Towns Fund©
Delivery Partner

Commercial Models and Attracting Investment

This paper provides guidance on considerations for Towns on the commercial structure of a project for which they have received a Towns Fund allocation. It provides this information in the context of understanding the structure and content of a Business Case.

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GLOSSARY

Term	Definition
APMG	AMPG International are an accreditation and examination body
BBC-F	Better Business Cases – Foundation course
BJC	Business Justification Case
C3P3	Global Certified Public Private Partnerships (P3/PPP) Professionals' training course
DBFM	Design, Build, Finance, Maintain
DBFOM	Design, Build, Finance, Operate, Maintain
DLUHC	Department for Levelling Up, Housing and Communities
FBC	Full Business Case
HMT	Her Majesty's Treasury
ICW	Institute of Collaborative Working
JV	Joint Venture
OBC	Outline Business Case
O&M	Operations and Maintenance (Contractors)
PPP	Public-Private Partnership
PWLB	Public Works Loan Board
RAG	Red, Amber, Green
SOC	Strategic Outline Case
VFM	Value for Money
SRO	Senior Responsible Owner
SPV	Special Purpose Vehicle

INTRODUCTION

This section outlines the purpose and background to this paper, highlighting the content of the four sections (summarising the full content listed above). This allows readers to focus on the sections that are most relevant to them and potentially bypass sections where they already have detailed knowledge

PURPOSE

Drawing on experience of running HM Treasury's Better Business Case (BBC) training for circa 80 regeneration officers from the 101 Towns involved in the Towns Fund programme, and for members of the central DLUHC team, including the common questions raised, this guidance specifically considers the commercial case in parallel with the use of private / alternate financing.

We focus on the use of various contract models / partnership approaches in the context of an expectation that Towns will crowd in / attract financing alongside their Towns Fund grants in the delivery of their projects.

We are anticipating that this document is read by a wide audience, including those who have not attended the HM Treasury's BBC training, and therefore provide some sign posting below.

- Where readers have attended the HM Treasury's BBC training or are very familiar with the material used in this training, the sections on BBC and the Options Framework may be less relevant.
- Equally if readers are not planning delivery through a complex partnering arrangement, the section covering Joint Venture arrangements may be less relevant.
- Finally, if your interventions do not have a high degree of attracting private / alternate finance, then the sections on funding and finance, project finance, primary vs secondary market may be of secondary importance when reading through this document.

However, a full read of the document is recommended for wider capacity building beyond the term of the Towns Fund programme.

BACKGROUND

As the Towns Fund Delivery Partner, we have trained circa 80 regeneration managers from the 101 Towns participating in the Towns Fund and members of the central DLUHC team in HM Treasury's Better Business Case – Foundation (BBC-F) course, allowing them to go on to complete the accreditation exam should they choose to. Our approach to running this course meant that as well as covering the BBC-F syllabus material, it included lots of practical case studies and experiences of delivering regeneration projects and perhaps most important, allowed for participants to share their challenges as part of their learning.

One challenge we have taken from running multiple BBC-F courses as part of the Towns Fund programme is around how to progress the commercial delivery, especially if there is a desire to combine this with attracting wider investment beyond the Towns Fund grant monies to leverage further impact from their interventions.

In developing this guidance we draw on the Global Certified Public Private Partnerships (P3/PPP) Professionals' (CP3P) guide and training - [The APMG Public-Private Partnerships Certification Program (ppp-certification.com)](ppp-certification.com).

Like the BBC-F course, the CP3P guide and training has been developed and is overseen by APMG and held in high regards, given that thousands of public servants around the globe have been through the accredited training. Outside of the Towns Fund Delivery Partner arrangements there is an opportunity for Towns Fund participants to undertake the 2-3 days training and accreditation exam but we suggest that for most, this summary guidance will be sufficient.

STRUCTURE

This document is divided into the following four sections:

- **Business Cases**: this section gives an overview of the five-case model, with specific comment on the commercial case
- **Commercial Models:** this section outlines a series of commercial models that underpin procurements and ongoing delivery. The use of a particular commercial model depends on the circumstances, with the aim being the use of the commercial model that offers best value for money across the whole life of the project / assets
- **Attracting Investment:** this section provides some high-level principles around funding and financing, including private / alternate financing. It explains the important relationship between particular commercial models and the ways in which funding and financing, including private / alternate financing is attracted and deployed
- **Next steps and further reading:** this section makes linkages into other material developed as part of the programme

BUSINESS CASES

This section gives an overview of the five-case model, with specific comment on the commercial case.

The material in this section will be familiar to anyone who has been through the HM Treasury Better Busines Case training, however in the commerical case section it reinforces messages on the current challenges with the construction market and then comments on the timing of the full business case, which should run in parallel with the procurement

BETTER BUSINESS CASES

Before considering Public-Private Partnerships it is helpful to revisit some of the Better Business Case material used during the BBC-F training. Figure 1 below outlines the five-case model and shows the over-arching question asked by each case. This guidance focuses particularly on the commercial case, but then in turn the nature of commercial delivery, including whether it involves the use of private / alternate finance, which can heavily influence the economic case and options appraisal, the finance case and the management case. Hence readers should continue to note the inter-connectivity between the five cases.

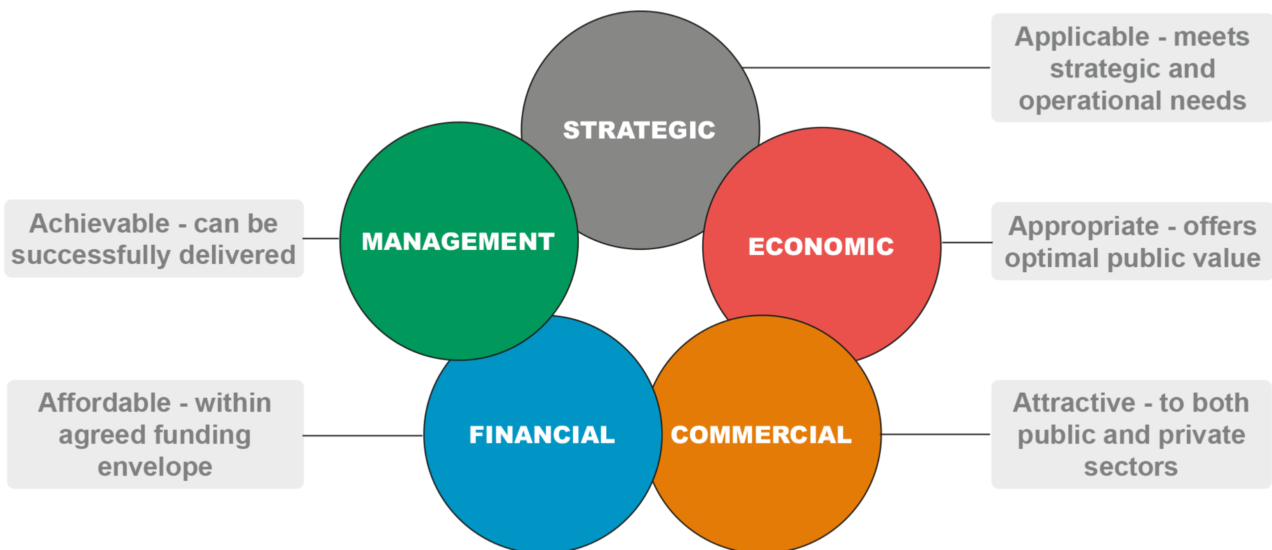

Figure 1 - Better Business Case Five Case Model

Under the Better Business Case approach, we pause upfront to carefully consider the nature of the intervention we are looking to progress and the architecture of the business case process. One key question includes whether there is in fact a programme of projects, meaning a programme level business case is needed (and potentially sub-programme business cases, as we believe is the case with many Towns delivering under the Towns Fund programme). Programmes represent the virtual, temporary governance arrangements, with the actual delivery of interventions happening through projects.

