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PORT DEVELOPMENTS IN ASIAPAC:

A platform for regional growth and global trade

BY MICHAEL HARRISON AND RICHARD GUIT

Riding the wave: Australian student accommodation transactions

BY HARVEY WEAVER, MELINDA HARRIS AND PHILIP VERNON

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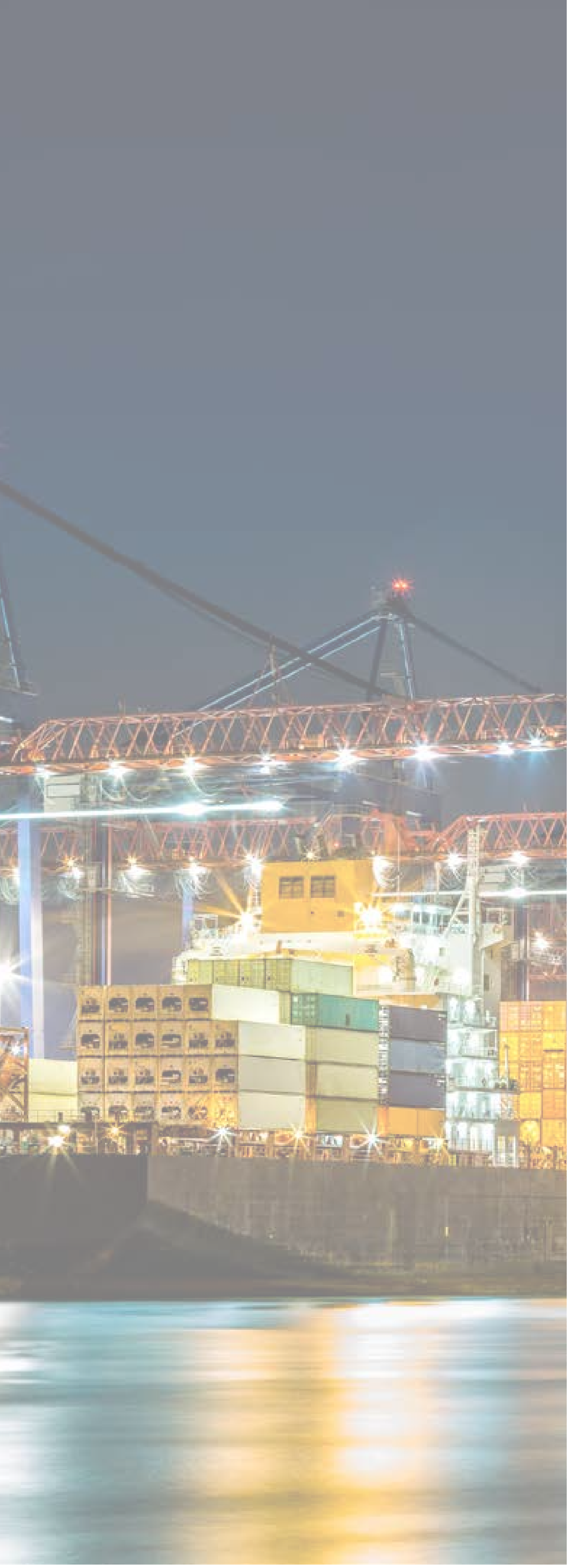

An overview of this issue

I am delighted to introduce this eighth issue of **Infra**Read, our biannual publication covering a range of legal and transactional issues relevant to the global transport and infrastructure space.

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PORT DEVELOPMENTS IN ASIAPAC:

A platform for regional growth and global trade

by Michael Harrison and Richard Guit

This article provides an overview of the various approaches to procuring port infrastructure and port services across Asia Pacific (for both government-owned and private ports).

We consider both whole-of-port and specific infrastructure (both land and marine), in the context of some of the more notable examples from Indonesia, Malaysia, Myanmar, Singapore, Sri-Lanka and Australia.

Background

Global sea-borne trade flows have slowed. In Asia Pacific the growth of some sea-borne trades has flattened, and in some areas declined slightly. At a macro-level, this reflects the Chinese slowdown, including at Chinese gateway ports. Nevertheless medium term growth is projected to be positive, with this growth to underpin and contribute to the increasing GDP of countries within the Asia Pacific region.

Ports are an enabler of trade, as around 90 per cent of global trade is sea-borne. Where ports are capacity-constrained, trade is inhibited and for this reason we continue to see focus by governments on "unlocking" the capacity constraints at and associated with ports. In many cases, the sea bed and land in ports is government owned. Theoretically, government ownership enables better facilitation of trade and policy implementation for the wider economic benefits of a region, state or country. This theory is challenged by fiscal reality. Competing calls on government capital increasingly mean that governments do not have the cash to spend, or the inclination to commit available funds, to unlock capacity constraints and to improve efficiency.

Unlocking capacity constraints and improving efficiency at ports can be achieved through increased port capacity and associated landside logistics (through infrastructure enhancement or development) and increased efficiency of marine and landside operations (through infrastructure enhancement and service innovation). In addition, competition between ports (and between terminals within ports) facilitates price competitiveness which itself drives efficiency. Furthermore, competition in the shipping industry has an impact on port development: the shipping industry exerts pressure on ports to invest to enable use of larger vessels. The response of ports to this pressure can affect decisions as to choice of transshipment port.

Ports are valuable,[1] and port capacity, of itself, is valuable.[2] The private sector is prepared to pay for and invest in this value proposition; indeed the development of transshipment ports around the world (including the world's largest, Singapore) demonstrates the value of transshipment port capacity to the shipping industry. Increasingly new ports and new port infrastructure are developed with the involvement of the private sector – a private sector comprising some of the world's most admired and best run companies. Best practice leads to increased service levels, improved efficiency of

1 Privatisation proceeds allow for government spending (or deficit reduction) now, within the current election cycle.

2 The ability to charge for use of ports (and, as such, port capacity) provides a clear pricing path in an environment of growth, and the ability to achieve economies of scale and efficiency gains.

operations and appropriate allocation of public spending.

Port models

Key to the consideration of how best to address port capacity constraints is an understanding of port models and port activities.

Port models: In general terms, there are four port models:

- **private service model**: the whole port is owned and operated entirely by the private sector;[3]
- **public service model (public service port)**: the port is owned and operated entirely by the host government or a government entity;[4]
- **service port model or labour model (tool port)**: the port (equipment and land) is owned by the host government or a government entity, and is either operated by government, or the government contracts with the private sector to operate all or part of the port; and
- **landlord model**: the port (whether publicly or privately owned) leases land within the precincts of the port to the private sector to undertake activities within the port, and the private sector invests capital to allow it to undertake those activities (effectively each private sector party is granted a concession, which may or may not be exclusive).

The structure of any port procurement depends largely on the port model and the activity being procured. In each port model, it is convenient to allocate activities into the broad categories of **Governance**, **Infrastructure** and **Operations**. These categories lend themselves to different approaches.

In our view:

- **Governance** activities such as security and quarantine matters are most appropriately and best undertaken by the relevant host government entities, who have the necessary expertise and resources to undertake them, recovering the cost of these Governance services through charges levied direct on the shippers.
  Other governance functions such as the harbour master role, vessel scheduling and berth allocation can be performed either by government or (with certain controls) the private sector.
  Maintenance of certain infrastructure – such as navigation aids – also falls within the Governance category, and may be undertaken by the government or likely more efficiently by the private sector under a services agreement;
- **Infrastructure** is best built by the private sector, and there is certain infrastructure (in particular Terminals and Ship Loading Facilities) that is appropriately designed, built, financed, operated and maintained (DBFOM) by the private sector entirely or a consortium comprising government and the private sector on a concession basis (typically in the form of a long term lease) to undertake activities for the period of the concession. On the grant of any concession on a DBFOM basis, once the infrastructure is developed and operational, it becomes integrated into the port operations, with the holder of the concession entitled to charge for use of the facilities for the term of the lease, sometimes on a regulated basis, sometimes not; and
- **Operations** within ports have long been undertaken by the private sector (whatever port model is used), with private sector stevedores either providing stevedoring services across the port or within an area leased to the stevedore (often in the context of a container terminal or other specific terminal such as a Ro-Ro) and in many ports towage services have long been provided by world class and world scale companies. Also pilotage and other local services (such as bunkering) are typically provided by the private sector.

Landlord model and mixed ownership

The **landlord model** and **mixed ownership and operatorship** of ports and ports infrastructure is increasingly becoming the prevalent model.

Where government remains the landlord, the landlord model and the mixed ownership and operatorship models allows government to maintain the ability to invest itself (for the benefit of the wider

As a general statement port activities comprise:

1. **Governance functions**: including **Customs, Quarantine and Immigration, Harbour Master** – vessel traffic management within the port, including to manage any collision; and, **Policing and Security Management**,
2. **Infrastructure (development and operation and maintenance) functions**: including **Breakwaters, harbour walls and shore protection and bridges; Port Channels and Dredging** – capital dredging and maintenance dredging – channels and berth boxes/pockets; **Jetties, piers, quays and wharfs, and berths; Terminals** – container terminals, roll-on-roll off, passenger terminals; and **Ship Loading Facilities** – dry bulk commodity storage and conveyors and loaders and liquid storage and loading; and
3. **Operational functions: Land side** – storage and warehousing and transport (likely road and rail, within the port precinct) and transport and logistics (to and from the port precinct); and **Stevedoring** – loading and unloading, and handling, of cargo services; **Marine side** – pilotage, towage, mooring and unmooring and services; **Infrastructure** developed under Design, Build, Finance, Operate and Maintain procurement structures.

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3 A private service model places market risk (and actually or prospectively market power because of barriers to entry for competitors) with the private sector, but the host government will want to be assured that it is able to achieve the benefits of the multiplier effect within the broader economy. It is reasonable to assume that the private sector will be concerned to achieve improved efficiency across all activities, and that it is likely to contract to achieve this, including to develop port capacity.

