SESSION 2000/2001 SEVENTH REPORT

COMMITTEE FOR FINANCE AND PERSONNEL

# Report on the Inquiry into the use of Public Private Partnerships

VOLUME 2 — WRITTEN SUBMISSIONS — PART I

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# COMMITTEE FOR FINANCE AND PERSONNEL

## POWERS

The Committee for Finance and Personnel is a Statutory Departmental Committee established in accordance with paragraphs 8 and 9 of Strand One of the Belfast Agreement and under Standing Order No. 45 of The Northern Ireland Assembly. The Committee has a scrutiny, policy development and consultation role with respect to the Department of Finance and Personnel and has a role in the initiation of legislation.

The Committee has the power to:

- consider and advise on Departmental budgets and annual plans in the context of the overall budget allocation;
- approve relevant secondary legislation and take the Committee Stage of relevant primary legislation;
- call for persons and papers;
- initiate enquires and make reports;
- consider and advise on matters brought to the Committee by the Minister of Finance and Personnel.

## MEMBERSHIP

The Committee has eleven members, including a Chairperson and Deputy Chairperson and a quorum of five members.

The membership of the Committee since its establishment on 29 November 1999 is as follows:

- Mr Francie Molloy (Chairman)
- Mr James Leslie (Deputy Chairman)
- Mr Alex Attwood
- Mr William Bell
- Mr Seamus Close
- Mr Nigel Dodds MP*
- Mr Derek Hussey
- Ms Patricia Lewsley*
- Mr Alex Maskey
- Mr Peter Robinson MP*
- Mr Peter Weir

* Mr Oliver Gibson was replaced by Mr Dodds on 2 October 2000.

* Mr Gardiner Kane was replaced by Mr Robinson on 2 October 2000.

* Mr Donovan Mc Clelland was replaced by Ms Lewsley on 15 January 2001.

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| A | Prof Stephen Glaister, Imperial College London |
| A | Transport 2000 |
| A | Professor Austin Smyth,Transport Research Institute NI |
| A | Professors Jane Broadbent, Richarsd Laughlin, University College London |
| CG | Department of Culture Arts & Leisure |
| CG | Department of Education |
| CG | Department of the Environment |
| CG | Department of Enterprise Trade & Investment |
| CG | Department of Finance & Personnel |
| CG | Department of Health Social Services & Public Safety |
| CG | Department of Higher & Further Education, Training & Employment |
| CG | Department for Regional Development |
| CG | Department for Social Development |
| CG | Northern Ireland Audit Office |
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| GBCG | National Assembly for Wales |
| GBCG | National Audit Office |
| GBLG | Dorset County Council |
| GBLG | Leeds City Council |
| GBLG | London Borough of Camden |
| GBLG | London Borough of Harrow |
| L | L'Estrange and Brett |
| NDPB | Altnagelvin Hospitals HSS Trust |
| NDPB | Belfast City Hospital Trust |
| NDPB | Belfast Institute for Further & Higher Education |
| NDPB | Council for Catholic Maintained Schools |
| NDPB | Eastern HSS Board |
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| PS | Compass Plc |
| PS | Confederation of British Industry (NI) |
| PS | Construction Employers Federation |
| PS | Jarvis Plc |
| PS | Major Contractors Group |
| PS | Northwin Consortium |
| PS | PricewaterhouseCoopers |
| SDC | Committee for Higher & Further Education, Training & Employment |
| U | Irish National Teachers Organisation |
| U | National Association of Teachers in Further & Higher Education |
| U | Northern Ireland Public Service Alliance |
| U | UNISON |

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## CIPFA

CIPFA is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government. CIPFA's members work (often at the most senior level) in public service bodies, in the national audit agencies and major accountancy firms. They are respected throughout for their high technical and ethical standards, and professional integrity. CIPFA also provides a range of high quality advisory, information and training and consultancy services to public service organisations. As such, CIPFA is the leading independent commentator on managing and accounting for public money.

### INTRODUCTION

1. CIPFA is pleased to submit this memorandum of comments to the Northern Ireland Assembly committee for finance and personnel inquiry into public private partnerships.
2. CIPFA is one of the leading professional accountancy bodies in the UK and specialises in the public services. CIPFA's members work (often at the most senior level) in public service bodies, the national audit agencies and major accountancy firms.
3. CIPFA offers advice and guidance to its members and to the organisations that they serve in relation to financial stewardship issues. Earlier this year, through the work of its Treasury Management Panel, CIPFA published guidance for finance directors in the public services on public private partnerships, and this memorandum of comments draws on the work undertaken by CIPFA for that guidance. CIPFA's comments relate to public private partnerships in general, rather than to individual schemes. However, CIPFA's comments are founded on the experience of senior officer practitioners who are actively involved in private finance initiatives /public private partnerships throughout various elements of the public services.

### THE PUBLIC POLICY FRAMEWORK

4. CIPFA recommends that public private partnerships should be seen as one in a range of financing and procurement methods available to public service managers, to meet identified and planned investment needed to maintain and develop public services.
5. It is CIPFA's view that best value will be obtained overall when public policy frameworks assist the consideration of options on an equal footing.
6. A factor that will facilitate this is the introduction of resource accounting and budgeting throughout the public services. In essence, resource accounting means that money spent will be recorded in the year it is used, not in the year it is spent (unless the two are the same). This will mean that the cost of capital investment will be spread over the life of the project, whether procurement is via a public private partnership or through traditional procurement. For public private partnership schemes, the service user will pay a service charge. For publicly funded procurement, the service user will be charged with (notional) interest on capital value and will have to make an allowance for depreciation.
7. It would be consistent with this to treat expenditure on the acquisition of fixed assets through traditional procurement differently from current spending, by controlling the former through prudential, sustainable investment limits.
8. This would have the following important benefits:
    (a) it would put public service managers far more on a par with those in the private sector and would make it much easier to compare the relative benefits of public procurement and of projects financed through public private partnerships

(b) it would force consideration of whole life costing

(c) it would give public service managers the incentives to choose efficient capital projects when undertaking traditional procurement – for traditional procurement as opposed to public private partnerships, control frameworks often actually incentivise cheap-up-front but expensive to run projects.

## VALUE FOR MONEY

9. It is CIPFA's view that the decision to proceed with a scheme should be based on objectively evaluated value for money.

10. No two public private partnership schemes are identical. As such, it is not possible to be prescriptive about what features ensure good value for money. However, the following are issues that ought to be considered in developing schemes so as to deliver good value for money:

(a) **Scope of the scheme**

The public sector can generally provide finance for investment more cheaply than the private sector. Consequently, any scheme that is only about financing capital investment is unlikely to deliver good value for money. As a general rule it is likely that schemes where there is a good balance between service provision and capital investment will offer greater scope for value for money. However, there will be exceptions to this, particularly where the asset created will be used by third parties. Also, if the scope of the scheme is artificially extended, by bundling together services that are not interdependent and offer little scope for efficiency through integrated management, this is unlikely to achieve good value for money.

(b) **Best Value**

The principles of Best Value, as embodied in statute for local authorities, provide a means of rigorously examining public private partnerships, and could be used throughout the public services. The application of the "4c's" (challenge, consult, compare and compete) advances a comprehensive scrutiny of all aspects of a proposed scheme in terms, not only of its suitability for public private partnership, but also its context within public service priorities and resourcing.

(c) **Appropriate risk allocation**

If good value for money is to be secured, risks must be allocated to the party best placed to manage them. Without risk transfer, the private sector partner will be guaranteed an income but may set charges to give an inappropriately high return. But if the public sector tries to transfer risks that the private sector cannot manage then the private sector will charge a premium, compromising value for money. It is also important to recognise that ultimate responsibility for ensuring that services are provided will remain with the public sector.

(d) **Service specifications**

To achieve best value for money, in a public private partnership the public sector should determine the outputs required, allowing the private sector to be innovative in determining how these can be achieved. The outputs should include clear and measurable performance standards understood by all parties and, wherever possible, a programme of continual improvement over the life of the contract.

(e) **Alignment of interests**

A public private partnership involves a long term relationship and value for money will only be achieved if there is a partnership between the private and public sectors with the interests of both parties truly aligned, with both parties incentivised to act in their joint best interests.

(f) **Flexibility**

Any long term contract must build in sufficient flexibility to allow for changed circumstances and governance arrangements ought to allow for such flexibility.

## CONCLUSION

11. As the letter inviting comments to the committee's inquiry states, there is a pressing need for substantial further investment in public services and infrastructure. It is CIPFA's view that consideration of the issues listed in paragraph 10 above, combined with a control framework for capital investment that evaluates and

considers funding options on an equal footing, will greatly assist the appropriate use of both public private partnerships and traditional procurement to achieve this.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## LONDON SCHOOL OF ECONOMICS

9 April 2001

I have written extensively on the PFI in the NHS in England. My current research addresses the nature of the investment decision as a whole. The PFI is then just one element of this. Rather than make a more formal submission I am enclosing some material regarding the PFI which has been published elsewhere.

To summarise my view, the key issue is whether the new PFI-built hospitals will provide value for money. This judgement can only be made when we have the experience of several hospitals treating patients over a number of years. We know the revenue costs associated with them will be higher than with the old institutions they have replaced. The question is whether there will be benefits to compensate for these. The improved quality of the hospital environment may result in better care and hopefully better outcomes. But this all remains very uncertain.

I hope this and the material I attach proves useful. If I can be of any further assistance do not hesitate to contact me either by email or on 07974 329078.

**SEÁN BOYLE**

## PFI in perspective

*(A version of this was published in Public Finance, March 2001)*

Ever since the private finance initiative became an effective instrument for large NHS schemes, it has been the focus of sustained criticism on the one hand, and emphatic support on the other. The Government, in its Capital Investment Strategy [1], simply asserts it delivers schemes more cheaply than the public sector alternatives. Its critics argue that the savings are illusory but their detailed analyses are, according to NHS executives and Department of Health officials, inaccurate and misleading.

With disagreement so deep, is it possible to find any common ground? If not actual agreement on whether the PFI is beneficial to the NHS or not, at least agreement on what the key issues are?

We suggest the current debate is not helpful - focused as it is almost entirely on the method of financing investment and whether this gives 'better value for money'. To attempt an answer to this, the PFI must be placed in a proper context. That requires a clearer focus on the nature of the investment decision.

### *The investment decision*

The implied investment decision should be analysed:

- first, at the broad national strategic level;
- second, at the level of the local health economy; and,
- third, in terms of the nature of the investment proposal (in this case building).

Each level gives rise to different types of consideration.

At the national level: How should the government divide health resources between investment and current consumption? What kind of investment is required to deliver government health objectives?

At the local health economy level: What are the investment opportunities lost by putting large-scale investment into the hospital sector? Should there be more local investment in other projects or in the human capital required to deliver in the community, services once delivered within the hospital?

At the building level: What are the efficiency gains achieved by incurring higher capital or user charges? Will there be sufficient flexibility in the buildings delivered to cope with the uncertainty inherent in any forecast of future hospital activity?

And for each of these: How does the method of financing affect the objectives which have been set at each level?

It is only when decisions are assessed in the light of objectives set at each of these levels is it appropriate to examine whether the method of financing is right. There is likely to be some connection between method of financing and how well the decision fits with objectives at each of the above levels but those objectives are worth analysing independently of financing method.

Building better buildings leads naturally to considering how the building works in practice. We draw on some similarities with the current debate over London Underground. A recent NAO report [2] has suggested that the focus must be much more on what is known about how the system in use performs – in this case the London Underground. Interestingly, by making its remarks public before a decision on financing of the Underground has actually been made, the NAO may well have played a role in the ultimate outcome.

### *The strategic framework*

Government decisions on how to invest scarce national resources in the NHS should rest on how best to deliver its own health objectives such as improved cancer care or for the way that care is delivered, eg closer to home. However, decisions made on new hospital projects appear to have been taken in a strategic vacuum as if there were no need to question the type of investment required. At the national level it has been simply assumed that new hospitals are a good thing.

The Department of Health's Capital Investment Strategy naturally enough emphasised the scale of the present Government's commitment to new projects. The poor condition of much of the NHS capital stock would appear to justify extra investment, but in what?

The key issues surrounding the future of hospitals are not well understood. There remains a need for an agreed framework for considering the future development of the hospital system. The National Bed Inquiry was a start and there are signs that the Department of Health has recognised the need to take a strategic look at hospitals and their likely future development but there is a long way to go.

The Government's proposals for a 'modern' NHS, eg new elective care centres and the development of intermediate facilities, have implications for the role of what are now district and teaching hospitals. And both are also affected by clinical development, developments in research funding and organisation and in training. A great deal of work remains to be done to assess the implications of all these.

Decisions to build new hospitals should also reflect an explicit expectation of the nature of their contribution to better health, perhaps using some formal representation of how health care is produced. But the current debate is silent on this; we do not know the relation between the different inputs to the health system and measurable outputs: still less the impact on the health of individuals in society. The argument whether - over 30 years - private finance saves perhaps £10,000 a year becomes spurious when we realise that the need for these new buildings is unproven.

The decision on how best to invest scarce resources has received little better treatment at the level of the local health economy.

### *Local strategy*

The decision to invest scarce resources in hospital buildings should never be taken in isolation from the distribution of current and future resources in the local health economy. Investment in new hospitals poses opportunity costs on other services, however financed.

It would seem that the Secretary of State has accepted the logic of this argument. Making his latest hospital building announcement in mid-February 2001, he indicated that hospitals should be planned within the context of the local health economy saying that '*For too long hospital developments have been considered in isolation from other changes to local health services*' [3].

Moreover, even within a single hospital the decision to invest in buildings rather than equipment or human capital is one which must be justified. There are plenty of examples of cost savings associated with new technology or new drugs. On the other hand, new hospitals have not been shown to produce significant efficiency gains: they are not 'cash-releasing' but rather 'cash-consuming'. The opportunity costs may be felt in the form of lower bed numbers, loss of community services and so on: unless new hospitals can be built for a lower overall cost than the ones they replace this will be so.

The capital or user charges for new buildings maintained to a high standard are almost inevitably going to be more than those for the old hospital being replaced. So the nature of the improvements that result from the decision to invest becomes crucial.

### *Building better buildings*

At this level, there are several issues which do not wholly turn on the method of finance chosen, particularly the quality of building design and the efficiency of the buildings in use. We have suggested elsewhere that some trusts should be encouraged to hold design competitions and that the Department of Health should underwrite 'risky' and 'innovative' designs. Similarly it should support work on the economics of hospitals and other health buildings, perhaps, following the proposals for cancer care, in the form of a 'virtual' Institute.

At this level there may be an argument about appropriate methods of procurement for the task in hand, whether by private, public or some mixture of the two. Both private and public procurement processes can be improved over the situation in 1997. As far as the former is concerned, there would be little dispute that the process was expensive and time-consuming when the first round of hospital projects was negotiated while there is also little doubt that some public sector schemes ran grossly over budget.

The private process has been improved and will improve further. Equally, as the NAO suggest in relation to London Transport (2), there should be scope for the public sector to learn from the private. For example, if the incentive inherent in the private finance route to minimise lifetime costs by appropriate design and building techniques has been effective, then those designs and techniques can be replicated. If any schemes embody effective ways of allowing for the need to change the way space is used, then these too can be copied.

*The efficiency of the building in use*

Once the decision has been made to invest in a particular building the discussion should still go beyond the purely financial. Key is the ability of the procurement and financing arrangements to deliver what is required over time.

The NAO report on the financing of the London Underground set out five areas for separate analysis which we believe are equally important when looking at NHS investment decisions:

- the strategic context;
- the nature of the continuing relationship between private and public;
- the viability of long term contracts;
- managing the risks if they materialise; and
- incentive structures.

The strategic context for health care has been dealt with in some detail above. Applying the NAO analysis in an NHS context suggests a number of questions for public/private partnerships:

- Can the NHS partner be confident that the private partner cannot in the NAO's words 'demand excessive increases in payment as new requirements or unexpected contingencies arise'?
- Equally, as contracts over long periods can never be 'complete' ie fully specified for all circumstances, can the NHS be confident that there will be sufficient common interest for informal partnership to work?
- What risks arise from the division of responsibilities between the NHS and the private sector, particularly within hospitals? Is there a risk of a health equivalent of the wheels not matching the rails ? In other words, is the division between clinical and non-clinical services water-tight or are there areas such as cleaning and infection control, where the two may overlap?

There are equally tough questions to be posed for the public option:

- What happens if there are project cost or time overruns?
- What confidence can there be in the ability of trusts to maintain running costs in line with those set out in financial plans?

And there are some questions which apply to both:

- What happens if too much or too little capacity has been provided?
- Have the risks attached to possible changes in desirable clinical configuration been allowed for?
- What other risks may have to be managed and who is best placed to do so?
- What kinds of change in service delivery do the financial arrangements encourage or discourage?
- Will the financial arrangements make it easier or harder to change the 'balance of care'?

These are not easy questions to answer. We believe that if there was a wider understanding of the risks and uncertainties facing future hospital building and the likely development of clinical services, then they could be more intelligently discussed. Out of that discussion a clearer view of the advantages of different financial arrangements might emerge.

### *Finally finance*

We do not propose to go over well-trodden ground again [4]. We would simply point out that the nature of the arguments, as evidenced in the pages of Public Finance and elsewhere, where basic figures such as scheme cost and bed numbers are in dispute, is not helpful to anyone. Nor is it helpful that values are put on the risks transferred to the private sector without any explicit justification particularly as these values are critical to the 'value for money' issue.

Neither is it useful for the Department of Health and its ministers to accuse people of getting the figures wrong without going on to set the record straight. There must be a standard presentational format and an agreed set of figures in the public domain together with an explicit and justified set of calculations for the value of risk transfer.

### *Concluding remarks*

In conclusion: the arguments about the finance of hospitals have persistently ignored a range of non-financial issues. The method of finance is important but the balance of the debate must now change.

Currently we have a headlong charge into investment in hospital buildings with little strategic thought. But these use limited resources and moreover there are revenue costs associated with the use of capital in the future. We need to be sure that the money has been spent in the right way. We are not in a position to be so.

*References*


1 Department of Health, Capital Investment Strategy, 2000.

2 National Audit Office, The Financial Analysis for the London Underground Public Private Partnerships, 2000.

3 Department of Health, Long Term Investment to Build 21st Century NHS, PR 2001/0088, 15 February 2001.

4 Boyle, S and Harrison, A, 'Healthcare Building: Public-Private Partnerships', in Healthy Partnerships, Kelly G & Robinson P (eds.), Institute of Public Policy Research, 2000.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## EXTRACT FROM A SEMINAR BY PROFESSOR STEPHEN GLAISTER – "TRANSPORT POLICY, CONTROL AND VALUE FOR MONEY: THE NEXT WAY?" - USED AS A SUBMISSION IN THE COMMITTEE FOR FINANCE AND PERSONNEL'S INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

**HM Treasury, private finance and control of Local Authority expenditure**

The row about who should own and control the London Underground has gone to the heart of a constitutional issue that affects the whole country: devolution of control and accountability for public services to local authorities versus Treasury centralisation.

The government's Public Private Partnership for the Tube – promoted and controlled from the heart of Whitehall – has not been made to work as envisaged. The government has steadfastly refused to discuss a fallback should their temporary privatisation of the Underground – the PPP – fail. So there is now no surviving proposal as to how re-building the Tube is going to be funded and financed. High annual payments by central government are now inevitable - so the Treasury ought to consider how such resources can be most effectively used. Prudent, locally accountable revenue bond finance does have a proven track record and would facilitate devolution.

*The origins of the London Underground Public Private Partnership*

The 1997 Labour Government had a commitment to resolve the London Underground's long term funding and financing problems. There were several options. One possibility would have been simply to carry on with state ownership and direct grants, and to improve on the government-appointed management. Another would have been a return to the situation when the Greater London Council ran the Tube: to hand it over to Transport for London as a job lot, together with some kind of promise (hard to believe and unenforceable in practice) of year-by-year cash grants.

The Treasury was unwilling to continue to provide cash grants without fundamental reform of the Underground, including replacement of the (government appointed) public sector management by private sector management. After nine months gestation the government proposed a solution that would have been a curious mixture of full-blown, "conventional" utility privatisation; the Private Finance Initiative; competitive procurement from the private sector; and operation by the public sector. The principal features were a horizontal split between day to day operations by the public sector and infrastructure provision by the private sector. There would be a further, vertical split of the private infrastructure provision into three distinct groups of lines. Crucially, this was all to be glued together by commercial contracts lasting for all of thirty years. These contracts were to both procure the physical work to be done and to secure the finance necessary. They would enable payment for heavy investment in the early years to be repaid out of forecast overall profits in the later years. Arguably, the consequence would have been to achieve the worst of all worlds.

The original intention was that the contracts would be negotiated and completed by April 2000, and immediately transferred to the Greater London Authority, which would come into existence a few months later. Therefore, an important feature of the scheme was that it would have greatly fettered the freedom of the new Mayor of London to run the Underground in the way that he or she saw fit. The government did not seem to regard this feature as a disadvantage.

A better alternative would have been to follow through the logic of the creation of proper, devolved government for London: hand the Underground over to the Greater London Authority and allow the capital to take responsibility for its financing by issuing revenue bonds.

*The regulatory regime?*

The experience with the UK telecommunications, energy, water and railway privatisations showed the vital importance of having a carefully designed and clear economic regulatory regime. The proposals under the PPP for the Underground were different, but far from clear. Denying that they were following the "Tory" model of privatisation, the Labour Government legislated to create the post of PPP contract arbiter. This official was to adjudicate disputes about the operation and terms of the contracts and carry out reviews at fixed seven and a half year intervals to ensure that the contractors, if efficient, were able to achieve the rate of return they had originally bid.

The presence of an independent regulator, bound by powers and duties set out in legislation in advance, can reduce the regulatory risks perceived by the private sector thereby easing the way to the creation of the new arrangements. But when discretion has to be exercised against a set of public interest criteria this constitutes economic regulation, which is not the normal job of an independent arbiter.

*Flexibility in the contracts*

A central question is the extent to which everything can and should be tied up in a binding contract with a term as long as thirty years. An independent arbitrator and the courts could be used to settle contractual disputes. But there are complications which mean that it may not be sensible to attempt to write fully determinate contracts. For instance:

- the long time scale of the contracts against a local economy which could change quickly, and is certainly subject to cyclical forces;
- the existence of shared facilities;
- the public service characteristics of the 'output' at issue, together with direct and legitimate political responsibilities which will themselves change in nature quite frequently;
- the difficulty of defining and measuring the several dimensions of service quality with sufficient precision to be enforced by contract alone;

*Partnership?*

The government have emphasised their view that a spirit of "partnership" would obviate a reliance on formal contract or rigorous independent utility regulation. However, this appeal to a spirit of partnership is unrealistic in the context of contracts lasting for decades, where the amounts of money involved are so large. Companies will owe a duty to their shareholders to employ the best legal expertise available in order to make the strongest possible case for favourable financial settlement.

*Procurement or financing?*

Part of the Government's reasons for proceeding with the PPP approach has been to achieve "private sector efficiencies" by having private sector companies handle all contracting, engineering and construction, rather than being administered by the public sector. However, this approach risks confusing the handling of capital needs with the handling of operating budgets. Public sector operating agencies can (and do) achieve operating efficiencies, if given the appropriate targets and incentives, as well as the leeway to achieve these targets. What is more, it is entirely feasible for public sector agencies to hire private sector construction managers for major projects, as was the case with the Channel Tunnel, and was finally adopted for completion of the Jubilee Line Extension.

*Alternative approaches*

The London Underground PPP is important because of its sheer size (the same order of magnitude as all the other Private Finance Initiative deals taken together) and the extreme length of its contracts. But many of the difficulties with it are also experienced by officials providing other public services under the Treasury-imposed PFI.

There is a case for devolving the power to make decisions back to those best in a position to make them, in an environment where responsibility and accountability is clear for the decisions made. Local authorities should be free to decide on priorities and the manner in which projects are financed should be a secondary consideration.

If political decentralisation is to function effectively once again, it is essential that local authorities have access to capital financing in order to plan and implement sensible programmes for replacing infrastructure assets.

A financing mechanism could be that of bonds, of which two options are possible:

government-guaranteed bonds (issued under the same aegis as those for the Channel Tunnel Rail Link); or 'revenue bonds', instruments issued at rates slightly above those for public sector interest debt, but backed by dedicated revenues and thus not included in the national government's borrowing programme.

*Government bonds*

Successive UK governments have financed major investment programmes in housing stock through the use of housing associations. A government-appointed and funded institution - the Housing Corporation - provides funding (itself provided by the government) to trusts and other registered private landlords which allows them to raise the resources necessary to build or refurbish social housing. There is, in effect, no risk to the landlord because the government is underwriting all the financing of their investments. Yet borrowing by housing associations with such risk-free conditions does not count as public spending or borrowing. By contrast, the Treasury would count bond-financed borrowing by the Underground as public borrowing. One obvious financing approach available to Transport for London, as an alternative to the proposed PPP, would be to issue bonds for the capital reinvestment needs of the Underground. Since the cost of capital would no doubt be less than the cost to the private sector consortia under the PPP (as demonstrated by the favourable rates of less than five per cent achieved with the successful CRTL issues), the same total resources could well be sufficient also to finance investments for new capacity, which is not presently considered under the PPP proposal.

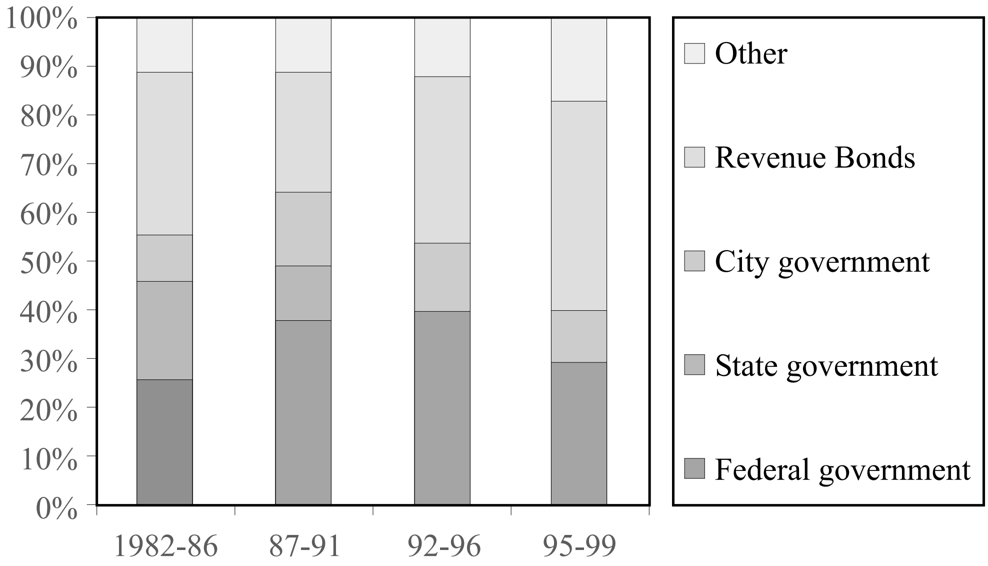
*Revenue bond financing*

Another financing approach being is revenue bond financing. A revenue bond is one that is issued with the security of a dedicated stream of user fees, fares or taxes; that is sold through the private capital market system; and bought by the investing public, whether private or institutional. The pledge of dedicated revenues becomes the bedrock of financial assurance, and there would thus be no recourse to local or national government guarantee. The revenue bond mechanism is a common approach to financing major infrastructure projects in the US. Some agencies in the US, for example the Port Authority of New York and New Jersey, finance all capital investment with revenue bonds, without any inclusion of state or local taxation funds, although some US government funding programs for airports or mass transit could be used also by the Port Authority. The New York MTA, in the past two decades, has issued well over $14 billion in revenue bonds that are backed by tolls, fares or dedicated taxes, to help finance its major capital reinvestment programme.

