This report summarises the Council's options in relation to future shareholding in the companies, including a proposal for the sale of the Council's shares of the companies.

2.2 At the time of investment in the companies it was anticipated that it would be used to deliver significant construction through the BSF programme. With the ending of the programme by the Government in 2010, only those schemes which had reached financial close went ahead. The companies have been used to deliver 15 projects but a shareholding in the companies is not fundamental to the ongoing operation of the County Council, and does not

have a strategic fit with other developments such as Herts Living Ltd. Also, given the overarching need to review the structure for County Council's company holdings, this is a helpful simplification of those holdings.

3. Recommendations

3.1 The Resources, Property & the Economy Cabinet Panel will consider a report on this item of business at its meeting on 15 December 2017. The Panel will be invited to recommend to Cabinet *"That Cabinet::*

i. agrees and authorises the sale of the County Council's minority shares of 20 shares in the LEP and 180 shares in Hertfordshire Schools Building Partnership Phase 1 Holdings Limited for the total sum of £1.745m to Building Schools for the Future Investments LLP ("BSFI"); and

ii delegates to the Director of Resources and Chief Legal Officer authority to finalise the terms of the sale of the shares of the companies, and the approval to agree the Sale and Purchase Agreement, and all other required legal documents and for the Chief Legal Officer to execute the required legal documents relating to the sale."

3.2 The Cabinet Panel's recommendation/s to Cabinet will be reported orally at the Cabinet meeting and circulated to Members in the Order of Business sheet.

4. Background

4.1 On 29 November 2010, Cabinet agreed recommendations that the Council forms a Local Education Partnership with Balfour Beatty Education and that the Council establishes with Balfour Beatty Education a joint venture company - Hertfordshire School Building Partnership Limited ("HSBP", or the "LEP"). In addition, two further companies were established: Hertfordshire Schools Building Partnership Phase 1 Holdings Limited ("HoldCo"), and Hertfordshire Schools Building Partnership Phase 1 Ltd ("ProjCo", being a wholly-owned subsidiary of HoldCo). This related to the delivery of the BSF programme where the Department for Education ("DfE") prescribed that a local delivery partnership must be formed as the delivery vehicle for the BSF programme. Balfour Beatty Education were the successful contractor chosen following an EU compliant procurement process to form the delivery partner for the Private Finance Initiative ("PFI") contract to rebuild Marriotts and Lonsdale School, a design and build contract for the expansion of Nobel School, including an ICT and Facilities Management contract. In addition, a strategic partnering agreement was entered into between the County Council and HSBP. The PFI special project vehicle ("SPV") formed to hold the PFI contract in relation to Marriotts and Lonsdale was HoldCo.

4.2 The intention of the joint venture with a private partner, as detailed above, was that each local authority, as a stakeholder in their local delivery partner, would plan a co-ordinated renewal of their entire secondary schools estate through

BSF. Whilst large parts of the BSF programme were cancelled in 2010, the first phase of the programme in Hertfordshire was sufficiently far advanced to receive funding, and in consequence the standard delivery structure needed to be put in place. Beyond that, it was still felt to be beneficial for the Council to be a stakeholder in the joint venture:

- To work with the Council to support low cost delivery of future programmes of school building.
- To support a partnership approach to project development.
- To complement and support the Council's efforts to attract additional capital funding from the government.
- To act as an additional framework-type service provider.

4.2.1 There were also financial benefits to the Council from holding a share in the joint venture which are discussed in more detail in section 6 of this report.

4.3 The original (DfE) model for the joint venture was of shares of 80% with the Private Sector Partner, County Council (10%) and Building Schools for the Future Investments (the governments delivery arm for the BSF programme) (10%). As the government chose not to exercise its rights in investing in the joint venture, the Council chose to exercise its option taking a 20% share. As a consequence of this, the Council now owns directly or indirectly a 20% stake in both the LEP and HoldCo.

4.4 Financial close in the project was reached in January 2011 with senior debt being supplied by Aviva Insurance – whilst this gave a slightly lower interest rate from the beginning of the project there is no option to re-finance which is often the case in PFI projects. Balfour Beatty and the County Council as owners of the companies were also required to provide sub debt and this was done on 30 August 2012. The investment in the companies by way of shares was £198, the County Council's share of this was £38 (200 shares) (£20 in Hertfordshire Schools Building Partnership Limited, £18 in Hertfordshire Schools Building Partnership Phase 1 Holdings Ltd and nil in Hertfordshire Schools Building Partnership Phase 1 Ltd).

