support for recovery

The Department of Health has provided details on making loans the primary means for providing financial support to providers in financial difficulty. Steve Brown reports

The Department of Health has recently confirmed plans to change the way it provides financial support for providers in financial difficulty. Public dividend capital (PDC) funding – both for capital and working capital purposes – will in future be supported in most cases with interest-bearing loans. Recent PDC issued in 2014/15 would also be converted to loans.

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The NHS has been on a journey to improve the transparency around capital and other financial support and to provide the right incentives and costs for the use of these funds. The change started with the creation of foundation trusts and a more commercial-style approach to borrowing based on affordability, but NHS trusts in more recent years have followed suit. So for normal business activities for solvent organisations, capital expenditure or short-term working capital requirements (beyond what can be met from depreciation and surpluses) should be financed by loans.

These loans are from the Department of Health, which is advised by the Independent Trust Financing Facility (ITFF – formerly the Foundation Trust Financing Facility). Providers wanting such a loan should apply to the ITFF, with foundation trusts applying directly and trusts going via the NHS Trust Development Authority.

Where things get more difficult is with providers in financial difficulty. In October last year, the Department published guidance on the range of finance available to support NHS providers. It clarified that the 'secretary of state may provide loans and/or public dividend capital to support FTs and NHS trusts in financial difficulty subject to the development of an appropriate recovery plan.'

This support – known as interim support – recognises that trusts in financial difficulty – where repayment of a loan may initially be unaffordable – still need to undertake essential development of their assets and can't reduce patient services to deal with the cash consequences of being in deficit. In particular, interim support provides financing while a recovery plan is put in place and agreed with either Monitor or the TDA. Once a recovery plan is in place, longer term financial assistance – or planned term support – will be considered.

In March, the Department issued further guidance providing more detail about how interim support will be provided from 2015/16 going forwards. While to date this support has been provided in the form of PDC, in future the guidance makes clear that for foundation trusts, loans will be the default mechanism. At the same time, some foundation trusts with temporary PDC issued in 2014/15 are having this support converted to a loan format. (PDC issued on a temporary basis should be paid back in year unless subsequently converted to permanent PDC.)

There are a number of issues likely to be driving the change in approach. PDC issued for capital purposes (and originating PDC to reflect the state's equity investment when the organisation was first set up) contributes to an organisation's net assets and so incurs a cost of capital. In particular, assets financed with PDC would attract a 3.5% charge collected through the annual PDC dividend. But PDC issued as revenue support has no capital charges as there is no asset created.

Different perspectives

So there is a potential issue about the gap between PDC liability at a national level and the overall net assets this has contributed towards. Another driver is how the support is viewed by the receiving organisations. If the support is seen as 'free finance', what impact does that have on boards? The move from PDC to loans for normal course of business support is seen to have had a beneficial impact in getting boards more involved in capital decisions – fully challenging the need for a loan and focusing on the costs and affordability over the repayment period. There is an argument that this discipline should

Interim support and deficit funding

The Department of Health provided £509m of interim revenue support to 21 NHS trusts and 10 foundation trusts in 2013/14, according to a report published alongside its annual accounts for 2013/14 in July last year. In 10 cases, the support was for £20m or more, with three providers accounting for nearly a quarter of the total.

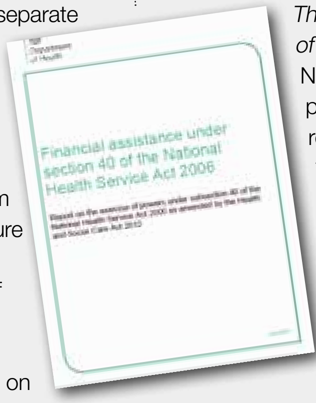
A further 17 providers (11 trusts and six foundations) shared a further £95m of interim capital support for essential capital works. All but four of these providers also received revenue support.

The Department's July report referred to interim deficit support. However, the more recent guidance refers to interim revenue support. This tweaked terminology helps to distinguish this support from separate non-recurrent provider deficit funding.