4 It is fair to say that even in public service ports and service ports some activities will be undertaken by the private sector, not necessarily under term contracts, but as contractors of the host government. The public service ports and service ports models do not preclude the government from involving the private sector in the development of some infrastructure on a piecemeal basis, but may not allow the host government to achieve efficiency levels that in the case of transshipment ports will attract increased trades.

economy) while at the same time allowing the private sector to fund the development of the port infrastructure.

We are increasingly seeing wholesale private sector participation in landlord model ports owned by government – through privatisations of existing ports and development of new ports. On a port privatisation the private sector generally becomes the lessee of the whole port, and landlord of facilities and terminals within the port (with government remaining the owner of the sea bed and the underlying land on which the port is built or is to be built). As the private sector becomes the lessee of the whole port and landlord of facilities and terminals within the port, there is likely to be alignment between the promotion of trade and the commercial drivers of the private sector lessee of the port – critically realising the value of valuable port capacity. Also, to the extent that the government landlord is concerned to ensure the promotion of trade, the regulatory regime will typically require the port lessee to develop and implement a development programme that recognises promotion of trade. On a port development, the same underlying principles hold true.

Examples of Landlord models and mixed ownership and operatorship in Asia Pacific

Port development is not new, and it is fair to say that in many ways the Asia Pacific region has led the way for some time.

In **Malaysia** the key container and bulk ports are Port Klang and Port of Tanjung Pelepas. Port Klang is the world's 12th busiest container port. It is administered and regulated by the Port of Klang Authority (POKA). POKA is the landlord. At Port Klang there are two distinct ports – Northport (privatised) and Westport (developed), both privately operated. Northport is privately owned and operated by Northport Malaysia Bhd, which is part of the MMC Corporation Berhad Group. Westport is owned by Westport Malaysia Bhd (part of the Westport Holdings Malaysia Bhd Group).[5] Port of Tanjung Pelepas has been developed (and continues to be developed) by MMC Corporation Berhad Group as a transshipment hub, providing competition to Singapore. Port Tanjung Pelepas is one of the 20 busiest ports in the world, with a current container capacity of 10.5m TEUs.[6]

In **Indonesia** the key container ports are Port of Tanjung Priok (Jakarta), administered by PT Pelabuhan Indonesia II (Persero) (IPC), and Tanjung Perak (Surabaya) administered by PT Pelabuhan Indonesia III, both top 50 world ports in terms of scale. In terms of the development of capacity in Indonesia to address increased trade, IPC has the mandate to develop the New Priok Port, involving the development of capacity at Tanjung Priok from 5m TEU to 18m TEU. As part of the development of the New Priok Port, IPC has brought together a consortium of world class and world scale companies (Mitsui & Co. Ltd; Nippon Yusen Kabushiki Kaisha; and PSA International Pte Ltd) to participate in the construction and the operation of a new container terminal at the New Priok Port. This new terminal is being developed by, and will be operated by, PT New Priok Container Terminal One, and will provide 1.5m TEUs of new container capacity.

In **Sri Lanka**, Colombo Port is the largest port, and, again, a world scale one. The Sri Lanka Port Authority (SLPA) is progressing the development of facilities at Colombo Port to improve the value of Colombo Port to global shipping lines and to increase its share of the trans-shipment market. It would appear likely that the SLPA, as the landlord, will seek private sector investment to develop a new container terminal applying a DBFOM model, with the grant of a lease to the private sector to design, build, finance, operate and maintain the new container terminal under a 35-year lease. This illustrates the value of port capacity both for the purposes of the entry and exit points for imports and exports from Sri Lanka, but also the value to the Sri Lankan economy of transshipment. As we noted above, Singapore is the largest transshipment hub in the world, and the vast majority of the traffic that passes through Singapore is transshipment traffic: Singapore's achievements stand as one of the best advertisements for how the multiplier effect of port capacity can add to, and benefit, economic activity.

In **Myanmar**, the Myanmar Port Authority is progressing the development of new port facilities (at existing ports and new ports). The challenge in developing new coastal ports in Myanmar underlines the fundamental development need for any port: the need to be as close as possible to the "in country" users of port services (in the case of bulk ports) and to be as close as possible to the markets using imported goods and the industries producing export goods (in the case of container terminals). Which came first: the port or the demand for services provided by the port? The involvement of major Chinese players in the development of special economic zone developments (and the attendant port developments) assists in answering the question and illustrates that these Chinese companies see the prospective trade flows that will be serviced by the development of ports in Myanmar, and around the Bay of Bengal generally: the development of ports will service trade flows from China and into

5 Westport is a container, break bulk, dry bulk, liquids and vehicle (RoRo) port.

6 Twenty-foot equivalent unit.

China through the ports, as well as exports from, and imports to, Myanmar.

Australia,[7] has in some ways been catching up with trends in the rest of the Asia Pacific region. Over the last four years or so, the Ports of Darwin, Brisbane, Botany, Newcastle and Kembla have been privatised using the grant of a long term lease to the lessee of each port (Port Lessee) with Port Lessee collecting rental income from the facilities and terminals leased with the port, and port charges (including from use of navigation channels and wharfage). The Port of Melbourne is in the process of being privatised, and Fremantle Port has been prepared for privatisation, applying the same long term lease model. While port privatisation in Australia is not new (The Port of Geelong was privatised in 1996), the privatisation of the largest container and general cargo ports and one of the busiest bulk ports (Port of Newcastle) is new. In addition, in recent years ports in Australia have rediscovered the benefit of the DBFOM model, and a number of new key port facilities have been developed using this model.

Realising the value of port capacity

Port capacity is valuable and critical to the promotion of trade. Any procurement structure should be structured in a way that ensures port capacity is optimised, and the value of it maximised.

To achieve optimisation, there is a move towards "performance based" arrangements (PBAs) to incentivise the efficient port operation outcomes. Procurement documents provide for measurable outputs reflecting those outcomes.

In the context of container terminals, for example, PBAs can range from measurement metrics for the efficiency of time alongside (the amount of time a vessel spends adjacent to the quayside) versus time worked (the discharge of cargoes); crane rates (in effect the number of lifts in a given period of time); dwell times (the period of time a container spends in the stacking yard before being discharged from the terminal); and in some cases, greater modal share of rail (but this largely depends on the existing and planned future distribution networks). Given that container terminals are not "set-and-forget" infrastructure, sustained inability to comply with any PBAs will impact on port efficiency and revenues.

Accordingly, procurement documents containing PBAs include remedies designed to ensure that the required outcomes are achieved. We have seen whole-of-port landlords strive for the container terminal operators (CTO) to maintain a stated share of overall container trade within a port (and provide termination rights if the threshold is not met over a period of time) or a minimum TEU throughput by reference to overall trade. The theory behind this risk allocation structure is the desire to ensure that the use of the terminal asset is maximised and that the CTO does not "sit" on a valuable asset without maximising the opportunity, and is incentivised at the same time to achieve optimal efficiency. For private sector participants to accept PBAs of this kind, they will need to be satisfied that they will be provided with a level playing field so that existing or new CTOs will not be favoured in a way that might hinder their ability to achieve PBAs.

Governance of the port and competition

Given that port capacity is valuable, the private sector is prepared to buy existing port assets and fund the development of new infrastructure (typically on a DBFMO basis) and to pay the port landlord for a concession if it is satisfied as to the trade flows (and any risk to trade flows). However, just as the port landlord will seek to incentivise optimisation of efficient port operations, the private sector will be concerned to address risks of **governance of the port** and **competition** (within the port or within country) affecting the ability of the private sector to perform under the procurement documents.

Governance of the port – Vessel scheduling and berth allocation: The control of vessel movements in port is likely to be a critical factor in the efficiency of terminal operations and therefore the ability to achieve throughput commitments under procurement documents is an issue which the private sector will want to consider closely. Different ports operate different systems. Vessel traffic management within the port will affect the value of port capacity. As we note above, these activities are governance activities, and they may be undertaken by government or a government entity or, possibly, by the private sector.

Competition: Competing terminals, both within the port and within country, will affect the value of port capacity. This covers for instance, the installation of further capacity within the port (through another terminal or by promoting expansion of the currently existing terminals) or the development of a new port at some point into the future. Government and government entities are concerned to promote competition to drive efficiency and to achieve optimisation. The private sector is most concerned to ensure that there is a level playing field on which it can compete.

Conclusion

Sea-borne trade will continue to dominate global trade flows. The Asian economies will continue to provide a platform for growth and global trade. For these reasons alone, Asia Pacific ports will continue to provide opportunities for investment and development capital. In fact, domestic regional economies such as Indonesia will be "hot spots" (in their own right) as governments seek to enable domestic trade throughout the archipelago. As a firm, we continue to assist our clients to maximise these opportunities in the ports sector across the Asia Pacific region.

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7 Australia has some of the busiest bulk ports in the world (Port of Hay Point (including Dalrymple Bay), Gladstone, Port of Newcastle and Port Kembla, Port Hedland, Port Walcott and Dampier (including Cape Lambert) developed for the export of iron ore and coal) but the container and general cargo ports are relatively small by world standards.

RIDING THE WAVE:

Australian student accommodation transactions

by Harvey Weaver, Melinda Harris and Philip Vernon

The final quarter of 2014 saw a number of high-profile deals reach close in the New South Wales infrastructure market, including the A$8.3bn North West Rail Link Project, the A$2.2bn Sydney Light Rail Project and the A$1-2bn Northern Beaches Hospital Project.

In this wave of "mega deals", the achievement of financial close on the University of Wollongong's A$270,000 student accommodation transaction attracted little publicity. Eighteen months on, however, and the impact of the Wollongong transaction is now being acknowledged, and is being seen by many as the catalyst for a wave of student accommodation transactions that comprise one of the hottest infrastructure sectors in Australia.