Figure 5 shows how bonds of this kind financed the New York subway in four, five year programmes since 1982.

In the United States, local authorities or state governments create "public benefit corporations", allowing the public sector to retain control of the public-purpose agency, while separating the financing source and responsibility from the general activities of government. In the UK, a similar structure would be the trust mechanism, which has many precedents. Trusts were common in the 18th century as a means of funding and procuring local services - they were the very beginnings of local government. The Turnpike Trusts provided much of the early road infrastructure, and the Trust Ports were established at the beginning of this century as a 'public trust', with the capacity to issue bonds. The Port of London Authority was created in 1908 as a public trust agency with the capacity to issue its own bonds, secured by port revenues. It still exists. The London Passenger Transport Board, which operated both the Underground and bus system, existed as a trust from 1933to 1948. It was directed by a board appointed by independent trustees, and given the authority by Treasury to issue bonds for capital investment.

**Figure 5. Funding Sources for the MTA Capital Programmes**




*Source: Metropolitan Transportation Authority, New York.*

Given stable cash flows and a watertight legal structure, the financial markets would find no difficulty in suggesting ways of creating financial instruments to finance transport in London. Since London Transport currently produces net revenues from operations, the cash flow already exists to support the issuance of revenue bonds. The revenue stream to support these bonds could be composed of a variety of dedicated funds and grants, which might include some or all of:

- surplus operating revenues
- pledged government capital grant

- revenues from Council and/or Business Rate Precepts
- congestion fees and charges
- In future, other dedicated fees, fares or taxes could be established to add to the revenue stream.

An annual level of £250 million in operating surplus could support a level of annual debt service of that amount. At interest rates of 7.5 per cent, and for a term of 30 years, this would support a bond issue of approximately £3 billion. At these ratios, every £100 million of added revenue source would support a bond issue of £1.2 billion. Were additional funds to be made available to support capital investment, either through commitment of government grant (which we think necessary under the PPP proposal), from special fees or levies, or from proposed congestion charges, then the additional revenue streams would support additional tranches of revenue bonds. This would provide ample capital for route expansion or for new projects as well as for re-investment.

There is every reason to expect that the financial markets, in both London and New York would regard favourably issuance of revenue bonds for the Underground, at interest rate levels that would closely align with government issued-debt. This was certainly the case with the CTRL bond sales in mid-1998. Under this scenario, the cost of financing investment in the Underground would be substantially less than the cost of private sector borrowing, a factor that should be used as a major element in any assessment of the private consortia bid proposals.

Municipal bonds were, of course, traditionally used by local authorities in Britain during the early years of the 20th century as a way of financing major infrastructure schemes. It is significant to note that no UK local authority has ever defaulted on a loan.

*Scrutiny*

There can be effective scrutiny. New York State government retains a firm control of the governance and, via the Metropolitan Transportation Authority board, the operation of the public transport system, while the Authority's bonds are rated by the rating agencies and are sold in the private capital markets. The Governor of New York State appoints the Chair and several board members of the MTA. The Mayor of New York City and officials of the suburban county governments in the region make other appointments to the board.

The MTA prepares a 20-year capital needs statement, and from this formulates a five-year capital plan. This plan must be approved by the New York State legislature, which also approves the financing plan, and sets a cap on the maximum volume of bonds to be issued for each five-year plan. On some occasions, there are state-wide referendums about the issuance of a bond.

Opponents have argued there have been problems associated with bonds issued to fund the refurbishment of the New York subway. They confuse two entirely separate issues. The MTA, as a New York State government entity, has issued and repaid bonds successfully since 1982. New York City did face difficulties in 1975 with repayments due on bonds it had issued. However, New York City is a wholly different institution from the MTA.

*Beyond the Underground*

The existing, core reinvestment needs of the Underground is but one of many transport infrastructure needs for the future of London. Using these prototypes, it is possible that Transport for London (TfL) could be authorised to establish a structure such as a trust company with the capacity to issue its own revenue bonds. This financing could be then used for all Underground, bus or other transport needs such as purchasing the capital investment to implement congestion charging.

This public trust/revenue bond structure, if established for the entire scope of Transport for London, would enable the Mayor to use available transport funds and grants flexibly, including the dedication of a portion of general transport funds toward underpinning bond capacity. What is more, the establishment of this type of financing structure could provide the flexibility to accommodate investment in areas other than transport, as the process of local government for London develops. Clearly, it would be necessary that HM Treasury agree that this type of financing would be genuinely self-sufficient, and that the trust form of organisation would pose little or no risk to the government. This approach would also demand very good management of the link between raising the required capital and managing the actual investment. In addition, annual debt service on bonds could place demands on the GLA's revenue capacity in the initial years, if new revenue resources are limited or constrained.

*Beyond London*

London is not the only city or town in Britain that will need significant investment in its public transport system in the years ahead. If and when other urban areas adopt congestion charging (in line with government policy) there will be a need for transport infrastructure investment so that car users can find alternative ways of travelling. In accordance with the ten year plan local authorities will have to increase bus services, build tramways and institute other transport improvements before the congestion charges are first levied. At the moment there is no way (apart from conventional local government spending) of financing public transport improvements of this kind. It would be possible to use a PPP-type arrangement to fund public transport schemes in towns and cities outside London. But the kind of infrastructure that might be needed in these centres would be very different from the kinds of investments envisaged for the Tube. In these circumstances, a bond issue by a local authority (or by some other organisation) could be used as a way of raising resources for public transport investment in advance of income from congestion charges becoming available. As in London, this would almost certainly be a less expensive way of raising money than by the private sector.

The issuance of a bond imposes a healthy discipline: a clearly defined and distinct legal structure which has separate accounts, transparent statements of assets and liabilities, clear and enforceable objectives, a long term capital plan with long term financing commitments and a degree of isolation from day to day politics for the directors. It separates good management and procurement from efficient financing.

*Treasury consent*

In the UK the Treasury would have to give general consent to this type of financing if it were to proceed. But Britain will need significant investment in the years ahead given the obvious need to re-build its crumbling infrastructure. Scrutiny arrangements and the discipline demanded by bond-holders would give the Chancellor comfort as he let go of the purse-strings. Moreover, he would please the financial markets, which are hungry for bond issues.

The long-running debacle over the funding of the London Underground is simply a visible manifestation of a struggle between central and local government over who should decide how best to re-invest in the nation's capital stock. The present system has a handful of civil servants and ministers in Whitehall making all the decisions for the whole country. Revenue bonds, possibly subject to local referendums, offer a responsible localist solution to a major problem.

**Conclusion**

It is good to have a ten year plan and a commitment by the Treasury to fund it. But the plan should be used for its proper purpose: as a framework for ordered debate about policy, rather than as a forecast over a ten year period.

The current plan needs to be revisited since circumstances have changed. It will also come to be called into question as fashion changes: the present plan is firmly based on delivering the particular objectives of the day, none of which is easily reconciled with facts relating to equity or value for public money.

The plan does appear to favour railways over other modes that are used by a far greater number of people. There are doubts about the technical and managerial feasibility of the scale of the expansion envisaged. Also, there are doubts about whether the private sector will be able to invest the very large amounts of capital and whether the public sector will be willing to meet the full cost that the declared policies turn out to imply.

A standard value for money approach is necessarily narrow in its considerations but it is reasonably objective and robust against changing fashion. Estimates quoted in this paper suggest that a growing railway with increasing public support can have an objective justification, comparable with the high rates of return often found for road schemes, but only if the investments are in the right places: in particular, where passenger densities are high, as on the commuter routes to the large cities. However, such investments will not necessarily be good "social policy". The bus seems to have been given relatively little attention. Car use has spread so widely through the population that public expenditure to help the motorist may do more to help the poor than public expenditure on railways.

The ten year plan is essentially centralist. It chooses particular objectives on behalf of all local authorities. It potentially puts a great deal of money and therefore power in the hands of Whitehall. In turn, its agency, the equally centralist Strategic Rail Authority, is showing signs of exerting influence on the local transport plans in London and the other big cities. In parallel, the Treasury maintains a strong and direct central influence through its "rules" and the public spending control process. In particular, the Private Finance Initiative and Public Private Partnership policies – also recently endorsed by the Strategic Rail Authority - fetter the discretion that local authorities have. The attempt to impose the PPP for the London Underground has been the leading example.

Should central governments wish to take devolution of powers to local authorities(including the Greater London Authority) more seriously, then the revenue bond mechanism, secured on revenues, central government grant and local taxes, offers a proven alternative mechanism for creating locally accountable capital financing. At the same time, considerable national tax funds will continue to be involved, so there will remain the need for central government, its agencies and local authorities to setout some objectively verifiable criteria about what constitutes good value for this money, together with a regime of local and national scrutiny against those criteria.

A move in this direction would be a fundamental and welcome reform of the relationship between central and local government.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## TRANSPORT 2000

April 2001

### SUMMARY


1. Most of the benefits of PPP and PFI deals are either outweighed by disadvantages or remain impossible to guarantee with any certainty. When compared with the relative attractiveness and security of financing investment within the public sector through bond issues, PFI/PPPs seem an unduly risky means of funding. We would not recommend that the Executive should go ahead with such deals unless it can clearly be shown that the benefits outweigh the risks involved. Moreover, any PPP deal involving a large programme of transport investment should be subjected to independent scrutiny prior to any contracts being signed, as has been the case with the National Audit Office's examination of the proposed PPP deal for the London Underground. We recommend that the Northern Ireland Audit Office should be asked to carry out a similar examination of any PPP deal involving transport investment in the region.

2. We believe that bond financing remains a much more attractive option. If Treasury constraints preclude the option of government-backed bonds, then we recommend that the Executive should use revenue bonds to finance that part of public transport investment which cannot be funded directly by the public sector. For environmental and social as well as economic reasons, we believe that congestion charging and workplace carparking levies could form two valuable sources of revenue to support such a bond issue.

3. However, we also believe that the Executive should look again at the possibility of leasing the rolling stock currently required by Translink. We would urge the Executive to ensure that the tens of millions of pounds which would be saved by leasing rather than outright purchase should be invested in the urgent task of upgrading the railway infrastructure in Northern Ireland.


### ABOUT TRANSPORT 2000

4. Transport 2000 is the leading lobby group promoting sustainable transport policies in Great Britain and Northern Ireland. Its aim is to persuade governments and local authorities to make their transport policies sustainable and socially inclusive. Transport 2000 has 1100 member organisations and individuals in the United Kingdom, including 50 in Northern Ireland. It has been instrumental in helping to persuade the UK government to adopt a more sustainable approach towards transport.

### INTRODUCTION

5. Transport 2000 warmly welcomes this very timely inquiry by the Committee for Finance and Personnel into Public Private Partnerships. We believe that a very thorough public debate is needed before any further decisions are taken on either Public Private Partnerships or other Private Finance Initiative projects in Northern Ireland. We would urge the Committee to do all it can to ensure that individuals and organisations at every level in society are able to participate in this debate.

6. We hope that, once the Committee itself has defined some of the key issues involved, it will attempt a wider form of consultation on the relevant issues in a manner accessible to the general public. We also hope that the Committee will seek the views of the public on a range of finance options. We believe the Executive also has a responsibility to stimulate public debate and to seek the widest range of public views on this subject. To this end, we would urge the Committee to recommend that the Department for Finance and Personnel (possibly in conjunction with the Office of the First and Deputy First Minister) should hold a public consultation on financing options for public sector projects in Northern Ireland.

7. We have limited the scope of this submission to the funding of public transport which is the policy area of concern to us. While we would hope that the Barnett formula can be successfully renegotiated and that Northern Ireland will benefit to a greater extent from the UK government's substantial public sector spending surplus,

we appreciate that other sources of funding are likely to be needed for public transport. In this paper, we outline our serious reservations about the Public Private Partnership formula which is currently being seriously considered by the Department for Regional Development. We believe that the Department would be better advised to fund public transport infrastructure investment through revenue bonds backed by revenues from measures such as congestion charging and workplace car park levies.

## PUBLIC PRIVATE PARTNERSHIPS: THE DOE'S PRELIMINARY WORK AND PLANS

8. In December, 1999, the Department of the Environment for Northern Ireland (DOE) and PricewaterhouseCoopers (PwC) published a report entitled *Public Private Partnerships: Outline Business Case.* Transport 2000 only recently became aware of the existence of this report. We requested a full copy of the report from the Department for Regional Development (DRD) which has taken over responsibility for transport matters from the DOE. Instead, we were sent a Summary Report which does not provide sufficient information to assess some of the key conclusions which were reached.i We have again requested fuller information and, at the time of writing, still await this information from the DRD.

9. The report, which was written by PwC, concluded that a Public Private Partnership should be established for the public transport system in Northern Ireland based on one or more operating concessions. This conclusion was reached despite the fact that the report found that the cost to government of the Public Private Partnership options would be £0.5bn higher under a PPP than it would be if public transport was retained in the public sector (£2.4bn under a PPP as opposed to £1.9bn within the public sector) over the first 15 years of the PPP.ii While it is hard to judge from the limited amount of information available in this summary report, the favourable assessment accorded to the PPP options appears to be based on their perceived ability to narrow this difference through a greater level of cost reduction and revenue generation than would be available through either of the public sector options investigated. However, PwC also acknowledges that it has not actually made any estimate of the additional cost savings which might result within its 'enhanced' public sector option (two are investigated but one is simply the status quo).iii Moreover, it does not appear to have estimated the potential for increased revenue generation within the enhanced public sector option.

10. PwC also points to the benefits of the transfer of risk to the private sector which it asserts would result from a PPP arrangement. This assumption is highly questionable for reasons that will be outlined in our more general analysis of PPPs below. The report also asserts that 'the [PPP] concession options score highly in terms of minimising the scope for annual cost variations. The public sector options score do not score [sic.] as highly as the risk of cost overruns remains with the public sector.'iv Again, this is a questionable assumption which we would challenge. Finally, we would point to the problems inherent in an analysis which contains 15-year projections for an arrangement which is much more likely to last 25-30 years. The reasons for this concern are also outlined in our more general analysis below.

11. What especially concerns us about this report is that it presents a five-year timetable for the implementation of a PPP which envisages swift progress under a devolved government with a 'dedicated team' being established, a Memorandum of Understanding being signed and legislative change being initiated in 2000.v Indeed, a 'project team' had already been established and it is not clear whether this team was just meant to produce the report or to continue with the implementation of a PPP. The team consisted of six representatives of PwC, including the Project Director, Stephen Kingon, one member of MVA Limited and one member of Dibb Lupton Alsop. Linked to this was an 'Operations Group' consisting of six senior executives from Translink. The project also had a 'Project Board' consisting of Ted Hesketh, Managing Director of Translink, a representative of the Northern Ireland Transport Holding Company and seven civil servants, including one Treasury representative.vi

12. We have asked the DRD if any further work has been undertaken in the light of this report and we await the DRD's response. However, the Minister for Regional Development, Gregory Campbell, has recently said he is keen to explore the option of bond finance and the possibility of a non-profitmaking trust to administer the expenditure of such finance. We very much welcome his move as we believe that this option would be a much more accountable and cheaper means of raising the necessary finance than the types of PPP option envisaged in the PwC report.

13. We are also concerned, however, that the Executive has limited options available for future enhancement of rail infrastructure through failing to use two mechanisms which might have provided much of the most essential funding. One of these lies in the current tranche of relevant European Union funding which has now been allocated. We accept that many of the key decisions were taken prior to devolution but Ministers in the

current Executive could have looked again at the allocation of funds. We do not believe that any sincere or considered attempt was made by the former DoE, the DRD or the Department of Finance and Personnel (DFP) to bid for significant EU funds for public transport in Northern Ireland, despite the serious level of underinvestment in rail infrastructure in particular. We believe that the government missed an invaluable opportunity in this regard. We further believe that the DRD is currently missing a further vital opportunity to invest in rail infrastructure through its decision (still to be finally confirmed) to purchase outright rather than to lease rail rolling stock. We set out our case in this regard in the final section of this submission.

**PUBLIC PRIVATE PARTNERSHIPS: OUR RESERVATIONS**

14. While we do not rule out the possibly of the use of a PPP arrangement for the management and funding of public transport, we have serious reservations. We would ask the Committee to bear in mind very carefully the serious criticisms which have been made of the proposals drawn up by PricewaterhouseCoopers for a PPP for the London Underground, and the concerns raised with regard to PPPs at a more general level.

15. A number of reports have thrown doubt over the claims made for the benefits of a PPP arrangement. PPPs form part of the government's Private Finance Initiative (PFI). The underlying premise of PFI is that the private sector is capable of more efficient management of assets and operations than the public sector. However, the creation of PFI is actually a means developed by the government to get round its own rules on public borrowing. The Treasury is concerned that government departments or agencies might seek to overcome funding constraints by borrowing. Therefore, it insists that all borrowing is seen as adding to the government's deficit. Such borrowing can only take place with the explicit permission of the Treasury. Through PFI, a private sector company borrows the money and is repaid for taking this risk through charges it levies for the services it is providing the public sector.

16. Proponents of PFI deals argue that such schemes save the government money by delivering projects at a lower cost than would be the case if the scheme was developed and implemented in the public sector. They also contend that the financial risks involved in the project transfer from the public to the private sector under PFI. PFI contracts tend to be lengthy – 25 or 30 years is the norm. Moreover, they are legally binding. Supporters of PFI say such contracts enable investment to be planned and implemented on a stable, long-term basis. Traditionally, the UK government has planned its spending in three-year cycles which tends to militate against long-term infrastructure investment in transport, in particular. A final benefit claimed for PFI is that it stops politicians meddling with investment projects for their own ends; contracts can be renegotiated but the costs of so doing will be much more evident than would have been the case in the public sector.

17. However, it is highly questionable whether all the above arguments are valid. Even where they are valid, the costs of PFI/PPPs may well outweigh the benefits. There are four problem areas: accountability, the length of the contracts, the transfer of risk, and the value for money test used to judge the worth of PPP proposals.

**Accountability**

18. In a report for the Institute of Public Policy Research, Stephen Glaister, Rosemary Scanlon and Tony Travers have pointed out that concerns with regard to commercial confidentiality mean PPP deals cannot be subject to proper scrutiny when they are being set up.viiAs they note, public scrutiny of an arrangement involving a large amount of public funding is a key principle of good public administration. Travers has commented that the contractual relationships in the proposed PPP arrangement for the London Underground are so complex that it will be 'virtually impossible' to attribute responsibility if problems emerge.viii The Industrial Society has also expressed concern about the lack of public accountability in the proposed PPP for the London Underground; under the proposed deal, contracts can only be reviewed every seven-and-a-half years.ix

**Length and complexity of contracts**

19. Glaister et al. also document problems with the lengthy duration of the contracts. As they point out, the value for money argument for long term contracts is only a convincing one if expenditure on the assets is genuinely irreversible. This does apply to infrastructure but not to rolling stock where stock can be leased or sold.

20. Secondly, long-term contracts are inflexible which can prove a problem if economic circumstances change. Railway travel is likely to be affected by the state of the regional economy. If changes have to be made for such reasons, altering clauses in the contracts is likely to prove expensive. As Glaister et al observe:

If economic circumstances turn against the provider in a long-term contract then it may become unreasonable to expect him [sic.] to continue on the basis of the original contract terms. Indeed, to continue to enforce the long-term contract may simply result in failure of the company and the necessity to renegotiate.x

21. On the other hand, if things work out well, the provider will expect to realise their contractual right to the profits. This makes a PPP-style deal a very one-sided one because it is a 'win, win' situation for the provider.

22. Moreover, the complex nature of the contracts means that they are likely to be very expensive to negotiate and execute. The different parties to a PPP arrangement are expected to enter into the deal in a spirit of 'partnership'. Yet, as Glaister et al. comment:

We think the appeal to a spirit of 'partnership' is unrealistic in the context of contracts lasting for decades, where the amounts of money involved are so large. Companies will owe a duty to their shareholders to employ the best legal expertise available in order to make the strongest possible case for favourable financial settlement.xi

**Transfer of risk**

23. Under a PPP arrangement, any shortfall in operating profit has to be made up through additional public sector funding. As Glaister et al. state:

Unless substantial penalty clauses are included in the contract and they are enforceable in practice, all risks fall to the public sector, not to the private sector.xii

24. In the case of the proposed PPP for London Underground, the Commissioner of Transport for London, Robert Kiley, asserts that the private consortia involved in the PPP would be insufficiently penalised for poor performance; of particular concern is the fact that they would be permitted to keep their full profit if the level of service they deliver is 5% worse than currently prevails. Mr Kiley concludes:

'The overriding obligation to ensure service means that the entire risk can never be transferred. And when coupled with the absence for meaningful supervision or contractual enforcement of the [private consortia] by [Transport for London], it means the transfer of risk is largely illusory.'xiii

25. Indeed, the company which devised the PPP arrangement, PricewaterhouseCoopers, has since admitted that the complexity and length of the PPP contracts means they would be difficult to enforce making risks likelier to rebound on public sector. The head of their macroeconomics unit, John Hawksworth, has stated that the case for PPP 'remains more a matter of faith than of science'.xiv

**Value for money test**

26. The crucial test used by the government and local authorities to justify PFI/PPP deals is to measure the cost of a PFI deal against what it is estimated that the same project or investment would have cost if it had been implemented and managed wholly within the public sector. In the case of the proposed PPP for the London Underground, the National Audit Office has questioned the validity of the 'public sector comparator' used to justify the proposed London Underground PPP.xv Glaister et al. argue that it is not enough to measure the notional value of providing the investment in the public sector on the basis of the current performance of the public sector in this field. Potential efficiency gains must be taken into account in drawing up the public sector comparator. It is also vitally important that the public sector comparator includes a scenario where the public sector body is allowed greater freedom to borrow money. One very attractive means of doing this is through the issue of bonds which is discussed below.

27. While there are clearly some modest benefits from PFI/PPP deals, most of the benefits are either outweighed by disadvantages or remain impossible to guarantee with any certainty. When compared with the relative attractiveness and security of financing investment within the public sector through bond issues, PFI/PPPs seem an unduly risky means of funding. We would not recommend that the Executive should go ahead with such deals unless it can clearly be shown that the benefits outweigh the risks involved. Moreover, any PPP deal involving a large programme of transport investment should be subjected to independent scrutiny prior to any contracts being signed, as has been the case with the National Audit Office's examination of the proposed PPP deal for the London Underground. We recommend that the Northern Ireland Audit Office should be asked to carry out a similar examination of any PPP deal involving transport investment in the region.

## BOND FINANCING

28. By contrast, financing public investment through bond issues is an attractive means of raising additional investment for long-term large-scale infrastructure investments and rolling stock acquisitions. In its report for the government on its London Underground proposal, PricewaterhouseCoopers (PwC) compared the efficiency savings which it predicted would accrue from a PPP to those to be achieved from bond finance. PwC predicted that the PPP option would result in a higher level of efficiency savings within the first 15 years.xvi The PwC report acknowledged that the cost of capital would be considerably lower under the bond financing option than under the PPP option . However, it predicted that, when compared to the financing costs of bond finance, any higher financing costs involved under the PPP would be outweighed by the scale of the efficiency savings which would result during the first 15 years. Yet, taking the same assumptions used by PwC, Glaister et al. show that, when a prediction is made for the period beyond the first 15 years, the PPP option is not self-financing even allowing for the efficiency savings assumed by PwC.xvii They further show that a programme of investment financed by bonds over a 30-year period is likely to require a much lower level of government grant than a PPP.xviii

29. Moreover, Glaister et al. also argue that it should not be assumed that only a PPP can deliver efficiency savings; the need to retain the confidence of financial markets is a major incentive in ensuring that bond-financed schemes are well-managed. They observe:

> Part of the Government's reasons for proceeding with the PPP approach [in the case of the London Underground] has been to achieve 'private sector efficiencies' by having private sector companies handle all contracting, engineering and construction, rather than being administered by the public sector. However, this approach risks confusing the handling of capital needs with the handling of operating budgets. Public sector operating agencies can (and do) achieve operating efficiencies, if given the appropriate targets and incentives, as well as the leeway to achieve those targets.xix

30. If the Northern Ireland Executive does decide to proceed with the issue of bonds, it has two options open to it. It can issue government-guaranteed bonds. These were the type issued in order to part-finance the Channel Tunnel Rail Link. The other option is to issue 'revenue bonds' – these are issued at a slightly higher rate than government-backed bonds. However, they are guaranteed by dedicated revenues and are not, therefore, included in the government's borrowing programme.xx A number of agencies in the United States, including the Port Authority of New York and New Jersey, and the Metropolitan Transportation Authority in New York, make extensive use of revenue bonds to finance capital investment. Glaister et al. suggest that the revenue stream to support these bonds in the case of London Underground could include the following:

- surplus operating revenues
- pledged government capital grant
- revenues from Council and/or Business Rate Precepts
- congestion charges and fees

31. All of the above could apply to public transport investment in Northern Ireland (with the Regional Rate replacing the third item above). Workplace car parking charges could supply another income source. Glaister et al. estimate that every additional £100m of added annual revenue source would support a bond issue of £1.2bn over a 30-year term (likewise an annual sum of £10m would support a bond issue of £120m).xxi They further propose that Transport for London (the public-sector company responsible for transport in London) could establish a trust company which could issue its own revenue bonds. This arrangement would be cheaper and much more flexible than the PPP option, while securing a guaranteed long-term revenue stream for investment. A similar arrangement should be considered for public transport in Northern Ireland.

32. We recommend that the Department for Regional Development and the Executive as a whole should consider the option of revenue bond finance very seriously.