A further question to consider is whether it is a stand-alone project or part of a pipeline of projects; whether these are major schemes that are significant in scale and complexity to warrant a three-stage project business case consisting of a strategic outline case (SOC), outline business case (OBC) and full business case (FBC). This three-case model is shown in Figure 2, with the accompanying activities and decision points.

Should the project be very simple (and not novel and/or contentious to use HM Treasury terms), either standalone or because of the existence of an overarching programme business case, a single gate business case may be appropriate – a business justification case (BJC). With the Towns Fund it is unlikely that BJCs can be used for the substantive projects (indeed, Towns are advised against the use of BJCs for the substantive projects), but we recognise that they have the potential to be relevant to decisions around procuring technical and specialist support. Meanwhile, it is important to keep in mind that the business case does not end with the sign-off of the FBC and the decision to contract but continues through to delivery. This is centred around the enacting of the management case arrangements in relation to costs, benefits and risk tracking across the whole life of the asset / contract term and to undertake periodic post-implementation project reviews. Figure 2 summarises the stages of a business case for major schemes.

Figure 2 - Stages of a Business Case

THE OPTIONS FRAMEWORK

The options framework is promoted by HM Treasury to construct a robust long list of realistic options, leading to a shortlist, then identification of the preferred way forward at SOC, before the final preferred option at OBC. This is discussed in the HMT BBC-F training and the underpinning HM Treasury Project Business Case guidance (2018), supported by a detailed case study.

This was seen as a particularly helpful tool and we have reproduced the options framework in Table 1 below. The options framework encourages those involved in the business case development (i.e. the decision making) to be actively involved through a workshop or series of workshops in the long listing, short listing, etc. Assuming a complex business case / decision, those involved should represent the project team, led by the senior responsible owner (SRO), with representation from a wide range of stakeholders, technical specialists (including finance, commercial, HR, etc.) and business partners.

Table 1 - Options Framework

Items	Description
Scope – 'what' is being delivered?	Coverage - business functions, levels of service, geography, population, user base and other parts of the business. Driven by business needs, service requirements and the scale of organisational change required to improve service capabilities.
Solution – 'how' is this delivered?	Potential 'products' (inputs and outputs) and enabling work streams and key activities required. Driven by available technologies, recognised best practice and what the marketplace can deliver.
Delivery – 'who' is delivering the solution?	In-house, outsourced, alliances and strategic partners. Driven by internal/external resources, competencies and capabilities. Drives deadlines, milestones, dependencies, economies of scale, benefit realisation and risks.
Implementation – 'when' is this delivered?	Piloting, modular delivery, big bang and phasing/ tranches. Critical path for delivery of the agreed products and activities and the basis for the project plan.
Funding – 'who pays' for the solution?	Public or private capital, alternative revenue streams, operating and financial leases, and mixed market arrangements. Driven by the availability and opportunity cost of public funding, Value for Money and the characteristics of the project.

This group, in the workshop setting, will consider each of the items in Table 1 and come up with a range of possible options against each row. Then these options are scored, which at the SOC stage, when we are doing the long listing down to the short listing and coming up with the preferred way forward, is likely to be on the basis of a RAG scoring or a numeric 0-5 / 0-9 scoring.

The shortlisting provides the “business as usual” position (which is used as a baseline), the “do minimum” option (i.e. which only just achieves your spending objectives / your needs) and then two or three options that either go further or do things differently. There will be a process of cost / benefit justification to consider whether it is good VFM to go further than the “do minimum” option.

At SOC stage we combine what comes out from the RAG or numeric scoring of each row of Table 1 into a series of feasible options. At OBC stage we would then expect to see the RAG scoring approach replaced by the economic appraisal of the shortlisted options in line with the Green Book principles. Including the valuation of benefit, costs, as well as undertaking risk appraisal.

The final row in table 1 considers the “who pays” question. This paper has a particular focus on the “who pays” question through setting out the possible funding and financing opportunities for a project. In turn we expect the “who pays” question to have implications for the “who” delivers, “how” they deliver, including potentially “when” and in some instances “what” they deliver questions. This assumes that the “who pays” question results in an active rather than a passive investment.

THE COMMERCIAL CASE AND THE TOWNS FUND

The commercial case is about whether the potential deal is attractive to the public and private sector and whether it will result in a successful procurement and contract. The business case guidance (and in particular the BBC-F training) is set up to consider the procurement of property and infrastructure by the public sector from a private sector supply chain.

The business case approach and its application are very flexible when it is well understood. Therefore, we can substitute arrangements where we are buying services. We can also address where there is no procurement and instead a single source extension, delivery plan, memorandum of understanding, or a joint venture arrangement.

The approach works for public sector to voluntary sector and public sector to public sector arrangements. As described in this paper, it also works for private finance / alternate finance arrangements and for market led proposals, whereby the supply chain brings forward ideas and approaches.

Regardless of the nature of the commercial arrangement, there is an expectation that the commercial case will set out the answers to a range of questions such as the term of any arrangement, the basis of the payment and performance arrangements, implications for poor performance, and wider risk transfer considerations, which are themes explored later in the paper.[1]

Figure 2 above showing the business case development for major schemes culminates in the ability to make a decision on whether to proceed with the procurement (i.e. the launch of the procurement), which happens once the OBC is approved.

The procurement then runs in parallel with the development of the FBC, with the FBC being drafted to describe the deal that is being developed and will be delivered. This timing is more challenging for the Towns Fund arrangements. Towns have been asked to produce an FBC (or FBC lite) in advance of securing the grant funding.

At this point, while there may have been significant market engagement, there are instances in which Towns will not have launched a procurement yet. There is rationale to this approach as it would be problematic to launch a procurement without knowledge that, as described in the financial case, the

[1] For the avoidance of doubt, we do not cover any procurement process or procurement law questions in this paper.

funding is in place (which contributes to budgetary affordability) to pay for what is being procured. Hence there is an element of "chicken and egg" that Towns need to be mindful of and must contend with.

It is now important to overlay onto this the facts that:

1. many of the Towns who are part of the Towns Fund programme have not traditionally progressed many complex procurements, hence the anticipated response of their local supply chain to their offers is untested;

2. the property and infrastructure supply chain continues to navigate through an uncertain period, with concerns around the ability to secure labour and materials, construction price inflation, etc; and

3. the desire to bring in private / alternate finance, which might look to different delivery arrangements/mechanisms/models to those proposed by the Towns.

Therefore, it is important to consider the following:

- Scenarios whereby, despite having been awarded Towns Fund grant monies, a Town cannot spend the monies - we have anecdotal evidence of instances from other programmes where monies have not been fully utilised, therefore this risk needs to be managed effectively.

- Extended or long delivery timescales, higher costs than originally forecast or a combination of both factors which can influence increased costs.

- The actual deal offered, which may well reflect the best value for money deal, is significantly different from the original proposal.

We therefore anticipate the need for further stages of business case development beyond the FBC lite versions, to ensure that there is an FBC that reflects "the deal done", and provides that step off point for benefit, cost and risk monitoring.

It will be important for the Towns to monitor the progress of their interventions, but also for DLUHC to track projects over a reasonable period to confirm the achievement of the intended outcomes.