Apart from transactions being procured by universities themselves, which are the subject of this article (and which, in Australia, are attracting infrastructure investors such as AMP Capital, Capella, DIF, Infrared, John Laing, Morrison & Co. and Plenary along with operators such as Campus Living Villages, UniLodge and Urbanest) there is also a wave of property developers (both domestic and international) who are adding student accommodation to what would otherwise have been more traditional residential or commercial property plays in and around key areas for students such as Brisbane, Melbourne and Sydney.

This article highlights the key issues faced by universities, sponsors and financiers in developing on-campus student accommodation transactions. It also provides points of comparison between the structures used in Australia and the more mature UK market.

Characteristics of the transactions and key drivers

The transactions currently in the market (such as La Trobe University and Curtin University) and those which have recently closed (e.g. Australian National University (ANU)) usually involve an up-front payment from the project company to the university. This is in return for the right to receive rental income paid by students and certain other revenues derived from a defined set of residences over the life of the transaction, typically between 30 and 40 years. The project may also involve the construction of new residences by the project company or by the university, on-campus accommodation being generally preferred as this ties in with the overall university experience – a key differentiator when compared to the private rental market. The rental streams from these new residences usually form part of the transaction.

***UK Perspective:** in the UK there is generally a mix of on-campus and town centre accommodation. Town centre accommodation may sometimes be perceived by investors as having an advantage over campus accommodation, as it may have enhanced alternative use options and a greater residual value in circumstances where funders may be required to exercise security over the assets following a termination scenario.*

In terms of services (discussed in more detail below), the project company will generally perform facilities management services at both the new and existing residences (Hard FM). The university may contract out, or retain, student-facing type services such as pastoral care, applications for accommodation and internal cleaning, etc., (Soft FM), with the model selected being driven by the requirements of the particular university. The university typically retains marketing responsibilities for the student accommodation, as this ties in with the marketing of the university and allocation of student places more generally, and it is commonly accepted that the university is best placed to manage this. Given the link with demand, marketing is a key area of focus for the project company and its lenders.

In general, the structure of the transactions is best described as a form of hybrid PPP. While in many of the transactions the overall style of documentation and risk allocation bears many of the characteristics of a PPP transaction, these are not transactions awarded by a state government, as would be the case in a PPP transaction, and there is no availability type payment. While occupancy support, if any, may potentially underpin a degree of revenue (and therefore give financiers comfort), the project company still takes an element of demand risk, coupled with some exposure to rent adjustments.

While the above sets out a general approach, in practice the structure of each transaction very much depends on the university involved and its key drivers. For example, when formulating a view on the university itself, the following factors are seen as important to the strength of a long term partnership:

- its reputation (including if it is a member of the leading "Group of Eight" universities in Australia);
- location and number of campuses (e.g. close to the central business district of a city, spread over a number of campuses or on one site);
- student numbers and target profile at the university;
- financial standing (many universities in Australia have credit ratings);
- the kind of courses offered at the campus at which the residences are located;
- overall demand for accommodation at the relevant campus (historic and projected); and
- projected level of future expansion (offering the private sector an opportunity to deploy further capital in the future).

***UK perspective**: similar considerations apply in assessing the creditworthiness of a university in the UK (the Russell Group being an equivalent to the Australian "Group of Eight") but UK universities do not typically have credit-ratings. The UK Guarantees scheme has been used in circumstances where it has been more difficult to raise finance, i.e. the University of Gloucestershire's Pittville Campus project.*

The structure of each transaction is heavily influenced by the key drivers for the particular university. In some cases, a key driver is to maximise the value of the up-front payment from the project company, (for example, if the capital is earmarked to be used to reduce outstanding debt, or for other projects at the university such as new academic and research facilities). In other cases, the principal driver may be the provision of new accommodation (if the current student accommodation stock is aged and/or there is immediate demand for new accommodation) or the introduction of private sector expertise into facilities management, with an up-front payment being less of a factor.

Depending on the size of the transaction, an up-front payment may not be realistic, (for example, if the number of existing residences is low and the project company is being asked to fund the new-build accommodation). For some universities, achieving an "off balance sheet" treatment for the transaction is important so as to free up (or not constrain) future borrowing limits – this needs to be factored into the structuring at an early stage.

***UK perspective**: in the UK it is the norm for student accommodation projects to be off balance sheet.*

Key issues during construction

As mentioned above, some transactions require the project company to build new student accommodation, typically to replace outdated accommodation stock or to meet unmet demand. The latter was the case on the Wollongong transaction. Universities typically specify the minimum number of new beds and required student mix based on a demand study commissioned by the university and made available to bidders.

For the most part, construction risks on student accommodation transactions are allocated in much the same way as on social infrastructure PPPs and the same types of risk issues are typically encountered, such as site condition, contamination and defect risk. How the market responds to such issues often depends on the amount of due diligence material made available to bidders (for example, geo-technical reports and contamination surveys) and the extent to which the market is given an opportunity to undertake its own due diligence on the proposed new student accommodation sites – a practical issue for the universities to manage is access around student semesters.

The approach to planning risk in Australia can differ markedly between transactions and is typically influenced by jurisdictional requirements or State-specific planning regimes (for example, in Victoria "public use" zoning can make planning risk an easier risk to negotiate than in other States). Like PPPs, standard practice is to require the project company to obtain all other relevant approvals. Depending on the location of the new student accommodation, this may include approvals such as bushfire overlays, which are likely to be an issue in more rural campuses.

Similar to the approach taken on education PPPs, in developing construction timetables and setting target completion dates, the parties will need to be mindful of academic timetables and time frames for allocating students to residences before the commencement of each academic year. Where existing residences are to be replaced by new student accommodation, the decant of students from one residence to another will also need to be factored in to avoid unnecessary disturbance to students and to minimise periods where student rents are not being received by the university or the project company.

The project company will be incentivised to meet target completion dates to maximise the amount of rental proceeds it will receive during the contractual term. Nevertheless, regimes will also need to be developed to cater for late construction completion and to include defect liability periods (potentially backed by defect bonding granted in favour of the university). On student accommodation transactions, late completion is a critical issue as alternative accommodation will need to be provided to affected students. The cost of providing alternative accommodation is typically met by the project company which will need to understand from the university what contingency plans it normally has in place (e.g. use of available beds at nearby establishments).

***UK perspective**: in the UK we would typically expect to see a construction support package that may well include a performance bond which could continue through the defects rectification period but it would be in favour of the project company and not the university.*

Inclusion of existing accommodation

A feature of the current wave of student accommodation transactions (including Wollongong and ANU) is for the university to monetise the revenues flowing from the university's existing student accommodation portfolio over the term of the concession period, in return for an up-front payment. However, to extract maximum value from this element of the transaction, it is essential that relevant existing student accommodation facilities have a residual life of at least the length of the proposed concession period. To achieve this, the university may require the project company to undertake and fund up-front refurbishment works to bring existing student accommodation up to the required condition standard.

Universities typically try to transfer to the project company as much latent defect risk for existing student accomodation facilities as possible. However, this risk allocation is often hotly debated – the project company will usually "price" the latent defect risk and this will affect the amount of the up-front payment that the university will receive. Universities can take steps to try to mitigate the project company's concerns by commissioning condition surveys and allowing the project company to rely on the survey reports. Universities may also allow bidders to undertake their own "on site" due diligence of the relevant student accommodation facilities.

On some recent transactions (e.g. Wollongong), universities have recognised that some existing student accommodation

facilities only have a short residual life and it therefore does not offer value for money to require the project company to undertake extensive refurbishment works. Instead, the university may stipulate at the outset of the transaction that a particular student accommodation facility will be excluded from the transaction at an agreed point in time so any refurbishment requirement can be scoped appropriately.

Scope of services

The practice that has been followed on recent student accommodation transactions (e.g. Wollongong and ANU) is for the project company to provide the Hard FM services to new and existing residences, with the university continuing to be responsible for the Soft FM services. However, the split between what constitutes Hard FM or Soft FM services can differ quite markedly between transactions and is often influenced by the importance that a university places on providing a "student experience" to its students or the extent to which the university wishes to outsource services to the private sector. Given the limited number of participants in the Australian market who are capable of providing "pastoral care" and other Soft FM services to students, the market preference is generally for the university to provide the Soft FM services (or to outsource it to a third party during the contractual term but to still be at risk for it under its contractual relationship with the project company).

If a university retains responsibility for providing Soft FM services, the manner in which it does this can have a significant impact on the quantum of revenue that flows to the project company. In particular, marketing of student accommodation and allocation of beds are key areas of focus. Recent transactions have managed this interface by requiring the university to comply with a Soft FM service specification and by developing a bespoke Key Performance Indicators (KPI) regime to measure the university's performance against agreed criteria. Taking its lead from abatement regimes that are a common feature of PPP deals, the Wollongong transaction also introduced a "student rent" retention regime to incentivise the university to perform its retained services to the required standard. Sub-standard performance can result in the university paying amounts to the project company which are only reimbursed once the university has remedied the underlying issue: the key difference when compared to a normal PPP abatement regime is that the university does not forego the money provided it effects a remedy, so the issue becomes principally one of cash flow timing.

The project company's provision of its services will also be measured against an output specification and relevant KPIs. A reciprocal retention regime has also featured on recent transactions. Following the approach taken on PPPs, it is also usual practice for default and termination events to be included in the project documents as another means for the university to incentivise appropriate performance by the project company.

UK perspective*: UK student accommodation projects do not typically include a deduction regime for poor performance although there would typically be a performance points mechanism which could ultimately lead to termination for poor performance.*

Demand and occupancy

The student accommodation market in Australia has recorded strong growth in the last decade, attracting international and domestic capital to what is regarded as a long-term and steady asset class. A range of factors can influence demand for student accommodation at a university, including:

- the university's location, standing and reputation;
- the academic courses available;
- increases or decreases in the number of international students studying in Australia (principally students from Asia);
- affordability;
- supply of competing residential accommodation;
- proximity to the university; and
- the pastoral care and additional facilities available at purpose-built student accommodation.

