

Full Business Case PPP/PFI Addendum

Provision of New Maternity Unit, Crosshouse Hospital



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1. INTRODUCTION

- 1.1 The Full Business Case (FBC) for the “Provision of new Maternity Unit, Crosshouse Hospital” was recommended for approval by the Scottish Executive Health Department, Capital Investment Group (CIG) on the 24 August 2004 and subsequently approved in a letter dated 14 September 2004 from Ian Gordon, Acting Chief Executive, NHS Scotland. Following approval, negotiations continued between NHS Ayrshire and Arran and Ayrshire Hospitals Limited, resulting in financial close on 6 October 2004.
- 1.2 The purpose of this addendum to the FBC is to set out the changes to the project between FBC approval and financial close.

2. DESCRIPTION OF CHANGES IN THE PROJECT SINCE FBC APPROVAL

- 2.1 The functional content of the project and the design solution developed in collaboration between NHS Ayrshire and Arran and Ayrshire Hospitals Limited has remained virtually unchanged since the approval of the FBC.
- 2..2 Issues have arisen in respect of additional conditions, associated with external works requested by East Ayrshire Council, Roads Department not contained in the “Approval of Reserved Matters” i.e. inclusion of resurfacing of circulating carriageway at the main roundabout entrance to Crosshouse Hospital. As part of the final negotiations, prior to financial close a provisional sum of £100,000 was included in the capital costs within the financial model to allow for possible increased planning costs that became apparent in the latter stages of the project.

3. DETAILS OF THE CONTRACT STRUCTURE

3.1 Contractual Framework of the Project

Ayrshire & Arran Health Board (**the Board**) developed a contract for the new Maternity Unit at Crosshouse project (**the Project**) based as closely as possible on the Scottish Executive Health Department Standard Form Project Agreement, Version 1 (**the Standard Form**). The contract structure recognises the interests of all parties to the Project Agreement (**the Agreement**), including the funders and the various sub-contractors providing services to the Board. The terms of the Standard Form are retained, but in line with applicable guidance for using the Standard Form some provisions of the Agreement have been tailored to the particular requirements of the Project. These were described in more detail in Appendix 13 to the FBC and further in Section 5 below.

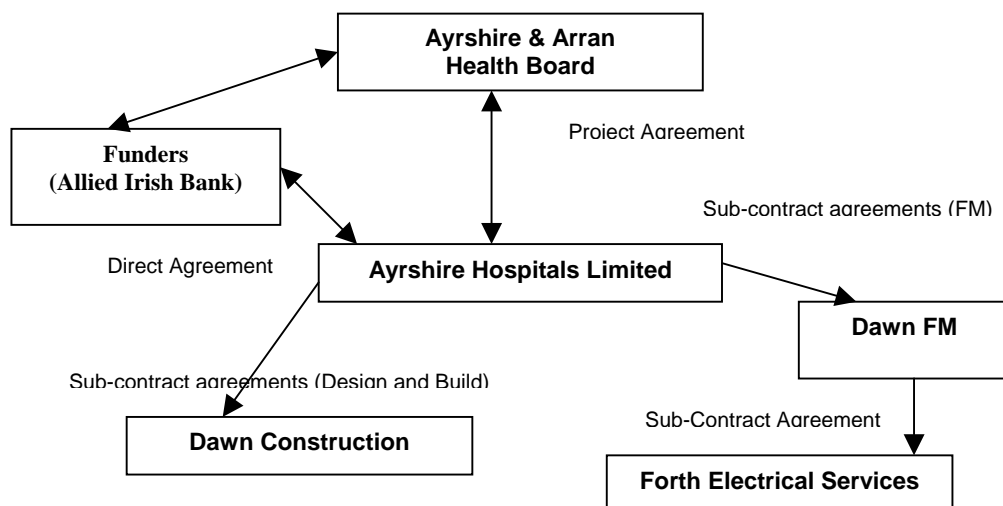
3.2 Principal Sub-Contracts

- Design and Build contract with Dawn Construction Limited
- FM Agreement with Dawn FM
- Financing Agreement and other documentation with Allied Irish Bank (AIB)

These documents create the contractual relationships represented in diagrammatic form in Section 4 below.

4. CONTRACTUAL FRAMEWORK

A Special Purpose Company (Ayrshire Hospitals Limited) has been established to deliver the project. The proposed structure is described by diagram as follows :



5. CONTRACT SUMMARY

The Board entered into a Project Agreement with AHL on 6 October 2004 in substantially the same terms as the Scottish Executive Health Department Standard Form Project Agreement Version 1 (**the Standard Form**). Accordingly, the Project Agreement provides for the financing, design, construction and provision of certain services in connection with the Maternity Unit at Crosshouse in standard SEHD and PFI terms.

As required, the Board in its Full Business Case provided SEHD with details of all amendments made to the Standard Form as at July 2004. A small number of additional changes have since been made to secure financial close and these are narrated in Appendix 1. The Board is confident that the Project Agreement reflects as closely as possible Standard Form terms and remains entirely faithful to the principles behind the Standard Form drafting.