5. Balfour Beatty's sale of their interest

5.1 Balfour Beatty notified us of their intention to sell their shares in the companies in June 2016. In line with the shareholder agreement Balfour Beatty offered their stake in the companies to the Council at a value of between £8.5 - £9m. The Council decided not to exercise this option given that is not fundamental to its ongoing business. The sale was made to BSFI, a specialist infrastructure firm who focus on such long term investments. BSFI is a subsidiary of International Public Partnerships Limited ("INPP") an infrastructure investment fund listed on the London Stock Exchange which is managed by the Amber Infrastructure Group ("Amber"). INPP's investment in BSFI is managed by Amber.

5.2 Amber has subsequently approached the Council to assess whether it would be interested in selling the minority interest in the companies to BSFI. This

paper sets out details of the offer from BSFI and the considerations in reaching a decision.

6. Education business case

- 6.1 Whilst the Council has commissioned HSBP to design and build a number of schools since 2011 alongside the Building Schools for the Future programme, they have not been used exclusively for the delivery of the schools building programme. This is because the HSBP building construction is better suited to new build rather than the pattern of refurbishment and extension that applies to the majority of the programme. However, including the original BSF projects, a total of about 15 distinct projects have been procured via HSBP, in circumstances where our analysis has been that it is the most beneficial procurement approach. Construction works, other than those through HSBP, are let through the property construction frameworks. Latterly, no new projects have been let to HSBP due in part to the decline in the scale of the primary expansion programme and the nature of the projects we have undertaken. Secondary expansions tend to be delivered by the schools themselves rather than via the Council.
- 6.2 Going forward we would wish to continue to have HSBP available as a procurement and delivery route for new schools, to complement other frameworks and to be used in those circumstances where it seemed most beneficial. This is not precluded by the sale of the authority's interest in the companies, given the long term nature of the strategic partnering agreement with HSBP. There is an argument that the existence of the JV gives us visibility of the costs and some of the risks involved in the HSBP route and, all other things being equal, would be an argument for retention of our interest. However, it is not of itself a conclusive argument, and indeed the Council has always been careful to ensure there is clear separation between its role in managing its ownership share in the companies (exercised through appointing the Assistant Director Finance as a Director) and the procurement decisions for schools works undertaken within Education.

7. Legal Considerations

- 7.1 The Council issued an OJEU notice on 7 April 2009 in relation to the BSF programme. That OJEU included the ability to create a long term strategic partnering relationship between the County Council and the companies created by the BSF programme. This was all concluded in accordance with the applicable EU procurement rules (via competitive dialogue), and led to the creation of the companies. In accordance with the procurement, HSBP and Hertfordshire County Council entered into the strategic partnering agreement ("SPA") on 14 January 2011 for the delivery of improved education facilities and services in the County Council and associated community infrastructure & accommodation. Whilst the SPA was created with the purpose of delivering schools, the OJEU and procurement was not limited to education buildings only. HSBP as a delivery vehicle therefore is potentially wider in scope.

- 7.2 This has enabled the Council to deliver successful construction to schools in Hertfordshire. The SPA is for a period of 10 years (until 2021) and has the option to be extended for an additional five years.
- 7.3 As part of setting up HSBP a Shareholders Agreement dated 14 January 2011 was originally entered into between Hertfordshire County Council, Balfour Beatty Education Limited and HSBP, (as set out in this report BSFI purchased the shares to replace Balfour Beatty). This agreement includes the right for the Council to sell its shareholding, and give first rights to purchase such to BSFI.
- 7.4 If, as set out in the recommendations of this report, Cabinet permitted the sale of shares in the companies, the SPA would continue in operation, as there are no requirements in the SPA to terminate due to changes in shareholders of the companies.

8. Financial Considerations

- 8.1 As set out in paragraph 4.4 one of the obligations of the shareholders was to provide sub debt and the Council's share of this was £903k (from a total sub debt of £4.5m) which was invested on the due date. The LEP financial model signed off at financial close estimated a real investment rate of 11.00% on this sum.
- 8.2 Up to 31 March 2017, the Council have received repayments of £46k plus interest of £414k on the sub debt, which leaves an outstanding balance of £857k.
- 8.3 Over and above this the Council has received dividends of £249k. This reflects the profitability of the project between the unitary charge (made up of the PFI credits and schools contribution) and management, maintenance and lifecycle costs. The Council contributes to the operation of the company through participation of an officer appointed Non-Executive Director(s) at the HSBP Board which meets on a quarterly basis. This contribution is estimated at no more than 5 days per annum for each Director. Whilst the current constitution allows for two Hertfordshire appointed Directors, only one of these positions is currently appointed to.
- 8.4 Given the size of the Council's holding (20%) there is not a ready market for sale of the shares. Any price is therefore based on an assessment of likely net funding streams to the close of the contracts for those schools in 2036, discounted to current prices. Over 60% of the income is relatively fixed as it relates to repayment of the loan; the balance is in respect of dividends from profits made on the effective operation of the management and maintenance. Based on the option offered to the Council for sale of Balfour Beatty's shareholding, the initial assessment of the minimum price the Council could expect to receive was estimated to be £1.8m.
- 8.5 Following ongoing dialogue and negotiation, Amber made a best and final offer of £1.905m in early March for the sale of the Council's interest. This is