In the Australian market, establishing satisfactory levels of demand for student accommodation is critical to fostering lender comfort and maximising bidding interest. Usually, the university undertakes an extensive due diligence process, prior to approaching the market, gathering relevant data and preparing a demand report. However, determining levels of demand with any certainty in the medium to long term is very much an art rather than a science. Each university will also have its own unique features which impact on existing and future demand for its student accommodation.

Equally important is providing evidence of strong historical and current occupancy. In the Australian market, the provision of direct or indirect occupancy support by the university can facilitate higher gearing, help optimise internal rates of return for equity and, as a consequence, result in a larger up-front payment to the university, even where prospective demand is less certain. Occupancy support is also seen by the private sector as a mechanism for incentivising the university to try to achieve maximum occupancy over the term of the transaction.

An example of direct occupancy support is the subsidisation by the university of student rent where occupancy levels dip below an agreed percentage or within agreed parameters. To maximise the up-front payment, the occupancy support level selected may seek to cover senior debt, with equity taking risk above that level.

Forms of indirect support vary across transactions and include, for example:

- protection around the treatment of the university's student accommodation outside of the transaction (for example, controls on the accommodation applications process and amounts of student rents charged at those residences);
- right of first offer or refusal in respect of the finance, construction and inclusion in the transaction of new student accommodation at the university;
- accommodation guarantees offered by the university to certain categories of students; and
- strict controls over Soft FM activities which impact on occupancy, such as marketing of the student accommodation. As mentioned above, this may include detailed KPIs applying to marketing activities, with obligations around minimum marketing spend and regular marketing planning and reporting. The project company may also seek retention amounts, as discussed above, and ultimately step-in rights to take over the marketing itself if marketing KPIs are not being met.

UK perspective*: many UK transactions will include some or all of the above terms of indirect support. It is common in the UK market to include a requirement for certain specified tests (e.g. in relation to historic and projected future occupancy levels and demand) to be passed before the university can build or take on any further new student accommodation.*

Whether or not occupancy support is offered is a balance between the contingent financial exposure to the university, the need to attract investors (and, just as importantly, lenders), maximising the up-front payment and the impact on other elements of the transaction, such as the "off balance sheet" assessment.

Revenue and value

As noted above, an up-front payment is usually made to the university for the right to receive the student rental income stream flowing from the student accommodation included in the transaction. In order to procure funding for the transaction, the project company will require a high level of certainty regarding the levels of this income over the entire term of the transaction. On the other hand, the university will typically want to ensure that student rents cannot be increased in a manner which might damage its reputation, or its relationship with its students. Both parties have an interest in ensuring that student rents are set at a level which facilitates high occupancy of the residences.

The necessary certainty can be achieved by ensuring that the student rent adjustment mechanisms are objective (i.e. the amounts of student rents are not controlled by the university or by the project company) and are generally in line with the expectations of students occupying the residences, without unexpected significant increases occurring at any time. The mechanism may involve adjustments linked to the Australia Consumer Price Index, fixed percentages or market rates (or a combination of these). The student rental amounts may also be locked in for the first year or first few years of the transaction. Depending on the location of the university and other relevant factors, there could be difficulties in benchmarking student accommodation rental amounts against the "market" (e.g. little comparable private sector accommodation) and, for this reason, other means of adjustment may be preferred.

UK perspective*: rent increases in UK student accommodation projects are usually linked to the Retail Prices Index, often with a cap and collar and usually with a set of agreed factors which can lead to additional adjustments to the rents to mitigate increases in certain costs of the project company. In some projects rents can also be benchmarked against other equivalent accommodation in the market.*

Additional value can be derived by increasing the minimum number of weeks students have to commit to in the student accommodation agreements, although this is a sensitive issue for the student population and needs to be carefully handled.

It is also important to ensure that the student rent adjustment mechanisms in Australian transactions are capped where necessary; for example, to account for certain Goods and Services Tax exemptions applying to student rents and the statutory requirements applicable to student rents, the subject of the National Rental Affordability Scheme (a government scheme incentivising the provision of affordable accommodation which some universities have been able to take advantage of).

While student rent is the primary form of revenue in student accommodation transactions, other revenue to be included in a student accommodation transaction will depend on the preference of the university and the value that can be derived from such income. In addition to student rent, revenues can also derive from:

- a range of fees and charges associated with the accommodation and paid by the students (such as charges for utilities and internet usage);
- commercial income derived from the residences (car parking, cafes, laundry services, etc.); and
- income from use of the accommodation outside of the academic terms, including for conferences, school groups and short-term stays.

Conclusion

The student accommodation sector in Australia is here to stay for the foreseeable future, as there are a number of universities in the market for such deals or who are contemplating them. Competition for these transactions is strong with the potential for long term cash flows, the possibility of participating in further expansion of the university's student accommodation and the more general opportunity of partnering leading education establishments proving particularly attractive.

For universities this type of transaction offers access to capital beyond the more traditional debt solution, capital which can be used to fund other projects within the university which might otherwise not be possible due to capital constraints. For students, the benefits are significantly improved accommodation and related amenities which contribute to an enhanced student experience, provided rents are maintained at affordable levels.

The scale and complexity of the transactions coming to market should not be underestimated, however, and so the sector demands real commitment from investors and their lenders if they are to properly understand it: as this article demonstrates, an understanding of "standard" availability-based PPP deals will only get investors so far. They need to understand both the micro factors relevant to the actual accommodation, along with macro factors such as student demographics, local and international academic competition and the future of tertiary education more generally. Provided investors are willing to invest the time to do this, the sector offers a potential pipeline of deals and a chance to play a role in shaping the landscape of Australian tertiary education.

UK perspective*: in the UK market the current trend is for universities to develop accommodation to attract foreign students. Since domestic students are now also paying tuition fees, students on the whole are more discerning about what they get for their money. It remains to be seen whether Brexit will have an impact on the attraction of the UK for foreign students.*

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COMMUNITY CONSENT FOR INFRASTRUCTURE PROJECTS:

Designing the strategy; reaping the benefits

by Gavin Scott and Tony Denholder

Infrastructure and resources projects can have a very significant impact on land and communities. Project proponents are increasingly using sophisticated community engagement strategies in the approval phase of a project to address community concerns about these impacts.

Failure to properly engage with a local community can be extremely risky. There are examples of failed projects due to poor community engagement all around the world. Even where consulting with affected communities is not a mandatory requirement, gaining support (or at least reduced opposition) from stakeholders is an important step to establishing a sustainable project.

This article details an approach to creating and maintaining a robust community engagement strategy, which in turn should lead to a project that not only receives all the necessary regulatory approvals, but one which is also supported by the affected community. The recommendations set out in this article reflect the experiences that we have gained through meeting and negotiating with numerous Indigenous communities over the past 20 years on behalf of infrastructure and resource companies.

Aim

Companies should develop clear internal strategies to demonstrate how they intend to meet their community consent and consultation requirements from the outset. Often there is tension between the desire to begin a project quickly and the need to properly engage with the community and understand the legal aspects of the project. Numerous resources are available to help organisations develop internal policies that address community consultation.[1] For example, the International Finance Corporation has created a financial valuation tool that projects probable risk outcomes of social projects and financial benefits.[2]

1 Global Reporting Initiative, (2009) 'A Resource Guide to Corporate Human Rights Reporting' https://www.globalreporting.org/resourcelibrary/A-Resource-Guide-to-Corporate-Human-Rights-Reporting.pdf (Accessed 2 June 2016); International Council on Mining and Metals (ICMM)(2015), Land Acquisition and resettlement: lessons learned https://www.icmm.com/document/9714; Australian Government, (2010) 'Social Responsibility in the Mining and Metals Sector in Developing Countries.'

2 International Finance Corporation (IFC),(2016) 'Create Business Value through Sustainable Investments', www.fvtool.com.

Confirm regulatory requirements

National regulatory regimes relating to community consultation are at different stages of development around the globe. However, where there are gaps in national regulatory regimes, proponents can consider numerous regional and international legal standards and guidelines.

Before entering a new jurisdiction, project developers should have a clear understanding of the relevant international and regional frameworks. They should then conduct an analysis of the national regulatory regimes that may apply to their proposed project, and document specific procedural and regulatory requirements relating to their project, such as when and how a project should be announced and the requirements for project approval plans, land transfers and compensation. Once these are recorded, proponents should consider what additional requirements may exist.

Doing the minimum under local laws may not be sufficient to withstand the scrutiny of investors, joint venture participants and other external stakeholders. Consequently, developers should conduct an analysis of the gap between the requirements of local legislation and the requirements of international standards. This analysis should result in an internal engagement plan that considers how the higher international standards will be reached.

Identify relevant communities and cultural practices

Understanding local communities and their cultural practices (social baseline data) in the geographical area of a proposed project is key to creating a relationship with local communities and government. This understanding can also form the basis for developing a tailored community consultation process and highlighting social issues that may arise during the lifetime of a project. To ensure a proper understanding of local communities and cultural practices, social, environmental and planning specialists should be engaged to collect data.

Community stakeholders can provide important local information about their local communities and cultural practices. This information can then form the basis of a holistic community consultation process that directly addresses identified needs. Consulting the local or regional government is an important step to understanding its capacity and complexities. However, as previously indicated, local governments may not have a framework in place to cater for the social issues which may arise during a project. Consequently, engaging directly with the local community may be more effective in revealing information about leadership structures and community governance. However, a word of warning: local leadership may not be representative of all members of the local community. Therefore, companies should be careful not to assume that they have collected all the data that they need.