## LEASING OF ROLLING STOCK

33. Transport 2000 has consistently argued that, given the limited public sector funds currently available in Northern Ireland for transport, Translink should lease new rail rolling stock and spend the considerable sum saved on upgrading the railway infrastructure. For example, Translink and the Department currently have an additional £105m to invest in rail improvements over the next three years. They propose to spend £70m on purchasing 23 train sets. Yet, the same number of train sets as the Task Force recommended for purchase under the consolidation option (23), could be obtained at an annual cost of between £7m and £8.3m

excluding maintenance, or £9.7m and £11.5m including maintenance. These figures are based on the general proportionate figures for leasing repayments quoted within the industry and are not dissimilar to figures quoted in the recent Railways Task Force report.xxii

34. Given the time-lags which are likely to be involved in leasing (although they should be shorter than purchasing), we estimate that the total outlay on rolling stock through leasing over the next three years would be between £14.8m and £17.5m.xxiii This would leave between £87.5m and £90.2m to be spent on infrastructure improvements.

35. Moreover, leasing enables the burden of risk to be transferred wholly to the lessor. This would be the case under an operating lease (the equivalent of a car hire lease) which is the standard type of lease for rolling stock in Great Britain. This view is borne out by PricewaterhouseCoopers (PwC) in a memorandum to the Department.xxiv The memorandum lays out a range of alternative scenarios and assumptions; under some of these leasing appears more attractive while, under others, purchase appears better value for money. The memorandum cautiously suggests that the benefits of leasing might be thought to outweigh the costs.

36. However, we believe that the document could have much made a much more positive case for leasing; a great deal depends on the assumptions used by PwC. We would take issue with two critical assumptions that are made in this document. Firstly, PwC's calculations assume a discount rate of 6%. We have been advised that, from an accountant's perspective, PwC has selected a relatively low discount rate in this instance. We are further advised that it would be more realistic to assume an 8% discount rate which would make leasing appear much more attractive.

37. Secondly, the calculations also assume a 30-year life span and thus a 30-year amortisation (writing-off) period for the train sets. Given that Translink is anxious to replace many train sets which are not yet 30 years old, we do not believe that this is a realistic assumption. Moreover, developments in train technology and the evolution of a leasing market in rolling stock in Britain both make it more likely that all railway companies in Britain and Ireland will wish to update their rolling stock more frequently. It is clear that demand for train services is linked to the comfort and appearance of the rolling stock. Again, we are advised that, if a shorter lifespan was assumed in the calculations, leasing would appear more attractive.

38. One of the benefits of leasing is that rail rolling stock can be updated and changed with much greater ease as technology improves and circumstances change. By contrast, outright purchase is much more inflexible and the risk is borne entirely by the purchaser. The flexibility offered by leasing is acknowledged by PWC which concludes:

In effect, an operating lease … [ensures] that the assets can be returned irrespective of their market value at the time of return. It is therefore a matter of judgement of whether the flexibility, and certainty of cost over 7 years [the time-span of the leasing arrangement being considered by the Department], is worth the additional cost [as calculated by PwC]. The flexibility being that it leaves open the options for future PPP types of arrangement; or the flexibility to change the rolling stock to a different model.xxv

39. Finally, in correspondence to us, the Department has told us that any savings achieved through leasing would automatically go back into the Executive's overall funds and that there is no guarantee they would be spent on transport.xxvi We would urge the Executive to agree to ring-fence any such savings to ensure they are spent on upgrading railway infrastructure.

**DR LIZ FAWCETT**
**Northern Ireland representative,**
**Transport 2000**

*Transport 2000 gratefully acknowledges the assistance of an independent expert who wishes to remain anonymous in reaching some of the conclusions expressed in this submission.*

i. PricewaterhouseCoopers (6th December 1999) *Public Private Partnerships: Outline Business Case Summary Report* (Belfast: PricewaterhouseCoopers and DOE)

ii. *Ibid.,* pp. 40-41.

iii. *Ibid.,* p. 42. A public sector model is also examined which makes use of PFI funding but this is not rated so highly in the report as the concession options.

iv. *Ibid.,* p. 44.

v. *Ibid.,* p. 46.

vi. *Ibid.,* p. 10.

vii. Glaister, Stephen, Rosemary Scanlon and Tony Travers (2000) *Getting Partnerships Going: PPPs in transport* (London: Institute for Policy Research)

viii. *The Economist,* 7.12.00.

ix. The Industrial Society (2000) *The London Underground Public Private Partnership: An Independent Review by The Industrial Society* Executive Summary (previously available on The Industrial Society website). See also Glaister, Stephen (2001) 'Transport Policy, Control and Value for Money: The Next Way' (unpublished seminar paper given at the Northern Ireland Economic Research Centre Scott Policy Seminar, 29th March, 2001, Malone House, Belfast).

x. Glaister et al., *op. cit.,* p. 10.

xi. *Ibid.,* p. 23.

xii. *Ibid.,* p. 17 [our emphasis]

xiii. Kiley, Robert (2000) *Report to Mayor Ken Livingstone regarding the Feasibility of the PPP Structure as Currently Proposed* [publication details and page numbers unavailable]

xiv. *The Economist, op. cit.*

xv. Comptroller and Auditor General (2000) *The Financial Analysis for London Underground Pubic Private Partnerships* (London: National Audit Office)

xvi. This information is taken from Glaister et al., *op. cit.* They cite a government summary of the PwC report produced in December, 1999.

xvii. Glaister et al. *op. cit.,* p. 19.

xviii. *Ibid.,* p. 20-21.

xix. *Ibid.,* p. 25.

xx. *Ibid.,* p. 25.

xxi. *Ibid.,* p. 28. Their calculations are based on advice from municipal investment banking experts. They assume an interest rate of 7.5%.

xxii. The higher figure in each case represents industry figures we were quoted when the price of 23 train sets had been envisaged to be £82.3m. The lower figure in each case is more likely to apply, given the lower costs of the train sets (now priced at £70m). The Task Force report referred to is Northern Ireland Railways Task Force (2000) *Interim Report* (http://www.railwaystaskforceni.gov.uk/pdf_files/railwaysinterim.pdf)

xxiii. This figure assumes a leasing package which includes maintenance. It also assumes that no trains are leased in Year 1, 12 train sets are leased in Year 2 and 23 train sets are leased in Year 3 (in line with the assumptions which appear to have been made in the relevant section on leasing in the Task Force report). Maintenance could be subcontracted back to Translink through such a package which means jobs would not be at risk.

xxiv. Correspondence from PricewaterhouseCoopers to the DRD commenting on leasing proposals for Translink, 9th November, 2001, kindly released to Transport 2000 by the DRD.

xxv. *Ibid.*

xxvi. Letter to Transport 2000 from Paul Sweeney, Deputy Secretary, DRD.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## TRANSPORT 2000

5 May 2001

Thank you very much for your kind invitation to give oral evidence to the Committee. We are honoured to accept your invitation and look forward to seeing the Committee at 2.00 pm on Friday, 11 May. In advance of our appearance before the Committee, we wish to bring to its attention the enclosed letter from Richard Aiken at the Department for Regional Development. This letter responded to our request for further information relating to the Summary Report entitled *Public Private Partnerships: Outline Business Case* produced by the DoE and PricewaterhouseCoopers to which we referred in our submission. You may recall that we felt the Summary Report did not contain sufficient information to assess properly some of the key conclusions which it reached.

As you can see from the letter, the Department is refusing to give us any further information relating to this report. We wish to draw to your attention the enclosed judgement from the Parliamentary Ombudsman relating to a not dissimilar request for information from the Department for the Environment, Transport and the Regions. We would ask the Committee to note especially paragraphs 2.20-2.32. We believe that, in the case of our request, the public interest outweighs considerations of commercial sensitivity. While no final decision has been taken with regard to Public Private Partnerships in relation to public transport in Northern Ireland, we believe interest groups and ordinary individuals have a right to play an informed role in participating in public debate on the issue. It is absolutely central to the future of public transport in Northern Ireland. If an Executive Department has commissioned a report which recommends various PPP-style options over public sector alternatives, the public has a right to see the full details of those recommendations.

Moreover, you will note that Mr Aiken specifically states that the Department cannot release details of the public sector comparator used in this report. Yet, you will also be aware from our submission that the National Audit Office recently criticised aspects of the public sector comparator used in the PPP proposals for the London Underground drawn up by PricewaterhouseCoopers.

We have written to the Department's Permanent Secretary to make a further request for this information under *The Code of Practice on Access to Government Information.* We have pointed out that we are making an oral submission to your Committee, and that our inability to have access to the full substance of the report has been detrimental to our efforts to make as informed a submission as we would have wished.

We hope that the Committee will be good enough to consider our right (and that of any organisation or individual) to have access to this information in particular and to any such information relating to appraisals of and proposals for PPP/PFI options and schemes.

**LIZ FAWCETT (DR)**
**Northern Ireland Representative,**
**Transport 2000**

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## PROFESSOR AUSTIN SMYTH

May 2000

## CURRICULUM VITAE FOR PROFESSOR AUSTIN SMYTH

### CURRENT POST

| | |
|---|---|
| **Employer** | Transport Research Institute, Napier University |
| **Post** | Professor of Economic Aspects of Transport (since March 1999) |

### PREVIOUS EMPLOYMENT

| | |
|---|---|
| 1997 - 1998 | Senior Economist(Director Designate), Arup Transportation, Ove Arup & Partners, London |
| 1989 - 1999 | Professor of Transport, University of Ulster (at Jordanstown), School of the Built Environment |
| 1987 - 1989 | Strategic Planning Consultant, Northern Ireland Railways Co. Ltd |
| 1985 - 1987 | Senior Economist and latterly Head of Economics, Transecon International / Transmark |
| 1985 | Project Manager, Cambridge Systematics (now Hague Consulting Group) |
| 1983 - 1984 | Research Associate, University of Newcastle, Transport & Operations Research Group |
| 1982 | Research Officer, Northern Ireland Tourist Board |

### Key Data

Dr Austin Smyth was appointed to the newly created **Chair in Transport Economics, Transport Research Institute, Edinburgh** in March 1999 where he is responsible for developing transport economics and policy related research. Between 1997 and 1998 he was employed by **Arup Transportation (Ove Arup & Partners)** based in their London office. He had previously been employed between 1989 and February 1999 (excluding November 1997-November 1998) as Professor of Transport at the University of Ulster (Jordanstown). Prior to that he was employed in senior positions with a number of transport consultancies and operators both at home and abroad. Professor Smyth has almost twenty years experience in research and consultancy world wide. He has wide applied experience in EU states, Eastern Europe as well as North America, the middle East and Thailand.

In the GB public transport and transport planning sectors he has undertaken studies for amongst others **London Underground Limited, the Welsh Office the Scottish Executive, the former Tyne and Wear PTE** as well as a number of private sector clients. He has also continued to devote much time and energy to research and consultancy in Northern Ireland and the Republic of Ireland. Over the last 15 years clients there have included **Belfast City Council, the Department of the Environment (NI), Larne Harbour Limited, Northern Ireland Railways., Citybus, Ulsterbus, Translink, the General Consumer Council for Northern Ireland Dublin Bus, Iarnrod Eireann (Irish Rail), the Department of the Marine (ROI)** as well a wide range of voluntary bodies.

His commissions in Ireland have been instrumental in construction of the Belfast Cross Harbour Rail Bridge and the Great Victoria Street station, the implementation of the Belfast - Dublin high speed rail project, reintroduction of an enhanced late night bus service for Belfast in 1981, the first with flow bus lanes in Belfast in the late 1980's as well as appraisal of the pilot Easibus accessible bus schemes in East Belfast and North Down. He has appeared as expert witness at a number of major planing inquiries.

He was a member of the Panel appointed on behalf of the **Welsh Office** in connection with the recently completed **M4 Common Appraisal Framework study**, a project in which he co-ordinated the design and execution of a major stated preference based modelling initiative on inter-urban travel. He has also been a member of a government appointed panel advising authorities in Northern Ireland on the use of multi criteria techniques on a major urban corridor study in 1993-1994. In 1999 he authored a briefing paper on the UK/Scottish Transport White papers on behalf of **the Scottish Parliament's Transport and Environment Committee**. In July 2000 he was invited to join the **Northern Ireland Executive's Rail Task Force** as an adviser which has recently undertaken a comprehensive assessment of the future of rail system in the region. In September 2000 he joined the **Scottish Executive's External Advisory Panel in Multi Modal Studies for Scotland**. In March 2001 he was appointed as an expert adviser by the **Northern Ireland Executive's Department of Regional Development** in its preparation of long term transportation strategy for Northern Ireland. He is also currently advising of **the Scottish Parliament's Transport and Environment Committee** on **the Scottish Executive's** budget process and funding allocations for transport 2002-2005.

## INTRODUCTION

This inquiry into Public Private partnerships (PPPs) is timely. Devolution of power to the Northern Ireland Executive and Assembly has brought home what is now commonly referred to as the region's infrastructure deficit. This encompasses a range of utilities including water and sewage as well as transport and other capital plant associated with publicly owned services. The basis for suggesting the existence of such a deficit reflects unfavourable comparisons not only with Great Britain but also the recent investment levels achieved in the Republic of Ireland. The implications, certainly in the longer term, are a loss of relative competitiveness and poorer levels of public services, with the various consequences such a state of affairs has for education, health and other services as well as the environment and social justice. In this submission the focus is on transport reflecting the raison d'être for the Transport Research Institute. Nevertheless the funding related issues for transport cannot be divorced from other calls on government and the Committee will obviously be mindful of this in coming to its overall conclusions. In summary what society here regards as its needs require expenditure levels which exceed the allocation Northern Ireland receives from the so called block grant. We will return to this wider issue later

## GENERAL CONTEXT OF PFI/PPP

The Inquiry has identified a number of general issues as well as requests for more specific information on individual projects. We intend focusing on the first, not least because in the context of Northern Ireland there are so few examples of any involvement by the private sector in financing let alone funding transport. However, we also urge caution in drawing too many conclusions in relation to transport from experience elsewhere, including Great Britain, given the significant differences in the regulatory and control framework applying in Northern Ireland compared to England and Wales, or indeed Scotland. Nevertheless, some useful insights can be drawn from examples in other locations which we assume the Committee will be informed off from its investigation. Should however it desire further information on or observations/opinions on the lessons arising from particular PFI/PPP projects elsewhere for Northern Ireland we would be happy to oblige at oral hearings.

## EUROPEAN PERSPECTIVES ON TRANSPORT FUNDING

The United Kingdom has had a systematic tendency over a protracted period of time to invest less in transport than most other EU contries. For instance, between 1985 and 1993 infrastructure investment in the UK as a share of GDP averaged 1.06% compared to France 1.1%, Germany 1.2% and Switzerland 1.5%. This disparity is reinforced in absolute terms, given the UK's lower GDP per capita e.g. Germany in 1994 238 ECU's per head of population compared to the UK 120 ECU's.

Moreover, unlike the UK many EU countries ring fence revenues for transport. For instance, France operates the versement transport – a payroll levy used in big cities.

Germany earmarks a proportion of fuel duty to pay for local transport policies while The Netherlands has established an infrastructure fund with the aim of consolidating different types of public funding for amounts required by transport.

## UK AND NI PERSPECTIVES ON TRANSPORT FUNDING, REGULATION AND CONTROL

In the UK the Treasury has consistently opposed the attribution of tax revenue for specific purposes such as transport although more recently concessions have been conceded in the relation to revenues raised from road user charging schemes. However, it is this very uncertainty over allocations of government tax revenue, together with low level of funds actually provided from the public purse for transport that has been the main stimulus for development of the PFI concept and its successor PPP. In effect these reflect an implicit recognition that insufficient investment has and is being made by the state in infrastructure including transport.

In Northern Ireland the situation is even more problematic because of differences between the region and the remainder of the UK. Since the 1980's there has been a substantial shift of much of the UK's transport sector from public ownership to the private sector. These include airports, railways and the bus industry as well as most ports. Moreover, even where infrastructure remains in the public sector the tendency has been to place residual administrative control in single purpose bodies such as the Highways Agency (HA), which is responsible for trunk roads in England and Wales. Furthermore, many local authorities together with the HA are involving the private sector in everything from new road construction to operations of the administrative aspects of local highway authorities. This extensive move from the public to the private sector means that an increasingly significant proportion of transport financing is provided via the private sector even if much of the funding, both capital and revenue support, continues to be provided by the taxpayer. In Northern Ireland the situation is very different with relatively little contribution being made by the private sector to transport. Apart from privatisation of the Belfast International Airport and the long standing role of private industry in a number of ports, Belfast City Airport and the road freight sector, almost all other transport infrastructure and the public transport system remain in state ownership and are fully regulated.

In addition, Northern Ireland transport spending, unlike England and Wales is drawn from the Northern Ireland block grant and not identified explicitly at Cabinet level. Typically transport has not been a priority of the UK government at a national level and thus has not tended to be a prime beneficiary when government has felt able to increase public spending and has also found itself one of the first casualties when cuts have been required. In Northern Ireland transport, as a result of being one step further removed from top level decision making, has faired even worse than in Great Britain. This has been reinforced by the focus of government activity over much of last three decades on security related expenditure, the particular needs of a relatively poor population in terms of benefit entitlement, as well as health care, in addition to a history of relatively high levels of funding of the road system up to the 1970's. Indeed the period of the Troubles has had a devastating impact on the viability of and support from government for the public transport system. In addition, the system of Direct Rule, together with the focus of most local politicians on matters other than transport and infrastructure, has resulted in the longstanding underfunding of the transport sector compared to every other constituent part of the UK and the Republic of Ireland.

Taken together with the anticipated constraints on public expenditure here the continued reliance on the public sector for transport in Northern Ireland poses fundamental questions as to whether any acknowledged infrastructure deficit can really be made up from public funds. Inevitably this raises the issue of the potential role for other sources of funding as well as mechanisms to finance such funding.

## CRITIQUE OF THE PUBLIC FINANCE REGIME

Procedures for raising and allocating public funding are not rational or effective. Typically Departmental spending plans cover three years. Big infrastructure schemes usually extend over an even longer time period and once committed are hard to get out of. Therefore there is reluctance on the part of the Treasury, which controls the allocation of funding to spending Departments, to give approval to such projects. Moreover, actual funds available to Ministers are subject to annual negotiation between Departments and The Treasury. The latter tends to take a narrow outlook based on fiscal rectitude, with the result that the value of even medium term three year financial plans is undermined by the annual spending review.

Departments and or nationalised transport industries take care not to overspend one year to another. The annual review of public expenditure does not contain provisions for a savings budget from one year to another year. Moreover, there is no opportunity to vire between transport and other ministries. Significant overspend means going back to seek a transfer from the reserves. Therefore, Departments tend to underspend until near year end. In relation to the nationalised industries, which uniquely to Northern Ireland includes the entire public transport system, Government. finances these industries by setting External Financing Limits (EFL's) in an attempt to control overall public expenditure and public sector borrowing. The External Financing Requirement (EFR) represents the outturn take up of grants by companies such the Translink group of companies.

All of these forces make it difficult to guarantee long term strategies and large projects with long lead times Departments shy away from these The result is great unreliability in support to publicly owned infrastructure and services and a greater tendency to respond more favourably to short term crises and challenges rather than make adequate provision for long term planning of such areas of responsibility as transport. The crisis over the future of the Northern Ireland railway system in 2000 is but one example of the sustained underfunding of infrastructure over many years reflecting all the inherent limitations in the current system of public funding and financing. Clearly given the circumstances pertaining to transport regulation and control as well as policy decision making in Northern Ireland the situation is even less satisfactory here than elsewhere in the UK.

## THE EMERGENCE OF A ROLE FOR PRIVATE SECTOR

It was acknowledged in the early 1980s that EFL's were limiting investment by nationalised industries. The so called Ryrie rules were drawn up in an attempt to clarify the eligible criteria relating to and thus provide more potential for private finance. Decisions to provide funds for investment were to be taken under conditions of fair competition among private sector borrowers with any links to the rest of the public sector monopoly power not resulting in schemes offering investors less risk than available to private sector projects. Eligible projects were intended to generate benefits in terms of improved efficiency and profit from the additional the investment, commensurate with the cost of raising risk capital from the financial markets.

In 1993 the then Chancellor of the Exchequer published a consultation document intended to promote greater participation by the private sector, including joint ventures with the public sector. By the mid 1990s the Treasury had developed a policy to replace public funding with private financing better known as the Private Finance Initiative (PFI).

Labour in opposition put forward a further development of PFI to incorporate the idea of leasing/franchising arrangements in conjunction with the private sector while control continued to reside with public sector, all without raising the official level of public expenditure . This became incorporated into what is now referred to as known as Public Private Partnerships (PPP)

## ECONOMIC BASIS OF PPP/PFI

It is important to draw a distinction between financing and funding. In the case of the former responsibility lies in raising finance to fund projects in return for a series of cash payments. In contrast funding is the provision of the resources required to build the project or provide the service. It is confusion between the two which leads to an assumption that under PFI/PPP's the private sector is replacing resources in the past more typically provided by the public sector. This indeed may still be the case in whole or in part. However, it is more typical to find PPP's or PFI backed schemes involving the private sector raising the finance to provide the facility which in turn is funded by the public sector through payments back to the private sector finance of the project.

One of the major arguments advanced in support of the PPP approach has been to achieve "private sector efficiencies" by having private sector companies handle all contracting, engineering and construction, rather than being administered by the public sector. Indeed, unless the cost savings achieved by such "private sector efficiencies" in implementing the project are greater than the additional costs incurred by the private sector in borrowing or raising the finance in some other way, compared to public sector funding costs, then the PFI scheme will ultimately cost the tax payer more. This applies even where the resulting asset/service is profitable. Where ongoing revenue support is required, such as is likely to be the case in much of the transport sector, it is very likely that the cost of the project through its entire lifecycle from implementation to ultimately cessation will be greater than under a publicly funded and financed arrangement.

Central to the case for use of the private finance route is transfer of risk from the public to private sector. Risks apply to both public and private finance routes. At issue is under which scenario are the costs associated with the risks greater. The costs associated with risks are generally regarded as lower for the public sector which is then reflected in the lower interest costs for borrowing typically assumed to apply under that mode of funding/financing. Shifting risk onto the shoulders of the private sector is regarded as providing a greater incentive to the private sector provider of a facility to increase efficiency to reduce risk or limit its impacts. It is this transfer of risk to the private sector that enables promoters of schemes even if they are publicly owned to have the potential of having such projects excluded from their EFLs/EFR's and thus not being regarded by the Treasury as contributing to the PSBR.

## THE BENEFITS OF PPP/PFI

By virtue of the fact of having such projects excluded from their EFLs/EFR's and thus not being regarded by the Treasury as contributing to the PSBR, it is possible to secure much greater long term stability in strategic planning, for instance for major infrastructure, even where these schemes are ultimately publicly funded, often at higher cost, than under the traditional public finance route. This is particularly true where there is an acknowledged shortfall in available public funding over the short/medium term.

The cost of this ability to undertake more effective long term planning is twofold, first reflecting the higher costs frequently incurred by the taxpayer and secondly the fact that the PPP/PFI route will tend to pre-empt future policy decisions by reducing the flexibility inherited by future policy makers having their budgets already top sliced through being tied into long running legally enforceable contracts with private companies. Nevertheless for a railway operator or road authority or indeed the responsible government department that dis-benefit in the future may be worth paying for to secure benefits in addressing the infrastructure deficit in the short term.

## PROCUREMENT THROUGH PRIVATE FINANCE

With all the publicity surrounding PPP/PFI it is possible to confuse a requirement for meeting the capital needs with that of managing operating budgets. Public sector operators agencies can achieve operating efficiencies, if given appropriate targets and incentives, as well as the freedom of action required to achieve these targets. Indeed the case of Translink demonstrates this case already. Moreover, it is entirely feasible for the public sector to hire the private sector to undertake the project management of major construction projects. This has happened with some success in the case of both the Channel Tunnel Rail Link and in the latter stages of the Jubilee Line Extension project..

A PFI scheme may also focus purely on procurement of a capital asset through a tendering process with in built provisions for penalties in the wake of a failure to meet delivery at contracted quality of service levels. The private sector borrows the money to build and maintain. It also services debts in return for a financial stream of payments. Under this scenario the private sector bears the risks of cost overruns and performance failure risks.

The introduction of real competition to procurement and more involvement by the private sector in management can offer potential cost savings. PFI/PPP can help in realising these objectives. However this must be set against the additional borrowing costs incurred by the private sector and the costs incurred in bidding by the private sector.

Indeed, procurement from the private sector under this model may lead to higher calls on public purse while at the same time leading to reduction in the Public Sector Borrowing Requirement PSBR, the target set by the Treasury to control overall public spending.

The situation is even more complex with inherently unprofitable service typified by many bus and rail services. Where inherently unprofitable activities are involved private sector funding as distinct from financing is unlikely. While the private sector may be attracted to financing such an operation given sufficient incentive from government, even with private sector participation there will be an increase in the public sector commitment no matter how financed.

Sooner or later the Taxpayer will have to pay for unprofitable schemes and delaying that payment will ultimately cost the taxpayer more. For instance, in the case of road schemes financed through so called shadow tolls the tax payer must ultimately pay and pay more. The analogy in all these cases is with an individual purchasing on higher purchase; inevitably this costs more than a straight cash purchase.

**FEASIBLE ALTERNATIVE FORMS AND STRUCTURES OF FINANCING**

In addition to the conventional public financing route a number of other sources are potentially available dependent upon the nature of the scheme, its revenue generating potential and wider political and socio economic considerations. These options include funding investment directly from revenue, an option unlikely either apply to or to generate sufficient sums to pay for most infrastructure projects in Northern Ireland. However, in the future it may well be that such funding mechanisms as water charges or road user charges could go a considerable way to offsetting investment requirements in water and sewerage and the transport system. Again there are or are foreshadowed to be precedents elsewhere in the UK and operational abroad.

Another financing mechanism could involve use of bonds. There are two forms of these:

- government-guaranteed bonds (e.g. the Channel Tunnel Rail Link);
- revenue bonds issued at rates slightly above those set for public sector borrowing, and backed by dedicated revenues- as a result not included in the PSBR.

There are precedents for both in the UK in relation for instance to social housing and in earlier days public transport and urban investment by councils. However, of particular relevance to current requirements here are the lessons to be drawn from US experience with particular reference to urban region and other transport/gateway infrastructure.

**Government bonds**

In relation to the Government Bond format it can be argued with considerable conviction that the cost of capital would be less than the cost to the private sector consortia under a PPP arrangement There is, in effect, no risk to the bond promoter because the government is underwriting the financing of their investments. Yet borrowing by housing associations with such risk-free conditions does not count as part of the PSBR. If the same position could be achieved by some body responsible for infrastructure the costs would be considerably lower than for a PPP arrangement However the portents for this are problematic as typically the Treasury is more likely to regard a nationalised transport company if was to proceed down this route as generating further public spending and borrowing. Nevertheless the Channel Tunnel Rail Link is an example where Government adopted a less rigid perspective.

**Revenue bond financing**

The revenue bond is one issued with the security of a dedicated stream of user fees, fares or taxes. It is sold through the private capital market system and bought by the private sector investor. The dedicated revenues gives the necessary financial assurance without recourse to government guarantee. The revenue bond mechanism is a common approach to financing major infrastructure projects in the US.

