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20 March 2020

Dear Member

Cabinet – 26 March 2020

I am now able to enclose, for consideration at the next meeting of the **Cabinet**, the following reports that were unavailable when the agenda was printed.

To add to your agenda for the meeting on **26 March 2020**

17. **Crediton Hub** (*Pages 3 - 12*)

To receive an update report from the Deputy Chief Executive (S151)

Yours sincerely

Sally Gabriel
Member Services Manager

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CABINET
26 MARCH 2020
CREDITON NHS HUB - UPDATE

Cabinet Member(s): Councillor Alex White
Responsible Officer: Andrew Jarrett, Deputy Chief Executive (S151)

Reason for Report: to provide the Cabinet with an update on the negotiations and due diligence undertaken since the decision in July 2019 to approve the loan with delegated authority to the Deputy Chief Executive. Further, to provide the Cabinet with an opportunity to understand the final terms and how the arrangements for the project as a whole will work.

RECOMMENDATION: Arising from the previous decisions of Cabinet and Full Council, to note this update report setting out the progress of the negotiations and the due diligence undertaken.

Financial Implications: The financial implications are included in this report.

Legal Implications: The Council has received expert advice from Michelmores with their experience in projects, banking, loan agreements etc. Furthermore, the state aid implications, explained in the previous report, are the subject of Counsel's advice which has been sought in light of the revised terms. The Deed of Priority will secure the Council's ability to recover the loan as a priority over the NHS England's ETTF funding. The Council will have a first charge over the land on which the new surgery/hub will be built (including the buildings erected on it).

Risk Assessment: the risks were set out in the previous report and, where they are modified or mitigated in the subsequent negotiations, this report explains that. The Deed of Priority secures the Council's capital input and the interest rate mechanism addresses the issue of any rate changes between the date of the loan agreement and actual drawdown.

Equality Impact Assessment: There are no equality impacts in relation to this report and its recommendations.

Relationship to Corporate Plan: This supports the aim of supporting sustainable and prosperous communities by working in partnership with statutory and non-statutory bodies. In particular, it will help to promote new, more integrated approaches to good health for the residents in the Crediton area.

Impact on Climate Change: None directly arising.

1.0 Background

1.1 Cabinet are reminded that a number of reports and updates have been provided over the past year following an approach in 2018 by representatives of two GP Practices who were proposing to merge and locate to a new building in Crediton. They asked the Council to consider making a loan for part of the project, the remainder to come from NHS England's Estates and Technology Transformation Fund (ETTF).

- 1.2 Following an initial urgent decision taken in December 2018 to enable the GP Practices to make a funding bid to the ETTF, there have been extensive discussions between officers, the Council external legal advisors and those acting for the GP Practices. Furthermore, the GP Practices have been involved in extensive and protracted negotiations for the land purchase and with the ETTF.
- 1.3 A formal report was brought to Cabinet on 25 July 2019 (covering report included at Appendix 1) with a recommendation through to Full Council on 11 September 2019. The Group Manager for Finance provided a further update to Cabinet on 13 Jan 2020. In February, the Cabinet recommended the Budget and Capital Programme for 2020/21 to Full Council and this was approved on 26 February 2020.
- 2.0 **What the Cabinet and the Council has agreed to date and what is now on the table**
- 2.1 The original proposal was to make a loan of £2.1m at a fixed rate of 3.75% for a term of 28 years. When the request came in late 2018, it was expressed as a NHS project. This was not correct. The project is that of the GP Practices, Chiddenbrook Surgery and New Valley, in Crediton. Further, the NHS's ETTF, seeing the benefit and purpose behind the project, has stepped in with the bulk of the funding – 83.5% of the overall project cost.
- 2.2 Subsequently a briefing was given to Cabinet in January 2020 highlighting the request to increase the loan by £75k following an update to the project costs. Further, the Deputy Chief Executive proposed to increase the interest rate charged to c4% based on the recent government increases to the PWLB lending rates. This additional £75k was included in the now approved Budget and Capital Programme for 2020/21. So, to confirm, the Council has agreed the principle of the loan (with delegated authority to the Deputy Chief Executive) and the amount of the loan (£2,175,000.00). The term will now be 27 years from practical completion of the project - because the rental payments from NHS England to the GP Practices will not be available until they are able to occupy the premise for the purposes of providing healthcare.
- 2.3 The proposal now is the crystallisation of the terms and details behind the project. This has been arrived at after a prolonged period of due diligence undertaken by the S151 Officer; the Deputy S151 Officer; the Monitoring Officer and with the expert advice from Michelmores – specifically on the loan agreement which they have drafted in liaison with VWV Solicitors who act for the GP Practices. Both firms have extensive practice in commercial property, property development, healthcare, funding agreements, lending transactions, due diligence etc. Appreciating that this was a concern which remained for some members, Michelmores have also commissioned advice on state aid. The costs of the advice provided to the Council will be met by the GP Practices.
- 2.4 As with any project of this kind, the details do evolve – due in this case to negotiations by the GP Practices over land purchase and specifically as a result of a change in stance and commitment by the ETTF. For example, one of the original asks was that the Council's funding be used for the purchase of the land and the first phase of the build. Whilst the Council has sought, and will still