Identify impacts and opportunities for the community

Each jurisdiction is different in terms of existing mechanisms that may be used by a government to encourage community consultation. Some jurisdictions may not clearly integrate social impact assessments and community engagement. Other jurisdictions may require developers to conduct social impact and cultural heritage assessments and then prepare social impact and cultural heritage management plans. Once social baseline data has been collected, developers should use that data to identify impacts and opportunities for communities and local groups. Developers should consider establishing an internal best practice policy that goes beyond meeting the legal regulatory requirements necessary to better establish a robust community consultation process.

A social impact assessment should be used to understand potential impacts and opportunities during the consultation process. Do strategies relating to the resettlement of affected communities need to be developed? Is the cultural education of staff required? What possible conflicts could arise throughout the lifetime of the project and what strategies could be used to avoid them? What opportunities are there to reduce the marginalisation of local groups?

Identify appropriate engagement process

Meaningful engagement with stakeholders should be an ongoing process throughout the lifetime of a project. Two-way communication and interaction between the project and its stakeholders is an important aspect of community consultation that is often overlooked. Once a developer has assessed the impacts and opportunities it must review its method of community consultation to incorporate culturally sensitive nuances and an understanding of the locality.

Internal processes that couple cultural values (identified during the collection of social baseline data) with an appropriate community engagement process need to be developed. The process for engaging any individuals who will be displaced as a result of the project should differ from that with the broader community. Effective communication is the key to obtaining consent and building a strong relationship with the local community. Communication should be culturally sensitive and appropriate. Small conscious choices can be made to build a robust community consultation procedure. For example, where the project requires a consultation team, the team should be gender balanced and include local people so that communication is delivered to all members of the community in a culturally appropriate manner.

Planning for implementation of strategy

The most important aspect of developing an appropriate community consultation process is ensuring its implementation. A project negotiator should be appointed to assist with implementation, and uniform processes need to be established for matters such as forming agreement protocols for consultations and determining appropriate venues for consultations. Everyone involved in project implementation from site level to corporate management needs to fully appreciate the importance of providing adequate time for proper consultation, negotiation and agreement.

Engagement

Community engagement is an ongoing process throughout the lifetime of a project. Instead of being vague about corporate commitments, developers should actively seek to promote their internal engagement policies and how they align with international standards. All stakeholders should be informed, consulted and empowered through constant communication and interaction. Community engagement should be monitored, recorded and, when required, amended. Recognising local communities as an asset rather than a barrier is crucial to the success of projects.

Conclusion

If a project impacts on a local community and the developer does not properly engage with the community, this can have a negative effect on the success of the project. Proper community engagement will increase the likelihood of success of project approvals requiring consent and consultation with the impacted community. Furthermore, regardless of legal regulation, proper community engagement will provide a continuing "social licence to operate" for a project which is vital to a project's success.

Ashurst has over 20 years' experience advising on negotiation strategy and securing agreements with impacted communities and Indigenous groups on development projects. Importantly, we also assist our clients in building enduring relationships with Indigenous stakeholders and in developing practical long term strategies, so that agreements remain workable long after the lawyers have left the scene. We often meet Indigenous groups in their community and assist our clients in ensuring that negotiations are culturally appropriate.

Our team is consistently at the forefront of developments in law and policy relating to the social impact of projects, cultural heritage and appropriate legal structures to deliver compensation and other benefits to impacted communities. We act on some of the largest deals between Indigenous groups and mining companies in Australia and have experience in advising on strategies to engage with local landholder groups in Papua New Guinea and in Indonesia.

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BUST OR FLUSH:

Contracts with NHS Trusts, a risk or an opportunity?

by Jane Staveley

Is it the case that the United Kingdom's National Health Service (NHS), with an annual budget of £114.7 billion (revenue), £3.6 billion (capital) and the 4th largest workforce in the world, is too big to fail? The answer to this question holds the key to the "risk rating" of doing business with NHS Trusts.

This article looks at contracts between private sector parties and NHS Trusts, and considers what is likely to happen if an NHS Trust gets into financial difficulty. Unless expressly stated otherwise references to "NHS Trust" means both NHS Trust and NHS Foundation Trust.

NHS Trusts – current position

"*NHS trusts are forecasting an end-of-year net deficit of around £2.3 billion. The estimate, based on survey responses from 83 trusts, comes as NHS national bodies are imposing stringent financial controls in an effort to reduce the deficit to £1.8 billion by the end of the financial year. This underlines the risk that the Department of Health will breach parliamentary protocol by overspending its budget.*"[1]

The above extract from a recent King's Fund Report also identifies that:

- more than two-thirds of trusts (67 per cent) and 9 out of 10 (89 per cent) acute hospitals are forecasting a deficit at the end of 2015/16;[2]
- more than half of trusts (53 per cent) are concerned that they will not be able to meet nationally-imposed caps on their agency staff spending, while a fifth (22 per cent) say the caps may have an impact on their ability to recruit the staff they need to provide safe care;
- nearly two-thirds (64 per cent) of trusts are reliant on extra financial support from the Department of Health or drawing down their reserves;
- more than half of trust finance directors (53 per cent) are concerned about meeting productivity targets – the highest level of concern at this stage of the year since the King's Fund survey began; and
- Clinical Commissioning Groups are in a better financial position, although nearly one-fifth (18 per cent) are forecasting a deficit and nearly a third (29 per cent) are concerned about meeting their productivity targets.

In reaction to this critical financial situation, the Department of Health has introduced a budget "re-set" for NHS Trusts, described below.

Impact of the NHS "re-set"

On 21 July 2016, NHS Improvement and NHS England announced a seven point set of actions to cut the annual NHS Trust deficit and to "sharpen the direct accountability" of NHS Trusts to live within the public resources made available by Parliament. The announcement has been followed by detailed Guidance.[3] The proposals include:

- allocating £1.8 billion out of the Sustainability and Transformation Fund to reduce the deficit (see above) to £250 million;
- imposing "financial control totals" which NHS Trusts must deliver on;
- introducing a new intervention regime of "financial special measures".[4] These are in addition to the existing special administration regime set out in statute and described in more detail below.[5]

1 King's Fund Report [18.2.2016] "How is the NHS Performing?" – Quarterly Monitoring Report.
2 Barts has the largest deficit of all NHS Trusts and Foundation Trusts at £134 million.

3 www.england.nhs.uk/2017/07/operational-performance.
4 The financial special measures are set out in Annex H of The Strengthening Financing Performance and Accountability 2016 – 2017 published by NHS Improvement on 21 July 2016.
5 The five NHS Trusts put on the new financial special measures regime are: Barts Health NHS Trust, Croydon Health Services NHS Trust, Maidstone & Tunbridge Wells NHS Trust, Norfolk & Norwich University Hospitals NHS Foundation Trust and North Bristol NHS Trust. There are a further 13 NHS Trusts on the "waiting list".

- imposing control caps on management costs; and
- announcing a two-year NHS planning and contracting round linked to the Sustainability and Transformation plans.

It is recognised in the Guidance that NHS Improvement, as regulator, already has intervention powers under statute and is not seeking additional powers. The purpose of these new measures is to accelerate intervention and to set out the steps to be taken in more detail than is prescribed by statute. For example: the Department of Health will reserve the right to exchange surplus assets for cash where an NHS Trust needs an injection of funds. NHS Improvement can appoint an Improvement Director onto the NHS Trust's board. While it is unlikely to benefit an NHS Trust to challenge the Guidance, it is possible that some of the steps described in the Guidance may be outside the regulator's statutory powers.

At the same time, an NHS Trust could be put in "quality" special measures overseen by the Care Quality Commission. This is also covered by the new Guidance.

It is possible to exit the financial special measures regime by putting forward an approved robust recovery plan and showing significant "wins" in implementing it within two months.

Avoiding special measures – alternative options

Even before the introduction of the financial special measures described above, NHS Trusts in financial difficulty have been trying to find savings to reduce their deficit in order to ward off being put into the statutory special administration regime. These savings may be achieved by, for example:

- merger – two or more NHS Trusts or Foundation Trusts (FTs) can merge, e.g. Peterborough and Stamford with Hinchingbrooke;
- reducing or refinancing debt – Northumberland County Council effectively refinanced elements of the PFI contract entered into by Northumberland Healthcare NHS Foundation Trust to the tune of £100 million; or
- reducing operating costs – a number of NHS Trusts and FTs are reviewing their contracts with the private sector, particularly facilities management contracts, reviewing lifecycle costs, insurance premium risk-sharing and potential debt refinancing to establish whether savings can be found.[6]

First signs of trouble

Is the NHS Trust delaying payment of a monthly service fee beyond the contractually agreed payment period or has it stopped paying altogether? This could be a sign of financial difficulty and presents the other contracting party[7] with a choice: it could terminate the contract or keep the contract going and allow the debt to accrue interest and/or sue under an indemnity for losses.

Most contracts with the NHS are under the NHS Standard Contract. The references in this article are to the General Conditions ("GC") of the 2015/2016 edition. The NHS Trust would be in default if:

- the amount owed exceeds either 25 per cent of the expected annual contract value, or if no expected annual contract value, then the equivalent of three times the average monthly income to the other contracting party, and in each case, payment is not made by the NHS Trust within 20 operational days of notice;[8] or
- it is in persistent material breach of its obligations.[9]

There is no compensation regime if an NHS Trust is in default. Therefore the other contracting party will have to sue for the debt due (together with interest payable). Interest accrues at a rate of two per cent over LIBOR. In this context, we consider below the statutory remedies that may be taken by the regulator where an NHS Trust or an FT is in financial difficulty.

The statutory special administration regime[10]

Does it make a difference if a trust in financial difficulty is an NHS Trust or an FT when contemplating whether to terminate a contract or keep it in place? Neither NHS Trusts nor FTs are subject to the general insolvency law applicable to companies under the Companies Acts. The special administration regime is similar for NHS Trusts and FTs but there are subtle differences. For ease of comparison these differences are set out in the table below.