A bond issue by for instance The Northern Ireland Executive could be used as a way of raising resources for transport investment in advance of income say drawn from motorway tolls or congestion charges becoming available This would almost certainly be a less expensive way of raising money than by the private sector.

**Leasing**

The possibility of leasing being employed to fund infrastructure in Northern Ireland has been advanced in recent years, in part as a response to shortfalls in available resources in the public sector. Most recently this model was put forward in the context of the crisis which faced the Northern Ireland Railway system in 2000. Leasing is the mode of supplying rolling stock for most of the privatised railway system in Great Britain. As with most PFI/PPP schemes the objective is to make good current shortfalls in resources necessary to implement a rehabilitation or improvement project by defraying the costs to later and ultimately at a higher price to the taxpayer than could be achieved by the public sector funding route.

It is important to distinguish between an operating lease and a finance lease. The former is typically of much shorter duration. More critically with an operating lease the risks and rewards associated with owning an asset remain with the lessor rather than the lessee. In contrast with a finance lease while ownership of the asset technically stays with the lessor, to all intents and purposes it passes to the lessee. For example with a finance lease one is committed to a long schedule of payments which one cannot get out of except through paying penalties. This risk must be fully accounted for in one's balance sheet. For that reason accounting rules make a sharp distinction between the two forms of leasing.

An operating lease does offer some very distinct advantages. At the end of the lease period one has the choice of renewing the lease or seeking a replacement asset from an alternative source. There is a useful flexibility here.

The key issue is whether it offers an advantage over buying. Two key assumptions are involved here. The residual cost of the asset at the end of the lease period and the discount rate use to calculate the present value of the lease payments over the period of the lease. If one is optimistic about a very high residual value for the asset and one believes the discount rate can be appropriately low, then buying is better than leasing. However if either of those two assumptions is significantly inaccurate, then leasing is the better option.

Arguments can be made for both buying and leasing. Whether one favours one over the other depends on certain educated guesses about the future. For these reasons any categoric claim that for example buying is better than leasing must be treated with extreme scepticism.

For a nationalised company or public authority it is currently unclear as to the extent that such organisations would be permitted by The Treasury to adopt a leasing arrangement. This reflects whether or not the charges involved are regarded as contributing to the PSBR. Once again the issue relates to risk transfer and the related issue of residual value of the leased assets. In the case of the operating lease the leasing company (assumed to be in the private sector) has to find a new customer for the assets it owns. Thus in purchasing the asset in the first case it will have to bear the risk of finding such a customer, something likely to be reflected in the charges levied under the first lease. In the case of the finance lease the leasing company bears little such risk as the asset will be near to or life expired at the end of the lease period. Moreover, as unlike in the case of a GB privatised rail company NIR is publicly owned it is difficult to achieve transfer of risk to the private sector as the lease lengthens.

There are indications that shorter leases of up to 7 years may be acceptable to government while longer term leases are not. In the case of railways for which there are precedents in Great Britain the differences in technical conditions and likely rolling stock requirements between Northern Ireland and Great Britain will significantly reduce the residual value of rolling stock offered for lease here at the end of an operating lease. The result is likely to be lease charges under any operating lease significantly higher than for an equivalent lease in Great Britain. This would tend to increase any cost differential between a lease arrangement and outright purchase within the public sector or bond based funding in favour of the latter options.

**WIDER ISSUES, LIMITATIONS AND CONSTRAINTS WITH THE ENVIRONMENT OF PPP/PFI**

A point to consider in relation to both leasing and a wider PFI/PPP model is the small scale of the potential market here for such facilities. There is little local experience of PPP/PFI and thus skills available in Northern Ireland are relatively poorly developed in these activities These conditions are likely to reduce the number of potential private sector companies interested in entering the market, thus tending to increase both the bidding and delivery costs for any such contracts awarded by Government. The implication would be to tend to reduce the advantage of each of these initiatives relative to the status quo.

The schemes likely to warrant such treatment will tend to be of strategic importance to Northern Ireland. Nevertheless the area will continue to be reliant on considerable sums of public expenditure for the foreseeable future. Thus prioritisation of PPP/PFI projects in relation to other schemes demands appraisal on a common and consistent basis. Social cost benefit analysis and the wider framework suggested in the transport sector by the Guidance on Multi Modal Transport Studies provides an obvious approach to ensuring overall the most cost effective use of scarce resources.

The particular social and economic factors prevailing in Northern Ireland inevitably mean that considerable attention must be paid to the wider issues of targeting social need and justice in coming to conclusions on the merits of such financing mechanisms. This will also facilitate assessment of value for money in relation to capital investment and service improvement. It will be evident from this paper that key assumptions relating to borrowing costs, interest rates, residual values and related issues will have to be carefully considered in the application of any appraisal methodology.

**CONCLUSIONS: KEY FACTORS FOR SUCCESSFUL APPLICATION OF PPP/PFI**

The private sector has been involved in the provision/delivery of infrastructure in the UK throughout periods of public ownership. What has varied is the form and extent of that involvement. It has traditionally focused on new capital works. However, over the last two decades such projects have expanded to encompass Design and Build, Design Build Maintain and Design Build Operate and Maintain contracts. More recently the private sector has become involved with existing systems, including rehabilitation and maintenance work, as well as service provision. There are many examples elsewhere in the UK in the transport sector encompassing rail, buses and airports.

In Northern Ireland it is apparent that public funds, both now and in the foreseeable future, are likely to be insufficient to address the infrastructure deficit facing the area. For the future, therefore, the question must be not whether the private sector should be involved but the extent of its participation and how value for money in the widest sense can be achieved for the taxpayer. However, this does not preclude raising the necessary revenue to fund infrastructure, as distinct from financing it through a range of potential revenue sources including user charges for roads and public transport receipts. Moreover, there is clearly a potential role for bonds as described above. However, any involvement by the private sector in financing must achieve genuine risk transfer from the public to private sector. With essential public services however, the extent of this may be limited given the state's requirement ultimately to step in if the private sector involvement should fail.

Both bond financing and effective private sector participation can achieve a movement of the financing off balance sheet and thus reduce the official level of public sector borrowing. However, the former is more likely in many cases to lead to a reduced call on public funds over the long term compared to the latter. In either of the these models it is probably true to say that schemes would have to be bundled into large packages due to the economies of scale in the bidding/arrangement and administrative costs involved.

Thus in advancing investment in infrastructure in Northern Ireland there may be a requirement for major restructuring in the patterns of control and regulation for transport and other utilities. There may be a case for creation of Northern Ireland Infrastructure Company **(NIinfraco)** incorporating roads, rail and utilities. This could take the form of either a non for profit trust within the private sector along the lines of Glas Cymru, a non profit company limited by guarantee and which has recently purchased Dwr Cymru (the Welsh Water utility), or an arrangement along the lines of a contemporary US revenue bond agency/public benefit corporation at arms length from political control but remaining in the public sector. Either of these could provide a vehicle for promoting bond financing or in the latter case engaging in a modified PPP type contracts where these proved to offer value for money.

Alternatively **NIinfraco** could become a well regulated privatised company or remain in the public sector and offer opportunities for long term leasing arrangements with the private sector along the lines of the London Underground PPP. Indeed, not withstanding the ongoing delays and revisions to the LUL PPP, **NIinfraco** could offer potentially attractive investments for the private sector, dependent upon the extent of risk transfer, underlying financial viability, funding availability from existing sources and new revenue streams as well as the regulatory provisions in any contract agreed.

The first of these would require establishing a well resourced (technical skills) regulatory body perhaps modelled on the lines of the Strategic Railway Authority/Office of the Rail Regulator, but covering all publicly owned infrastructure.

We would be happy to expand on these ideas at an oral hearing. Ultimately however, determining the extent of the private sector involvement demands an appraisal process offering genuinely objective assessment of value for money across all options, which in turn implies affording each ‘model’, including the status quo, an opportunity to develop its best case for securing the role to provide Northern Ireland with the infrastructure the area requires for the 21st Century.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## JANE BROADBENT, JAS GILL AND RICHARD LAUGHLIN.

Professor Jane Broadbent and Dr Jas Gill, School of Management Royal Holloway, University of London and Professor Richard Laughlin of The Management Centre, Kings College, University of London provide this evidence. We have been undertaking research into PFI both generally and specifically into the NHS in England. Part of the research has been undertaken in the context of our roles as university academics and the Research Board of the Chartered Institute of Management Accountants (CIMA) has specifically funded the work in the NHS. All this work has been undertaken with a view to providing impartial research findings and with no restriction on our independence. In providing this evidence we will follow the structure provided by the request for information provided and will address certain of the questions we wish to address in turn. Our evidence relates specifically to PFI and reflects our own views rather than those of any research funding body. Given that our empirical research has been undertaken predominantly within the NHS our understandings are particularly related to this area. This submission supplements other academic papers supplied to the NI Assembly at an earlier stage.

1. **What do you see as the benefit of PPP/PFI? Are there identifiable benefits to the public and the stakeholders?**

1.1. There is debate and various views as to whether there are benefits to PPP/PFI and it is particularly difficult to give a global answer to this question. In particular it is perhaps easier to assess the impact of PFI where there is a relatively simple relationship between the parties and the outcome of the transaction is easy to define or where there is some negotiability about the need for the service. Where the relationships between the various stakeholders are complex, where the output is difficult to define and where failure of the service provided is seriously problematic evaluation becomes difficult.

1.2. The above argument highlights that in a complex project the difficulties of PFI relate to the fact that there may well be diverse stakeholder groups who do not have congruent interests. Hence the introduction of PFI has provided market opportunities for many stakeholder groups – financial and legal advisers for example - but has at the same time been argued to provide threats to others – workers who fear that the imperative to cut costs to achieve value for money can only be achieved at the expense of their terms and conditions of employment. It should be recognised that the contrasting needs in this situation will not be easy to reconcile.

1.3. If the benefits to the public or to other stakeholders are to be identified then some clarity as to the intention of PFI at the highest policy level needs to be provided. At the moment there is much ‘noise’ in the system. The Initiative started in the UK (in the 1992 budget statement made by Norman Lamont) as a means to gain investment whilst dampening public borrowing. Latterly and in line with arguments that this was not relevant, given that the levels of spending associated with PFI would not be detrimental to overall policy on borrowing limits (Robinson 2000), this stance has altered. Now the justification is that there is a need to demonstrate value for money (vfm) and risk transfer. Nevertheless many people still hold the belief that there is a macro economic justification for PFI that means that if they do not use PFI then there will not be an opportunity for them to undertake a particular scheme. This confusion was exacerbated by the debate as to the accounting treatment of PFI that concerned whether PFI can be seen as ‘on’ or ‘off’ the balance sheet of the public sector organisation. This confusion about the intent of PFI may well mean that schemes are promoted because of a belief that this is the only way to obtain a particular service. Whilst this may not preclude the development of schemes that give vfm and risk transfer there are potential problems. Investment appraisal decisions are by their nature tenuous and those who promote a scheme often provide an optimistic view of what might be achieved. If there is a view that the only way to provide investment is through the adoption of PFI, the incentive to optimism is even greater. This may well endanger the attempts to ensure that the only schemes to go ahead are those that offer vfm.

2. **Are there wider issues, limitations and constraints associated with the environment of the PPP/PFI that have to be addressed? Are the skills and guidance available?**

2.1. There are perceived to be areas that are not ‘PFI-able’. The area of mental health is often seen as such, although it should be recognised that there is some PFI in this area and again perceptions and reality are not necessarily congruent. Clinical care more generally has been deemed to be outside the scope of PFI, although this has not precluded the development of large hospital schemes in the NHS based on the provision of what have been called 'asset-based services' (building the hospital and providing maintenance and hotel services). In this area those providing clinical services work alongside the private sector that provides the hotel services and runs the building. Whilst the NHS is used to working alongside the private sector – competitive tendering has been in force for some time - the level of responsibility is somewhat broader under PFI. In essence the private sector has the possibility of being far more proactive in the way that services were delivered than formerly and the balance of power is different, as the private sector is a relatively larger stakeholder.

Whilst the contractual arrangements are meant to deal with the issue of responsibility, it should be noted that the contract is negotiated in what is likely to be a relatively adversarial manner. It is likely to be there as a means of clarifying what should be done in the case of the failure to deliver by one of the parties and this must lead to a relatively individualistic stance by each of the parties. However, for the contract to 'work' in practice will require co-operative negotiation as it is unlikely that the contract will have anticipated all the possible problems. A relational contracting base must be developed (Broadbent and Laughlin, 2000). This has led some to question the extent to which the different stakeholders can work together and some have raised the question as to whether in fact the better solution is to abandon the idea of partnership altogether and leave the provision of health care discretely in either public or private sector. Kelly and Whittlestone (2000) raise the question of the location of the boundary between what is 'clinical' and what is not; in this sense the question of what is suitable for PFI is being debated. Clarification of the scope of the scheme should seek to address this issue.

A wider problem remains if PFI is to be a central mode of procurement. If there is a perception that some areas of activity are perceived to be seen as 'difficult' and not attractive to the private sector and PFI is seen as the only way forward, there could be a tendency towards marginalisation of certain areas that suffer this label.

2.2. There are a number of financial and legal firms that now provide services to the sector. Equally the various Departments of Government have moved towards standardisation as a means of providing support and reducing the transactions cost of PFI. Nevertheless if the level of service received is to be seen as suitable then there is a need to ensure that the skill to negotiate a contract is developed and retained in the public services. In this respect there is a contradiction. There is a stated need to allow the private sector to bring new ideas to develop innovative solutions that will provide vfm. At the same time a deep understanding of how services are provided is also needed to ensure that those who use the services can function adequately and also to ensure that the contractors are not at an advantage in the negotiation. In essence we would argue that a good contract relies on strong and well-informed partners on both sides. Whilst contractors are gathering experience with each contract they sign, for many public service organisations each deal they strike will likely be either the only or one of a few deals that they may be involved with. For example, any NHS Trust signing up a PFI procurement of a hospital will sign a contract for a period of up to 60 years and hence the only time that an employee will meet this situation again in his or her working life is if they move to a different Trust. Equally, there is evidence that public service employees are migrating to the private sector, either to work as advisors or to transfers of employment as a service is moved. The implication of this is that intellectual capital may be being accumulated in the private sector at the expense of the public sector. In the long run this may well lead to a situation where it is more difficult to obtain vfm from these deals because of the lack of expertise in the public sector. Partnerships UK (PUK), itself a PPP, formed in June 2000 is intended to deal with this issue in part. Whilst it can provide the financial and economic expertise the issue of whether organisation specific intellectual capital can be retained remains in question.

3. **How should the strategic importance and prioritisation of PPP/PFI projects and the inter-relationship with other schemes be assessed and managed?**

3.1. Prioritisation of projects should be related to strategic need and not the mode of funding.

3.2. It must be realised that the problems of prioritisation of projects may be less of an issue at procurement than the problems of prioritisation at a later date when flexibility to contract or change the nature of service delivery is required. When a long-term contract has been set up there is a cost of premature curtailment of that contract and this may well be a factor in future decision making.

4. **Are there any particular social factors that should be assessed and managed and how have PPP/PFI schemes impacted upon them?**

4.1. PFI has been the subject of vociferous and well argued criticism of the approach. One example of this is the controversy relating to the Pimlico School in London, where community action has led to appeals against the process. Resistance to PFI/PPP has been a particular case in situations where there is a worry that the profit motive is inappropriate. For example where the impetus to profit is feared to undermine safety or where it may undermine a relationship (as between doctor and patient, for example) or where the need to provide profit for shareholders will divert scarce resources from the provision of the service.

The arguments for and against the financial justification for PFI are hard held on both sides. In the case of the NHS, examination of the business cases shows that the justification of value for money provided in the financial analysis prior to investment predominantly relies on the valuation of risk transfer. Schemes only show value for money because of the valuation of the transfer of risk that is assumed to take place. There is as yet no evidence that risk transfer in the NHS will ensue, as schemes are only just operational. Pollock (2000) argues from a broader range of contexts that ex-ante analysis has shown that risk transfer may not always be realised. Hence the nature of the risk transfer and whether that transfer does work remains to be evaluated in that situation. If services provided by a PFI/PPP are seen as socially essential or non-avoidable then the possibility of allowing failure is reduced at best and failure may well be unlikely to occur. Evaluation of PFI/PPP will be needed to track this issue.

Alongside the economic debates as to whether PFI shows value for money, the extent of unease amongst communities that are asked to accept PFI/PPP type developments should also be considered. Whilst this is difficult to value, it should be taken into account in the context of the impact on the general legitimacy of decision makers at all levels. It should be recognised that managers who have to lead schemes of this type in order to ensure the provision of a service to the community may well lose the support of the community they seek to serve.

4.2. Cost can be cut to provide value for money in a number of different ways. New approaches to service delivery, new technologies and the linking of design to operation are all ways that are seen as possibilities offered by PFI/PPP. Whether there is any social benefit or downside in the amalgamation of facilities management and building design in the NHS remains to be seen as the new facilities come into operation. However, in situations where the cost structures are such that labour costs are the greatest element there will be an incentive to drive that down. Clearly this can be done in a number of ways but if the terms and conditions of the workforce are simply reduced then there is a social cost that may be carried by the individual, but may also be carried by the state (in terms of income supplements or sick pay etc.) Attention might therefore usefully be paid to this possibility.

5. **How can value in relation to capital investment and service improvement best be assessed?**

5.1. Various points that relate to this question have already been made and this summarises and extends the earlier arguments. The issues relating to the testing of schemes for vfm are fraught with difficulty - as is the case in any investment appraisal. As noted earlier one element of this relates to the difficulty of predicting the future. The tendency to optimism by these who are wishing to promote a scheme is a tendency that is not simply related to PFI schemes. Hence the projected cash flows that form the base of any appraisal will always be tenuous. Cash flows relating to the various schemes are subject to discounting, to allow total flows to be calculated at present day values. This takes into account the fact that, when comparing the same raw amount, cash received now is worth more than that received in the future. The problem of which rate should be used to discount the cash flows has been subject to debate and the 6% rate applied has been criticised as favouring both the private (Gaffney et al. 1999) and public sector, (Grout, 1997). It follows that there is always likely to be controversy about the Net Present Cost (NPC) of schemes, particularly where there is controversy about their nature.

The NPC of a PFI scheme will be compared with the cost of a Public Sector Comparator (PSC). The NAO has done work that has led to the development of standard guidance in respect of the calculation of vfm, which includes the calculation of a PSC. Whilst this has provided some assistance relating to the methods adopted there remains some latitude in the construction of the PSC that means that again the figures remain contestable.

When it is recognised that the overall contracts can run for up to 60 years, with several times in which the terms can be re-negotiated, it becomes clear that the whole issue of ex ante calculations of vfm are difficult. It follows that there is a critical need for post project evaluation. The NAO has been closely involved in this process, but has only been able to take ‘snapshots’ of schemes. Follow up work will be required. The need will be to ensure that the vfm and risk transfers that were predicted have taken place and continue to take place. Care must be taken to ensure that the early contract prices prior to expected breaks for re-negotiation of prices do not prove to be ‘loss-leaders’. The financial evaluation must be accompanied by social evaluations that explore the stakeholder perspective over time. It should be recognised that the quantification of the latter will not always be possible to achieve, but that judgement will have to be brought to bear in the evaluation of social issues such as the acceptability of the approach to delivery and the relative weighting given to the views of different stakeholders.

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## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## DEPARTMENT OF CULTURE, ARTS & LEISURE

12 April 2001

**1. Request for Information (1):**

i. DCAL has only limited experience to date with PPP/PFI projects, but it is already aware of factors important to its success. These include innovation of approach, trust between all partners, value for money in meeting the public sector's needs and a demonstrable risk-transfer to the private partners in the case of PFI projects.

ii. PPP/PFI has a number of possible benefits to the Department. It offers the potential to achieve better value for money *vis-à-vis* more conventional approaches, through, improved risk allocation/management and more tangible efficiency incentives in the private sector. It could also potentially offer new and innovative approaches to addressing a range of issues, both within and outside DCAL's direct remit. This should result in benefits to the public and stakeholders in terms of improved services and revenue streams which would be identified in the value for money assessments of projects.

iii. However issues around the tendering processes and viable project scale in PPP/PFI may impact on its successful application in the Department. To date, DCAL has not identified any material gaps in the supplier market base. Guidance and skills issues are being addressed in liaison with the Department of Finance and Personnel and expertise is building up as a project caseload evolves.

iv. DCAL already recognises the strategic importance of PPP/PFI in its Corporate Strategy through its commitment to identifying innovative PPP/PFI schemes to deliver capital priorities. It should be accepted, however, that PPP/PFI will not always be suitable and in many cases more conventional procurement methods are likely to prove more realistic and better value for money. The interrelationships between the different schemes are handled in the normal way, with due regard to capital development priorities, project costs and outcomes and the resource environment in which the Department operates.

v. In DCAL, there are a number of social factors to be addressed in capital projects, not least in relation to New TSN, for instance, in terms of promoting social inclusion in the Arts and Libraries. There are a number of PFI schemes at various stages of development in the Library sector, and if these are brought to successful fruition, they should impact positively on these social factors.

vi. Obviously, exchequer funding proves the main alternative to private finance. However, EU funding sources and the International Fund for Ireland may be appropriate in specific cases. Value for Money and affordability are key aspects in all cases.

vii. DCAL understands overall policy on PFI/PPP is managed by OFMDFM and DFP, but believes policy developments should be carried out in consultation with other Departments. More specific guidance regarding the types and scale of project that lends itself to PPP/PFI would be particularly helpful.

viii. Public procurement and privatisation would represent the main alternatives, although PPP can take on a number of different structures, such as joint ventures and self-financing (private) schemes.

ix. The economic rationale is usually given as potentially offering more efficient procurement of services and innovation over the public alternative, although this remains to be demonstrated on an individual case basis. More generally, however, PFI/PPP may offer real economic (and social) advantages over alternatives where it leads to projects with positive economic (and social) impacts going ahead sooner than otherwise would be the case.

x. This is a complex area involving counterfactual comparisons based on what would have happened in the absence of PFI/PPP, and may therefore require benchmarking exercises tailored to individual cases.

**2. Request for Information (2):**

i. Within DCAL, there are a number of projects currently being considered in the Library sector, viz the Electronic Libraries for N Ireland project (ELFNI) and the construction of Antrim and Lisburn Libraries. A new library for Antrim is being provided through a PFI arrangement but is only a small part of a much larger procurement for a new bus station being taken forward by DRD. This approach, where library provision is considered as part of a much larger development, would seem to represent the best opportunity for unlocking the potential of PPP and PFI.

ii. The other projects are at earlier stages of development and negotiation and it would not be appropriate to elaborate on the details at this juncture, and as DCAL takes forward its work programme over the coming years, there will be a number of projects requiring major capital investment across its remit and in all these areas it will be examining the potential to utilise PPP (including PFI).

**MICHAEL McGIMPSEY MLA**
**Minister of Culture, Arts and Leisure**

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## DEPARTMENT OF EDUCATION

6 April 2001

Thank you for your letter of 20 March requesting information concerning this Department's views on Public Private Partnerships. This Department's response to each of the questions listed in the Requests for Information (1) and (2) attached to your letter are set out in the attached annex.

I very much welcome your Committee's inquiry into what is clearly an important subject for many Departments, and one which deserves serious consideration. My Department are happy to share with your Committee as much information on our experiences and knowledge of PPP/PFI as possible to assist you in your inquiry, although you will no doubt appreciate that we also need to be careful not to jeopardise our negotiating position with respect to private sector companies by putting any commercial-in-confidence information into the public domain.

In seeking to address the serious problems affecting the infrastructure of the schools estate, my Department has formed the view, on the basis of experience in undertaking pathfinder PFI projects over recent years, and after consultation with schools authorities, the Assembly Education Committee and Unions, that reliance on public sector capital investment alone will not be sufficient to meet the urgent needs of schools. Accordingly, we plan to make further use of the PPP/PFI approach, to complement conventional public sector capital investment, in the Department's capital investment programme, as I announced on 1 March this year.

The five main PPP/PFI projects that have successfully been procured in the schools/education sector are:

| School | Capital Value (£m) | Date of Contract Award |
|---|---|---|
| ELB Accruals | 3 | December 1998 |
| Accounting System Drumglass High School | 7 | June 1999 |
| St Genevieve's High School | 14 | August 2000 |
| Wellington College & Balmoral High School (single contract for both schools) | 19 | October 2000 |

In response to your inquiry team's request, my Department has also forwarded copies of the Full Business Cases for each of the above projects.

If it is your Committee's intention to invite this Department to give oral evidence at a public hearing as part of this inquiry, I would be most grateful if you could advise me in advance of the likely topics the Committee wishes to focus on in detail. This would enable my Department to respond more completely and fully to questions raised in what is, I am sure you will agree, a very complex and technical subject.

I wish you and your colleagues well in your inquiry and I look forward to your Committee's report on this matter. I will want to look closely at the findings of the inquiry and will personally review, on an ongoing basis, the nature and scope of PFI/PPP projects as they are further developed in education. I will also want to consider the strategic and operational issues, which may be raised, with the Minister for DFP, Mark Durkan, and Executive colleagues.

**MARTIN McGUINNESS MP MLA**
**Minister for Education**

# ANNEX A

The information set out in this annex are the responses of the Department of Education to the questions set out in the Request for Information (1) and (2) from the Committee for Finance and Personnel as part of its inquiry into Public Private Partnerships, which were attached to the letter of 20 March from the Chairman of the Committee, Mr Francie Molloy, to the Minister for Education, Martin McGuinness. These responses employ the same numbering as that used for the specific questions raised in both Requests for Information.

## REQUEST FOR INFORMATION (1)

## GENERAL CONTEXT OF PFI/PPP

1. PPP/PFI solutions to service needs in the public sector may offer better value for money because:

   (a) the various elements of risk associated with a project are allocated by those best able to manage it;

   (b) the private sector has greater incentives to secure efficiency gains compared to the public sector;

   (c) there is a greater likelihood that the full value of assets will be exploited;

   (d) totally new and innovative approaches to the provision of the required services may emerge;

   In the education sector PPP/PFI provides a means, in conjunction with conventional public sector capital investment, whereby the level and pace of capital investment can be increased in order to deal with the very significant backlog of major capital works in the schools estate, valued at some £500m. Secondly PPP/PFI also offers the potential, by means of the appropriate transfer of risk, for raising standards in the delivery of education through arrangements which enable school management to place greater focus on their core business of education.

2. The key factors include the following:

   (a) it is essential that any PPP/PFI project deal results in genuine and appropriate transfer of risk from the public sector to the private sector;

   (b) there needs to be a viable market for the services to be purchased – ie the capacity, expertise and finance within the private sector to deliver the services required needs to exist;

   (c) projects need to be of a sufficient size to attract private sector bidders. In addition, the larger the project is in capital terms, the more likely it is that good value for money deals will be achieved. The lower threshold in this respect, below which it is suggested that value for money PFI/PPP deals are difficult to procure, is generally regarded to be in the range of £5-10 million, while the optimum size is considered to be those with capital values in excess of £50 million;

   (d) the deployment of sufficiently well trained and resourced public sector procurement teams is essential to ensuring effective procurement of value for money deals.

