

# BSF – Financing issues

**Paul Rowan** and **Richard Clancy** at DWPF Ltd, discuss the financing issues in respect of the Building Schools for the Future (BSF) programme...

**T**hrough its BSF programme, the Government seeks to invest circa £2bn pa as part of its capital investment programme to rebuild or refurbish every secondary school in England. Of the £2bn pa, some 50% is expected to be covered by PFI credits. Such an investment programme presents both significant challenges and huge opportunities.

By way of a recap, BSF envisages the following corporate structure where the newly incorporated Local Education Partnership (LEP) facilitates three types of contract with the Local Authority (LA), resulting in payments being made:

- in the case of a PFI project, to a ring-fenced SPV undertaking the design, build, operate and maintenance obligations of a PFI project, ie. a unitary charge supported by PFI credits;
- for traditionally procured design and build projects (D&B), against verified expenditure on milestone dates; and
- for ICT projects, per D&B above.

## Funding

We believe that bespoke funding solutions will be required by the LEP and its subsidiaries.

The LEP will be financed by equity and subordinated (or mezzanine) debt, as well as other conventional corporate facilities, eg. working capital and/or supply chain creditors and the usual overdraft facilities. These financing sources need to be sized based on the activities proposed to be undertaken and set out in the LEP's Business Plan based on the Strategic Partnering Agreement (SPA) entered into by the LEP and the LA. Given that a significant Group corporate structure will exist in time, this task should not be underestimated, especially the consolidation of cashflows and other accounting reports that will be required for decision-making amongst the LEP's stakeholders. Such complexity requires a comprehensive financial model capable of reflecting projects in isolation at the SPV level, as well as in consolidated form at the LEP level with the other types of contract undertaken.

LEP subsidiary SPVs undertaking ring-fenced PFI projects will require project finance in one guise or another. However, given the spend curves of initial projects and the pipeline of business derived from the exclusive contract awarded at the outset, careful thought should be given to arrangements for long-term fixed rate funding and/or hedging, as flexibility may well deliver better value for money. The incorporation of a Fund Co at the outset to channel funds through to LEP PFI SPVs or even a PFI Hold Co is worth analysis, as is ensuring that funding and hedging facilities entered into at the outset with the first subsidiary SPV do not thwart future funding options. Even ideas like variable unitary charges in the short term should not

be discounted. Sponsors and equity providers spend a lot of time and incur significant costs trying to bundle existing financing for traditional PFI investments to facilitate a refinancing. BSF, with its pipeline of business, presents the opportunity to avoid some of these difficulties through forward planning.

Clearly, funders will be keen to prevent cross-contamination from, say, a poorly performed D&B contract on a PFI project, and wish to reduce the risk of a PFI SPV having its LEP parent default under the Strategic Partnering Agreement.

## Accounting

These projects could result in the creation of a significant group company structure, with each company adopting the accounting policies and procedures of the overall majority shareholder being the Private Sector Partner (PSP). This will have important implications if the PSP is a single corporate entity and not a joint venture company. Will sponsors really want the significant assets and loans within a LEP on their own balance sheet?

This point may well result in third party equity providers and/or the major players in the supply chain being encouraged to invest in the LEP via a PSP joint venture. Third party equity players may prefer a seat at the 'top table', but without getting too involved in either the preparation of the Business Plan and its implementation, or the compliance with SPA obligations. Alternatively, third party investors may want to confine involvement to investing directly in the LEP's PFI SPVs.

## Tax

Again, the group company structure will create opportunities in relation to tax planning and indeed VAT considerations that may be applicable to a group structure. Tax planning is essential when dealing with any complex group structure; early consideration of these aspects is recommended.



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