

# NON-PROFIT DISTRIBUTING MODEL – THE FUTURE FOR WELSH INFRASTRUCTURE PROJECTS?



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The Welsh Government has committed to three infrastructure projects using the Non-Profit Distributing (“NPD”) Model – the redevelopment of the Velindre Cancer Centre; [“dualling” of sections 5 and 6 of the A465](#); and the 21<sup>st</sup> Century Schools Project. Together, these aim to raise £1.9 billion of infrastructure investment.

On 30<sup>th</sup> September 2015, the Welsh Government published a [Written Statement](#)<sup>i</sup> providing an update on the 21<sup>st</sup> Century Schools NPD Programme, in which the success of NPD was praised for delivering value for money. This followed an [earlier announcement](#)<sup>ii</sup> by Jane Hutt in March 2015 at a Financing Welsh Infrastructure event, which *“outlined how innovative finance, including through the Non-profit Distributing (NPD) investment model, and new borrowing powers would help the Welsh Government to boost economic growth, address austerity, and support sustainable jobs.”*

## What is NPD?

The Non-Profit Distributing (“NPD”) model is simply an alternative funding structure for public-private partnership (“PPP”) projects that would previously have been carried out under the Private Finance Initiative (“PFI”). Many of the perceived problems with PFI stemmed from the private sector receiving surplus “windfall” profits on top of their anticipated rate of return, and also loss of public control over public sector assets.

Therefore, what NPD seeks to do is to create a structure under which –

- The private sector takes a fixed rate of return
- The public sector has greater control and transparency over the project company delivering the project, usually through a “golden share” giving enhanced voting rights on key issues, although other methods are possible
- Surplus profits are not distributed to the private sector. Instead, they can be returned to the public sector, used to pay off debt, or invested in more or higher-standard services or infrastructure.

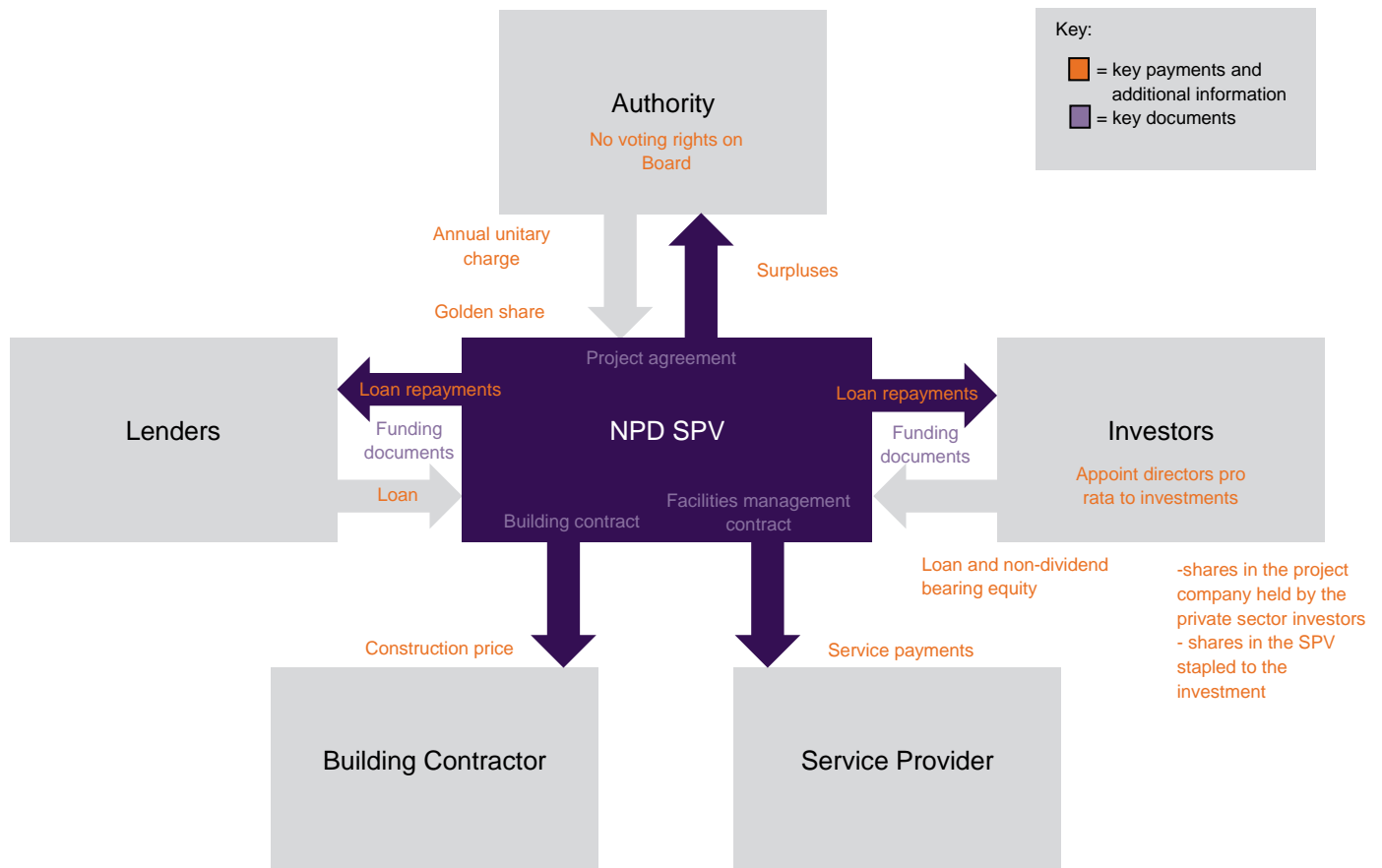
It is therefore not a “not for profit” model. Contractors and lenders are expected to earn a normal market rate of return, as in any other form of privately-financed PPP deal.