COMMERCIAL MODELS

This section outlines a series of commercial models that underpin procurements and ongoing delivery. The use of a particular commercial model depends on the circumstances, with the aim being the use of the commercial model that offers best value for money across the whole life of the project / assets.

THE GRAPH OF COMPLEXITY – COMMERCIAL MODELS

The diagram in Figure 3 was developed by the Institute of Collaborative Working (ICW) who spun out of the Department for Trade & Industry and led on the development and use of tools including the international standard on collaborative supply chain working, ISO44001.

Figure 3 shows the different contract models / partnership models available alongside the different partnership behaviours needed in each contract model / partnership model. This is driven by the costs / benefits / risks, and contract term and complexity of the model.

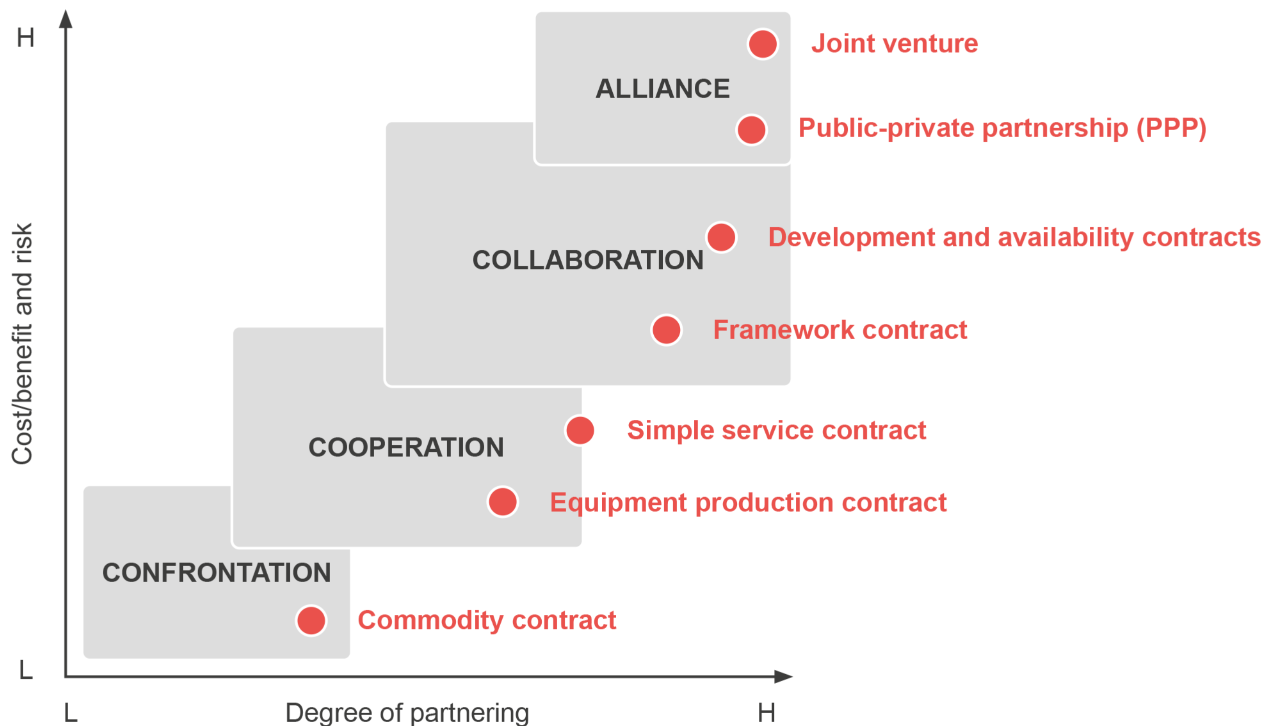

Figure 3 - The 'Graph of Complexity'[2]

To give some practical examples, with commodity contracting (e.g. stationery), you will be interested in cost, time, and quality but once the transaction is completed (stationery supplied and paid for) the relationship will end – there is no consideration of wider socio-economic / VFM benefits.

If you were to procure social care support through a long-term contract as a commodity contract, it is likely that things would not go well with the need to build an effective relationship in the delivery of the service which reflects a continuous period of time (as opposed to a defined point of delivery).

Hence for public services, especially those that focus on driving socio-economic change / VFM benefits, the shaping and structuring of more complex, longer-term contracts are important. These are matched with the need for behaviours around collaboration and alliancing to respond to change and pro-actively adapt to ensure successful delivery.

This is what we have with the Towns Fund, Towns Investment Plans and Town Deal Board and hence we anticipate the focus will towards the centre to right hand side parts of Figure 3 above.

This paper now moves onto Joint Ventures and then Public Private Partnerships (PPP) which reflect the upper right quadrant of Figure 3 where there is a need for a high degree of partnering to deliver complex transactions which can unlock major benefits.

[2] Institute for Collaborative Working

JOINT VENTURES (JV) – A DEFINITION

As is often the case with public services, most things have been delivered before, but often this leads to levels of understanding becoming interchangeable and hence we think it is useful to reference back to supporting materials as guidance to help.

In the case of JVs, we have relied upon on the March 2010 HM Treasury JV guidance, per the link provided Microsoft Word - 160310 Joint venture guidance 1.doc (publishing.service.gov.uk).

Here we use the term "entity" to denote the setup of a new company, formal partnership, etc – i.e. something beyond a contractual arrangement, which is what a PPP is as defined below.

The definition of a JV from this guidance is:

> *"The term joint venture can describe a range of different commercial arrangements between two or more separate entities. Each party contributes resources to the venture and a new business is created in which the parties collaborate together and share the risks and benefits associated with the venture. A party may provide land, capital, intellectual property, experienced staff, equipment or any other form of asset. Each generally has an expertise or need which is central to the development and success of the new business which they decide to create together. It is also vital that the parties have a 'shared vision' about the objectives for the JV."*
>
> Further – *"It is important to distinguish the formation of a JV entity from purely contractual arrangements, such as contracts for the provision of goods or services or a concession, whereby a public sector body gives a third party (the "concessionaire") the right to provide services to the public in consideration of payment, e.g., tolls payable to cross a bridge forming part of a public highway."*

We have seen arrangements where a JV (or other entity is formed) and then a PPP or other form of complex contract is overlaid.

The HMT guidance is helpful as it does include a range of technical considerations. For example, there is some discussion on the nature of the entity, company, formal partnership from a legal perspective.

This builds on some of the knowledge and learning that has been requested by and offered to Towns around different company forms and the considerations of the following topics:

- fees and charging mechanisms,
- board representation,
- state aid / subsidy control,
- tax and accounting considerations,
- TUPE and other HR issues,
- exit strategy and wider risk management.

As set out in this paper, these same topics are likely to be relevant for PPPs and in many cases for wider Towns Fund projects.

PUBLIC PRIVATE PARTNERSHIPS (PPP) – A DEFINITION

The definition of a PPP, involving financing, taken from the CP3P guide is:

> *"A long term contract between a public party and a private party for the development (or significant upgrade or renovation) and management of a public asset (including potentially the management of a related public service), in which the private party bears significant risk and management responsibility throughout the life of the contract, provides a significant proportion of the finance at its own*

risk, and remuneration is significantly linked to performance and/or the demand or use of the asset or service so as to align the interests of both parties."

This description is important as when attracting investment from the private / voluntary sector, Towns need to adopt a project / contract finance model, which allows for the features explained in the definition above.

If Towns were merely borrowing through the private / voluntary sector as corporate finance into the Council's general funds it is highly unlikely, although not impossible that the private / voluntary sector can match the interest rates that a Council can access and therefore there is a high risk that "passive" corporate financing will not reflect a value for money position.