3. The following issues may be relevant here:

   (a) residual ignorance within the wider public sector and some antagonism by trade unions to the concept of partnership with private sector companies in delivering public services;

   (b) a relative lack of requisite commercial knowledge and skills in the public service required to negotiate complex PPP/PFI deals;

   (c) relative immaturity of the facilities management industry within NI;

   (d) in certain circumstances NI companies may have difficulty in competing in this market due to their smaller size compared to larger, and in some cases more experienced, competitors outside NI; and

   (e) limited capacity, skills and experience of locally based consultancy companies.

4. In using PPP/PFI in the development of the schools estate the overriding imperative, from the Department's point of view, is that projects are selected and prioritised on the basis of educational need.

5. Concerns have been expressed to DE, particularly by trade unions, about the impact on public service employees of PPP/PFI projects. In all PPP/PFI projects in education the terms and conditions of employment of public sector employee, who have transferred to private sector operating companies, have been protected under the TUPE regulations. In addition, in each project contracting school authorities have secured deals which ensure that comparable pensions provisions are provided for staff transferring to private sector companies.

6. Initially most procurements in this area were PFI deals involving the Design Build Finance an Operate model contract. Increasingly, different forms of partnership between public and private sectors have developed, including Joint Ventrureships, for example. The Department is keen to assess and evaluate such developing models to complement conventional procurement approaches to addressing the infrastructural needs of the schools estate.

7. The Department plans to make strategic use of PPP/PFI to complement its conventional public sector capital investment thereby increasing the volume and pace of capital investment in he schools estate. The use of PPP/PFI is not viewed as viable or cost-effective in all circumstances, particularly small capital projects. However, there may be potential for cross-cutting exploitation of PPP/PFI as the market matures.

8. In the Department's experience, feasible alternative forms and structures of financing are dependant on both the size of projects and the approach and composition of private sector consortia bidding for deals and can include bank senior debt, equity debt and financial bonds as well as joint ventures and 3rd party revenue streams. The specific issue of re-financing PPP/PFI deals is currently the subject of investigation by HM Treasury and revised guidance on this matter is expected later this year.

9. PPP/PFI deals bring into sharp focus the economic dynamics of effective risk transfer and life-cycle costing in capital investment projects into the overall evaluation of value for money deals and thus help avoid the short-termism that can potentially impact on conventional public sector procurement.

10. The assessment of additional value and service improvement should be an integral part of the procedures for evaluating the outcome of any PPP/PFI project. The precise evaluation techniques will vary between projects but should involve establishment of an initial baseline and benchmarking where this is feasible. In education PPP/PFI projects economic appraisals techniques, based on HM Treasury 'Green Book' guidance have been used in full in the development of all Public Sector Comparators and subsequently in the evaluation of private sector bids. These provide for the assessment of all capital and service elements in proposals by the private sector and ensure that value for money judgements made are soundly based.

**REQUEST FOR INFORMATION (2)**

**SPECIFIC PROJECTS AND PROGRAMMES**

**Bid Process**

1. Output specifications were clearly defined for every project and where necessary, clarified with private sector bidders in the course of negotiation. In certain cases, specifically specialised educational equipment, bidders requested and were provided with, more input based information in order to ensure that specialist equipment provided would be functionally fit for teaching purposes.
2. This is currently difficult to judge as only 1 of the 4 schools PPP/PFI projects which have reached financial and contractual close is at the operational phase, and in the single case this operational phase is only in its first 6 months. The other 3 schools are currently under construction and are due to become operational early next year. Great pains were taken in the negotiations of each project to ensure that the private sector operators were able to provide the highest possible degree of functionality and fitness-for-purpose in their designs, construction and services, and early indication are that the operational reality is that requirements are being met and in some case at very high levels of quality. There are plans to undertake Post Project Evaluations within 1-2 years of operational phases commencing in each case which will enable more definitive judgements to be made in respect of the effectiveness of specifications and their subsequent implementation.
3. A wide ranging market sounding study was undertaken by the Department in which over 60 private sector companies provided information and comment on the feasibility of PPP/PFI in the NI school sector. This assisted in raising levels of awareness of the needs of NI schools among potential bidders and provided important market intelligence to the Department which assisted in formulation of a strategy for the use of PPP/PFI.
4. The main areas of risk identified in all schools projects were Design, Build/Construction, Finance, and Operation (including availability and service performance standards) but excluding substantive volume risk, in that it was judged that pupil enrolments of schools could not be appropriately managed by the private sector.
5. The evaluation criteria categories employed in each of the schools PPP/PFI projects included (i) Design/Technical Services, (ii) Financial, and (iii) Legal, and were notified to each bidder at the ITN stage. Quantitative scores were applied in each case on the basis of rigorous evaluation by appropriate specialists on the procurement team, using weighted values and a risk matrix. Comparison of the various weighted scores associated with each bidder provided a means of ranking of bids.
6. Both outline and full business cases complied fully with DFP guidance on the preparation of PPP/PFI Business cases.
7. The PSC was based on the preferred option for public sector capital procurement within an Economic Appraisal. This was developed to include the range of services, with the scope of each project costed on a full life-cycle basis and adjusted to reflect risk transfer.
8. A rang eof consultancy companies were appointed as advisers on each of the schools PFI projects to provide specialist expertise in corporate finance (PriceWaterhousecoopers), property and technical issues (Chestertons) and legal advice (Dibb Lupton Alsop) at the outset of the projects.
9. Among the key contractual issues arising in all of the schools PFI/PPP projects were the following:-
    - ownership of land and assets
    - early termination of contract arrangements
    - force majeure risks
    - payment mechanism
    - unavailability of insurance
    - surplus land development agreement.
10. The tendering process in each of the schools PPP/PFI procurement projects generally worked well in all cases, with private sector bidders able to respond to Invitation to Negotiate documents and requirements within set timescales and to the required quality. However, the overall procurement process was longer than expected, given the novelty of negotiating the first PPP/PFI deals in the NI schools sector and lack of standard

contract forms or output specifications for schools at the outset. This was also exacerbated by the absence of dedicated resources in the form of core procurement teams. In the planning of future PPP/PFI projects, steps have now been taken to ensure sufficient resources are put in place at the outset for procurement teams, and that procurement timetable are realistic in the context of the size and complexity of the project.

11. The direct costs required to deliver the schools PPP/PFI projects arise in the main from external consultancy costs. Other costs arise from public sector staff involvement and training in project teams, on which no detailed figures are not available. All consultancy support costs in each school PPP/PFI project were met by the Department. The total expenditure on consultancy support for the 4 schools projects amounted to £1.9 million.

**Completed Deals**

*Performance Management*

12. In all cases the service requirements of individual school projects were described in output terms supplemented where necessary by clarification on individual service elements, which in some cases necessitated more input oriented information. In all cases bidders proposed various solutions to meet output specifications which included innovations in design and service delivery, such as synthetic all-weather playing pitches. The quality of service targets and standards used were at least those minimum standards that would apply in all new school buildings projects. These minimum standards are, in general, set out in the Department's Building Handbook.

13. In planning of the initial pathfinder projects in 1996 there was very little information available to enable robust estimates of project procurement costs to be determined. In addition, the projects team were heavily reliant on external consultancy support due to the absence of specialist commercial and legal skills and knowledge required to undertake procurements of this kind, and at the same time seeking to develop both policy and strategy on the future use of PPP/PFI. As a consequence the project costs were significantly greater than that initially estimated. However, the department ensured that the lessons learned during this process, and the new skills and knowledge acquired by public sector staff involved, was carefully documented and evaluated for future use. This ensured that best value for money was obtained for these projects costs. In respect of estimated service costs set out in the Outline and Full Business Cases for each project, it is not yet possible to make a definite judgement on the validity or accuracy of these costs. This will be addressed in due course in each project when Post Projects Evaluations are conducted up to 2years after the commencement of the operational phase of each contract.

14. It was not appropriate to transfer volume, or demand risk, in any of the schools PFI projects other than minor elements associated with catering services. Therefore demand forecasts as such were not applicable to the payment mechanism in these projects.

15. The performance management system in all schools PPP/PFI projects related both availability of facilities and standards of service provision to the payment mechanism. As indicated already, it will not be possible to make definitive judgement regarding the effectiveness of payment mechanisms implemented or contracted for, until Post Project Evaluations have been completed.

*Financial*

16. The accuracy and completion of financial models associated with each schools project were quality assured by corporate finance consultants contracted by the relevant schools authorities. In several instances this resulted in changes being made to improve their robustness prior to financial close in each project. The key financial risk was the bankability of financial deals as reflected in the models used. In addition key financial ratios were tested by corporate financial advisers acting for schools authorities, as well as advisers working with banks acting as the senior debt funders in each case. In terms of impact, these financial risks highlighted the critical role played by funders or banks in the delivery of PPP deals in general.

17. Being conscious of the absolute necessity to control public sector costs and obtain value for money in any PFI/PPP deal, the Public Sector Comparator provided a critical benchmark against which to assess the value for money and affordability of PFI/PPP proposals.

18. As the schools pathfinder projects in NI were among the very first in the UK to be procured using PFI/PPP there was little if any comparative information on similar projects available for use with respect to rates of return to the private sector. The emphasis from the public sector perspective was focused upon value for money to the taxpayer.

*Contractual*

19. The contracts agreed in each case were closely aligned with HMT guidance on standardised contracts forms which reflects best practice in this area. In addition, legal advice on the completeness, appropriateness and enforceability of the contract forms used was obtained from specialist commercial lawyers contracted to the Department. It is too soon to provide a definitive view on variations to these contracts, most of which were only signed in the latter half of last year.

20. The areas of risk allocated in all the PFI/PPP schools contracts cover Design, Building/Construction, Finance and Operation (including availability and service performance, but excluding volume or demand risk in terms of pupil enrolments) of the schools' facilities and services contracted.

*Social*

21. A key issue, which could be construed as social concerned staff transfers from the public sector to the private sector under TUPE, concerned protection of pension rights which are not covered by TUPE Regulations. In all the PFI schools contracts negotiations school authorities succeeded in obtaining the provision of comparable pensions provision for transferred staff, thus protecting their interests. Those staff affected, were consulted by relevant school authorities and their unions on these matters. The Department has consulted fully with all schools authorities and many stake holders including unions on its strategic planning for the use of PPP in the future. It is further planned that systematic consultation with all key stakeholders will be a key feature of future PPP projects.

*Property*

22. In three of the four schools projects certain parcels of land, which was determined to be surplus to the educational requirements of the school authority, were included as part of the PPP deal. These properties provided development opportunities to bidders, which encouraged better inter-bidder competition and secured market value for the properties transferred. These values were quality assured by the Valuation and Land Agency. As a result the unitary payment to be paid by the relevant school authorities was substantially reduced, thereby significantly enhancing the affordability of the deal from the public sector perspective. Where surplus land deals formed an integral part of PFI/PPP schools deals, claw-back arrangements, whereby income or profit realised by private sector developer above agreed threshold would be shared with the public sector, were agreed. In such cases the mechanisms agreed provided for the share of such profits or income due to the public sector to be increased as the absolute level of surplus income or profit increased, thereby fully protecting the public sectors long-term interests.

*Construction*

23. It is essentially a contradiction to the principles inherent to PFI/PPP to suggest that construction costs in a Public Sector Comparator and the private sector proposed financial model should be comparable as this does not allow for different solutions to meet the requirements of the public sector by the private sector. For example, in one of the schools pathfinder projects the PSC included building costs, in respect of a major refurbishment of the school. The private sector bidder's costs in this case included construction costs for a brand new school. It was therefore not possible, nor indeed appropriate, to directly compare both sets of construction costs per se. Professional advice was obtained by schools authorities in each case to provide assurances that construction and facilities management costs proposed by the private sector were reasonable and appropriate to meet the requirements.

24. Only one of the four schools projects has been completed in terms of construction and has been operational since September 2000 (Drumglass High School in Dungannon). In this case the school authority has, to date, registered no serious dissatisfaction with the match between specification and completed works.

25. No Post Project Evaluation reports have yet been completed. It is planned that these would be carried out between 1 and 2 years after commencement of operational phase in each project. Therefore the first PPE report should be available in 2002.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY
## DEPARTMENT OF ENVIRONMENT

1 May 2001

I refer to your Chairman's letter of 20 March asking for information to assist the Committee in its Inquiry into the use of PPP/PFI to finance and provide public sector services and infrastructures improvements in Northern Ireland. I understand that you and John Small have since discussed the matter. The department is grateful for the additional time it was given to prepare its response.

I should explain that the Department of the Environment is a largely regulatory department with a small capital spend, some £4m, or 4% of its overall allocation. This means that its scope to use PPP/PFI is rather more limited than most other departments. Similarly, our experience with the methodology is narrower. We have, however, used private finance in two recent projects and trust that the Assembly Committee finds the information we provide in relation to those projects useful in its work.

We provide three inputs. The first is a departmental response to the more general questions asked in your request for information. The remainder cover the two major projects we have brought forward.

These are:

(a) the replacement of a computerised processing system in the Planning Service

(b) the replacement of vehicle testing, IT, related services in the Driver & Vehicle Testing Agency.

If you need any further information, we will provide it as soon as possible. I understand that the Committee might wish to take oral evidence on the Department's experiences in managing these projects. Again, we would be happy to assist, and await your further contact.

## REQUEST FOR INFORMATION (1)

1. What do you see as the benefit of PPP/PFI? Are there identifiable benefits to the public and stakeholder.

   In the department's experience, the potential benefits of PPP/PFI are: -

   - The transfer and allocation of risk
   - Bringing viability to high outlay projects. Procurement through PFI converts high initial capital costs into a series of transaction payments which results in a smoother flow of expenditure. The funding of this expenditure by receipts from fees has enabled projects to proceed where capital funds would have been very difficult to find.
   - Development of a partnership approach where the provider and the client have worked together to achieve successful outcomes.
   - Can provide value for money and affordable services for the public
   - Potential for introduction of wider expertise and fresh ideas
   - Can provide single point project management for the client

2. What do you see as the key factors for the successful application of PPP/PFI?

   - Clear vision and specification of required outcomes and their scope.
   - In depth knowledge of business needs.
   - Effective two-way communication between the service provider and the client.
   - Scope for innovation in design which enables the service provider to design away risks and bring new ideas to the way the service is provided;
   - Clear understanding of risk and risk management.
   - Identifiable market providers to ensure competition among suppliers.
   - Commitment of both parties to a successful outcome.
   - Dedicated and expert teams on both client and service provider groups

3. Are there any wider issues, limitations and constraints associated with the environment of the PPP/PFI that have to be addressed? Are there gaps in the supplier market base? Are the skills and guidance available?

   - The primary concern is the length of time that such procurements can take, the cost of the procurement process and the complexity of contracts, although this last has been helped by the provision of a Model Contract by CCTA.
   - It would seem that commercial interests need more guidance on the requirements of bidding.
   - There did not appear to be any gaps in the supplier market base.
   - The department has either developed, or had available, sufficient guidance and the skills including the use of resources internal to government, or by purchasing consultancy support.

4. How should the strategic importance and prioritisation of PPP/PFI projects, and the inter-relationship with other schemes, be assessed and managed?

   The department considers that its experience in this area has not been sufficient broad to enable it to provide a substantive input to this question

5. Are there any particular social factors that should be assessed and managed and how have PPP/PFI schemes impacted on them?

   Again our experience does not cover this point

6. What alternative procurement options do you believe should be considered?

   Where market interest cannot be demonstrated for a PPP/PFI procurement then the traditional procurement methods of the purchase or leasing of the systems/services might be pursued. This will also apply where a PPP/PFI procurement cannot demonstrate Value for Money and the purchase or leasing of the systems/services may represent a more cost effective solution. This of course assumes that capital is available for funding of projects by the traditional means.

7. How do you suggest PPP/PFI should be taken forward in Northern Ireland?

The sharing of experiences and expertise of previous PPP/PFI procurements would seem to be essential in nurturing a successful ethos, although there are limitations of simple comparisons as many projects are distinct and discrete.

A further suggestion would be the "fast tracking" by DFP of the necessary clearance of such contracts. It is of course recognised that the complexity of such contracts is a major hurdle and that the timeframes can be significant in terms of the overall project timeframe. A means of streamlining the clearance procedures and the ability to react quickly to Best and Final Offers could significantly reduce the time involved in negotiating such contracts.

8. What are the feasible alternative forms and structures of financing?

The department would not consider it is in a position to respond to this point.

9. What do you see as the economic basis for PPP/PFI?

The economic basis for PPP/PFI might be generated from the interacting effects of Value for Money, competition, risk transfer. In addition, payment for service as opposed to purchase of an asset allows projects to become viable where capital funds are not readily available.

10. How can value in relation to capital investment and service improvement best be assessed?

Where the activity which is the focus of the PPP/PFI project is closely monitored in terms of performance/ output targets and cost recovery/ fee setting trading accounts it could be possible to identify cost savings and service improvement.

## INFORMATION (2)

**SPECIFIC PROJECT**

Replacement of a dated computerised development control case processing system – PLANAPS - with a modern GIS based system which covers the full breadth of the agency's development control function. The project excluded desktop hardware and data-communications but included application software, server hardware/ software, data capture and conversion, and management and support of the system.

**Bid Process**

1. Were the output objectives of the projects clear and established in relation to need? Did any of the objectives stray into inputs and delivery mechanisms?

   A detailed Statement of Service Requirement (SSR) was produced which clearly identified the outputs and services required.

   A number of objectives did detail preferred delivery mechanisms. This was necessary due to investment on going within the agency in a number of other computer services, and the desire to ensure compatibility.

2. How good was the specification of the requirements compared with implementation and operational reality? Please summarise the differences?

   Due to the lead-in time involved in developing and implementing the system that operates in a dynamic environment, a number of the requirements had to be modified. The main differences resulted from changes in legislation e.g. Prior Approval procedures, Environmental Assessment and business processes.

   As a major cultural change for the agency staff, a significant number of which had never used a computer, a number of changes were also necessary during implementation to address the human factors.

3. Did the project benefit from any initial enquiries into private sector interest and were potential areas for innovation identified?

   Prior to the commencement of the project the agency carried out a Feasibility Scoping Study and Feasibility Study into the replacement of the computer system and in order to establish that market interest existed. Once this had been confirmed, a formal procurement project was initiated. With regard to innovation, during the procurement the advantages of implementing a Geographical Information System (GIS) based system were identified and subsequently adopted. This involved the capture on digital OSNI maps of all information currently held by Planning Service offices on paper maps and additional system functionality to allow the plotting and retrieval of spatial information.

4. What areas were identified for risk transfer?

   A risk register was agreed and the following risks transferred: -

   - Project Financing;
   - Design and Build;
   - Implementation/Delivery;
   - Operation & Maintenance;
   - Volume Risks, and
   - Technological Obsolescence including Residual Values.

5. What were the evaluation criteria used and how were they applied? In particular how were risks and variants assessed in the ranking of bids?

   The evaluation criteria used were: -

   - Assessment of the proposal's compliance with the mandatory requirements as set out in the Statement of Service Requirement;
   - Quality of the solution offered, including where relevant, additional features or services offered;
   - Cost;
   - Quality of the supplier organization;
   - Procurement and Contractual Requirement compliance;

- PFI assessment - value for money; risk transferal; and funding methods.

A score and weighting was applied to each of the above evaluation criteria and the proposals individually scored.

In terms of risk, the scores for each criterion were multiplied by a factor that represented the assessed risk. For example, in the case of criteria relating to the solutions proposed, this was the risk associated with the proposed technology, i.e. at one extreme the perceived risk of using new and relatively untested technology or at the other extreme the risk of using dated technology.

6. What were the key features of the business case?

The key features of the business case were: -

- identification of the need for a new system;
- definition of the project objectives and boundaries and identification of constraints;
- definition and evaluation of options;
- consideration and comparison of the funding options; and
- demonstration that the Project was viable as a PFI project representing Value for Money.

7. What were the nature, form and features of the public sector comparator?

In this case the Project was financially free standing, the system being funded by means of a transaction charge which forms part of the planning application fee, and a Public Sector Comparator was therefore not required.

8. What were the skills and expertise recruited into the Project Team and when? Please list the Advisers, Contractors and Financing organisations involved?

Business Development Service of DFP – Prince Methodology – Initiation of Project

Terry Coburn – Central Computer and Telecommunications Agency(CCTA) (procurement process, contract) – Initiation of Project

Central IT Unit(GB) PFI Unit (PFI guidance) – during completion of Business Case and consideration of PFI as a procurement method

Mike Thompson – DOE PFI Advisor – during completion of Business Case

Colin Tennant – PricewaterhouseCoopers (financial aspects of the contract) – during contract negotiations

9. What were the key contractual issues and when were they identified?

Risk Transferral – on preparation of the risk register at preferred bidder stage

Performance Measures/Service Levels – during contract negotiations

Payment Mechanisms/Penalties - during contract negotiations

Termination - during contract negotiations

10. How realistic was the procurement timetable and tendering requirements?

Due to a change in the requirement, and the need to revisit certain aspects of the procurement the timetable slipped by some six months. The change resulted from a review of the agency's IS Strategy which recommended that the Planning Service use Geographical Information Systems as a corporate tool and thus the requirement was amended to add additional functionality incorporating a GIS.

11. What were the sources and amount of funding and payments required to deliver the PPP/PFI?

With regard to the costs incurred in carrying out the project, including procurement and implementation, the source of funding was primarily the Agency's budget allocation. Some notional charges were incurred within the Department. Payments made for consultancy advice, including services provided by CCTA, were:

| | |
|---|---|
| PricewaterhouseCoopers | £1,575 |
| CCTA | £5,405 |

The amount of costs incurred directly by the Agency's staff and through notional charges was not disaggregated in the Agency's financial system and is therefore not available.

## COMPLETED DEALS

### Performance Management

12. Were the requirements and specification appropriately output-orientated? Did they encourage innovation? Were the quality of the service targets and standards required reasonable?

    The specification was on the whole output orientated. However, due to the nature of the services being procured the specification did include a number of required inputs primarily in terms of the details to be recorded to allow the agency to fulfill its statutory obligations.

    The specification and the procurement process actively encouraged innovation and variant bids.

    In terms of the service targets and standards during live running the response time targets have been identified as unreasonable due to data-communications problems internal to the agency and the DOE and beyond the control of the provider.

13. How valid were the assumptions made in the business case, and how accurate were the initial estimate of project and service costs?

    The assumptions in the business case were, on the whole, accurate and the initial estimates were realistic as they were based on indicative costs provided by one of the potential suppliers.

14. How accurate and appropriate were the demand forecasts of the services required?

    In terms of the number of transactions the actual number has been slightly higher than the projections due to increased numbers of planning applications having been received. In addition, the increased staff complement impacted on the number of licences, etc required.

15. What were the performance measurement systems and how effective were the associated payment regimes?

    The contract specifies system performance and serviceability levels which must be complied with in order to receive payment. Any failure to deliver the agreed service to the performance and standards specified will result in the reduction of the transaction fee. In addition the contract penalised the provider for late delivery.

    The payment mechanism has been effective to date in ensuring that the provider delivers a quality service.

### Financial

16. How accurate and complete was the financial model and the assumptions made? What were the estimated financial risks? How did they impact on the deal?

    By using indicative prices provided by one of the potential suppliers the financial model and assumptions were as accurate and complete as possible.

    The financial risk identified were: -

    - Project Financing including availability of funding;
    - Time and cost over-runs;
    - Reduction/Increase in number of planning applications;
    - Development Costs;
    - Residual Values; and
    - Provider Insolvency.

    The impact of the above risks on the deal was that a guarantee was required from the provider's parent company.

17. How relevant were the Public Sector Comparator costs to the PPP/PFI?

    As previously stated (response to Question 7), the system is funded by means of a transaction charge which forms part of the planning application fee. It is therefore financially free standing and a Public Sector Comparator was not required.

18. What assessment has been made on the rates of return payable to banks, providers of equity and subordinate debt and how do these compare with returns on similar projects?

    The profit margins and cost of financing were disclosed by the provider. The assessment carried out by the Department's financial consultant confirmed that these were reasonable.

**Contractual**

19. How complete, appropriate and enforceable was the contract provisions and what issues and variations were necessary later?

    No problems have been identified with the contract's provisions although refinements and changes to the system have been implemented through the contract's formal Change Control Procedures. The changes have mainly been focused on minimizing human failures in using the system and incorporating recent legislative changes which have impacted on the business process.

20. What risks were allocated in the contract?

    Project Financing, Design and Build, Implementation/Delivery, Operation & Maintenance, Volume Risks, and Technological Obsolescence including Residual Values.

**Social**

21. What staff transfer and TUPE issues were present and how were they managed? Are there any lessons to be learnt about consultation with stakeholders and others affected by the PPP/PFI?

    The only stakeholders affected were staff. The main lesson learnt was the importance of generating ownership of the system among users.

**Property**

22. What property disposals and gains were included and how did the PPP/PFI benefit from their presence? Were there any clawback arrangements and how would any surplus value be shared in the deal?

    No property disposals or gains were included. Any revenue generated through sale or use of the system by third parties is to be shared between the Agency and the service provider.

**Construction**

23. How did the construction costs compare with the estimates in the Public Sector Comparator?

    As previously stated, a Public Sector Comparator was not required.

24. How well did the construction and property specification match the completed work?

    In terms of the specification the system on delivery matched 99% of the requirement.

25. What is the summary of the findings of any project evaluation report?

    The post project review is currently being completed. The draft report states that the Project has successfully replaced the previous system offering greater functionality and providing a building block for the future.

# REQUEST FOR INFORMATION (2)

## RESPONSES IN RELATION TO DRIVER AND VEHICLE TESTING AGENCY (DVTA) PROJECT

### Specific Projects

DVTA has just signed a contract for provision of Vehicle Testing, IT and related Services with the Romaha Consortium.

### Title

Driver & Vehicle Testing Agency Vehicle Testing Equipment Project.

### Main Features

- Consortium supplies an overall service, (exclusive of staff) for which they are paid;
- Service must be maintained at "peak" level;
- Equipment must be calibrated and refreshed periodically;
- DVTA's staff will use the Service to test customer's vehicles to statutory requirements;
- Service replaces DVTA's old and obsolete equipment;
- DVTA will be able to increase its capacity for testing the ever increasing numbers of vehicles, introduce new vehicle tests required by EC directives and improve customer service through reduction in waiting times and other services.

### Bid Process

1. Were the output objectives clear and established in relation to need? Did any of the objectives stray into inputs and delivery mechanisms?

   Project outputs were clear from the start and included in the initial Information Seminar and Information Memorandum provided for interested firms and in the Invitation to Negotiate (ITN). Bidders were required to accept these. The outputs required have not changed and form part of the agreed contract. In the event of conflict between the required output and the input sections, the contract specifies that output requirements take precedence.