The main difference is that revenue support provides cash to help organisations deal with the cash shortfalls that arise from having an income and expenditure deficit – the deficit remains clearly visible in the statement of comprehensive income.

In contrast, deficit funding provides income that will impact on the reported financial position.

According to the National Audit Office's *The financial sustainability of NHS bodies* report last November, NHS England provided £60m of non-recurrent deficit funding to 13 providers in 2013/14, under advice from the NHS Trust Development Authority. Fifteen NHS trusts received deficit funding in 2014/15 according to papers from the NHS TDA.



be just as good – perhaps better – for providers in financial difficulty.

Five financing facilities are described in the March document, *Interim support finance*. Three are to support revenue requirements and two for capital. The two capital facilities include PDC and loan options. However, the document is clear that capital PDC support will only be in exceptional circumstances for both foundations and trusts.

'It will not be available for capital requirements that can reasonably be considered to be part of a trust's normal business commitments,' the guidance says. It does not spell out what exceptional circumstances might look like, but it is believed that PDC could be the route taken if the capital was needed to fund a development that had a greater good – for instance, enabling service improvements and savings across a broader health economy. If PDC was issued, as with other capital PDC, there would be no routine repayment. But, again as with other PDC, the Department could require repayment in part or in full where this was deemed affordable, perhaps most obviously where there was a subsequent capital receipt for assets replaced by the new investment.

"Capital PDC support will not be available for capital requirements that can reasonably be considered to be part of a trust's normal business commitments"
Interim support finance

What is completely clear is that loans are now the default position going forward for providers in financial difficulty needing support for capital expenditure. While the specifics of the loan terms and warranties may differ, this effectively brings trusts in financial difficulty in line with solvent providers.

Interest will be charged at the National Loans Fund rate on the day of the loan agreement – payable every six months. And the principal will be repaid in equal instalments over an agreed term.

Repayment terms

In contrast, in all three of the facilities aimed at supporting revenue requirements, there is no expectation that organisations will 'routinely' repay principal, although principal may become repayable on maturity of the loan or at the point when a recovery plan has been agreed. This acknowledges that the affordability of a loan can't be assessed in the interim phase while the trust is in an unsustainable position. However, the organisations will face interest or other charges from the outset.

An interim revolving working capital support facility is likely to be the first facility that all providers access on first moving into financial difficulty and requiring working capital support to meet salaries and other payments. A cap will be placed on the amount of borrowing through this facility – set at up to 30 days of operating expenditure. If an organisation's financing requirements exceed this level, in effect the borrowed amount would be converted to an interim revenue support loan – the second of the two products that have been set up.

This is different from the old system, where trusts received temporary PDC until they could apply for a full year's permanent PDC requirement. Effectively, the Department has taken out the annularity of the process. So, in fact, the working capital facility would stay with an organisation throughout the whole period that it is working up its recovery plan.

There are different interest rates that apply to the different products – 3.5% for the working capital facility and 1.5% for the loan – the higher working capital rate being aimed at encouraging organisations to keep additional borrowing down.

The interim revenue support loan is the default route for foundation trusts and the loan is also available to trusts on request or where this is recommended by the TDA. However, a third product has also been created for NHS trusts – interim revenue support PDC, a replacement for permanent PDC previously provided for interim support. As this funding would not attract a service charge through the PDC dividend, a commitment fee equal to 1% of the total award amount will be charged.

In all three cases for the revenue interim support, the support/loans may become repayable at the maturity of the loan, which should coincide with the development of an agreed recovery plan. At this point the affordability of the principal repayment would be assessed and, in the cases where there was a robust plan to return to financial sustainability, planned term support could be put in place including a repayment plan for full or part repayment of the borrowed amount. Repayment of interim revenue support PDC may also be considered at this point.

There is a balance to be struck between imposing additional financing costs on organisations already in financial difficulty and providing them with penalty-free financial support. But there is a clear message being sent that the distressed organisation finance mechanism is not a route to easy money. All providers within this system can expect to be subject to more scrutiny than in previous years and far more scrutiny than other providers. And for foundation trusts, the cost of receiving this support is the loss of some of their autonomy.

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