We therefore need long term partnerships between the public and private sector that go beyond purely the provision of funding. For example, private and voluntary sector organisations may partner in order to share responsibility for taking on the risk of the project and delivering it in the long term.

Expanding on the PPP definition above, we now take each phrase in turn and provide an explanation.

Table 2 - Elements of PPP definition

Phrase	Explanation
Long term	• Risk transfer to the private party for a significant part of the life of the property or infrastructure asset
Contract	• Written document setting out obligations of both parties • Sometimes very complex • Award via public competitive tender process
Public party	• Government or agency acting on behalf of the government • Also known as Procuring Authority in the Guide
Private party	• The private sector company or companies involved in delivering the project (could be voluntary sector) • Private partner relates to contractual counterparty to the public party • Consortiums set up a new company or SPV (Special Purpose Vehicle)
Development and management of the asset	• Contractor builds to a high standard in order to reduce ongoing maintenance costs • This might result in increased operating profit of contractor, combined with savings to the public body
Significant upgrade or renovation (alternate to development)	• Capital intensive projects
Potentially including the management of a related service	• Guide focused on property and infrastructure provision • But allows for ongoing management and operation (i.e. delivery of services) • E.g. contractor builds a major transport system and then • operates the system
Significant management responsibility	• The bulk of the management of the asset is the responsibility of the contractor • Includes responsibility for life-cycle cost management
Significant risk transfer	• Majority of risks / significant risk transferred to the private party to manage (assumes that private party is best placed to manage the risks – this is the business case / VFM case) • Contractor will bear potential losses if the risks are not managed appropriately
Significant	• Transfer of the bulk of the risks • Where risk better managed by the public partner it should remain with the public partner

DESIGN, BUILD (OR MAJOR UPGRADE / RENOVATION), FINANCE, OPERATE AND MAINTAIN (DBFOM) AND OTHER PERMUTATIONS

As outlined in the section above we are expecting the use of PPP contract models / partnership approaches / commercial arrangements in many cases, especially where there is a need to attract investment.

A DBFOM arrangement brings the long-term (typically 7-25 years depending on the asset class) contract structure needed but it should be noted that there are a number of permutations that could be adopted here:

- A DBFM arrangement reflects a position whereby the Town / public sector bodies / other unrelated third party still retains operations control of the building day to day. This is true of a school, where the operations are run by the teaching staff, the Local Authority or an Academy Trust, even if the building fabric and its maintenance is outsourced. Also, a PPP can be a DBOM or DBM model, where the private /voluntary sector partner is not bringing finance.

Figure 4 below summarises the contractual relationships and structures in a typical PPP arrangement. Here we have the Town contracting with the Private Partner, usually a Special Purpose Vehicle (SPV) set up solely for the delivery of the project, though it could be directly into an Outsourcing or Construction Company.

Figure 4 assumes a DBFOM or DBFM model, with private finance. This private finance (debt and equity) comes into an SPV. Firstly, the SPV (or Outsourcing or Construction Company) coordinates the Construction Contractor. Once the facility is built, the SPV coordinates the Operations and Maintenance Contractor(s) (O&M).

Here we show monies flowing from the Town to the SPV over the term of the contract, which is used to fund the O&M and repay the debt, and ultimately equity. However, this could be entirely, or in part service user payments, into the SPV for the same purpose.

Figure 5 highlights the six steps to the contractual arrangements, including the potential handback to the Town at the end of the contract term.

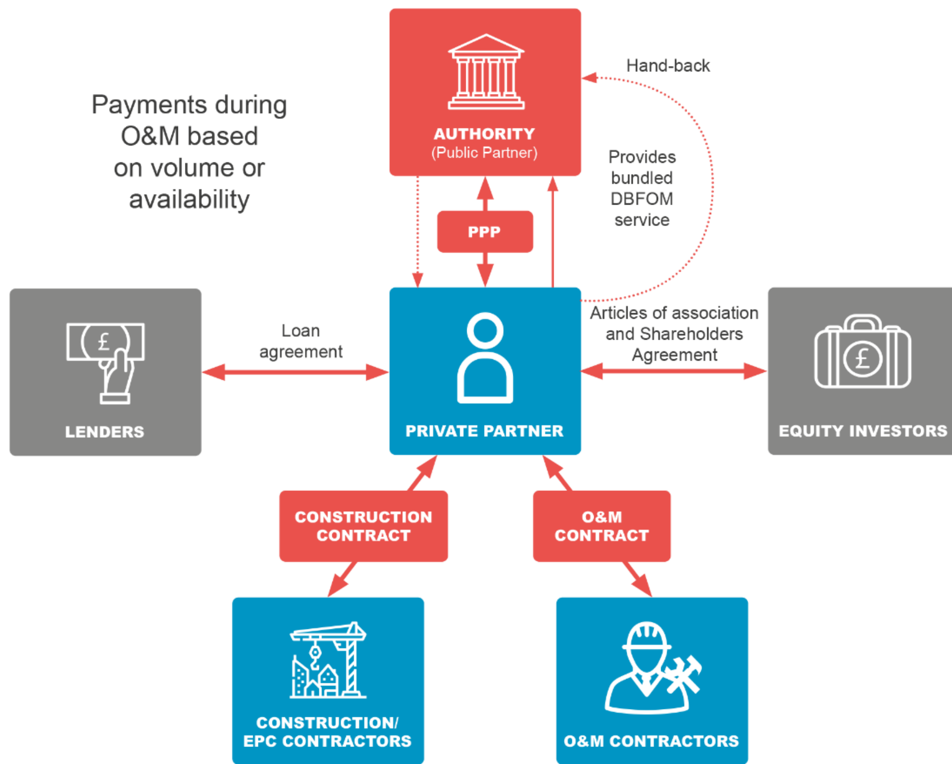

Figure 4 - Contractual relationships in a PPP arrangement – simplified (taken from the CP3P guide and training)