2. How good was the specification of the requirements compared with implementation and operational reality? Please summarise the differences.

   Output specification was based on DVTA's known legislative requirements and business needs. Original bids did not fully meet this but bidders had been encouraged to provide variant bids and subsequent negotiation ensured output requirements would be met. Recognition of difficulties encountered by other projects made it imperative that the contractor demonstrates through agreed commissioning tests that the proposed system works before implementation. Concessionaire has to build a pilot centre and demonstrate the system meets output requirements before equipment installation begins, otherwise the contract falls.

3. Did the project benefit from any initial enquiries into private sector interest and were potential areas for innovation identified?

   Following assessment of business needs, DVTA carried out a business evaluation project aimed at maximising return from the current system and carried out market sounding. It researched equipment, system and manufacturer availability and commissioned an economic appraisal on the options for moving forward. Considerable benefit was gained from these exercises:

   - knowledge of system and equipment availability;
   - networking with manufacturers to discuss and explain the potential benefits to both sides.

   An information seminar was also held to bring together potential consortium members from different areas (financial, legal, manufacturing etc). The successful consortium was formed from this meeting.

4. What areas were identified for risk transfer?

   DVTA was clear that it could not transfer risk for areas Government controlled, such as specific legislation changes. All other areas of Risk were considered for potential transfer to a concessionaire.

Apart from the usual risk transfer of areas such as construction delays, DVTA passed to the concessionaire such risks as capacity (i.e. the overall annual level of vehicle testing capability) and availability (i.e. the risk that the service was unavailable and not capable of performing vehicle tests to the standards agreed), as both sides agreed the concessionaire was best placed to meet these. DVTA had originally planned to transfer demand risk to the contractor but re-assessment during negotiations indicated negative cost benefits in this proposal. However, unexpected surges in demand will be met at the contractor's expense where these impact on the capacity mechanism. To validate that suitable risk transfer was achieved, a report by the project's financial advisers was compiled as required under Treasury Interim Guidance issued 29 September 1997, and submitted to the Northern Ireland Audit Office (NIAO). NIAO was "satisfied with PWC's judgement, that under interim Treasury guidance, this project should be accounted for off balance sheet". DVTA noted that later guidance could affect accounting treatment.

5. What were the evaluation criteria used and how were they applied? In particular, how were risks and variants assessed in the ranking of bids?

- Bids were evaluated on the criteria set out in the Invitation to Negotiate. These were Design/Technical; Services; Financial and Legal. Appropriate consultants and subject experts (including GPA, the Government Procurement Agency) were consulted and involved throughout the evaluation process.
- Each criterion had clear expectations and weightings set against it prior to bid closing date and bid assessment, i.e. prior to bids being opened or considered - important from an equality standpoint. The Project Steering Board (PSB) agreed the criteria. Bids were strictly assessed and marked against the relevant criteria by experts in each area.
- Variant bids were assessed in the same way as main bids.
- Risk transfer was assessed within the "Legal" criterion.
- Following evaluation, recommendations were made to and accepted by PSB.

6. What were the key features of the business case?

- The Outline Business Case (OBC) set out the business requirements for the
- Replacement of old and obsolete equipment;
- need for increased capacity; and,
- ability to perform new statutory tests.

The Full Business Case (FBC) confirmed these requirements still existed and showed how the bidder's proposal met the output requirements and was affordable while providing savings against a "Public Sector Comparator" (PSC). Risk transfer was also shown and it was demonstrated that savings achieved by this were additional to savings in comparison with the PSC.

7. What were the nature form and features of the public sector comparator?

Demonstrable Risk Transfer was needed to ensure the project was "off-balance-sheet". At the time, this was fundamental to PFI. Information asserting that DVTA's project could be accounted for off-balance-sheet was submitted to NIAO, who were satisfied with the judgement made. The comparator that DVTA used, with the approval of DFP, included an assessment of the equivalent staffing, equipment, construction and management requirements for providing a similar service to the basic output requirements in the ITN. It could not include the bidder's proposed solution to the output requirements as this was their proposal and risk.

8. What were the skills and expertise recruited into the Project Team and when? Please list the Advisers, Contractors and Financing organisations involved?

- The DVTA team included internal technical and administrative expertise, this was supplemented by legal financial and IT consultancy.
- Prior to commencement of the PFI Project, DVTA recruited the skills of an internal economist and commissioned reports from external consultants advising the best way to meet anticipated future requirements. After accepting the consultants' recommendations, DVTA used the Government Procurement Agency to procure experienced external PFI financial consultants (PriceWaterhouseCoopers) and departmental legal advice to procure experienced PFI legal advisers (McGrigor Donald). An IT consultant was procured through the GB Central Computers and Telecommunications Agency (CCTA), now part of the Office of Government Commerce (OGC) and a construction consultant from DOE. The external consultants were then used in procuring the PFI project.

- In addition to use of external consultants, DVTA set up its own internal project team, including technical and administrative staff and initiated a wider Project Steering Board chaired by the Agency Chief Executive and including DVTA staff (technical and finance), wider DOE staff (Policy, IT and construction) and DFP (finance).
- In addition to the permanent team and Project Steering Board, information was also sought at various times from DOE and DFP PFI Units, and Cabinet Office Treasury Taskforce. Views were sought from major customers.

9. What were the key contractual issues and when were they identified?

The key contractual issues, identified at the outset, were the ability to design and provide a quality service that allowed DVTA to meet business and customer needs over a 15 year operational period, especially on adherence to statutory requirements, service availability, capacity, management information, equipment quality, calibration and productivity.

10. How realistic was the procurement timetable and tendering requirements?

DVTA's PFI Project was one of the first PFI projects in Northern Ireland and was also a leader in terms of specifying a service requirement, rather than a construction project. The original procurement timetable was realistic in terms of reaching preferred bidder (BAFO) stage, as DVTA was able to control and manage this to a large extent. Once post BAFO negotiations commenced however, DVTA had no control over the consortium's subcontractor negotiations and the information provided to and received from them by the consortium. This is both a strength and a weakness of PFI as it enabled DVTA to stay away from the detail of subcontract negotiations but left it unable to apply as much pressure to make the progress that would have been possible under conventional procurement. In addition, the consortium had its own problems with subcontractors requiring to find an alternative IT supplier, funder and new project managers. DVTA, while concerned by the delay, could not influence progress towards finding new suppliers nor was it involved in the additional expenditure and time required by the consortium to source, assess and brief new suppliers.

11. What were the sources and amount of funding and payments required to deliver the PPP/PFI?

**Client**

DVTA procured its own external consultants and PFI team. All costs involved in this have been borne by DVTA. The total cost of the project to end March 2001 includes £386K on staff, £92K on management costs, training and travel, including £5K on travel by officials outside Northern Ireland and £511K on internal and external consultancy. Final costs will not be available for some time but will not be significantly different from those given. Apart from these costs DVTA has not had to pay anything to deliver the proposed solution and will not pay anything to the consortium until the first centre is successfully commissioned and working, likely to be in 6 – 8 months time. All payments to the concessionaire will be on the basis of the agreed unitary payment, based on availability. The bidder will recoup their bid costs from within that amount over the lifetime of the contract. No payments other than the Unitary payment will be made by DVTA.

**Contractor**

Bidders provided their own legal and financial consultants and sought subcontractors to provide services to the consortium. Subcontractors also had their own legal advisers. The consortium's overall bid costs are not available to DVTA. However, it is assumed that their costs are at least equal to those of DVTA's. The consortium, also at its own cost, provided test machinery in a specially adapted building which has now become the solution test (pilot) centre and this is currently being fitted out as a training centre. Unless the pilot centre passes agreed commissioning tests, the contract could fall and the bidder will have to accept the current heavy level of expenditure as well as any losses arising from the pilot centre. It will not be entitled to any payment from DVTA until the first test centre is operating successfully.

## COMPLETED DEALS

### Performance Management

DVTA has only just signed a PFI Contract and the service will not be available until (a) the Pilot Centre has been successfully commissioned and (b) the new equipment installed at DVTA's 15 test centres. This is due for completion by late 2003.

12. Were the requirements and specification appropriately out-put orientated? Did they encourage innovation? Were the quality of the service targets and standards required reasonable?

    DVTA believes its requirements and specification were output orientated. The outputs required formed a complete chapter in the Invitation To Negotiate (ITN) and the bidder accepted these. A similar output based specification forms part of the contract.

    DVTA believes its output-based specification encouraged bidder innovation and the benefits of this are shown in the PSC, against which the PFI bid provides a better value for money solution due in part to the bidder's innovation. The Agreement also includes additional services over those listed in the ITN, another possible indicator of encouraging bidder innovation.

    Output based targets were set within the ITN (Requirement to meet capacity needs and Service Availability). Quality of Service targets and standards required were jointly produced during negotiations with the bidder. The targets and standards production process was intensive on both sides. DVTA required targets that ensured availability, capacity and productivity requirements would be met, while the bidder was concerned with the bottom line business targets.

13. How valid were the assumptions made in the business case, and how accurate were the initial estimates of project and service costs?

    - A number of different areas are involved here. The OBC included the following Key Assumptions:
        - The number of vehicles requiring vehicle testing will continue to rise for the foreseeable future;
        - The vehicle test will be extended to cover additional items;
        - The range of Agency Targets (Quality and Efficiency Indicators) must continue to be achieved.
    - The Key Assumptions are still valid. The numbers of vehicles requiring testing have continued to rise, the vehicle test will be extended and Agency Targets have become more challenging since the OBC was developed (December 1996) and the trends are still ongoing.
    - In terms of project costs, the initial assumptions on equipment cost are still valid, as they were based on available information, however, the successful bid included additional services and equipment and these costs were not included in the OBC. Comparison with the PSC shows that these additional items and their associated Service Costs provide Value for Money.
    - Procurement cost assumptions were low compared with actual expenditure, entirely related to unforeseen complexity and prolonged nature of negotiations. Additional time was required for several reasons,
        - PFI procurement was a new process for all parties;
        - Most PFI procurements had been construction related, little guidance was available for Service provision PFI projects;
        - Negotiations were intense and some consortium subcontractors and the original funder withdrew, requiring substantial adjustment time on both sides.

14. How accurate and appropriate were the demand forecasts of the services required?

    The increase in demand levels is running at the level anticipated and is consistent with predictions from NRTF (National Road Traffic Forecasts).

15. What were the performance measurement systems and how effective were the associated payment regimes?

    Little guidance was available on this during the negotiation period and DVTA believes it has produced an innovative and robust Performance Measurement System. It is based on two main areas "Availability" and "Capacity":

    - A "domino" effect was introduced, meaning that if an individual element of the process fails, the knock-on effect to other functions will be considered in payment assessment.

- "Availability" will be measured objectively using agreed performance measures, such as timing, numbers achieved, service working accurately, etc.
- Payment can be reduced where full service delivery has not been achieved.
- "Capacity" will also be measured objectively on the basis of the ability of the service to meet the demand for vehicle tests within specified waiting time limits.
- Worked examples showing the appropriate impact were developed;
- A penalty points system, has been developed, which could be used to terminate individual contracts or the complete agreement.
- The associated payment regimes have been agreed and tested through the use of various paper simulations but not yet tested in practice.

**Financial**

16. How accurate and complete was the financial model and the assumptions made? What were the estimated financial risks? How did they impact on the deal?

The accuracy and completeness of the financial model can only be assessed by the private sector, post completion, as they will be in possession of the actual costs and income. DVTA performed a review of the financial model and its assumptions for reasonableness e.g. tax rates assumed, financing costs assumed, inflation costs etc. The private sector valuation of risk is, as in all PFI deals, ultimately paid for by the public sector within the bidder's costs. The deal impact is two-fold:

- Value for Money/Affordability
- Negotiations to ensure that the risks are transferred.
- Further separate reports and advice were compiled on various areas including Transfer Pricing, Risk Transfer, Sinking Fund, Foreign Exchange and management of availability.

17. How relevant were the Public Sector Comparator costs to the PPP/PFI?

Where appropriate, the bidder's costs were used to inform the PSC to provide a reasonable basis for comparison. When such costs were not available or relevant, the most realistic means of estimating were used. DVTA believes the PSC provided a robust basis for comparison of costs.

18. What assessment was made of the rate of return payable to banks, providers of equity and subordinated debt, and how do these compare with returns on similar projects?

As part of the evaluation of bids received DVTA compared the rates of return payable to banks and the equity providers to acceptable market norms at that time. This is not a straightforward comparison, as essentially the rate of return sought by a provider of finance will depend on the risk associated with the investment. The DVTA project is technically complex and involves high risk to the providers of finance. Despite this the DVTA project returns compared favourably to market norms at the time

**Contractual**

19. How complete, appropriate and enforceable was the contract provisions and what issues and variations were necessary later?

The Contract has just been signed. DVTA is of the opinion that it is complete, appropriate and enforceable. The process is now in the development phase, which is time-limited (6 months). DVTA is currently at risk of only minimal internal costs and no impact on current vehicle test provision until the concessionaire completes commissioning tests to prove their proposed solution works.

20. What risks are allocated in the contract?

The key risks identified for DVTA's project were allocated to the party most suited to manage the risk. The FBC shows the bidder accepted risk for the following key areas:

- Capacity
- Availability and Performance
- Pricing
- Residual Value
- Operating Cost

- Design
- Construction and Financing; and,
- Exchange Rate.

DVTA accepted the key risk of demand, except where an unexpected surge in demand affects the contractor's capacity mechanism. Other risk areas, such as changes in legislation and safety requirements have also been allocated appropriately.

**Social**

21. What staff transfer and TUPE issues were present and how were they managed? Are there any lessons to be learnt about consultation with stakeholders and others affected by the PPP/PFI?

Previous Government reviews determined vehicle testing would be retained in the public sector in Northern Ireland and TUPE issues are thus not relevant. Key stakeholder buy-in was achieved though consultation with:

- Potential suppliers and consortium members
- Staff
- Trade Union side
- Major customers

Useful points were raised during discussions and these have been addressed and incorporated in the contract provisions where appropriate.

**Property**

22. What property disposals and gains were included and how did the PPP/PFI benefit from their prescence? Were there any clawback arrangements and how would any surplus value be shared in the deal?

No property disposal or gain is included in the Agency's Agreement.

- The bidder will take over some minor assets (old equipment) and pay an agreed amount for these.
- From the Financial Model, rates of return appear appropriate and not excessive even under the most favourable circumstances for the bidder.
- Possible refinancing by the concessionaire has been considered and while there is no specific mechanism for sharing any possible surplus value, any change can only be with DVTA's specific consent, providing a base for negotiation where appropriate.
- DVTA has negotiated a proportion of free additional use of the Service over the life of the contract for use for third party income generation should this become legally possible in future.

**Construction**

23. How did the construction costs compare with the estimates in the Public Sector Comparator?

Where appropriate, the bidder's construction costs were used in the PSC to ensure correct comparisons.

24. How well did the construction and property specification match the completed works?

Physical work has not yet begun.

25. What is the summary of the findings of any project evaluation report?

A Project Evaluation Report is planned but as contract sign has only just occurred work remains at a very early stage. The evaluation will not be possible for some time yet.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## MINISTER FOR ENTERPRISE, TRADE AND INVESTMENT

12 April 2001

I refer to your letter of 20 March in relation to the inquiry your Committee is conducting into the use of Public Private Partnerships (PPP), including the Private Finance Initiative (PFI), to finance and provide public sector services and infrastructure improvements in Northern Ireland. Your Committee also wrote to Mr Alan Gillespie, the Chairman of the Industrial Development Board (IDB). I am replying on behalf of DETI, including IDB.

At the outset let me state that I am fully committed to and support the use of PPP/PFI wherever possible. PPP/PFI allows the public sector to draw upon a wide range of managerial, commercial and creative skills possessed by the private sector. This, in turn, bring innovation and greater efficiency along with a focus on achieving long term value for taxpayers' money over the duration of a project. That being said, the areas of work in which my Department is engaged, with a relatively small capital works programme, somewhat restricts the scope for the application of PPP/PFI. The report produced for DFP in 1996 by a private sector consultant, Robin Horner, confirmed that PFI was best suited for application in areas such as transport, roads, health and education.

The attached Memorandum sets out my response to the Committee. You will note that I have provided two good examples of partnerships between the public and private sectors – the development of the Global Point international business park in partnership with Prologis Developments Limited and the provision of factory buildings under the Property Development Agreement (PDA) scheme. These are both innovative initiatives which seek to maximise the private sector's involvement in industrial and economic development. I can confirm that DETI will continue to seek opportunities for maximising practical private sector involvement in its programmes and schemes.

I am also copying my response and the Memorandum to IDB's Chief Executive.

**SIR REG EMPEY MLA**
**MINISTER FOR ENTERPRISE, TRADE AND INVESTMENT**

## MEMORANDUM OF EVIDENCE SUBMITTED BY THE DEPARTMENT OF ENTERPRISE, TRADE AND INVESTMENT

### Summary

DETI is strongly committed to working, wherever possible, in partnership with the private sector.

PPP/PFI allows the public sector to draw upon a wide range of managerial, commercial and creative skills possessed by the private sector. This brings innovation and greater efficiency along with a focus on achieving long term value for money over the duration of a project.

There are two areas of major collaboration with the private sector in the context of Public Private Partnerships. The Industrial Development Board (IDB) is currently involved in a project to establish a 147 acre international business park known as Global Point at Ballyhenry, Newtownabbey in partnership with a private sector investment partner, Prologis Developments Ltd. The IDB also collaborates with the private sector in the provision of factory buildings under the Property Development Agreement (PDA) scheme. Private sector developers who are prepared to provide, by way of lease or purchase, buildings to an agreed design, specification and cost for use by an IDB client company, may be eligible under the PDA scheme for discretionary "shortfall funding" aimed at bridging the gap between a developer's total development costs and the property's current market value.

### Introduction

1. DETI is strongly committed to working in partnership wherever possible with the private sector. Public Private Partnerships, including the Private Finance Initiative allow the private sector to bring a wide range of managerial, commercial and creative skills to the provision of public services. This brings innovation and greater efficiency along with a focus on achieving long term value for money over the duration of a project. Risk associated with a project is allocated to the public or private partner who is best able to manage it at least cost.
2. The Department, as a matter of established policy considers the application of the PFI option to all capital projects but the lack of a significant capital works programme restricts our scope for use. This is because the initial costs incurred by the private sector in bidding for and negotiating a PFI contract will be higher than the costs incurred in connection with the traditional procurement route and there will be insufficient opportunity for the private sector to recover its costs.
3. This was confirmed in 1996 by Robin Horner, a private sector consultant employed to DFP to consider the scope for the application of PFI in Northern Ireland, who recognised that the initiative was best suited for application in areas such as transport, roads, health and education.
4. Within DETI there are currently two major areas of collaboration with the private sector in the context of Public Private Partnerships. Both areas relate to the development of industrial property by the Industrial Development Board (IDB).

### General Context of IDB's Public Private Partnerships

5. Historically the industrial property market in Northern Ireland operated at relatively depressed levels. This was reflected in low land values and uneconomic rental levels. Private sector interest in the sector was low. The result was that IDB led the way in industrial development throughout the 1980s and into the 1990s.
6. Political stability and improving economic conditions have resulted in significant improvements in all sectors of the property market including the industrial sector. One outcome of these improving conditions is a higher level of interest by private sector developers in the industrial sector.
7. Recognising this improvement, IDB formally established its Private Sector Initiative (PSI) and associated commitment to working in partnership with the private sector in its Corporate Plan 1998-2001 "Competing Globally". The main vehicle used by IDB's Property Services Unit to encourage the involvement of private sector developers in the provision of premises for IDB qualifying companies is its Property Development Agreement (PDA) scheme. The PDA scheme has been particularly successful in attracting private sector support for projects in areas of greatest social need outside the Greater Belfast Area including Londonderry, Omagh, Kilkeel, Enniskillen and Newry.
8. In addition to the PDA scheme the IDB has sought to attract a private sector investment partner to be involved in the masterplanning, marketing and development of a high quality business park at Global Point International Business Park.

**Property Development Agreement (PDA) Scheme**

6. Where an IDB qualifying company has demonstrated a property need, the PDA scheme is designed to provide discretionary 'shortfall funding' aimed at bridging the gap between total development cost and current market value as an incentive to private sector developers who are prepared to provide, by way of lease or purchase, buildings to an agreed design, specification and cost for use by the company.

7. Over the past five years 13 PDAs have been concluded with private sector developers for the provision of premises for IDB qualifying companies. Currently seven IDB client companies are considering meeting their accommodation needs through the partnership arrangements under the PDA scheme.

8. The main benefits gained through the use of the PDA scheme include its leverage of funding from the private sector, the transfer of responsibility for the delivery of the project to those most able to manage the process ie the developers, the transfer of long term management/ownership of the building to the developer or end-user and the further expansion of private sector involvement in the provision of industrial property for IDB client companies.

9. The IDB PDA Information Note is attached for information.

**Global Point International Business Park**

10. Global Point International Business Park is strategically located at Ballyhenry, Corr's Corner, Newtownabbey. Its land area of approximately 147 acres and proximity to population centres, the motorway network, seaports, airports and railway infrastructure, two university campuses and Belfast city centre confirms Global Point as an excellent location for the establishment of a business park environment of international standing.

11. Consistent with the IDB's partnership approach to the delivery of property for its client companies IDB has sought an experienced investment partner of international standing to take the lead in the masterplanning and development of the site. Uniquely this partnership aims to jointly market Global Point to potential investors within IDB's target sectors of research and development, software, network services, e-commerce, electronics and health technologies. Target companies to be identified from both the IDB's and the partner's international business network.

12. IDB has appointed as its preferred investment partner Prologis Developments Ltd, a development company with a capital value of $7Bn, operating in 94 markets, with 1600 facilities and 40 masterplanned parks in Europe. Headquartered in Colorado USA Prologis has a UK base at Solihull, West Midlands.

13. By way of enabling this partnership initiative IDB has undertaken comprehensive earthworks and partial infrastructure works at Global Point. The removal of the risk associated with such earthworks, facilitates not only the attraction of a partner to the project but also maintains momentum in the development of the important business park facility.

14. Heads of Terms were agreed by the parties in July 2000 and progress has been made on developing a strategic approach to the masterplanning of the development, the agreement of a planning strategy with DOE Planning Service, the drafting of marketing proposals and the preparation of a formal development agreement.

15. As the IDB and its preferred partner move closer to the execution of a formal agreement, IDB has been working closely with DFP in respect of formal approval of the PPP project.

16. Comprehensive economic appraisals in respect of this partnership proposal are currently with DFP for approval. PricewaterhouseCoopers has completed the draft PPP Final Business Case (FBC) and negotiations are well advanced in respect of the formal development and marketing agreement. :'Estrange and Brett, Solicitors with expertise in property development and PPP/PFI, the Departmental Solicitors Office, the Valuation and Lands Agency are supporting IDB in these negotiations.

# IDB PROPERTY DEVELOPMENT AGREEMENT

## INFORMATION NOTE

### 1.0 Background

1.1. In its Corporate Plan “Competing Globally – Sustainable Growth in a World Economy 1998-2001” IDB has committed to encouraging the greater involvement of the private sector in its property activities.

1.2 In developing a more flexible approach to its property policy “Competing Globally” also commits the IDB to seeking further opportunities to develop partnerships within the public and private sectors which facilitate the development of new or supplement recent initiatives designed to stimulate the provision of property by the private sector.

1.3 One of the initiatives available to stimulate private sector involvement in the provision of premises for IDB client companies with an approved business case is the IDB’s Property Development Agreement (PDA) scheme.

1.4 Under the PDA scheme IDB is prepared to enter into contractual arrangements with property developers who can demonstrate a proven capability in providing premises to meet the challenging time, cost and quality demands of IDB’s industrial and commercial clients.

1.5 Developers prepared to provide, by way of lease or purchase, buildings to an agreed design, specification and cost for use by an IDB client company, may be eligible under the PDA scheme for discretionary “shortfall funding” aimed at bridging the gap between a developer’s total development costs and the property’s current market capital value.

1.6 The relevant IDB powers are contained in Article 10(2)(a) of the Industrial Development (NI) Order 1982.

### 2.0 Types of Building Supported

2.1 The following types of building, which must have a gross floor area in excess of 900 sq m (10,000 sq ft) will be considered:

(a) A new factory or other premises to meet the accommodation needs of an IDB client company.

(b) Refurbishment of or extension to an existing building to meet the accommodation needs of an IDB client company.

(c) In exceptional circumstances IDB may also apply these arrangements to the provision of approved buildings on a speculative basis.

2.2 To be eligible for PDA funding the building must be deemed capable in terms of size, design, specification, complexity or location as to have an alternative industrial or service use by a substitute IDB client company should the building be vacated by the original IDB client company during the designated control period.

2.3 In the case of an extension to an existing building due consideration must be given in the design, site layout and servicing of the building to facilitate independent use by a substitute IDB client company should the building be vacated by the originally approved IDB client company during the designated control period.

### 3.0 Financial Support

3.1 Discretionary financial support to the developer will be negotiated on the basis of a “shortfall contribution” representing the demonstrated difference between the developer’s total development costs and the current market capital value of the completed building.

3.2 Total development costs will be considered under the headings of site acquisition costs, standing building cost, professional fees, legal and agents fees, statutory charges, standard utility costs, finance costs, developer’s profit and other reasonable costs approved by the IDB.

3.3 Financial support will be discretionary and will represent the minimum shortfall contribution required to trigger development by the private sector. Higher levels of support may be available for development in designated areas of greatest social need.

3.4 The PDA development scheme is approved by the European Community This approval limits the level of the shortfall contribution to a maximum of 50% of the developer’s total development costs. The development agreement is obliged to include a condition to this effect.

3.5 IDB's shortfall contribution levels under the PDA scheme are reviewed on a regular basis to take improving market conditions into account.

3.6 At Practical Completion of the building the shortfall contribution is paid to the developer as a single lump sum. This payment is subject to the developer's Architect certifying that the building has reached Practical Completion stage and that other pre-conditions particularly in respect of final vouching of all costs have been met.

3.7 In exceptional circumstances a discretionary one-off interim payment up to 75% of the shortfall contribution may be paid at Practical Completion stage. The remainder of the shortfall being paid when all pre-conditions under the development agreement have been met.

**4.0 Site**

4.1 The building should be erected on a site owned by the developer or on a site leased to the developer by the IDB.

4.2 In the case of a site leased to the developer by the IDB, the developer will be required as a condition of the lease to complete development within a period not exceeding 18 months or shorter period as appropriate from commencement of the lease.

**5.0 Developer**

5.1 In establishing a Register of Developers IDB seeks to have suitable developers, meeting specified qualification criteria, with which it can react quickly in meeting the property needs of its indigenous and inward investment client companies.