Since 1 April 2016, the regulatory role of Monitor for FTs, and of the NHS Trust Development Agency ("TDA") for NHS Trusts, has been subsumed within the new NHS Improvement agency. Monitor has oversight of an FT's financial health as it awards and administers the licence to operate. NHS Trusts are currently exempt from needing a licence.[11] The TDA, as the regulator for NHS Trusts, oversees all aspects of performance and governance and ensures NHS Trusts comply with equivalent conditions to those imposed by a licence. This should give NHS Improvement early warning of an NHS Trust or FT in financial difficulty, and thus the special administration regime and other interventionary powers are steps of last resort.

In more detail

NHS Trusts

As refered to in the table opposite, the SoS may make an order (if he considers it appropriate in the interest of the health service) authorising the appointment of a TSA to exercise the functions of the chairman and directors of an NHS Trust. Within 45 working days of the appointment of the TSA, the TSA must consult certain parties and provide to the SoS and publish a draft report stating the action he recommends that the SoS should take. There then follows a consultation period (30 working days), during which the TSA must hold meetings with staff and other individuals who wish to attend.

Within 15 working days of the end of the consultation period, the TSA must provide the SoS with a final report stating the action that the TSA recommends that the SoS should take and within 20 working days of this the SoS must decide what action to take in relation to the NHS Trust. The guidance provided by the Department of Health sets out the type of recommendations one would expect to find in the report.

6 London Procurement Partnerships, an NHS-backed procurement body is advising NHS Trusts on how to cut PFI operating costs by at least 5 per cent per year.
7 "the other contracting party" is assumed here to be the private sector and not another NHS body.
8 GC 17.9.1
9 GC 17.9.2
10 This article does not propose to examine the role of the Deed of Safeguard in relation to PFI contracts.

11 NHS (Licence Exemptions, etc.) Regulations 2013.

Summary of Regulator's Statutory Powers where an NHS Trust or an FT is in financial difficulty

Statutory Action	NHS Trust	FT	NHS Act 2006 (amended by the NHS Act 2009 and the Health & Social Care Act 2012)
Merger – on the application of either an NHS Trust or an FT, the regulator may make an order dissolving one trust and establishing a new (FT) trust	✓	✓	S56
Acquisition – on the application of either an NHS Trust or an FT, the regulator may make an order granting the acquisition of one trust by another trust and for the transfer of property and liabilities	✓	✓	S56A & S56AA
Separation – on the application of an FT, the regulator may dissolve the FT and authorise the establishment of two new FTs	×	✓	S56B
Appointment of Trust Special Administrator ("TSA") – The Secretary of State for Health ("SoS") *may* appoint a TSA to exercise functions of chairman and directors of an NHS Trust. The chairman, directors and executive are suspended	✓	×	S65B & S65C
Appointment of Trust Special Administrator – Where Monitor is satisfied that an FT is unable to pay its debts it *may* appoint a TSA to exercise the functions of the Council of Governors and the executive who are then suspended	×	✓	S65D
Dissolution – Monitor may make an order to dissolve an FT and transfer property and liabilities to another NHS body or to SoS	×	✓	S65LA
Intervention – SoS issues intervention order to suspend/remove or replace directors	✓	×	S66 & S67
Default order – SoS issues default order – removing directors and executive, appointing new directors and executive and transferring property and liabilities to SoS	✓	×	S68
Dissolution – SoS may dissolve an NHS Trust	✓	×	schedule 4 part 3

In the guidance, the possible recommendations by a TSA are stated as being the following:

- merger with another NHS body;
- transfer of staff and services to another NHS body;
- a rescue whereby the NHS Trust leaves administration to continue on its path to Foundation Trust status;
- acquisition by, or merger with, another NHS Trust or FT; or
- dissolution and the transfer of services and staff to another NHS Trust or FT.

NHS Foundation Trusts

The process outlined above applies similarly to FTs except that Monitor fulfils the role of the SoS. Monitor must decide within 20 working days of receiving the TSA's final report whether it is satisfied that the actions recommended would achieve the objective set out in S65DA[12] and that the TSA has carried out his administration duties. Monitor must then supply a copy of the final report to the SoS who has a power of veto. The SoS can either approve the final report or reject it and send it back for amendment and so on until he is satisfied. Prior to the Health and Social Care Act 2012, the SoS had the power to "de-authorise" an FT, which would then become an NHS Trust. This power has been repealed as the intention is that all FTs should become NHS Trusts without any power to revert. Once Monitor has the SoS's approval to proceed, it can implement the TSA's recommendations or as it sees fit.

The Guidance recommends that the period of special administration should not exceed 12 months. An NHS Trust or an FT can exit special administration if it satisfies the recommendations of the TSA.

And the outcome?

Where an NHS Trust or an FT is the subject of an order listed in the table above, the relevant regulator may provide for the transfer of property and liabilities to another NHS body or to the SoS. Where an NHS Trust or an FT is placed into special administration, the TSA may make recommendations with the same effect. Therefore, the private sector provider will have a choice where an NHS Trust or an FT gets into financial difficulty, and selecting that choice will depend in each case on the circumstances: to terminate and recover costs but lose the right to future profits and possibly to future contracts, or to continue the contract and rely on contractual remedies, such as interest, and ultimately to rely on the regulator exercising his discretion (he has no obligation to do so) to intervene and transfer the contract to another NHS body.

12 S65DA of the NHS Act 2006 provides that the objective of the TSA is to secure:

(a) the continued provision of such of the services provided for the purposes of the NHS by the NHS foundation trust that is subject to an order under section 65D(2), at such level, as the commissioners of those services determine;

(aa) that the services whose continuous provision is secured as mentioned in paragraph (a) are of sufficient safety and quality to be provided under this Act, and

(b) that it becomes unnecessary for the order to remain in force for that purpose.

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US PUBLIC-PRIVATE PARTNERSHIPS:

Impact of new IRS Allocation and Accounting Rules

by Doug Bird

Although not a particularly enticing title, the "General Allocation and Accounting Regulations" interpreting the "private activity bond" limitations contained in Section 141 of the Internal Revenue Code (the "Code") issued by the US Treasury Department last October (the "New Regulations") have great practical significance for legal practitioners in the US tax-exempt bond market and will have an impact on how certain types of deals (e.g. waste-to-energy) may be structured.

Although many contractual arrangements between the public sector and the private sector with respect to infrastructure projects in the US are commonly referred to as "public-private partnerships" (P3), the New Regulations facilitate the use of a *true* partnership structure between a governmental entity and a private party by permitting, subject to certain limitations described in this article, the governmental entity's contribution to such a partnership to be financed with tax-exempt bonds (notwithstanding the lack of any permitted category of "private activity bonds" for such a project under the Code).

What are Allocation and Accounting Rules and why do they matter?

In the US, interest on bonds issued by state and local governments is generally exempt from federal income tax, unless such bonds are "private activity bonds", in which case such bonds must fit within a particular category and meet certain additional requirements in order to be tax-exempt.

Whether or not a bond issued by a state or local government entity is a private activity bond generally depends upon the use of proceeds of the bonds, the amount of private business use of the facilities financed, and the security for the bonds. Section 141 of the Code includes both a private loan financing test in Section 141(c) and private business use tests in Section 141(b) that govern these matters, as described more fully below (generally referred to herein as the "Private Business Use Limitations"). If a bond is a private activity bond under these tests, it must fit within a specific category under the Code and related regulations in order to be tax-exempt.

Categories of so-called "qualified" private activity bonds include certain types of transportation facilities, such as airports, docks and wharves (i.e. port facilities), certain mass transit facilities, and most often seen in the US P3 market in recent years, surface transportation facilities (i.e. roads and bridges that qualify for federal assistance). Other types of facilities (such as certain sewage and solid waste facilities and certain types of local district heating and cooling facilities) may also qualify, but

the limitations and requirements for tax-exempt private activity bond financing are cumbersome and difficult to comply with, and as such it is not often a viable choice for these types of facilities.

Prior to the New Regulations, compliance with the Private Business Use Limitations in connection with "mixed use" projects (i.e. a project that comprises both governmental use and private business use) financed in part with tax-exempt bonds has become increasingly burdensome and complex. The New Regulations reflect a new, more flexible approach by the Treasury Department for these types of projects. This may be due in part to the recognition that the categories of private activity bonds available for infrastructure projects in the US are very limited, preventing the use of tax-exempt financing for certain types of projects notwithstanding significant governmental use and public benefit.

The New Regulations (i) provide specific rules for the allocation and measurement of private business use in connection with eligible mixed-use projects, (ii) define "project" very broadly, and (iii) facilitate "public-private partnerships" in connection with mixed use projects by permitting the public partner to finance its capital contribution with tax-exempt bond proceeds. These changes can be expected to make tax-exempt financing eligible to some extent for certain types of projects and partnering arrangements between the public and the private sectors which were not previously eligible for tax-exempt financing to any extent.

New Allocation Rules for Tax-Exempt Bond Proceeds

Priority of Allocations

The new allocation rules only apply to eligible mixed-use projects, which are projects (i) that are financed with the proceeds of tax-exempt bonds and "qualified equity" pursuant to the same plan of financing and (ii) where one or more governmental persons, or a partnership in which at least one governmental person is a partner, must wholly own the project. For an eligible mixed-use project, the sources of funding for the project's capital expenditures are allocated in such a way that qualified equity is allocated first to the private business use, and any remainder is allocated to the governmental use, and the tax-exempt bond proceeds are allocated first to the governmental use, and any remainder to the private business use.