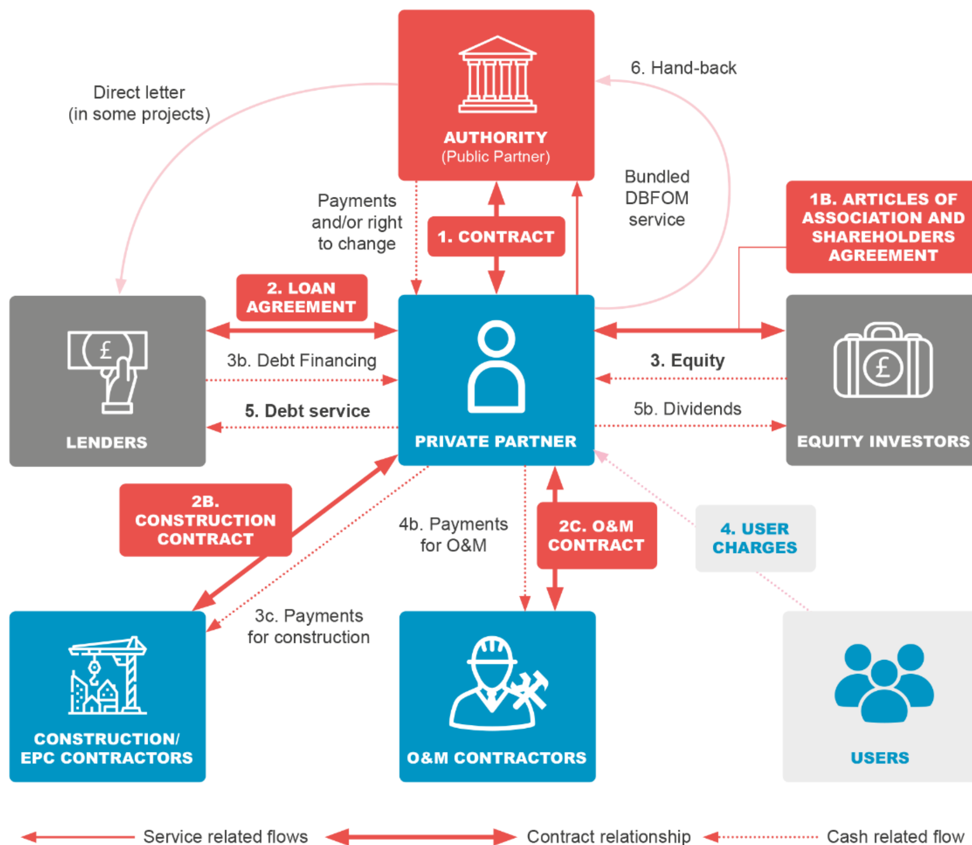

Figure 5 - Contractual relationships in a PPP arrangement – more complex alternative (taken from the CP3P guide and training)

DBFOM INTEGRATION VS TOWERS AND RISK TRANSFER

Towns will need to decide who is best placed to undertake the DBFOM, including on the basis of best VFM. In cases where the public body does not have the in-house design, build or maintenance expertise, these services will need to be procured in one way or another.

The question to be asked in the commercial case is whether it is better to combine and integrate these services into a single long term / whole life contract, or purchase the services as individual "towers" of short-term contracts.

Whilst it is not possible to generalise, there are advantages of linking the design and build. If a party has continued involvement in the operations and / or maintenance of a facility, they may have a different focus on how it is designed and built. An example of this is the Scottish Parliament, where the design, build, operation and maintenance activities appear to be progressed through individual ('towers of') contractual arrangements.

The other question relates to the form of contract, as to whether it is an:

- input-based contract, which essentially means the Town is paying on the basis of time and materials (i.e. the inputs); or
- output-based contract, which most PPPs are, where you are buying (or the service users / public are buying) a service asset to pre-agreed standards.

There is also potential for an outcomes-based contract, where the Town or service users are less interested in the delivery, and focussed on seeing a policy outcome achieved. In these instances, the mechanics of delivery can be left to the partner organisation.

When choosing between integrated DBFOM/DBOM/DBM compared to 'towers' of contracts, it is important to consider the following questions:

- **What are the benefits of combining/integration?** - *i.e. are there advantages in having the same party designing and then building the property or infrastructure? Also, if the party knows that they are responsible for delivering operations/maintenance of the property or infrastructure in the medium/long term they are likely to design and build with ease of operations and maintenance in mind*

- **What are the risks?** *These could include[3]:*
  - *Construction*
  - *Demand (operating/political/environmental)*
  - *Third Party revenue*
  - *Performance and availability*
  - *Change in relevant costs*
  - *Change in law*
  - *Obsolescence*
  - *Residual value*

- **What is the value of transferring the risks / having the risk held by the contractor, including the eight risks listed above?** *Is the contractor the party best able to hold those risks? Where this is the case then having the contractor holding these risks should offer best value for money.*

- **What is the value of innovation brought by the contractor?** *Here there is an expectation that the contractor, given their range of experience, should be able to bring ideas and approaches to the public bodies that may offer a better value for money solution. The ability for the contractor to do this will depend on the type of commercial model adopted and the procurement approach taken.*

[3] These risks also outline the eight standard categories of risks seen in PPPs

- **What is the value of the due diligence undertaken by the contract upfront and then through regular reporting?** *With more complex commercial models, for example PPPs, there is a significant amount of upfront work that is needed, not just between the public sector and the private sector but also down the private sector supply chain. For example, given the risk they typically bear, the prime contractor will want to know the costs of design and build from that contractor and as far as possible the ongoing operations and maintenance costs across the lifetime of the project. Also, when there is private finance involved the debt and equity providers will also want, as far as possible, certainty across the lifetime of the project. Then once up and running there will be well established reporting protocols, for example, the CFO of a PPP SPV will spend significant amounts of time regularly reporting to the lenders and investors. All of this due diligence planning will cost time and money, but also should bring value to project delivery.*

- **What is the value of passing the medium / long term property / infrastructure or service delivery challenge to the contractor?** *Does this allow the public body to focus on "front line" service delivery? The theory of PPP is that the public body is buy serviced accommodation over the long term delivered against a tight output specification. This should mean they have time instead to focus elsewhere. This has been evidenced in practice.*

Towns must consider who bears which risks as part of the commercial case, and this may also link to the other cases of the five-case model.

As above, the VFM theory is that risk is held by the party best able to manage that risk. Typically, with the design, build and maintenance of a community, commercial or residential property, the private sector partner is best placed to take construction risk, third party revenue risk, performance & availability risk, change in relevant cost risk (see below) and some aspects of change in law given its experience in delivering this type of project. The private sector partner can utilise this experience to manage and mitigate these risks. Generally, demand risk and residual value risk remains with the Town, but each deal will be different.

Given the breadth of projects that the Towns Deal will deliver, a bespoke approach to risk management should be taken to ensure there is rigour in how risk is allocated amongst parties. This will help to ensure that a VFM position is maintained.

It is important to note, that the risk transfer described above can be achieved without having private finance and can happen on a DBOM or DBM arrangement. However, the theory is that the injection of private finance sharpens up the private sector partner's commercial delivery incentives. This is the reason why PPP style arrangements have been undertaken by some UK financial institutes (in a role akin to the Town) and in jurisdictions with significant Government surpluses and reserves.

Should private finance be in place to fund all or part of a project, the VFM case for a project will be focused on whether the high cost of private finance is offset by the benefits of combining the DBFOM, risk transfer to the private sector and innovation from a private sector partner. Also, the involvement of a private sector partner provides value for a Town in that a significant portion of the end to end delivery will be passed across, allowing the Town to focus on front line services.

STAGES IN PPP PROCUREMENT

The diagram below provides a six-stage process for PPP procurement – across preparation; implementation and procurement; and contract management, including handing back.

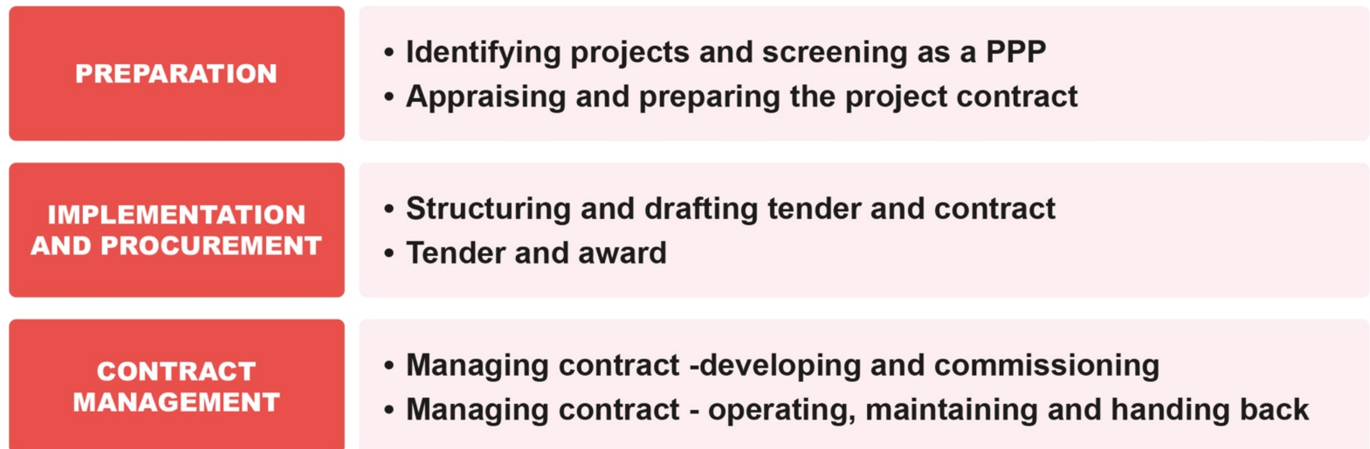

Figure 6 - Stages of the PPP procurement process

These stages can be mapped to the business case approach, with the identifying and appraising happening across the SOC and OBC. As above, there is an interplay between the commercial case and the economic case here. The economic case should firstly consider optimal VFM in terms of scope, solution, delivery, implementation and funding but then by looping back around to each of the five cases where we feel that using a PPP delivery model and private finance is advantageous / preferred.