5.2 Inclusion on the Register confirms that the developer has demonstrated the appropriate financial and technical capabilities, professional expertise and track record to deliver projects of a particular type and value on time. Establishment of the Register is therefore aimed at increased efficiency in implementing the PDA scheme avoiding developer qualification at the commencement of every project.

5.3 Exceptionally, an IDB client company may propose that their project be carried out by a developer who has not previously applied for inclusion on the IDB's Register. In such circumstances the proposed developer will have to meet the qualification criteria outlined in paragraph 5.2 above.

5.4 Developers who have qualified for inclusion on the Register may also be eligible for consideration and participation in other IDB initiatives aimed at involving the private sector in achieving its property objectives.

5.5 Developers wishing to be considered for inclusion on the Register will be required to complete an "IDB Register of Developers Application Form". A Property Development Agreement Project Status Report must also be submitted for each IDB client company property project. Copies of these forms are included as Annexes 2 & 3 to this Information Note.

5.6 Developers should have no commercial interest in the IDB client company or vice versa.

**6.0 Professional Consultants**

6.1 Developers must employ professionally qualified construction consultants, approved by the IDB, to prepare outline and detailed drawings, specifications other technical information and tender documentation generally, to invite competitive tenders, to agree grant eligible building costs and final accounts with IDB's representatives, to inspect the building works and to certify as Contract Administrator.

6.2 Developers must also employ professionally qualified, development and legal consultants, to prepare, negotiate and agree with IDB's representatives other elements of total development costs, the development appraisals and legal documentation at various stages of the process.

6.3 Developers must ensure that all consultants carry an appropriate level of Professional Indemnity insurance.

6.4 IDB's representatives will expect to see evidence that the level of fees agreed with professional consultants has been negotiated at a competitive level.

**7.0 Prior Arrangements**

7.1 Following initial examination and evaluation of the developer's outline proposals relating to the design, specification and cost of the proposed building and associated indicative development appraisal, as set out in Annex 1 Stage 1 hereof, the IDB may issue a letter of indicative offer setting out the level of shortfall contribution which the developer might expect. Such a letter would be issued on a "Without Prejudice and Subject to Contract" basis.

7.2 Prior to formal execution of the Development Agreement by the IDB, the IDB or the IDB's Agent must be satisfied as to the adequacy of the information submitted by the developer as listed in Annex 1 Stage 2 hereof.

**8.0 Use of Building, Control Period and Clawback Provisions**

8.1 The building must be occupied by an IDB client company and used for the purpose stated in the development agreement for a control period usually of four years from the certified date of Practical Completion.

8.2 Should the building, or any part of the building, be used at any time during the control period by a company which is not an IDB client company, the developer will be required to repay all or a proportion of the shortfall contribution.

8.3 This actual "clawback" amount will reflect:-

(a) the area occupied by an unapproved company.

(b) the apportioned market value attributable to that area.

(c) the period of occupancy by the unapproved company during the control period.

A void during the control period will not result in an IDB imposed penalty.

8.4 The developer may sell the building to the IDB client company or a third party investor during the control period. In such circumstances the purchaser and any further assigns will be bound by the terms of the development agreement.

8.5 In the event of a sale or lease of the building during the control period at figures in excess of those agreed in the development appraisal, the development agreement contains specific clawback provisions in respect of this excess.

8.6 In order to effect recovery of any amount to be repaid under the terms of the development agreement IDB will require a form of security from the developer and any assigns to cover the repayment liability.

**9.0 General Conditions**

9.1 Generally the development agreement will require the developer to:

(a) demonstrate good and marketable title to the scheduled lands;

(b) sign the development agreement within one month of its date of issue;

(c) comply with all planning authority, building control, health and safety and all other relevant statutory requirements;

(d) appoint capable, experienced and competent teams to design, manage and construct the proposed building;

(e) ensure that the building works are executed diligently and expeditiously, to programme and in accordance with the quality standards set;

(f) insure the building against loss or damage during the construction and control periods;

(g) afford reasonable facilities to the IDB or the IDB's Agent to monitor progress of the building works and inspect same on completion;

(h) ensure that the developer's Architect issues, subject to the building works being to the Architect's satisfaction, a Certificate of practical Completion;

(i) ensure that the building is maintained in a good state of repair and condition during the control period;

(j) ensure that the whole or any part of the building is not materially altered or sold during the control period without the prior written consent of the IDB;

(k) ensure that at Practical Completion or as soon as possible thereafter, all expenditure is vouched to the reasonable satisfaction of the IDB. The developer shall maintain detailed records of all eligible costs incurred for inspection by the IDB (see also Annexe 1 Stage3);

(l) execute the Debenture accompanying the development agreement in favour of the IDB as security for any liability to repay the shortfall contribution to the IDB, in whole or in part, during the control period.

9.2 This Information Note is intended to provide general guidance to developers. The terms and conditions of any contract are specific to a particular building and will be agreed between the IDB and the developer and will be contained in the project specific development agreement which is a legal agreement binding on both parties the terms of which cannot subsequently be set aside or amended.

9.3 Developers may obtain further information from the IDB's Property Services Unit, IDB House, 64 Chichester Street, Belfast, BT1 4JX. Telephone 90 545048 Fax 90 545000.

# ANNEX 1

## ACTIONS TO BE TAKEN BY A DEVELOPER

**At various stages of the PDA appraisal process the developer will be required to provide the following:**

**Stage 1 - Indicative Stage**

(a) Completed project status report.

(b) Outline general arrangement drawings.

(c) Outline building and services specifications.

(d) Elemental cost estimate clearly identifying any non-standard items.

(e) Procurement strategy.

(f) Outline development appraisal.

**Stage 2 - Definitive Appraisal Stage**

(a) Copy of site lease or other title acceptable to IDB.

(b) Detailed architectural, structural, civil, M & E and landscape drawings.

(c) Detailed specifications in relation to all building and services installations.

(d) Tender documentation including Tender Forms, tender reports and competitively priced Bills of Quantities for main contract building works and Schedules of Works for main sub-contract packages.

(e) Details of consultants appointments and fees.

(f) Details of funding arrangements.

(g) Details of sale or letting agreement.

(h) Evidence of statutory approvals and details of associated fees.

(i) Quotations from utilities in respect of standard supplies.

(j) Development appraisal to be agreed with IDB.

(k) Execute the lease, Development Agreement, Debenture and all other legal documentation.

**Stage 3 - Final Assessment Stage**

(a) Certificate of Practical Completion.

(b) Certificate of Making Good Defects.

(c) Final Certificate and detailed Final Account complete with full supporting documentation including Architects Instructions, major sub-contract accounts etc.

(d) Invoices and paid receipts for all other eligible expenditure e.g. professional fees, statutory fees, utilities charges etc.

(e) Bankers, Auditors or equivalent certification in respect of financing.

(f) Confirmation from the developer’s Health and Safety Planning Supervisor that all CDM requirements have been complied with.

(g) Verification of the execution of the sale or lease agreement upon completion and any subsequent assignments during the control period.

# COMMITTEE FOR FINANCE AND PERSONNEL
# INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## DEPARTMENT OF FINANCE AND PERSONNEL

11 April 2001

## PART 1

### LAND REGISTERS NI AND SYNTEGRA (BT) PFI PROJECT

#### General

The Land Registers (NI) is responsible for registering estates throughout the Province and holds hundreds of thousands of records proving ownership of property and land with precise boundaries and rights. It plays a key role in the conveyancing process when property is exchanged and records updated. The purpose of the project is to use a modern Geographical Information System (GIS) and databases to process all transactions on the Land Register more efficiently with the aim of reducing customer fees, turn around times and improve the quality of service.

The contract between Land Registers NI and Syntegra (BT) was the first financially free standing IT project in the PFI/PPP field. It won the coveted prize in the 'IT Winner' category at the PFI Awards 2000. The PFI Awards are the industry's benchmark, recognising innovation and excellence in the Private Finance Initiative. A select group of PFI experts from across the industry made up the panel and deemed the LRNI project to be outstanding and an example of the transformational effects of PFI.

The innovative nature of the project will give Land Registers the capacity to extend registration of title throughout Northern Ireland, thus increasing the amount of land information available to the public. It will also enable information to be provided and accessed electronically, will reduce turn-around times, improve performance quality, and, lend to a greater reduction in registration costs. As a financially free standing project, Syntegra are only paid once the service is operational and work is satisfactorily completed. The majority of risk therefore rests with Syntegra. This reflects the genuine partnership element of the project and is a win-win arrangement for both parties.

The Committee's questions and answers are listed below.

**REQUEST FOR INFORMATION (1)**

**Question**

**Number**

Q1. What doe you see as the benefit of PPP/PFI? Are there identifiable benefits to the public and stakeholders?

A1. Key benefits are that there is no public sector investment and the risk is transferred to the private sector. Access to expertise. Development of new services (eg internet based).

Q2. What do you see as the key factors for the successful application of PPP/PFI?

A2. Partnership. Relationships. Trust.

Q3. Are there any issues, limitations and constraints associated with the environment of the PPP/PFI that have to be addressed? Are there gaps in the supplier market base? Are the skills and guidance available?

A3. High bidding costs for private sector, particularly applicable to unsuccessful bidders. Lack of expertise and experience of PFI projects in NI (eg no local legal expertise available). Firms reluctant to become involved in too many PFI/PPP projects because of risks involved. Skills and guidance available (eg Treasury Taskforce documentation, local courses run by Consultants).

Q4. How should the strategic importance and prioritisation of PPP/PFI projects, and the inter-relationship with other schemes, be assessed and managed?

A4. There could be inter-relationships between separate schemes (eg same customers). There is a need for a global perspective to ensure that elements of the delivery of service are not duplicated (ie principles of joined up government).

Q5. Are there any particular social factors that should be assessed and managed and how have PPP/PFI schemes impacted on them?

A5. Not in relation to the LRNI scheme, but yes in relation to the health and education sectors for example.

Q6. What alternative procurement options do you believe should be considered?

A6. Doing it in-house. Contracting out. Privatisation. Leasing.

Q7. How do you suggest PPP?PFI should be taken forward in Northern Ireland?

A7. All major public sector capital investments must robustly demonstrate that PFI/PPP has been considered.

Q8. What are the feasible alternative forms and structures of financing?

A8. Shared capital investment. Financially free standing (ie payment on delivery of services – transaction based).

Q9. What do you see as the economic basis of PPP/PFI?

A9. Reduction in public expenditure. Possible better return for investment.

Q10. How can value in relation to capital investment and service improvement best be assessed?

A10. No increase in costs of service to customers. Improved Service.

## REQUEST FOR INFORMATION (2)

**Bid Process**

Q1. Were the output objectives of the project clear and established in relation to needs? Did any of the objectives stray into inputs and delivery mechanisms?

A1. Objectives clear. Procurement was via the negotiated procedure route which enabled objectives to be amended as we proceeded.

Q2. How good was the specification of requirements compared with implementation and operational reality? Please summarise the differences?

A2. Service still being implemented. To date stages delivered have met specification.

Q3. Did the project benefit from any initial enquiries into private sector interest and were potential areas of innovation identified?

A3. Yes, tested a range of potentially interested parties (eg Law Society, Council of Mortgage Lenders, locally based computer companies). Innovation areas were identified. Draft proposals were submitted and incorporated in the outline basis case.

Q4. What areas were identified for risk transfer?

A4. Solution development. Back conversion of data. Archive services.

Q5. What were the evaluation criteria used and how were they applied? In particular how were risks and variants assessed in the ranking of bids?

A5. An evaluation model was developed by Consultants which related to the statement of service requirement.

Q6. What were the key features of the business case?

A6. Affordability. Value for money. Innovation. Opportunity to deliver long standing PAC commitments. No staff reduction.

Q7. What were the nature, form and features of the public sector comparator?

A7. Not necessary because proposal was on a financially free standing basis ie no public sector investment.

Q8. What were the skills and expertise recruited into the Project Team and when? Please list the advisers, Contractors and Financing organisations involved?

A8. Technical, financial, management and legal viz Coopers and Lybrand, Price Waterhouse, and McGrigor Donald. They were appointed after approval received for outline business case.

Q9. What were the key contractual issues and when were they identified?

A9. Length of contract. Break option. Payment mechanism. Risk transfer. Access to information for audit purposes. Warranties and liabilities. Compensation payments. Change control. Project milestones. These were identified and discussed during contract negotiation prior to contract signing.

Q10. How realistic was the procurement timetable and tendering requirements?

A10. Timetable realistic. Contract negotiation extended because of the innovative nature of the contract.

Q11. What were the sources and amounts of funding and payments required to deliver the PPP/PFI?

A11. Consultancy costs amount to some £200k to signature of contract. Ongoing technical support throughout implementation.

## COMPLETED DEALS

### Programme Management

Q12. Were the requirements and specification appropriately output-orientated? Did they encourage innovation? Were the quality of service targets and standards required reasonable?

A12. Output orientated – payment only on completion of work. Very innovative – potential to deliver internet based service to our customers in line with Prime Minister's commitment to deliver Government services electronically. The service is not yet fully delivered.

Q13. How valid were the assumptions made in the business case, and how accurate were the initial estimates of project and service costs?

A13. Assumptions were valid. Cost on target.

Q14. How accurate and appropriate were the demand forecasts of the services required?

A14. Too early to assess.

Q15. What were the performance measurement systems and how effective were the associated payment regimes?

A15. Performance Measurement Systems are sufficiently detailed to enable us to perform a satisfactory audit of organisational performance and payments to supplier.

### Financial

Q16. How accurate and complete was the financial model and the assumptions made? What were the estimated financial risks? How did they impact on the deal?

A16. This was a financially free standing project where fees to supplier are dependent on work completed. LRNI receive revenue in advance of delivery of services. This imposes an onus on LRNI to employ sufficient staff to process increasing workloads. Places onus on supplier to deliver system which enables LRNI to process additional workload within staff costs constraint.

Q17. How relevant were the Public Sector Comparator costs to the PPP/PFI?

A17. See No 7 above.

Q18. What assessment has been made of the rates of return payable to banks, providers of equity and subordinated debt and how do these compare with returns on similar projects?

A18. Not relevant.

### Contractual

Q19. How complete, appropriate and enforceable was the contract provisions and what issues and variations were necessary later?

A19. The contract provisions allow for service and agreement change procedures. Data back conversion changes were necessary.

Q20. What risks were allocated in the contract?

A20. See No 4 above.

### Social

Q21. What staff transfer and TUPE issues were present and how were they managed? Are there any lessons to be learnt about consultation with stakeholders and others affected by the PPP/PFI?

A21. No staff transfers involved. TUPE covered in contract. Lessons – Trade Unions need better understanding of this type of arrangement and to be involved in the process from the outset.

### Property and Construction

Q22. What property disposals and gains were included and how did the PPP/PFI benefit from their presence? Were there any clawback arrangements and how would any surplus value be shared in the deal?

Q23. How did the construction costs compare with the estimates in the Public Sector Comparator?

Q24. How well did the construction and property specification match the completed works?

Q25. What is the summary of the findings of any project evaluation report?

A22-25 Not relevant.

# PART 2

## GENERAL OBSERVATIONS ON QUESTIONS 1-10

**Question**

**Number**

Q1. What do you see as the benefit of PPP/PFI? Are there identifiable benefits to the public and stakeholders?

A1. PPP/PFI solutions may offer better value for money because:

a. The various elements of risk associated with a project are better allocated and managed.

b. The private sector has greater incentives to secure efficiency gains compared to the public sector.

c. There is greater likelihood that the full value of assets will be exploited.

d. Totally new and innovative approaches to the provision of the required services may emerge.

Q2. What do you see as the key factors for the successful application of PPP/PFI?

A2. Successful application of PPP/PFI is likely to be realised through:-

- Examining the potential for PPP/PFI within the context of overall priorities and available resources
- Identifying the most promising areas for PPP/PFI and approaching the market with these in the optimum way

There needs to be a clear understanding of requirement, risks and how risks should be allocated between the public and private sectors.

Q3. Are there any wider issues, limitations and constraints associated with the environment of the PPP/PFI that have to be addressed? Are there gaps in the supplier market base? Are the skills and guidance available?

A3. The environment for PPP/PFI is not homogeneous and the approach needs to be tailored to specific circumstances including the institutional and legal frameworks that apply. NI companies are generally smaller in size and may need to form partnerships with GB or international companies to pursue larger PPP/PFI projects successfully. The importance of the issue varies on a case-by-case basis. There is a substantial range of guidance on PPP/PFI available and a growing level of expertise that can be called on. In some cases experience of similar projects in GB is available and may be a valuable practical supplement to the guidance.

Q4. How should the strategic importance and prioritisation of PPP/PFI projects, and the inter-relationship with other schemes be assessed and managed?

A4. PPP/PFI is one of a number of options that are available for procuring services including capital services. The strategic aims is to optimise the fit of these options to the public sector's required need so as to secure the best possible outcome within the constraints of available resources.

Q5. Are there any particular social factors that should be assessed and managed and how have PPP/PFI schemes impacted on them?

A5. Consideration of social/distributional factors (which can differ widely between projects) should be an integral part of developing the business case. Where appropriate TSN considerations may have been taken into account in assessing the priority and specification of a PFI project. However, the social/distributional issues flowing from a decision to proceed or not proceed with a particular project will probably be much greater than those that could be specifically associated with the method of procurement. Also hidden social/distributional factors, which may arise from overall policies that fail to deliver optimum value for money, cannot be ignored.

Q6. What alternative procurement options do you believe should be considered?

A6. In principle the full range of options should be considered in examining the procurement of services. Within PPP/PFI the construction of the Public Sector Comparator provides a guide to the costs of the conventional capital procurement option but where they are available other options should also be considered. Broadly the alternatives are likely to be more conventional forms of procurement requiring all the capital to be sourced from public sector funds (if available). Leasing may be another possibility in some instances, but such an arrangement must not be merely another expensive form of borrowing.

Q7. How do you suggest PPP/PFI should be taken forward in Northern Ireland?

A7. A new high level working group has been announced recently to oversee work on the review of the opportunities for the use of PPP/PFI in all major service provisions/infrastructure projects. This is a commitment within the Programme for Government aimed at increasing investment and to provide innovative and value for money solutions through PPP/PFI. Operational details about the working group are still under consideration. The present policy is that a PPP/PFI solution should be considered and may be adopted where there is a sound case on the grounds of value for money and improved services for doing so.

Q8. What are the feasible alternative forms and structures of financing?

A8. PPP/PFI embraces a variety of financing structures including joint ventures, transaction based payments and projects involving third party revenue streams. Beyond the current PPP/PFI structure the usual alternatives are privatisation of the service or conventional procurement that is a direct charge to public expenditure. However, the raising of loans by Government departments is of no advantage since these are an automatic charge against existing public expenditure provision.

Q9. What do you see as the economic basis of PPP/PFI?

A9. PPP/PFI may offer a more efficient means of allocating scarce resources so resulting in an increase in output and an improvement in material welfare.

Q10. How can value in relation to capital investment and service improvement best be assessed?

A10. The assessment of additional value and service improvement should be an integral part of the procedures for evaluating the outcome of the project. The precise evaluation techniques will vary between projects but may involve establishment of an initial baseline and benchmarking where this is feasible.

**MARK DURKAN MLA**
**Minister of Finance and Personnel**

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## DEPARTMENT OF HEALTH, SOCIAL SERVICES & PUBLIC SAFETY

3 May 2001

Thank you for your letters of 20 March and 3 April, concerning your Committee's intention to conduct a major Inquiry into Public Private Partnerships and an invitation for me or my officials to meet with the Committee.

As you will be aware, my Department faces tremendous pressures in its capital budget. The backlog of maintenance work necessary to properly maintain the existing estate amount to a sum in excess of £200m. In addition there are a number of major new developments which will need to be taken forward over the next few years – eg, Ulster Hospital, the new Regional Cancer Centre. The basic infrastructure of our hospitals and many of our community facilities is in many cases inadequate and we face major problems in replacing and updating hospital equipment and our ambulance fleet. Given these circumstances it is important that I use the resources made available to my Department to best effect, and that in doing so I explore all potential options for securing the necessary improvements.

I am conscious that in considering pubic/private partnerships and the procurement of services through privately financed initiatives, there has to be a genuine transfer of risk if value for money is to be achieved. I am also aware that the costs of such schemes can represent significant revenue commitments for a number of years ahead. For that reason transfer of risk value for money and overall long term affordability are key considerations for my officials in determining the way forward for individual cases. The Private Finance Initiative is one of a range of potential options for making use of scarce resources but it certainly does not substitute private funds for public investment in the long run, and it cannot provide a complete solution to our pressing need for more capital investment.

Since you have written separately to our 4 Boards, 19 Trusts, and the 4 HSS Councils, we have restricted our responses to the Department's overview and to one specific project which was delivered centrally and on a joint North/South basis. The attached Annex sets out my Department 's responses to each of the questions.

I am aware that the Committee has also sought copies of the Full Business Cases for each of the capital schemes which HPSS bodies have completed under the PFI process. I would ask that the commercial aspects of these be treated with some caution and that the Committee inform the Department of any intention to publish extracts which may impact on commercial confidentiality.

Regarding your invitation, while I would be pleased to attend in person, the issues you have set out for examination, I feel, would be more appropriate handled by my officials. They would be best placed to provide the information and input you are seeking, in relation to, technical and detailed aspects such as risk transfer and post project evaluation.

I would be grateful if you could contact Mr Rodney Scott on 90 525082 to arrange a suitable date and time.

**BAIRBRE DE BRÚN**
**Minister for Health, Social Services and Public Safety**

## REQUEST FOR INFORMATION (1)

**General Context of PFI/PPP**

**Q1.** *What do you see as the benefit of PPP/PFI? Are there identifiable benefits to the public and stakeholders?*

**A1.** The main focus for the Minister and the Department must be on providing the highest quality services in terms of health, social care and public safety, in the most cost effective way. In relation to capital investment in assets to support key services, PPP/FI offers an additional option in the business case process, which itself sets out to identify the best available option to resolve an identified need for capital assets to support essential public services.

Historically, the processes for public sector procurement and funding offered little or no opportunity to develop an appropriate allocation and transfer of risk – for example, the risk of construction cost and time overruns. In practice, the service carried all risks, whereas now there is an opportunity to transfer them. It may also provide opportunities for private sector innovation in the use of the assets and the provision of related services. The primary benefit to the public and stakeholders is argued to be in the ability of the public sector to provide better and/or more services for the same outlay, or the same services for less cost, over time. However, there is also the risk that while there may be cost savings in the short-term, as expenditure is shifted from the public to the private sector, in the longer term PFI projects could work out more costly in terms of the relatively high cost of repayments, the high cost of PFI negotiations and the escalating nature of the original costs of projects.

**Q2.** *What do you see as the key factors for the successful application of PPP/PFI?*

**A2.** It is an essential requirement in any PFI project that there should be a genuine transfer of risk to the private sector. To succeed over the publicly funded option, a privately funded solution must offer better value for money, with risk transfer as a significant determinant. Other success factors include a clear strategic context, enthusiastic commissioner support, and proven affordability. However, it should be noted that it is extremely difficult to transfer risk fully from the public to the private sector. Regardless of who actually delivers a public service, it is government which takes ultimate responsibility if something goes wrong.

**Q3.** *Are there any wider issues, limitation and constraints associated with the environment of the PPP/PFI that have to be addressed? Are there gaps in the supplier market base? Are the skills and guidance available?*

**A3.** Although firms here tend to be smaller, the schemes to date have also been relatively modest in size and this has local companies to form partnerships – for example with international manufacturers/providers of specialist equipment – in order to bid successfully for projects.

The Health Service in GB has been at the forefront of PFI from its inception, and a substantial amount of guidance and expertise has been developed which is available to bodies here, providing health and social care. In many cases experience of identical or similar projects in GB is available and can be called upon to assist in the development of local solutions. We can also learn from limitations and constraints experienced there such as the way in which long contracts can reduce the flexibility of the public sector or decide how resources are provided and can limit the ability to switch resources in the future.

**Q4.** *How should the strategic importance and prioritisation of PPP/PFI projects, and the inter-relationship with other schemes, be assessed and managed?*

**A4.** PFI is one potential solution to a need to procure services, including capital assets. The Health and Social Services have a well developed capital investment process. The first stage of any proposal for capital investment is a strategic context which demonstrates underlying service need and priority. The second stage (the Outline Business Case) examines the options and associated costs and benefits and identifies a preferred solution. At this stage the scope for a PFI solution is considered. Where a PFI solution emerges from a process of investigation, following up expressions of interest, tendering and negotiation, this is then presented in a Full Business Case demonstrating value for money and risk transfer, against the publicly-funded option (the Public Sector Comparator). All projects are required to be agreed with Commissioners (normally the relevant HSS Board) at all stages, and except in the case of minor schemes, submitted to the Department for approval.

**Q5.** *Are there any particular social factors that should be assessed and managed and how have PPP/PFI schemes impacted on them?*

**A5.** Consideration of any social factors (which can differ widely between projects) is an integral part of developing the business case. The Business Case and assessment of priority must take account of TSN issues. This is also reflected in the specifications for the project. One concern is the possible adverse impact on the pay and conditions of workers, the majority of whom, in the health service, are women. Apart from the equality aspect, there could be a knock-on effect on morale.

**Q6.** *What alternative procurement options do you believe should be considered?*

**A6.** In practice the full range of options should be considered in examining the procurement of services. Within PFI the construction of the Public Sector Comparator provides a guide to the costs of the conventional capital procurement option, set against the PFI proposal. Other options will also be considered. New configurations of the established PFI model are being explored – for example, in England the NHS LIFT proposals involve setting up a joint public/private company to invest in Primary Care premises in deprived areas. More generally it is important that alternative sources of capital funding are examined. This may entail political considerations on such matters as the Treasury rules; which currently disallow public bodies from borrowing from institutions such as the European Investment Bank and at preferential rates. There have also been discussions in the political sphere on the question of tax. raising powers for the Assembly or the issue of government or Assembly bonds. Experience in the US and GB may be of interest in this context.

**Q7.** *How do you suggest PPP/PFI should be taken forward in Northern Ireland?*

**A7.** The Department is alert to any opportunity whereby the services for which it is responsible can be enhanced through capital investment. Within those opportunities, PPP/PFI is accepted as providing one of a number of options. The Department is also aware of developments elsewhere and considers that it is not in a position to unilaterally develop the policy. However, in co-operation with its agents bodies, and liaising with other Departments here and the Health Service in GB and the South of Ireland it can take advantage of shared information, of the lessons learned in applying the policy and of possible ways to improve the process and apply it in more imaginative ways.

**Q8.** *What are the feasible alternative forms and structures of financing?*

**A8.** Bearing in mind our answer to question 6, PFI provides a range of financing structures including joint ventures and third party revenue streams. Apart from the direct application of public funds, there are no clear alternatives to these methods. The main model within the HPSSPS is a unique service to the public, free at the point of delivery, and there is no prospect of privatisation of core services.