The NPD model is defined by the principles of enhanced stakeholder involvement in project management; no dividend-bearing equity; and private sector return capped at a reasonable rate set in competition through an open procurement process compliant with EU rules. Investors bid a rate of return in competition.

It is important to realise that apart from this, NPD is not very different to traditional forms of PPP including PFI. In particular, the distribution of risk between public and private sector, including to construction and service contractors and their sub-contractors, is much the same.

Project Bank Accounts (as supported by Constructing Excellence Wales and Welsh Government) are not mandatory but could also have an important role to play in ensuring fair payment for sub-contractors.

## How are NPD projects structured?



There is no specific corporate structure requirement but so far NPD projects have adopted a structure that involves the creation of a special purpose vehicle (“SPV”) company limited by non-dividend bearing shares. Apart from one golden share, which is held by the authority, shares in the SPV are held by private sector investors. This follows the principle that the SPV should be managed by the parties whose lending is at risk. The golden share gives the authority controls over the corporate, governance and management structures of the SPV.

Investors appoint the majority of the SPV’s directors pro rata to their investments, which gives them control over the SPV. Ownership and control of the SPV transfer with investment, as shares are “stapled” to investment. To ensure visibility for the public sector over the governance and management of the SPV, a Public Interest Director is usually appointed to the SPV’s board. This individual is tasked with monitoring compliance with good governance and the NPD principles; bringing opportunities for refinancing to the board’s attention; and acting as an independent voice. In Scotland, this individual has been appointed by the Scottish Futures Trust (an independent company wholly owned by Scottish Ministers that processes NPD projects in Scotland) rather than the authority, which has rights of observation only.

## What does the ONS decision mean for NPD?

In July 2015, a review by the Office for National Statistics of an NPD project (the Aberdeen Western Peripheral Route), resulted in the project being given a public “on balance sheet” classification. Under

HM Treasury budgeting rules, this does not increase the overall cost of the project but means that capital charges are payable by the purchasing body, thus decreasing the amount of money available to fund other activities. It may also have tax implications (depending on the nature and structure of the project).

The decision has now been referred to Eurostat (the EU statistical body) for clarifications, as the ONS decision was based on application of the European System of National and Regional Accounts (“**ESA 2010**”), and a response is expected sometime in November. Therefore, the future progress of NPD is on hold until the decision and its implications are known.

### **What is the likely impact on NPD?**

ONS’ decision was largely founded on the degree of control exerted by the Scottish Government in the Aberdeen case. The “golden share” appears to be a key factor in ONS’ decision as to whether an SPV is classified as being subject to public or private sector control. It is therefore likely that the answer will lie in reducing the level of public sector control. ONS was also of the view that the public sector’s share of the rewards of NPD SPVs is too great for the assets to be classified to the SPV. ONS specifically commented on the fact that all of the surpluses are to revert to the Scottish Government. Therefore it may be necessary to consider some form of re-investment in the project (rather than full pay back to the public sector), or a “pain – gain” share mechanism similar to NEC-type contracts.

The Scottish Government and the Scottish Futures Trust are now looking at potential changes to the organisation and role of NPD SPVs to lessen the degree of public sector control with a view to securing a private sector classification. The outcome of these deliberations is likely to affect the form that NPD takes in Wales.

### **How can Blake Morgan help?**

We are on the National Procurement Service (“**NPS**”) framework for Major Commercial Contracts (which includes infrastructure) and therefore we can be instructed by any Welsh public sector body (including local authorities, Health Boards and Trusts, and further/higher education bodies), in accordance with the terms of the NPS framework.

Our rates for the NPS framework have been competitively tested therefore provide demonstrable value for money. We are also based in Wales, so we are readily accessible and can save you time and resources.

### **Our experience**

We have been advising on PPP infrastructure projects since the start of PFI (including Bute Avenue Cardiff, one of the first PFI road projects). Recent PPP and other major infrastructure projects we have worked on in Wales include –

- Aberystwyth University student accommodation PPP - £40M
- Neath Port Talbot CBC care homes PPP with Gwalia - £165M
- Designed for Life strategic health infrastructure framework (all 3 phases since 2006)
- SEWSCAP framework (both phases) delivering 21<sup>st</sup> Century Schools programme in South Wales
- Rhondda Cynon Taf CBC engineering joint venture with Capita - £75M
- Velindre cancer centre – preliminary advice on forthcoming NPD scheme

We are also able to call on specialist advice on the NPD model from **Shepherd and Wedderburn**, who are experts on the Scottish NPD model.

In addition, we have worked on a wide range of PPP schemes outside Wales including for the **UK Department of Health** and other public bodies, as well as private contractors (including **Balfour Beatty** and **Philips Medical**) and funding institutions.

This range of knowledge and experience led to our appointment as Special Adviser to the Welsh Assembly's Finance Committee when they undertook a report into alternatives to PFI. This included a detailed review of all alternative models (including NPD).

We are also familiar with the increasingly important body of **Wales-specific legislation** within which procuring bodies, contractors and funders will have to operate.

Therefore we are able to provide the **full range of services** necessary to implement NPD, at **value for money rates** and from a base **in Wales**.

### Contacting us

We would be very happy to come and speak to you about any matter arising from NPD, or any future proposed infrastructure projects.

Please feel free to contact Simon McCann or Penri Desscan.



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