based on a discount rate of 6.05%, which compares favourably with the standard treasury rate for PFIs of 6.09%. Since the original offer, the Council has received two further payments totalling £191k. Receipt of these means that some of the original offer has effectively been paid. Alongside this there are some interest adjustments, so the cash settlement sum reduces to £1.745m. Further detail is set out in the table below:

	Received to date	Future returns	Total Return
	1.4.2010-30.09.2017	1.10.2017-30.9.2045	
	£'000	£'000	£'000
Loan Stock Interest and Capital Repayments Forecast	553	2,234	2,787
Forecast Dividends	337	1,310	1,647
Total Forecast Investment Returns (if the authority continues to hold the investment)	890	3,544	4,434
Discounted Investment Returns @6.05% - Amber offer	890	1,745	2,635

8.6 Although the projected rate of return of 11% referred to para 8.1 above, along with the current cash value of the returns, seems attractive, the following should be noted:

- The cash value of the returns diminishes each year. This is because an element of the payments relate to interest on the initial investment. As this investment is repaid, the interest payments reduce
- A significant element of the future dividends (over £1m) are paid in the final three years of the partnership (2035 to 2037). This is in case any financial liabilities materialise in the project, in which case the dividends might not be received (see 8.8 below).

8.7 At the time investment in HSBP the risks to the Council from its shareholding were assessed to be relatively low. These primarily relate to:

- Performance deductions through unavailability etc. – these risks have been passed back to sub-contractors and are still assessed as low.
- Energy volume use – price risks are passed back to the school but the consumption risk remains with the company
- Lifecycle cost to maintain the facility to its build quality – a fund is set aside based on an assessment of maintenance costs over the contract period. These costs have the potential to increase over the contract period for unanticipated items.
- Other costs such as insurance, legal and audit exceeding inflation assumption.

8.8 There is nothing to suggest that any of the risks on these areas have changed fundamentally since the initial investment. However, sale of the shareholding would mean that the Council would no longer be subject to these risks particularly in relation to a contract that runs until 2037 (the one exception is that the Council wishes to take back utilities procurement (and the associated

risks and benefits regarding consumption) and plans are in motion to effect that).

- 8.9 From the £1.745m proceeds, the Council would first need to pay down the outstanding debt on the balance sheet. This is currently £0.8m, leaving £0.945m net proceeds for the Council. As this relates to rolled up interest and dividends, this would be revenue funding. It is suggested that the Council would consider using this to help drive transformation and generate further benefits for the Council.

9. Equalities Implications

- 9.1 When considering proposals placed before Members it is important that they are fully aware of, and have themselves rigorously considered the Equality implications of the decision that they are making.
- 9.2 Rigorous consideration will ensure that there is a proper appreciation of any potential impact of that decision on the county council's statutory obligations under the Public Sector Equality Duty. As a minimum this requires decision makers to read and carefully consider the content of any Equality Impact Assessment (EqIA) produced by officers.
- 9.3 The Equality Act 2010 requires the County Council when exercising its functions to have due regard to the need to: (a) eliminate discrimination, harassment, victimisation and other conduct prohibited under the Act; (b) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it and (c) foster good relations between persons who share a relevant protected characteristic and persons who do not share it. The protected characteristics under the Equality Act 2010 are age; disability; gender reassignment; marriage and civil partnership; pregnancy and maternity; race; religion and belief, sex and sexual orientation.
- 9.4 An EqIA has not been completed in relation to this report.

Background papers

Report to the Resources, Property and the Economy Cabinet Panel, December 2017

<http://cmis.hertfordshire.gov.uk/hertfordshire/Calendarofcouncilmeetings/tabid/70/ctl/ViewMeetingPublic/mid/397/Meeting/767/Committee/104/Default.aspx>