Also, during the SOC and especially the OBC there will be increasing levels of market engagement. Options may need to be revisited, for example, if the supply chain / investors suggest something innovative, whether in terms of scope, solution, delivery or implementation.

In some sectors we have seen market led proposals, where rather than the Public Body drafting the business case, they call for ideas in the form of HMT compliant business cases from the supply chain. This is especially efficient where we know there will be a wide range of innovative and emerging ideas.

The structuring and drafting of the project scope and contractual arrangements will happen during the OBC, prior to it being launched on the market as a tender. The tender and procurement processes will run in parallel with the FBC, with the award being made at the same time as the FBC is signed off.

Again, during this procurement / FBC process it is highly likely that there will be new ideas generated which may change the approach. The challenge is to consider whether these changes are so fundamental that it requires stepping back to OBC and potentially relaunching the tender, or if they can be accommodated through the FBC development process, which does involve reopening each of the five cases to record the actual deal to be signed.

Once the FBC has been developed to reflect the actual deals signed, this provides an excellent step off point for the next stages of the business case development. These are to enact the management case arrangements in relation to costs, benefits and risk tracking across the whole life of the asset / contract term and to understand period post implementation project reviews.

These stages of the business case development reflect the management of the contact – developing and commissioning and the management of the contract – operating, maintaining and handing back.

ATTRACTING INVESTMENT

This section provides some high-level principles around funding and financing, including private / alternate financing. It explains the important relationship between particular commercial models and the ways in which funding and financing, including private / alternate financing is attracted and deployed.

FUNDING AND FINANCE

In this section we focus on the distinction, made in the CP3P material (https://ppp-certification.com/), between funding and finance.

The CP3P material views funding as monies that do not need to be repaid, whilst finance as monies that do need to be repaid via funding streams such as existing income, new income, or asset disposals.

In the CP3P material it is suggested that financing is used for capex purposes, whilst funding is for revenue spend. This is consistent with the view that borrowing should, ideally, not be used to fund day-to-day expenditure, but instead be used for capital purchases.

PROJECT FINANCE

As already mentioned, we anticipate that any private / alternate investment alongside the Towns Fund grant and/or public body monies, including its own corporate borrowing is likely to be project finance.

This is because the private / alternate investment is unlikely to be at lower interest rates than a public body can borrow at (e.g. Public Works Loans Board – PWLB) hence to make the VFM case, the private sector investors or their contractor partners need to have wider and longer-term involvement.

Project finance is how we obtain money from lenders. The focus for lenders is on expected revenue stream, with lenders considering the project as a distinct entity with its own project assets, project related contracts and project cash flow.Three basic considerations that lenders need to be confident are present:

- An agreement to complete the project and a commitment to provide all the funding necessary
- An established demand for the project outputs such that the project will generate sufficient cash to meet all its operating expenses and debt servicing requirements
- Assurance for the availability of adequate funds during the Operations Phase of the project to maintain and restore the project in operating condition

The project finance lenders are unlikely to focus on the trading history or balance sheet of the borrower. Instead they will likely be more interested in the project and how successfully it can be delivered. The material below, including the “Waterfall” summarises the lenders considerations in terms of financial viability.

The order in which cashflows in a project finance arrangement are repaid (i.e. the last item to be distributed out of the ring-fenced special purpose vehicle is the equity returns / dividend payments) is often referred to as the “Waterfall”. This can include:

- Revenue
- Operating costs
- Reinvestment
- Taxes
- Debt principal
- Debt interest
- Reserve accounts
- Equity investments

The section above includes details of the due diligence needed for PPP arrangements. The lenders will very closely monitor the project’s performance (through the use of items such as its accounts and operational financial models) and the cash waterfall. This is to ensure that there is headroom across the term of the contract to deliver the design, build, operations (where included) and maintenance obligations, and absorb risk where necessary. Activities that are typically undertaken by lenders when assessing opportunities include:

- Decide on the basis of cashflow and debt profile
- Undertake sensitivity analysis to assess downside scenarios and risk

- Analyse risk structure of the contract to understand who will bear the key risks and rewards
- Exercise tight control over cash flows

FUNDING AND FINANCE OPPORTUNITIES

Below are a series of live funding and financing opportunities as of November 2021.

Funding

In relation to funding opportunities (i.e. monies available that do not need to be repaid) alongside the Towns Fund grant monies a public body can use its own monies / reserves. Also, there might be other grants that can be "pooled". Two recent examples of other grant pots are:

- The **Levelling Up Fund (LUF)** brings together the Department for Transport, the Ministry for Housing, Communities and Local Government (now DLUHC) and the Treasury to invest £4.8 billion in high-value local infrastructure up to 2024-25. The Fund will invest in local infrastructure that has a visible impact on communities. The Fund is designed to help local areas select genuine local priorities for investment.
- The **Social Housing Decarbonisation Fund (SHDC)** aims to upgrade a significant amount of the social housing stock currently below Energy Performance Certificate (EPC) C up to that standard, delivering warm, energy-efficient homes, reducing carbon emissions and fuel bills, tackling fuel poverty, and supporting green jobs. The government has announced £160 million for the first wave of the £3.8 billion will be available in financial year 2021 to 2022. The SHDF will offer the potential for registered providers of social housing, including private and local authority providers, to upgrade the energy performance of their social homes.

Financing

Below are some examples of finance opportunities (i.e. monies that do need to be repaid, and this would be via Funding streams, i.e. existing income, new income, asset disposals, etc.) alongside the Towns Fund grants.

These covers both Corporate Finance (i.e. borrowing against historic and existing income streams and balance sheet) and Project Finance (i.e. borrowing against a future project and its own cashflows, with the lender/investor generally supporting project delivery, accepting risk, bringing innovation, involved for the long term, etc.).

- **Prudential Borrowing – Public Works Loan Board or similar**
  - This is the most common approach used by public bodies with borrowing powers. This is a form of corporate finance but needs confirmation around the powers to repay. Currently, it has a low cost finance and is easy to arrange.
  - It does not link or formally tie itself to any specific project. Arguably it is the benchmark when considering the value for money of other lenders / investors proposals.

- **Prudential Borrowing – Specialist ESG loans**
  - Historically, the now discounted Salix Loans were at zero interest. There are other specialist loans, such as the Mayor of London's energy efficiency fund that in some cases offer sub PWLB interest rates.
  - Generally, these are project finance arrangements, i.e. linked to a specific project, but do not involve the lender / investor supporting project delivery, accepting risk etc. Therefore, the VFM case is purely that interest rates are lower, plus potentially there is some project specific due diligence and reporting offered by the lender / investor.