have, a first charge over the land enshrined in a deed of priority, its funds will not be needed until the end of the project – with the ETTF funds being used for the land purchase and the principal part of the build phase. The Council's position is therefore significantly better in this regard than it was previously.

- 2.5 Next we have the interest rate. With the anticipated drawdown of the Council's loan now being deferred for a number of months, it would not be appropriate to fix the rate now. The rates at which the Council may borrow (whether from the Public Works Loan Board (PWLB) or another lender) may vary between the date of the loan agreement and actual drawdown. The Council would not want to be in a position of lending at a rate which could be disadvantageous to it – for example if the PWLB rate increased again. The interest rate will therefore be PWLB + 1.5%. At the same time, we need to ensure that the interest rate does not fall below a certain threshold for the purposes of state aid – there is a mechanism in the draft loan agreement that secures this.
- 2.6 The interest rate will accrue from drawdown with a bullet payment being made at practical completion for the interest accrued to date. The loan – payments of interest and capital will then proceed as set out in the loan agreement for the duration of the loan.
- 2.7 Initially, it was envisaged that the Council's loan would be drawn down in a number of tranches as the project progressed to mitigate the risk. With the ETTF now providing the bulk of the funding to be used for the land purchase and principal part of the build phase, it is easier to justify and to administer a single drawdown later on.

3 Timescales

- 3.1 As often happens in such matters, there can be protracted negotiations and project work and then suddenly it all comes together in an apparent rush. The ETTF needs the Council's signed loan agreement as it will be appended to their funding agreement prior to that too being signed and completed. They want to do that on Friday 27 March 2020, we are told.
- 3.2 The project needs to get underway to ensure the funding remains in place and on terms which have been factored into the project costs. The build has been procured and, if delayed, there is a risk of increased costs and/or delay due to the contractors no longer being available. Contractors are naturally looking for certainty in the current uncertain times – and the contract will only be entered into when there is certainty of funding i.e. the loan and funding agreements are all completed. Having to re-procure could delay the project and increase costs.

4 Financial Implications

- 4.1 In over-arching financial terms the original £2.1m requested loan equated to 29.7% of the overall project funding at that time. The approved £2.175m now equates to 26.5% of the scheme, hence a lower proportion.

5 Risk

- 5.1 The new revised funding for the scheme has seen the ETTF contributing a significantly higher sum, including the land purchase at the commencement of the scheme. This means that the Council only have to fund towards the latter end of the project timeline, estimated to be in Dec 2020 as specified in the project Gantt chart and cashflow forecast supplied by the project team.
- 5.2 We have also received confirmation that any project overspends or time line delays will be met financially by an additional payment from the ETTF and will not result in an additional ask to the Council.

6 Conclusion

- 6.1 In regards to the loan agreement, Members are reminded that we will have a first charge over the property and that the loan agreement has the term set out above. However, due to the fact that we are making our funding towards the latter end of the project, we have recently agreed to change the terms to a fixed rate of PWLB (rate) prevailing at the exact time of the loan drawdown plus 1.5%.

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Circulation of the Report: Cabinet Member – Cllr Alex White; Leader – Cllr Bob Deed; Leadership Team; Group Manager for Finance; Group Manager for Performance, Risk and Data Security.

List of Background Papers: Appendix 1: Cabinet Report of 25 July 2019 (covering report only)

CABINET
25 JULY 2019
CREDITON NHS HUB

Cabinet Member(s): Councillor Alex White
Responsible Officer: Andrew Jarrett, Deputy Chief Executive (S151)

Reason for Report: To consider a long term loan arrangement to help facilitate the construction of a NHS Hub building in Crediton.