6. ECONOMIC ANALYSIS DEMONSTRATING THAT PPP/PFI PROCUREMENT STILL DELIVERS VALUE FOR MONEY

6.1 Financial close was reached on 6th October 2004. The following table summarises the key final adjustments as at financial close. The pre financial close model figures are included for reference purposes.

	Financial Close Model	FBC model
Senior debt swap rate obtained	5.145%	5.5%
Unitary charge as at 31 st July 2004 price base	£1.704m	£1.755m
Capital expenditure	£16.039	£15.939

The main driver of the unitary charge decrease was the decreased swap rate that was available from the market on the day of financial close. In addition there was a further decrease in operational costs of £0.005m per annum relating to a saving that was agreed for quality audits. An additional change was made to include a provisional figure of £0.100m capital costs within the model to allow for possible increased planning costs that became apparent in latter stages of the project. The overall net impact on the unitary charge resulted in a final figure of £1.704m as stated above.

6.2 Value for Money Assessment

The only change required within the Value For Money analysis (“VFM”) was the amendment to unitary charge, thus £1.755m was adjusted to £1.704m. No further amendment was required to the Public Sector Comparator (“PSC”) analysis as there was no change in risk allocation in these late stages of project negotiations. The PSC analysis already carried a £0.180m estimation for up-front planning costs, and this was not changed as planning costs were finalised at an estimated £0.175m.

The following table details the final results (again comparing them with FBC figures for comparison purposes).

	PFI NPV (£m)	PSC NPV (£m)	Value for money headroom £m
Financial close (i.e. final figures)	29.515	30.772	1.257
Previous FBC stated figures	30.395	30.772	0.377

The results conclude that the PFI option showed increased value for money compared to the PSC (see Appendix 2).

7. FINANCIAL APPRAISAL DEMONSTRATING AFFORDABILITY

A summarised comparison of the PFI unitary charge against the affordability limit is detailed in the table below :

Financial close PFI Unitary charge per annum	FBC PFI Unitary Charge per annum (i.e. previous model estimation)	PFI Affordability Limit per annum
£1.704m	£1.755m	£1.790m

The final model highlights that the unitary charge of £1.704m is within the affordability limits of £1.790m, and shows headroom of £0.086m per annum.

Overall Running Costs and Funding of Project

The table below summarises the overall running costs associated with the Ayrshire Hospitals Limited (AHL) solution and compares this with the updated Public Sector Comparator (PSC).

	Running Costs £000
Baseline	
Annual running costs of existing service	<u>£14,611</u>
a. PFI Option	
Projected annual running costs of new facility	15,251
Less - Budgets available for transfer	13,747
Gross additional cost of new service	1,504
Less - Savings from disposal of existing premises	804
- Adjustment of residual value to comply with SCIM	268
- Saving in unitary charge achieved at financial close	51
Net annual funding requirement	<u>381</u>
b. PSC Option	
Projected annual runnings costs of new facility	<u>15,251</u>
(net funding requirement is the same as the PFI option)	

The net annual funding requirement to be met by NHS Ayrshire and Arran under the PFI option amounts to £0.381m (2.5% of the projected annual running costs). Under the PSC option the annual funding requirements would have been similar or marginally higher.

8. ASSESSMENT OF RISK TRANSFER

The Public Sector Analysis was reviewed at Financial Close, however there were no changes in either the risk allocation or the underlying PSC costs. For clarity we have restated below the base costs and associated risks that came together to form the overall PSC NPV figure.

	£m (NPV)
Base Capital Costs	16.243
Base Operating Costs	7.370
Total Base Costs	<u>23.613</u>
Specific risk Adjustment :	
Capital costs	2.002
Life cycle costs	0.316
Operating costs	0.953
Total Specific Risk Adjustment	<u>3,271</u>
Tax adjustment	1.417
Optimism Bias Adjustment	2,471
Total PSC	<u>30.772</u>

9. ACCOUNTING TREATMENT

There was no change in the risks and rewards analysis of the project from the previous FBC submission that would impact on the accounting treatment. The Board therefore maintained an off balance sheet treatment for the project.

Audit Scotland has supported this view on accounting treatment. Attached is the appropriate Audit Scotland Opinion supporting this position, Appendix 3. In addition to this we attach a letter from Quayle Munro (the Board's financial advisers) summarising the key financial changes within the Project in its latter stages, Appendix 4. This was submitted to Audit Scotland and their opinion is in light of this document.

10. **APPROVAL BY NHS AYRSHIRE AND ARRAN**

10.1 NHS Ayrshire and Arran confirm that the project is integral to the Local Health Plan, the Financial Plan and the objectives of the NHS Board.

Signed :

Wai-yin Hatton
Chief Executive of NHS Ayrshire & Arran

Date :