- **Prudential Borrowing – Green / ESG Bonds including potential crowdfunding**
    - Recently we have seen Local Authorities issue Green / ESG Bonds. These can be corporate finance, where bond holders are just supporting the authority but with a commitment that the monies will be used for Green / ESG purposes, which given Local Governments social value responsibilities should be fairly straightforward.
    - Other Green / ESG Bonds are project specific, again with a commitment that the monies will be used for Green / ESG purposes, but also the bond holders / investors potentially taking a more active role in project delivery. To date the Green / ESG Bond interest rates have been sub PWLB rates and therefore, again offer VFM. The VFM case is strengthened should there be this link to more a more active role in project delivery and achieving a degree of risk transfer.

- **Project Finance, Private or Alternate Finance**
    - There is a long standing, well established approach to the use of project finance, private finance or alternate finance. The VFM case is that although the interest rates are higher, the active involvement by the lender/investor – or their supply chain partners – in supporting project delivery, accepting risk, bringing innovation, being involved of the long term, etc offsets this.
    - This is standard Public Private Partnership theory. In this instance we are assuming that the underlying assets and the financing liability is on the balance sheet. However, it is not the balance sheet treatment that should drive decisions, but instead the VFM assessment. There is well established guidance on this matter, found in HM Treasury's BBC and Green Book approach.

- **Lease Arrangements**
    - It may be helpful to see lease arrangements as a form of project, private or alternate finance. Again, with the new lease accounting standards (IFRS16) we would typically expect lease assets and liabilities to be 'on' balance sheets, but each arrangement should be assessed on its own facts.
    - However, the VFM test remains whether a lease arrangement (i.e. borrowing rather than build or buy) for the short, medium, or long term is better VFM. Lease arrangements provide flexibility not offered by building or buying, and it is possible to lease a range of green interventions, for example solar panels to be fitted on roof spaces or energy centres.

- **Pure Service Contracts**
    - Net Zero and wider ESG can look to the mega agendas of the UN Sustainable Development Goals and the concept of the Circular Economy. The latter moves away from extracting raw materials, manufacturing and then sending to landfill and instead focuses on a closed loop system where materials are reused.
    - Part of the Circular Economy thinking is the approach to buying as a service, rather than buying as an asset. Buying an electric vehicle service via a car share, an office desk by the day, or a lighting service can result in those assets being used more intensively.

- **Private to Private (or Voluntary to Voluntary)**
    - Often the real focus for a Public Body is the delivery of a policy outcome. There are instances where a purely private to private (or voluntary to voluntary) sector financing arrangement can achieve the outcome. This means the Public Body's involvement is different.
    - For example, if a Public Body wants an innovation hub to be built and run by the voluntary sector and there are also opportunities to develop commercial or residential space on the same site, it could be that this financing arrangement can be put together by the Public Body, but without the Public Body having control or investing the majority or even a significant proportion of the funds.

- If the economics and commercials of the deal work then arguably it is better if the private or voluntary sector are left to it. There is often some form of economic or commercial viability gap. However, this can be closed perhaps by a small capital injection from the Public Body or just through the Public Body providing a guaranteed level of usage, an underwriting.

Meanwhile, the guidance assumes that the match funding (no need to repay) or financing (to be repaid) is in the form of cash, either upfront or across a project term. However, for completeness it is important to note that match funding may be in the form of the provision of assets rather than cash investment. Many of the same considerations around the basis of which the asset or joint working staff are relevant, for example how will those offering the match funding be repaid and what risks are they taking. As above, there are also some accounting considerations relevant to the injection of assets.

DECISION TREE APPROACH TO FUNDING AND FINANCE

Funding and finance

Under the Towns Fund programme, Councils may have multiple projects. We have listed the following questions to help encourage Town's thinking around different types of funding and finance that may be applied to each project. This could also apply at a sub-programme level for multiple, similar projects.

1. Do you plan to crowd in additional funding / finance beyond the Towns Fund grant money – on the basis of the business case benefits, costs and risk VFM assessment?
2. If the answer to question 1 is yes, will this be funding (money that does not need to be repaid) or financing (money that does need to be repaid)? If the answer to question 1 is no, then skip to the section below on commercial models.
3. If the answer to question 2 is financing, will this be corporate finance (generally borrowing) or project finance (tied to the project and its outputs/outcomes)? If the answer to question 2 is funding, skip to the commercial models section. If the answer to question 3 is corporate finance, go to question 4. If the answer to question 3 is project finance, go to question 6.
4. If the answer to the question 3 is corporate finance, will the Council be prudentially borrowing through PWLB?
5. If the answer to question 4 is no, is the Council able to borrow as corporate finance below PWLB rates? E.g. through bond issuance/crowd funding. If the Council cannot borrow below PWLB rates please consider the business case for using higher cost borrowing.
6. If the answer to question 3 is project finance, please consider the following questions:
    a. is it Council borrowing, voluntary sector investment or private sector investment?
    b. is the intention that the higher costs of project finance (especially private sector investment) will be offset by the value of risk transfer to the investor/supply chain, by the value of innovation brought by the investor/supply chain, by the value of integrating the design, build, finance, operations, maintenance (or subset) over the long term, by the due diligence undertaken by the investor/supply chain?
    c. what is the Council's role? Is the project finance through the Council repaid by the Council; is the project finance through the Council but repaid by service users/third parties; is the project finance directly into a third party repaid by service users/third parties?
    d. Will you be using: PWLB; specialise ESG loans; ESG bonds (including crowdfunding); project finance; lease; pure service contracts (no asset); private to private arrangements; or a combination of these? These are summarised in the Funding and Finance Opportunities section of this paper.

Figure 7 below (generated specifically for this guidance) aims to provide a summary of the questions asked above. Care is needed in using this decision tree and we recommend it is used in conjunction with the questions above.