Using an example provided in the New Regulations, assume a building is funded 70 per cent with tax-exempt bonds and 30 per cent with qualified equity, and in a given year 44 per cent of the building is used for private business use. The example states that the amount of private business use for such year is 20 per cent. In other words, the first 30 per cent of private business use is allocated to the qualified equity, leaving 14 per cent private business use to be allocated to the 70 per cent financed with tax-exempt bond proceeds (i.e. 14 per cent divided by 70 per cent equals 20 per cent total private use of the project).

What is "qualified equity"?

Qualified equity includes proceeds of a borrowing the interest on which is not tax-exempt or subject to any tax credit, or other funds not derived from a borrowing, which in either case are applied to capital expenditures for the same eligible mixed-use project as the tax-exempt bond proceeds. Qualified equity does not include equity interests in real property or personal property.

Note that timing of the contribution of qualified equity is important. The qualified equity must be contributed as part of the "same plan of financing" as the tax-exempt bonds issued for the project, and must pay for expenditures related to the project on a date not earlier than the date on which such expenditures would be eligible for reimbursement from tax-exempt bond proceeds under applicable tax rules. In general, expenditures made 18 months prior to the issuance of the bonds can be reimbursed. Any such contribution must also be made before the placed-in-service date for the project.

Annual measurement

The New Regulations require that the foregoing allocation of qualified equity to private business use of a project be made on an annual basis, except for "output facilities" for which the allocation of qualified equity may be made on an average basis over the term of the bond issue, as discussed in more detail below. The aggregate private business use of the facility will only be attributable to the tax-exempt bonds to the extent it exceeds the amount of qualified equity in the project.

Expansive definition of project

The New Regulations provide a very favorable and expansive definition of "project". The New Regulations permit an issuer of tax-exempt bonds to treat as a single project one or more facilities or capital projects, including land, buildings, equipment or other property financed in whole or in part with the proceeds of a bond issue. Prior regulations permitted only functionally related facilities, such as adjacent buildings, to be included as part of the same project. In addition, with respect to output facilities (discussed below) with multiple undivided ownership interests (respectively owned by separate governmental entities or by both governmental and private entities), the New Regulations provide for the interest of each owner in the facility to be treated as a separate facility, provided that all owners share the ownership and output in proportion to their contributions to the capital costs of the facility.

Treatment of partnerships

Entity treatment under prior regulations

Under prior regulations, a partnership between a public and private entity was treated as a separate entity. This meant that the partnership was not considered to be a governmental entity, and tax exempt bonds (even private activity bonds) can only be issued by a governmental entity. This prevented any use of tax-exempt financing for the portion of the partnership's assets attributable to the governmental entity's interest in the partnership.

Aggregation treatment under the new regulations

The New Regulations recognize the development of various financing and management structures for government facilities that involve the participation of non-government entities. Notably, the term "partnership" in Section 7701(a)(2) of the Code includes various types of joint ventures and other arrangements, including public-private partnerships, even if the arrangement is not a partnership under applicable state law. Under the New Regulations, an arrangement that qualifies as a partnership under the Code can be treated as an aggregate of its partners, rather than a separate entity as was the case under prior regulations, for purposes of the Private Business Use Limitations. Under this aggregation treatment, the government entity is considered to directly own the partnership assets attributable to the government entity's partnership interest, thereby enabling the use of tax exempt bond financing for the governmental partner's portion of such assets.

With respect to the measurement of private business use of property by a partnership that includes a non-governmental partner, the New Regulations provide that such use will be considered private business use only to the extent of the private partner's greatest percentage share under Section 704(b) of the Code of any of the specified partnership items (i.e. income, gain, loss, deduction or credit). This approach can be relatively simple in standard partnerships, where each partner negotiates a fixed percentage of every item, but for more complex partnership structures, each partner's share of such items may not remain the same over time. Hence the New Regulations rely on each partner's greatest share of any partnership item to determine how much use is attributable to the governmental and non-governmental partners, respectively.

It is also important to note how the New Regulations measure private business use on a "floating" basis. Based on prior regulations, practitioners generally took the view that the private business use of a mixed use facility should be measured in terms of dedicated space (e.g. in a 10 story building, 30 per cent of which is funded with equity and 70 per cent with tax-exempt bonds, the view was that three floors could be dedicated to use by a private user without violating the Private Business Use Limitations). The New Regulations reject this view with respect to mixed use projects, and permit the private business use to be measured on a "floating" basis, such that the private user in the foregoing example could use any 30 per cent of the building without violating the Private Business Use Limitations.

Opportunity for waste-to-energy and other output facilities

What is waste-to-energy?

Waste-to-energy facilities create energy in the form of electricity or heat (or both) from the treatment of waste products. There are different types of waste-to-energy processes, including for example (i) landfill gas-to-energy facilities, whereby landfill gas emissions are captured, cleaned and processed and used to generate electricity either onsite or offsite, either for sale to a dedicated user or for sale into the electricity grid under federally regulated and state-adopted pricing regimes, and (ii) anaerobic digestion, which involves the production of energy (or fuel for the production of

energy) from digestates resulting from the non-thermal treatment of biological waste (e.g. food waste). A more detailed description of these types of facilities is beyond the scope of this article, but it is important to note that these technologies are now fairly well developed, and under the right circumstances can be useful components of a comprehensive plan by municipalities across the US to deal with the problem of landfill waste.

What is an output facility?
Under the Code, "output facility" means electric and gas generation, transmission, distribution, and related facilities, and water collection, storage, and distribution facilities. Waste-to-energy facilities, and the related transmission and ancillary facilities, are output facilities within the foregoing definition.

Measurement of private business use
Under the New Regulations, private business use of an output facility is measured on an average basis over the term of the tax-exempt bonds, rather than on an annual basis as is the case with other types of projects. This can be an important part of the structuring considerations for output facilities involving public and private partners, as discussed below.

Public-private partnership opportunities
Given the foregoing averaging approach taken by the Treasury Department in the New Regulations, and keeping in mind that the New Regulations provide for the allocation of private business use by a public-private partnership based on the private partner's greatest share of the specified items of partnership interests, one can imagine a variety of creative partnership structures between governmental entities and private parties involving mixed-use waste-to-energy facilities.

For example, tax-exempt bonds could be used to contribute to certain elements of the project for land, buildings and certain other facilities, including necessary site work and related waste transfer facilities, for such things as composting and recycling, which would presumably constitute governmental use. The private partner's qualified equity contribution could be used for elements of the project involving the production of energy (output) from which profit can be derived. The governmental entity could also take a certain amount of such output, providing more opportunity for allocation to the tax-exempt bonds. Note also that, with the averaging method of measuring private use, more output could be allocated to the governmental entity in later years to overcome anxieties about construction risk and unproven technologies in the early stages of the project.

Conclusion

The New Regulations provide new and welcome flexibility for the use of tax-exempt bonds in projects where such financing was not previously available, particularly where the public sector and the private sector have agreed to a true partnership or similar joint venture with respect to the development and operation of mixed use waste-to-energy or other types of output facilities.

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2016 INTERNATIONAL ANTI-CORRUPTION SUMMIT:

Implications for the infrastructure sector

by Angela Pearson and Emily Yamahiro

On 12 May 2016, the UK hosted a landmark international anti-corruption summit which concluded with a strong global declaration against corruption and over 40 participating countries each committing to specific action plans. The UK's commitments to combatting corruption are some of its most ambitious and significant to date, with proposals having direct impact on both domestic and foreign businesses, including those in the infrastructure industries.

Corruption and the infrastructure sector

The perception of the infrastructure sector as being vulnerable to bribery is nothing new. In the most recent edition of the Bribe Payer Index, Transparency International ranks the infrastructure sector as the world's most bribery-prone industry.[1] Corruption has traditionally plagued the infrastructure and construction sectors due to their unique characteristics.

Companies who build infrastructure are required to obtain various permissions from governments or local authorities, including planning permissions and licences. The process is often lengthy and complicated, and thus prone to abuse. In addition, infrastructure and construction projects are usually large in scale and often unique and project-specific. This makes it difficult to compare costs between projects, allowing scope for the concealment of inflated expenditure. Furthermore, there are often numerous parties involved, such as joint venture structures with local partners or multiple layers of contractors and sub-contractors, creating a complex project structure which hampers the tracing of any suspect payments. As the global appetite to expose and punish corruption increases, many countries are introducing anti-bribery and corruption legislation, some with extra-jurisdictional reach, and are increasing their enforcement activities. The likelihood of companies and individuals being prosecuted for bribery will therefore inevitably increase.

1 Bribe Payers Index 2011, Transparency International: http://www.transparency.org/bpi2011/results

Global movement to tackle corruption

On 12 May 2016, the UK government hosted a landmark international anti-corruption summit in London to tackle corruption at home and abroad. The summit, attended by leaders of more than 40 countries as well as representatives from major international organisations such as the OECD, the International Monetary Fund ("IMF"), the United Nations and the World Bank, concluded with a strong global declaration against corruption, as well as specific action plans and commitments by participants.

Ahead of the summit, the IMF published a report highlighting the impact of corruption on growth and economic development. The report quoted recent estimates which put the annual cost of bribery alone at about US$1.5 trillion to US$2 trillion (roughly two per cent of global GDP). It noted that the overall economic and social costs of corruption were likely to be even larger, since bribes constitute only one aspect of many possible forms of corruption. In light of such troubling statistics, the global urgency to tackle the issue was made clear by participants at the summit. The then UK prime minister David Cameron spoke of "*building a global movement against corruption*", with US Secretary of State John Kerry urging the "*global community to come together and have no impunity to corruption*".

UK's ambitious plan and impact on the infrastructure sector

To demonstrate their commitment to addressing this issue, all countries present at the summit signed the Global Declaration Against Corruption, committing to expose corruption wherever it may be found, to pursue and punish those who perpetrate, facilitate or are complicit in it, to support the communities who have suffered from it, and to ensure it does not fester in government institutions, business and communities. As host country to the summit, the UK announced some of its most ambitious and significant plans to date to address the issues of corruption. If implemented, many of these proposals will have a significant impact on businesses both domestic and abroad.