RECOMMENDATION:

- 1 To agree to make a loan to the GP Practice of £2.1m repayable over 28 years on an annuity basis at a fixed interest rate of 3.75%, subject to the Deputy Chief Executive (S151), in consultation with the Group Managers for Finance and Legal Services:
 - (a) Completing a suitable loan agreement with the Practice adequately protecting the Council's position;
 - (b) Registering a first charge over the relevant land and completing a deed of priorities to be registered at the Land Registry; and
 - (c) Being satisfied following the finalisation of any remaining due diligence deemed necessary, that the loan remains a financially prudent course of action.

before the Practice is permitted to drawn down any portion of the loan.
- 2 To agree to add this to the Capital Programme and to fund from External Borrowing when necessary.

Financial Implications: The financial implications are included in this report.

Legal Implications: Michelmores LLP have been engaged to advise on the loan agreement, including the implications of any ownership, property and valuation issues for the detail of the agreement. In terms of State Aid, the Group Manager for Legal Services advises that the following key principles apply and will be satisfied based on an assessment of the currently proposed lending terms:

- The lending is carried out in line with normal market conditions. A public body is afforded a wide margin of discretion when taking an entrepreneurial decision – it will only involve state aid if it is manifestly clear that no rational market operator would have entered into a transaction on the same terms.
- The European Commission sets a reference rate each month for each member state. A margin must be added to the reference rate and this depends on the creditworthiness and the security offered. The combination of the reference rate and the margin is the minimum rate which could be said to be within the realms of a normal market rate.

- The reference rate as of 1.7.2019 was 1.09% and has been notified as the same for 1.8.2019. It has been at this level since the beginning of the year. It is unlikely to change to any material degree before the loan is entered into. In adding the margin, the table below shows how it should work. These are the margins which the EC says should be added “in principle” to the reference rate to end up with the minimum rate which should be levied.

CREDITWORTHINESS	COLLATERALISATION		
	High	Medium	Low
STRONG	0.60%	0.75%	1.00%
GOOD	0.75%	1.00%	2.20%
SATISFACTORY	1.00%	2.20%	4.00%
WEAK	2.20%	4.00%	6.50%

The view of officers is that the creditworthiness is Good and the Collateral is High. Even if we were to take a very cautious approach and apply a margin which would be applied to a borrower with a satisfactory rating category (BB) and a medium security (collateralisation), this would result in a minimum interest rate of 3.29% (1.09% + 2.20%) - still well below the interest rate proposed.

Other bodies are included in the diversification of investment risk in the Treasury Management Strategy. An unlimited timescale is applied to such investments with a maximum transaction limit of £3 million. The loan therefore falls within these parameters and provision will be made in the budget for this investment by way of a loan, subject to Council approval.

Risk Assessment: We will have a first legal charge over the property and this is important in mitigating the risk and giving us a better “ranking” than the Estates and Technology Transformation Fund (ETTF) NHS who will have a second charge.

Equality Impact Assessment: There are no equality impacts in relation to this report and its recommendations.

Relationship to Corporate Plan: The loan will support the aim to work with local communities to encourage them to support themselves by supporting local communities to retain and develop their local facilities and services.

Impact on Climate Change: This is a financing decision and has no climate change implications for us as a council.

1.0 Background

1.1 We were approached towards the end of 2018 by representatives of two GP Practices who were proposing to merge and locate to a new building in Crediton. The new building was proposed to provide much more than just a larger GP Practice, but to be more of an integrated health hub with both GP and wider NHS treatment areas. The new building will be mostly funded by the NHS, but the GPs have to source a certain amount of the funding

themselves. They approached this Council to see whether we could offer a more competitive lending rate than that already offered by two banks. See Appendix 1 for the full scenario which was the original proposal (but has subsequently been updated).