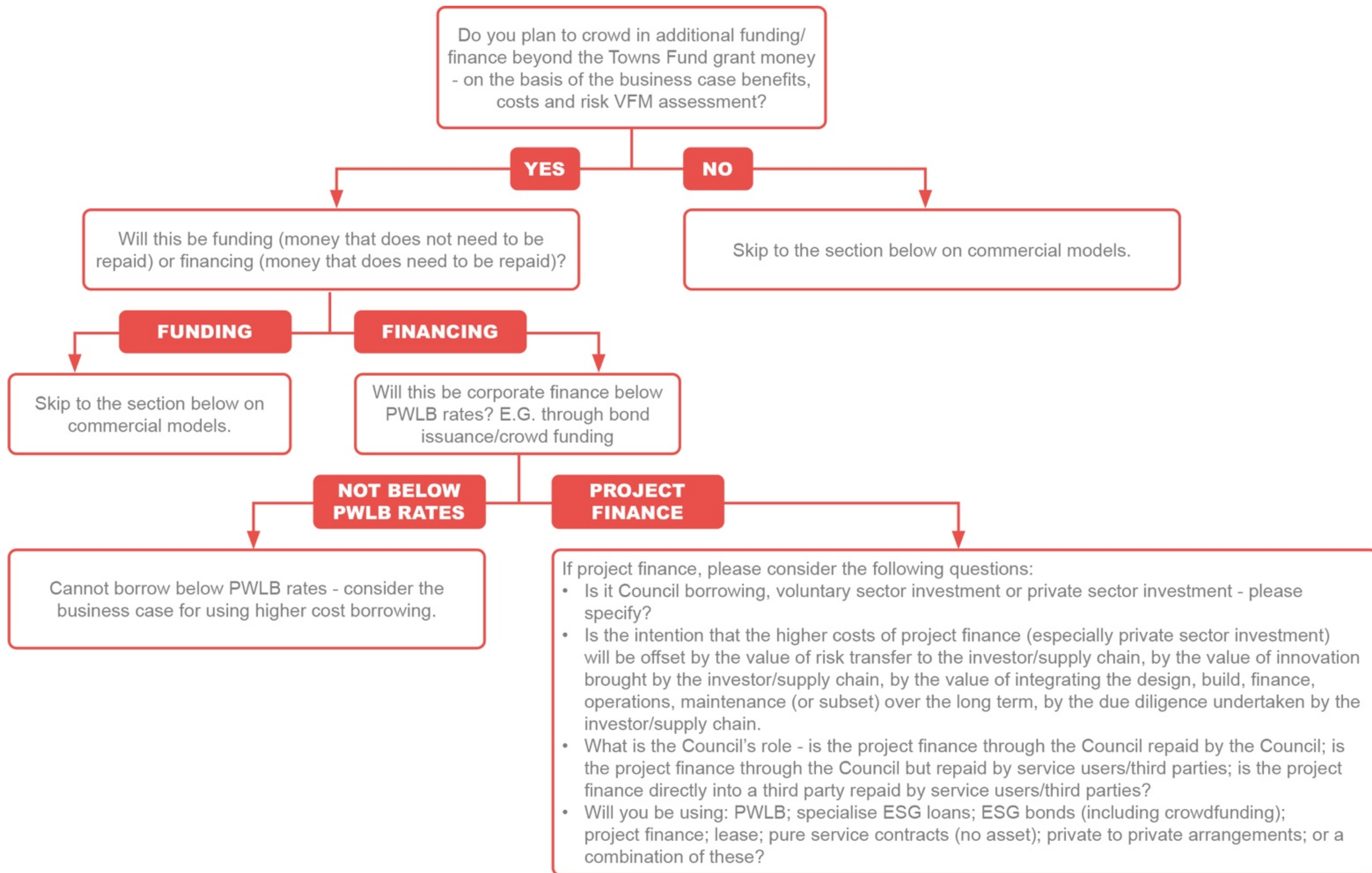

Figure 7 - Decision Tree

Commercial models

The following checklist should be considered in relation to commercial models.

Table 3 - Commercial Models Checklist

Question	Tick (✓)
Have you considered the range of models show in the graph above that was developed by the ICW?	
Which commercial model do you plan to use to deliver your Towns Fund project?	
Has this been assessed as the best VFM approach to delivering your project – balancing benefit, costs and risk?	
Based on the graph above developed by the ICW, what relationship do you require with your supply chain partners?	
Are the ongoing contract management and governance proposals consistent with this relationship?	
Does the commercial model meet the definition of a PPP outlined above? If yes, have you considered the PPP guidance?	
Does the commercial model meet the definition of a JV outlined above? If yes, have you considered the JV guidance?	
Where using PPPs/JVs have you considered:	
• **the value of risk transfer to the investor/supply chain;**	
• **the value of innovation brought by the investor/supply chain;**	
• **the value of integrating the design, build, finance, operations, maintenance (or subset) over the long term;**	
• **the due diligence undertaken by the investor/supply chain?**	
Has this consideration been formalised in the commercial case of the business case?	
Have you progressed market engagement in relation to your project?	
Will you be launching a procurement competition (whether for design, build, operator or maintain works or for a JV partner) following the approval of the FBC (lite)/business case seen by DLUHC which secures the Towns Fund grant monies?	
Do you plan to develop a final FBC, to run in parallel with the procurement, which will detail the actual project and deal completed?	
Based on initial market engagement/parallel procurements are you already aware of issues around construction price inflation, the availability of labour, the availability of materials? If yes, have these already been factored into the business case?	
Based on initial market engagement/parallel procurements are you already aware that the shape of the project is likely to be different from what was already proposed?	
Has the supply chain partner/investors already suggested an alternate solution?	

Finally, the following questions should also be considered when building the business case for your projects:

- Are you happy with the resource available to progress what could be a complex project?
- Has your team or members of the Council been trained in BBC? If not, do you think you would benefit from training in BBC. Also, would they benefit from training in PPPs/complex contracting/commercial models?

Meanwhile, although not covered in this paper, for PPPs in parallel to JVs there are a wide range of procurement, legislative, accounting and tax questions. These include opportunities to achieve specific accounting and/or tax treatments, which will deliver certainty for the public body and the supply chain.

PRIMARY VS SECONDARY MARKET

For completeness it is worth considering primary vs secondary market investment and to comment on displacement.

- Primary market investment creates new assets, property / infrastructure, economic activity.
- Secondary market investment is buying existing assets, again property / infrastructure, companies, etc.

The socio-economic analysis in the business case looks very different between these two types of activity. Arguably, secondary market activities merely increases the asset price and does not drive enhanced outcomes. In reality it is more complex than this, with it being possible that a secondary investment can drive transformation, provide a secure income stream, and/or secure the future of a business. However, it is important to understand this distinction from primary activities.

NEXT STEPS AND FURTHER RESOURCES

This section provides links into other material developed by TFDP as part of the Towns Fund programme.

INTERACTION WITH PREVIOUS ATTRACTING INVESTMENT GUIDANCE

There is a range of relevant TFDP-issued guidance and resources that this material builds on.

Match Funding Guidance

Towns have successfully submitted their Town Investment Plans and have prepared, or are currently preparing, Business Cases for their interventions. As part of the preparation of these Business Cases, Towns need to consider all the sources of funding and how these sources will be used to deliver their interventions.

This short note sets out guidance on match funding, and more widely co-funding, for Towns as part of the production of Business Cases for the projects that were allocated Towns Fund funding. While it is not an exhaustive or fully comprehensive note, it aims to support the development of the Business Cases and decision making of Towns.

It should be noted that a degree of judgement will still need to be applied by Towns on a case-by-case basis when explaining how match funding has been achieved. We have included some examples at the end of this guidance.

Click here to access and download the Match Funding Guidance.

Delivery and Procurement Methods Guidance

This short guidance evaluates both delivery and procurement methods against the needs of the Towns, setting out key considerations to consider when identifying the options for delivering their project. This document is purely informative and does not constitute advice. The options evaluated are as follows:

Delivery Methods	Procurement Methods
We considered the creation of a company to deliver the project and the options explored were: 1. Company Limited by Shares 2. Community Interest Company 3. Community Benefit Society	We considered the procurement methods to appoint a contractor under the direct contracting arrangements and these were: 1. Direct appointment 2. Open procedure 3. Restricted procedure 4. Competitive dialogue 5. Competitive procedures with negotiations

Click here to access and download the Delivery and Procurement Methods Guidance.

State Aid

This blogpost summarises the key changes to state aid (also known as *subsidy control*) arrangements as the UK formally left the EU and implications for towns.

Click here to access the blogpost.

CONCLUDING THOUGHTS

We hope that this guidance, and the underpinning guidance on business cases, commercial models, joint ventures and PPPs is helpful.

Also, in the case of business cases and PPPs the training programmes referenced are readily available for those that might be interested.

We do expect that market support will be needed where a Town is planning to progress a PPP with significant private /alternate finance against a backdrop of a complex supplier.

Where a Town is planning to limit its Towns Fund related spend to the grant money it has been awarded utilising pre-existing framework partners, under a straightforward design and build contract, then external support is less likely to be needed.