Open Contracting Data Standard

The UK has promised to implement the Open Contracting Data Standard ("OCDS") for contracts administered by the UK's central purchasing authority, the Crown Commercial Service. This would mean, for the first time, that the entire process of awarding public sector contracts, from the bidding stage right through to implementation, would be disclosed to the public. It would obviously have a very significant impact on those companies who are active in developing public sector infrastructure.

The move is intended to address public demand for relevant data to be made more readily available and more consistent in its format so it is easier to analyse. The difficulties in analysing the public data which is currently available creates hurdles for new suppliers or businesses wishing to bid for public sector business and also, crucially, makes it difficult for third parties, such as non-governmental organisations, to hold the government to account for the way in which public money is spent.

The change would ensure a clear public record of how government money is spent on public contracts and, importantly, its outcome. In addition, the disclosure of all data and documents at all stages of the process is designed to support fair and effective contracting and to encourage organisations to increase contracting transparency.

The UK government will begin trialling the principles of the OCDS on High Speed Two, a major rail infrastructure project which is currently in procurement. It is intended that the OCDS will be fully implemented in Crown Commercial Service contracts by October 2016, followed by the rest of government.

The UK is the first G7 country to commit to this standard. Following the summit, a number of other participating countries, including Mexico, announced that they were also planning to demonstrate movement towards full transparency by applying OCDS to their major projects.

A related initiative is the UK government's plans to introduce a conviction check process to prevent corrupt bidders with relevant convictions from winning public contracts. A number of countries have made similar commitments, which include the sharing of conviction information across border.[2] It is clear that there is a strong global appetite for transparency, and many countries are planning to implement a uniform (or similar) approach.

Potential revival of the offence of failure to prevent economic crime

In February 2016, construction and professional services company Sweett Group PLC was sentenced under Section 7 of the UK Bribery Act 2010 and ordered to pay £2.25 million for its failure to prevent bribery in relation to a hotel construction project in Dubai. Sweett Group PLC pleaded guilty and admitted that its subsidiary had paid £680,000 in bribes to secure a £1.6 million consulting contract in relation to the project. This was the first corporate conviction under the Section 7 "failure to prevent" offence since the Bribery Act had come into force.

Before the summit, David Cameron announced the UK government's intention to create a new offence, stating that "*… in addition to prosecuting companies that fail to prevent bribery and tax evasion, we will consult on extending the criminal offence of 'failure to prevent' to other economic crimes such as fraud and money laundering so that firms are properly held to account for criminal activity that takes place within them.*"[3] The plans to begin the long-awaited consultation on extending the scope of the "failure to prevent" model beyond bribery were confirmed by the UK government on 12 May 2016, with a view to beginning the consultation process in summer 2016.[4]

This announcement overturned a previous decision by the UK government, in September 2015, when it had announced that it would "*not carry out further work at this stage as there have been no prosecutions under the model Bribery Act offence and there is little evidence of corporate economic wrongdoing going unpunished*".[5] However, the conclusion of the first Deferred Prosecution Agreement ("DPA") in November 2015, followed by the first successful conviction under the "failure to prevent bribery" offence in February 2016, as well as the recent "Panama Papers" leak, may have given fresh impetus to revisit the issue. Furthermore, a second DPA has recently been secured, this time with a UK SME for its systemic use of bribes to obtain contracts to supply its products.[6] It has been alleged that contracts worth a total of over £17 million were implicated by this conduct. This development may also accelerate the discussions surrounding expanding the offence to other economic crimes.

Under current legislation, obtaining convictions for economic crimes such as money laundering, false accounting and fraud can prove difficult, as the prosecution needs to prove that a very senior person within the organisation (such as the CEO or Managing Director) committed the offence. If the proposed new offence closely mirrors the "failure to prevent" model, it will effectively create a strict liability offence, and allow law enforcement agencies to more easily prosecute corporations for failing to prevent such a corporate economic crime.

Although we are still waiting to see the full details of the consultation, this potentially wide-ranging extension may require significant expansion to corporate compliance programmes. This will particularly be the case if, as would seem likely, the current Section 7 defence of having "adequate procedures" in place to prevent bribery, is also available to companies in respect of an expanded economic crime offence. An extensive explanation as to what might constitute "adequate procedures" will need to accompany the new offence. Enhanced risk assessments; the creation of policies and procedures; staff training and monitoring the business to detect and manage economic crime risks which extend beyond bribery are all ways in which businesses could stay ahead of the change.

Public Registry

The UK is already the first G20 country to create a public central register of company beneficial ownership information for all companies incorporated in the UK. UK companies are now required to hold a register of "People with Significant Control" and, since 30 June 2016, this information is available to the public via the public register at Companies House.

The UK government has now committed to establishing a public register of company beneficial ownership for foreign companies who already own, or wish to buy, property in the UK, or who bid for UK central government contracts, including for infrastructure projects. If implemented, this would mean that any

2 These countries include: Afghanistan, Brazil, Columbia, Georgia, Germany, India, Italy, Jordan, Kenya, Malta, New Zealand, Nigeria, Norway, Spain, Switzerland, Tunisia, the UK, Ukraine and the US.

3 Article; The Guardian; 11 May 2016: "The fight against corruption begins with political will": www.theguardian.com/commentisfree/2016/may/11/fight-against-corruption-begins-with-political-will.

4 Government Press Release: https://www.gov.uk/government/news/new-plans-to-tackle-corporate-fraud.

5 Parliament Q&A: http://www.parliament.uk/written-questions-answers-statements/written-question/commons/2015-09-09/9735

6 SFO secures second DPA, 8 July 2016: https://www.sfo.gov.uk/2016/07/08/sfo-secures-second-dpa/.

non-registered foreign companies would no longer be able to own or to buy property in the UK or bid for UK public contracts. The UK is also driving an initiative to establish the automatic exchange of beneficial ownership information. Over 20 countries including Afghanistan, France, Germany, India, Italy, Kenya, Nigeria, Spain and Switzerland signed up to this new pilot initiative, with an aim of assisting each other's authorities in their respective investigations.

The UK government is aiming to conduct a consultation on registration of foreign ownership by the end of this year. This registry will help financial institutions and other businesses to conduct a thorough customer due diligence and will also assist HMRC and other government authorities abroad in their investigations.

Conclusion

The UK government is aiming to develop a cross-government anti-corruption strategy by the end of 2016. The level of commitment from the UK government, as well as other countries, is a welcome step in the fight against corruption which overshadows many industries, particularly the infrastructure sector.

However, at present only limited information is available, with many of the proposals outlined above being high level policy pronouncements. In addition, given the UK's decision in June 2016 to exit the EU, and with those who were closely associated with the above proposals, particularly the former prime minister, no longer within the new government, the future of the proposals appears unclear, at least in the immediate term.

Nonetheless, the plans proposed by the UK government are potentially significant for many businesses in the infrastructure sector, and companies in the UK and abroad will be eager to see the details and be given the opportunity to participate in the anticipated consultations. We will be tracking these developments with interest.

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Stop press

Partner appointment marks further step in Ashurst's ambition to become the leading firm in US infrastructure

In September, we welcome Andrew Fraiser as a partner in our New York infrastructure team.

Andrew joins from Allen & Overy where he was a partner in the banking department. Specialising in infrastructure projects for nearly 20 years, Andrew has advised public authorities, private equity investors, developers, contractors, operators and debt providers on some of the most complex and high-profile projects in the US and European markets.

Andrew is the only lawyer globally to have been ranked in Band 1 for PPP/P3 by Chambers Legal Directory in both the UK and the US. His contribution to the US infrastructure market was also recognised in the Financial Times' US Innovative Lawyers' Awards, 2015 and 2016.

Ashurst New York infrastructure partner Jason Radford commented:

"I am delighted that Andy will be joining the Ashurst US team. His experience and reputation in the US infrastructure market is first class. The addition of Andy to our team makes Ashurst one of a very small number of US based teams with a track record of representing the public sector, sponsors and lenders on deals that achieved financial close. Andy's arrival signifies the start of another key stage in our development to become the leading firm in the US infrastructure market."

Ashurst recognised for its work on high-profile global infrastructure deals

Our infrastructure team has been acknowledged in a wide range of prize-winning projects at the 18th annual Partnerships Awards, held on 12 May 2016 in London, recognising our work over the past two years advising on some of the most high profile, complex and innovative PPP projects across the globe.

The Thames Tideway Tunnel project, on which we advised the UK Government's Department for Environment, Food and Rural Affairs (Defra), has won the prestigious "Projects Grand Prix", in recognition of being the signed project to have delivered the greatest improvement in public services for the community it serves.

Other significant awards for projects on which we advised were: Priority Schools Building Programme – North East, UK ("Best Education Project" Gold award); Thames Tideway Tunnel, UK ("Best Waste/Energy/Water Project" Gold award); Toowoomba Second Range Crossing Project, Australia ("Best Road Project" Gold award) and M25 motorway, UK ("Best Completed Project" Gold award).

This latest accolade for the high-profile Thames Tideway Tunnel project follows on from other recent awards it has received, which include:

- Project Finance Deal of the Year (Thames Tideway Tunnel) – IFLR European Awards 2016
- Europe Water Deal of the Year (Thames Tideway Tunnel) – IJGlobal Awards 2015
- European Infrastructure Deal of the Year (Thames Tideway Tunnel) – PFI Awards 2015

Infrastructure partner Philip Vernon, who led the Ashurst team advising Defra, said:

"We are very proud of our role advising Government on the Thames Tideway Tunnel project. This novel and complex project is critical to the modernisation of London's essential infrastructure and this recognition of the importance of the project demonstrates how we continue to operate at the very forefront of the infrastructure market."

ashurst