- 1.2 We saw this as an opportunity not only to ensure that there was a modern, fit for purpose GP surgery in Crediton, as we were aware that the existing two practices were becoming inadequate, but also for the Council to lend to a suitable stakeholder who was willing to secure the loan and still provide us with a good rate of return on our money. In the current economic climate with the limited returns that are available to us, this was an attractive proposition.
- 1.3 The GPs and their representatives have undertaken public awareness sessions. This has been well received and we are pleased that the public and some of our councillors have been able to attend to see the plans and the details of the proposal.
- 1.4 The initial proposal to progress this project was brought as an Urgent Decision in December 2018. Since that time further work has been completed and the urgency of the request for funds subsided due to the extension of the timelines by the NHS. This delay has given us time to complete further due diligence and to be more involved with the decision making around the project. We are now in a strong position to recommend the granting of finance and give assurance on the level of risk.
- 1.5 We are mindful that the rate of interest we offer to the GP Practice must remain competitive and not “fall foul” of State Aid rates. We have therefore sought to offer an interest rate which is advantageous to the Practice partners but is still competitive and gives us a much better rate of return than our general investments. We will have a first legal charge over the property and this is important in mitigating the risk and giving us a better “ranking” than the ETTF NHS who have a second charge. The “secured” status of the loan also means we can mitigate risk and offer a better interest rate knowing that we have the security of the building and site should the project not progress appropriately. We also understand that it is in everyone’s interest for this project to be successful and that the NHS will be making a considerable contribution to the scheme, over double our requested requirement.

2.0 **Progress**

- 2.1 On 21 June 2019 the representatives for the GP Hub sent out Invitations to Tender for the proposed building works. The closing date for the Tender was 5 July 2019 and we await details of the successful bidder.
- 2.2 At the Planning Committee 3 July 2019, permission was granted for the “Erection of a 2-storey GP Practice – land at NGR 284429 99439 Joseph Locke Way, Crediton”. See Appendix 2 for Plan.
- 2.3 We engaged external expertise from Michelmores to supplement our in-house legal service provision. We now have a final draft of Heads of Terms which is mutually acceptable to both parties.

3.0 Financial Implications

- 3.1 We have a number of further background reports which give forecast costings for the project, details of the payments to be received in respect of the advance and the schedule of payments to the GP Practice from ETTF (the NHS funder). An overall financial costing schedule is attached as Appendix 4.
- 3.2 At the 11 July 2019 the PWLB rate available to the Council for a loan for 28 years is 1.93% (2.13% less 0.2% certainty rate). With the proposed interest charge to the GP Practice of 3.75% this equates to an overall surplus of over £750k over the 28 year period. This is calculated on an Equal Instalment basis with reducing interest elements. The initial income “surplus” to the Council is c£42k reducing to £2k at the end of the loan period, very similar to the mechanics of a repayment mortgage. The partners also agreed to fund our legal advice and other associated costs.
- 3.3 The Council, as part of its daily Treasury decisions, may decide to fund the advance from internal borrowing, if possible. This then increases the surplus made as we would not be paying an external lender. The cost to the Council would be the opportunity cost of not investing those funds. With our average return on investment of around 1% this would be a prudent approach.
- 3.4 With either external or internal borrowing there will be a Minimum Revenue Provision (MRP) payment to be made which would be offset by the principal repayments from the GPs. The Capital Financing Requirement (CFR) will be adjusted to include the possible need to borrow to fund the advance.
- 3.5 The Heads of Terms are being finalised and these will crystallise our requirements for repayment and the schedule of advances as not all of the £2.1m will be required immediately.
- 3.6 For the removal of doubt regarding the status of the parties to the agreement, the legal representatives have confirmed that the GPs are signing an Umbrella Agreement in advance of the other legal agreements. This legally binds all the contemporary Partners from the 2 practices together as an entity so that the new building project can navigate through its stages to completion and occupation into the future. It dictates the terms on how the two practices engage until such time as a new partnership agreement is signed post-merger. It accounts for eventualities and will bring the collective of Partners into the new building even if there is a stall on any part of the merger process.
- 3.7 The NHS/CCG has made a 28 year commitment for the payment of the GP’s “notional rent” which covers the loan for the project, alongside their other income streams.

4.0 Conclusion

- 4.1 We are confident that this is a sound project and we have undertaken robust due diligence which has included extensive fact finding and numerous meetings with the GPs and their representatives. This is a good project from an economic regeneration basis; developing a disused site and maintaining a

health provision hub in Crediton, and also a favourable financial proposition which will help mitigate the budgetary pressures we are facing in future years.

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Circulation of the Report: Cabinet Member for Finance – Councillor Alex White and Leadership Team seen and approved.

List of Background Papers:

- Appendix 1: Overview**
- Appendix 2: Plan**
- Appendix 3: Valuation (Part II)**
- Appendix 4: Financial costing schedule (Part II)**

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