**Q9.** *What do you see as the economic basis of PPP/PFI?*

**A9.** A PFI solution may, as a result of the business case process, be demonstrated as providing the most efficient use of scarce resources to increase or maintain health, social care and public safety services, thus contributing to the welfare of the population.

**Q10.** *How can value in relation to capital investment and service improvement best be assessed?*

**A10.** Arrangements for post-project evaluation are a feature of the Business Case process. Formal evaluation reports are required for all major schemes. Precise evaluation techniques will vary between projects but the benchmark will normally be the objectives set out in the Business Case.

## REQUEST FOR INFORMATION (2)

**Specific Projects and Programmes**

**Note:**

Within the Health, Social Services and Public Safety structure, services are normally provided by HSS Trusts, some HSS agencies, and the Fire Authority. These bodies normally own and manage their own assets and consequently devise, deliver and manage new capital investment. The Department has, to date, been involved directly in only one PFI projects – the regional clinical waste project. The responses below are in respect of that project.

## JOINT NORTH SOUTH CLINICAL/HEALTHCARE RISK WASTE PROJECT

This project was tendered under the rules in the European Directive for a Services Contract and is not wholly a PFI/PPP agreement. However, as a number of the issues in the contract are common to a PFI/PPP agreement the questions have been answered in that context.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

### WRITTEN SUBMISSION BY:
### DEPARTMENT OF HIGHER & FURTHER EDUCATION, TRAINING & EMPLOYMENT

23 April 2001

You wrote to me on 20 March seeking my Department's views on the use of Public and Private Partnerships (PPP), including Private Finance Initiatives (PFI) to finance and provide public sector services and infrastructure improvements in Northern Ireland.

My Department tests the value for money potential of the Private Finance Initiative in relation to all major infrastructure renewals within its area of responsibility. Three contracts have been signed to date, the North West and Belfast Institutes and the Department's IS/IT Project. A further two projects, the Tyrone Colleges bundled project which will provide new colleges in Omagh and Dungannon and the Main Campus of the Springvale project, are currently undergoing the PFI test. A further project, to provide new City Centre accommodation for the Belfast Institute to replace its College Square East and Brunswick campuses, is at an early stage.

The two PFI projects which have been signed by the Further Education sector were run as part of the DENI Pathfinder project which involved four schools and the North West and Belfast Institutes. The experience and expertise in relation to how these projects developed rests mainly with officials in DE.

Your request asks for information under two main headings. Annex A attached sets out responses to the questions raised in Part 1 of your enquiry. Annexes B and C contain information relevant to Part 2.

I hope this is helpful.

**DR SEAN FARREN MLA**
**Minister for Higher & Further Education,**
**Training & Employment**

# ANNEX A

## INTRODUCTION

The principal aim of PFI is to involve the private sector in the provision of public services, shifting the role of the public sector from owner and provider to enabler and purchaser and guardian of the interests of the end-users, the general public. The traditional procurement of public sector infrastructure and its related services, where Government is the asset owner and operator, has been supplemented in appropriate circumstances by the private sector assuming responsibility for design, construction, operation, management, maintenance and finance, with the public sector as the customer.

## CURRENT POLICY

The policy of the Department of Higher and Further Education, Training and Employment is to test the value for money potential of the Private Finance Initiative for all major infrastructure renewals within its area of responsibility. Three contracts have been signed to date and another two projects are currently being tested. So far, none of the Department's projects have failed the PFI test.

## PERCEIVED BENEFITS OF PFI

- It enables services to be provided earlier or on a greater scale than would be the case under normal procurement.
- It provides maximum opportunity to benefit from private sector innovation and management skills to deliver cost-effective management, operation and development of the further and higher education estate.
- It spreads the capital costs over a longer term, typically 25 to 40 years, offering the prospect to Government of funding more major projects in the short-term.
- It enables full schemes to be progressed, rather than a phased approach stretching perhaps over many years.
- It guarantees a pre-determined level of maintenance and facilities management services for the duration of the contract.
- Substantial elements of risk in relation to the provision and maintenance of accommodation and services are carried by the private sector.
- Allows the management of Universities and Colleges to devote more time to the core business of providing education and training.

## PFI: DISADVANTAGES

- There are significant long-term contractual commitments, with some loss of budgetary flexibility.
- The PFI procurement process is a complex procedure and can be labour intensive.
- A high level of consultancy support is required to provide the specialist expertise to progress the projects. Consultancy costs can reduce scope for improved value for money in PFI projects.
- There is no guarantee that a PFI option will always provide the best value for money.
- VAT is payable in full on the PFI unitary payment and has budgetary implications for both college and Department. [In a conventional procurement, a new build scheme is normally zero rated for VAT.]

## ENSURING VALUE FOR MONEY - THE PUBLIC SECTOR COMPARATOR

To confirm that value for money can be achieved, the awarding authority will, as part of its preparatory work, develop an outline business case comparing PFI and other options for meeting its needs. An outline business case will include a fully costed reference project or public sector comparator (PSC) <u>which tests whether an affordable investment option exists</u>. The PSC shows the cost to the public sector of providing services within the scope of the project, to the standard that it is proposing to buy through the normal procurement. It is used for an initial affordability test and is the comparator against which value for money for the PFI project will be judged at final contract negotiation stage. The PSC is refined throughout the PFI procurement process to take account of unforeseen changes and of new risks identified and to confirm it remains robust.

## EMPLOYEES TRANSFERRING FROM THE PUBLIC TO THE PRIVATE SECTOR

PFI projects can involve the transfer of employees from the public to the private sector. In the two further education sector projects non-teaching staff have transferred to the private sector. Employees transferring from the public to the private sector were protected under the Transfer of Undertakings & Protection of Employment legislation. There were no staff transfers in the Department IS/IT Project.

# ANNEX B

## FURTHER EDUCATION PFI PROJECTS

The following provides an outline response on the questions raised in the request for information (2). The paragraphs below correspond with the numbering of the questions. The North West college accommodation has only been available to the college sine February 2001 which means it is too early to make judgements in relation to a number of the questions. The Belfast Institute project is at an even earlier stage, accommodation will not be available until September 2002, so again it is too early to make judgements in relation to a number of the questions.

## BID PROCESS

1. The project specifications for both pathfinder projects were very much output based and were framed to meet the accommodation and service needs of NWIFHE and BIFHE while leaving scope for private sector innovation. The output specification was formalised into availability requirements and service requirements, both of which are included in the Full Business Cases.
2. Too early to judge.
3. Yes – the initial market sounding identified whether each project was likely to be successfully procured via the PFI route and thus reduced the risk of nugatory procurement expenditure. The market sounding does give an opportunity to the private sector to identify whether innovative solutions are possible in service delivery and accommodation needs. However, the market sounding exercise is aimed primarily at identifying market interest and it is unlikely that at that stage potential private sector parties would reveal their hand in terms of the actual innovative approaches which they may later propose.
4. These are set out in full in the FBCs for each project but are broadly, design, construction, operation, financial and to a lesser extent legal and regulatory.
5. Bids were objectively assessed against pre-determined criteria formulated to reflect output requirements in respect of the following key areas – technical, legal, financial and design. The scoring team had access to the appropriate technical advice. A weighting and scoring approach was adopted.
6. The business cases – both FBC and OBC were in line with treasury and DFP requirements.
7. The Public Sector Comparator reflected validated costs associated with the preferred public sector option/approach and included a valuation for transferred risk.
8. In broad terms, the project teams had access to Commercial, Financial, Legal and Technical advice and support. Support was also provided by in house departmental economists, technical advisors (BAB – Building Advisory Branch) and the education and training inspectors. A list of advisors, contractors and financing organisations is available but as this information is commercial in confidence the Department will require their consent prior to release of this information.
9. The key contractual issues included the Payment mechanism (particularly in relation to the security of payment under a range of scenarios), Design and Construction, Equipment Maintenance and Services, Employment Issues, Default and Termination and Dispute Resolution Procedure. These issues were identified and acted upon early in the process.
10. The procurement timetable was optimistic but this was partly due to the pathfinder status of the projects and the private sector contractor failing to obtain planning permission at an early stage.
11. The Department provided consultancy funding of £928k for the Belfast and North West projects. The level of consultancy costs required was related to the pathfinder nature of these particular PFI projects.

## COMPLETED DEALS

12. See 1 above. An innovative approach is also indicated by the fact that the final agreed solution differed quite significantly from the preferred public sector approach.

13. The PSCs did not change significantly over the period of PFI procurement. This reflected the robust technical advice and scrutiny to which the PSC had been subject at an early stage.

14. Too early to say.

15. Performance measurement systems were drawn up in line with HMT guidance but it is too early to say how effective the associated payment regimes were.

16. The banks tend to place the bidders financial model under intense scrutiny, which provides comfort, and it is also scrutinised by the Project Board's appointed financial advisors. Financial risks – eg indexation of payment mechanism – are required to ensure off-balance sheet treatment of the deal.

17. The Public Sector Comparator is extremely relevant as it provides the benchmark against which value for money potential can be measured.

18. The Department has collated a long-term series of swap rate data. It would appear that compared to PFI projects in GB the banks' required rates of return for PFI pathfinder projects are slightly higher in NI. However this could reflect the fact that at that stage the NI PFI market was in its infancy (perceived risk should reduce, as banks become more accustomed to dealing with PFI in Northern Ireland). Also larger bundled projects are likely to be more attractive to banks and money markets due to economies of scale and wider range of financial instruments available, eg bond markets etc.

19. Too early to say but the contract does have a dispute resolution procedure. This procedure provides for disputes to be handled by a panel of adjudicators, for construction, operational and financial matters, which are wholly independent of the Operator, the Institute the relevant sub-contractor and any of the major competitors of the relevant sub-contractor.

20. Broadly similar to answer 4.

21. Security, Attendant Portering, Caretaking and Cleaning staff transferred as part of the North West contract. These transfers were effected under the Transfer of Undertakings & Protection of Employment (TUPE) legislation and appear to have gone smoothly. The staff employed by the Institute were identified and dealt with at an early stage in process while others employed by the Education and Library Board whose staff had a right of transfer were not identified until later. The Institute advises us that a constant updating of staff affected by the transfer in-house and external is essential to allow the contractor to agree exact terms for individuals in relation to conditions of employment.

22. In both projects, the Belfast and North West Institutes, surplus land was disposed of and the proceeds used to offset part of the capital costs of providing the new accommodation. This had the effect of reducing the Unitary Payment. Profit sharing arrangements, with appropriate safeguards, were built into these deals to ensure that any excess profits, arising from any subsequent disposal, would be shared between the Contractor and the Department. In the case of the North West Institute the property has since been sold on at less than the threshold price.

23. Too early to say but the deals and bidders financial models did reflect the principle of full life costing.

24. The completed building is considered by the Department and by the Institute to have achieved the standards set in the construction and property specification.

25. Too early to say.

# ANNEX B - APPENDIX 1

**CURRENT DHFETE PFI SCHEMES**

**North West Institute (NWIFHE) –** The contract with the private sector contractor, Northwin Ltd, was signed at August 1999; it will provide, over 25 years, for accommodation and related services for the North West Institute. The new building will be the Institute's main campus on the Strand Road in Londonderry and will provide 7,500 sq ms of purpose-built accommodation. The new building has been available to the Institute since February 2001.

**Belfast Institute (BIFHE) –** The contract with the private sector partner, Northwin Ltd, was signed in July 2000; it involves the closure of the dilapidated Ormeau campus, with courses transferred to new accommodation at the Millfield campus. The target date for the occupation of the new accommodation is September 2002.

**Omagh and East Tyrone** – Project capital costs are approximately £30m to provide new colleges in Omagh and Dungannon. The Outline Business Case (OBC) has been prepared and has been submitted to the Department of Finance and Personnel for approval. Permission has also been sought, if the OBC proves positive, to proceed to procurement.

**Springvale –** This is a joint project, between the Belfast Institute of Further and Higher Education, to provide a Community Outreach Centre, and Applied research Centre and a Main Campus for the provision of Further Education/Higher Education courses. The total cost of the project is £70.7m with Government putting up £40m towards the cost of the £58m Main Campus. The University of Ulster and BIFHE are raising the remaining £30.7m. The Department has received the necessary assurances that the £30.7m is in place and are in the process of agreeing the final details of the letter of grant and associated memorandum. When the PFI Project Board and Project Team have been established tenders will be invited for the appointment of consultants to prepare the Outline Business Case.

# ANNEX C

**DEPARTMENT'S IS/IT PFI CONTRACT**

**INTRODUCTION**

This Annex provides information specific to the Department's IS/IT PFI contract. The paragraph numbering follows that used in the "Request for Information (2)" attached to Mr Molloy's letter of 20 March.

**BID PROCESS**

1. The output objectives for the project were very clear and were established in relation to business requirements which the newly procured IT systems were to meet. The Statement of Service Requirements (SSR) which formed the basis of negotiations with bidding service providers, was a very detailed document that was almost wholly based on outputs rather than inputs. A copy of the SSR can be made available if required.

2. The content of the SSR has compared favourably with the service that was eventually delivered. One of the main reasons for this was that the SSR was used as the basis for negotiations with service providers, and through these negotiations the formal contract between the Department and the winning bidder emerged. The most significant difference that occurred reinforces the point made at 1 above that the SSR was an output driven document. This change was a very different technical approach to one important aspect of the project that was agreed between both parties after contract signature. The underlying business need (output specification) was the same, but the method of delivery (input) changed.

3. At the very outset of the project (ie before advertising in the Official Journal of the European Community – OJEC) a *Market Sounding* exercise was conducted separately with 3 IT companies to ascertain if the project scope would stimulate interest in the context of a PFI procurement. The unanimous view was that it would. Potential areas of innovation were not addressed as a major issue at this stage in the project.

4. Section 10 and Appendix D of the business Case for the PFI project provides detailed information on risk transfer. However, in summary, the risks that were allocated between the two parties were in the following areas: design, construction, operation, regulation, legal and finance.

5. Detailed evaluations took place at each major stage of the PFI procurement process as follows:
   - Responses (9) to the "Pre-Qualification" process which followed the OJEC advertisement;
   - Responses to the SSR (3); and
   - Responses (2) to the Best and Final Offer (BAFO) process.

   Attached at Appendix 1 is a copy of the evaluation model for BAFO, as it is the most significant part of the project evaluation process. In the end, the issue of variant bids was not a significant factor in the procurement process.

6. The main underlying feature in the business case was that it was based on increased productivity resulting from the IT provided rather than on staff savings being delivered. This approach was accepted through the business case approval process.

7. A Public Sector Comparator (PSC) was not constructed for this project. While commenting on the lack of a PSC, DFP approved the business case. This was one of the earlier PFI projects.

8. The consultants who advised on the project were as follows:
   - Technical ] Deloitte and Touche (Lead Consultants)
   - Financial ] ASE
   - PFI Procurement Process ]
   - Legal ] Dibb Lupton Alsop

9. The key contractual issues included the following:
   - whether or not to use GB's Labour Market System (LMS) as part of the overall IT solution – ultimately the decision was not to;
   - whether or not to include a pre-determined (and bid) annual price increase – this was included in the contract;
   - whether or not to include a minimum or maximum approach to "technology refresh" – the overall approach taken was that the service provider would be responsible for ensuring that service levels continued to be met, and that technology refresh would be carried out as and when appropriate to ensure that this was the case;
   - whether to pay quarterly or annually in advance – the decision was taken to pay annually in advance, for which a discount was negotiated; and
   - whether to choose a 7 or 10 year contract – a 10-year contract was awarded, for which a slight cost reduction was negotiated.

10. The procurement process took almost exactly two years from OJEC advertisement in May 1996 to award of contract in May 1998. The main lesson learned from the procurement process was that the OJEC advertisement was issued too soon ie before the development of the SSR was sufficiently well advanced. The project itself could probably not have been much accelerated, but bidders could have been involved for a shorter period of time – perhaps by as much as 6 months. It should be noted that this was the first IT PFI project in Northern Ireland and model contracts were not available then to the extent that they are now. This also had the effect of lengthening the procurement process.

11. In addition to internal staff time, the total cost of the consultancy support identified at 8 above was £258,632. Existing internal staff were used, and consultancy was paid from existing IT consultancy and maintenance budgets.

**COMPLETED DEALS**

12. Yes, as indicated above the SSR was almost totally output orientated. Innovation was certainly not discouraged, but the requirement was for reasonably "traditional" IT services. The service level targets are also reasonably standard to the IT industry, and are based around system availability targets and system performance targets in terms of response times. There is also a "service credit" regime associated with selected service level targets. The service level targets and associated service credits are detailed in the PFI contract's "Service Levels and Service Credits" Schedule.

13. The PFI contract has two main volumetric service charges as follows:

    (i) one of the main operational IT system (the Client Management System – CMS). this volumetric charge is based on the number of concurrent user licenses for this business critical software. The charge is currently set at 450 concurrent users; and

    (ii) a "desktop" charge which covers most of the remainder of the services provided under the PFI contract, including the provision of PCs, printers, central and local servers, data communications capability, and Office Productivity Services (including the Microsoft Office suite of software and e-mail). this charge is currently set at 1,200 desktops.

    As part of the volumetric risk transfer inherent in the Accounting Treatment of the PFI "deal", a sliding scale of charges was negotiated for each of the above 2 service areas. Effectively this means that the charge associated with any increase or decrease in the number of users of either or both of the above services can be calculated immediately. This charging mechanism means that the basis for service charges under the IT PFI contract was known at the outset, and has remained constant throughout the operation of the contract.

    There are a number of small additional charges for other IT services delivered through the PFI contract's *Change Control* mechanism. These include general technical support services such as equipment moves, making IT systems available outside of office hours, and a variety of ad hoc IT services. These types of service are demand led, and tend to be less predictable.

14. From a **volumetrics** point of view, the contract was originally based on 500 users, although the business case option selection allowed for the services provided through the PFI contract to be extended to other business units, and the sliding scales referred to above provided a basis for calculating the new level of service charge that was appropriate. Expansion to the current user base of 1,200 was a combination of increases that were

anticipated at the business case stage (primarily to known Headquarters based business units), and staff increases resulting from the introduction of the New Deal Programme and the formation of the new Department of Higher and Further Education, Training and Employment (the original PFI contract covering only the Training and Employment Agency). From the point of view of the actual **IT services provided** through the PFI cotnract, the current requirement (which has been delivered) is very similar to the requirement as outlined in the original SSR.

15. The PFI service provider produces monthly *Performance Monitoring Reports* which report against all service level performance targets and the associated service credit regime in the PFI contract. These reports are reviewed at the monthly *Service Review* meetings between the provider's and the Department's respective contract management teams. The payment regime is based largely on the two service charges outlined at paragraph 13 above and are, therefore, reasonably stable and straightforward to manage. However, in addition to informing the service credit regime, the performance monitoring reports enable the additional ad hoc service charges to be monitored.

**FINANCIAL**

16. The main financial issues that were addressed in the contract negotiation process were how financial risk would be transferred to the supplier in a way that enabled the "deal" to be treated as off the Department's balance sheet from an accounting point of view. It was these considerations that were instrumental in the development of the two sliding scales that governed the two main service charges outlined at paragraph 13 above. These sliding scales enabled financial and volumetrics risk to be transferred to the service provider. This was a highly complex area of the negotiation process, and as well as involving the Northern Ireland Audit Office (NIAO) in the considerations, the Department's PFI Financial Advisers (Deloitte and Touche) conducted a very detailed analysis. This analysis culminated in a detailed Accounting Treatment report that was approved by their experts in England before being furnished to the Department and the NIAO.

17. As indicated at paragraph 7 above, a PSC was not constructed for this PFI project.

18. This question is not relevant to the IT PFI project.

**CONTRACTUAL**

19. The PFI contract has proven in practice to be complete, appropriate and enforceable. The main variation required was a new technical approach that was required for one specific area of the service provision – already referred to at paragraph 2 above. This has been handled through the "Change Control" mechanism established in the contract. The other main variation was in the increase in users and, as described above, the sliding scales in the contract's charging mechanism handled this scenario very easily.

20. The risk allocation in the contract is referred to at paragraph 4 above.

**SOCIAL**

21. TUPE was considered in the context of the PFI contract negotiations. The only staff potentially effected were the internal technical team (the Information Systems Unit – ISU). These staff were effected because their jobs were being outsourced under the PFI contract. As there were less than 20 staff involved, the Department agreed with the bidding suppliers that the staff would be given the option of joining the PFI supplier. As it turned out, none of the staff took this option, and were re-deployed to ISUs in other Departments.

**PROPERTY**

22. This was not a consideration in the IT PFI project.

**CONSTRUCTION**

23. As there was no PSC, this question is not relevant to the IT PFI project.

24. This is not particularly relevant to the IT PFI project. However, the IT systems provided are a very close match to the requirements specified in the SSR.

25. The project is at a reasonably early stage in its implementation, and formal evaluations have not as yet been completed. However, the attached Appendix 2 provides information on the major achievements of the Department's PFI project to date.

# ANNEX C - APPENDIX 1

## EVALUATION PROCESS FOR BEST AND FINAL OFFER (BAFO) RESPONSES

**CONTENTS:**



**ANNEXES**

**T&EA'S IS/IT PFI PROJECT - EVALUATION PROCESS FOR BAFO RESPONSES**

**1.0 Purpose**

**1.1 The purpose of this paper is to document the process which will be used by T&EA to evaluate BAFO responses in relation to its IS/IT PFI Project.**

**2.0 Elements of the Evaluation**

**2.1 The main elements of the evaluation will be as follows:**

(i) Completeness Check;
(ii) Equalisation Analysis;
(iii) Financial Evaluation;
(iv) Qualitative Analysis; and
(v) Recommendation

2.2 Elements (i) to (iii) and (v) will form the core of the evaluation. Where this level of evaluation produces a close result, element (iv) will be introduced to the evaluation process. A close result is defined as one where the difference between the total NPVs is less than 10% of the less expensive bid.

2.3 As outlined to bidders in Annex D to the BAFO invitation, the overall aim of the evaluation process is to select the bidder whose BAFO provides the economically most advantageous solution to the Agency over the period of the contract. The evaluation will be conducted on the basis of both a 7-year contract and a 10-year contract.

2.4 The BAFO invitation is attached as Annex A to this paper.

**3.0 Completeness Check**

3.1 The first element in the evaluation process, the completeness check, will be to confirm that:

(i) the BAFO response has been received no later than 3.00 pm on Friday 12 December 1997;

(ii) 10 bound copies and 1 unbound copy have been received;

(iii) the BAFO response is structured as requested at paragraph 1 of Annex C to the BAFO invitation; and

(iv) all of the information requested in the BAFO invitation has been provided – the checklist attached at Annex B to this paper will be used for this purpose.

3.2 Bidders not complying with (i) above will be automatically disqualified from the procurement.

3.3 However, the Agency reserves the right to request from bidders information which has been omitted from the original BAFO response and/or to request additional information which it feels is necessary to conduct the evaluation.

**4.0 Equalisation Analysis**

4.1 The purpose of this element in the evaluation process is to identify areas of the proposals as set out in the BAFO responses where differences exist, and to analyse which, if any, of the differences need to be adjusted to ensure that the bids can be compared on a "like for like" basis. The aim of this aspect of the evaluation is not to equalise out areas of proposals which offer distinctive value to those proposals, but is to ensure that proposals against the Agency's core requirement are evaluated on an equal basis. The aspects which will be included in the equalisation analysis may include, but will not be restricted to, the following:

- dealing with different presentation of information particularly costings;
- dealing with items on bidders' risk registers;
- the extent to which financial and operational risk has transferred to the bidders;
- assumptions made by bidders; and
- variant bids.

4.2 The equalisation analysis will also aim to evaluate information provided in the BAFO responses which is not directly quantitative in nature, or which has been provided to supplement related quantitative information.

An attempt will be made to quantify such information, but where this is not possible it will be dealt with as part of the qualitative analysis, if that element of the BAFO evaluation is used – see section 6 below. The information which is likely to be examined under this analysis will include, but may not be limited to, the following:

(a) approach to open book accounting;
(b) approach to European Monetary Union (EMU);
(c) improvements to service levels;
(d) approach to measuring service levels;
(e) estimating and development methodologies for CMS development;
(f) approach/options to third party organisations with whom the Agency contracts;
(g) alternative revenue streams;
(h) approach to encryption;
(i) approach to user training;
(j) information provided in the management summary to the BAFO responses;
(k) approach taken to optional services; and
(j) additional information which bidders may provide.

**5.0 Financial Evaluation**

5.1 The financial evaluation will be the primary quantitative element of the BAFO evaluation and will comprise of the following five stages:

1. Affordability Analysis
2. Access to finance
3. Risk Transfer Analysis
4. Value for Money (VFM) Analysis
5. Sensitivity Analysis

One to three above are tests which each bid must successfully meet, four is the main financial distinguisher, and five enables certain confirmations to take place.

5.2 Each stage is described more fully in the remainder of this section 5.

**5.3 Affordability Analysis**

5.3.1 The objective of the affordability analysis will be to ensure that the preferred bid can be funded within he known financial resources and financial profile available to the Agency. The analysis will consider:

- affordability vs PES plans; and
- affordability vs DRC commitments

The financial model used in the affordability analysis will consider both supplier costs and Agency costs, will be on a real (ie non Discounted Cash Flow) basis and will consider the timing of costs and benefits.

**5.4 Access to Finance**

5.4.1 This aspect of the evaluation will focus on the bidders' proposed method of funding the project throughout the period of the contract. The evaluation will take account of information already provided by bidders at the Pre-qualification stage of the procurement and will analyse information provided in the BAFO responses. The Agency reserve the right to request additional information in this area from bidders if necessary.

**5.5 Risk Transfer Analysis**

5.5.1 In order for proposals to be acceptable to the Agency, they must as a minimum meet Treasury requirements for off-balance sheet financing. This part of the financial evaluation process will be geared towards assessing the bids in terms of Treasury guidance on this issue.

5.5.2 This part of the evaluation will concentrate on establishing, firstly, that the capital cost of underlying IT equipment is less than 90 per cent in NPV terms of the total cost of the transaction. If this criterion is met, an examination of the risks during the operating phase of the contract will then be undertaken concentrating on the following key risks:

- demand risk

- availability and performance risk
- pricing risk
- residual value risk
- operating cost risk
- design risk

5.5.3 As a result of this evaluation an opinion will be formed as to whether or not the transaction can be accounted for off-balance sheet.

**5.6 Value For Money Analysis**

5.6.1 The objectives of the VFM analysis will be to fold:

i. to reflect the bid which offers the optimum value for money; and
ii. to ensure that the preferred bid offers value for money relative to the reference bid.

The primary basis for assessing value for money will be the development of a Net Present Value (NPV) for each bid in accordance with current HM Treasury guidance. NPVs will be calculated for each bid following any adjustments made under the equalisation analysis – paragraph 4 above.

5.6.2 The NPV model used will incorporate both costs incurred through the service contract and associated costs to the Agency.

Decision Rules

5.6.3 The preferred bid arising from the VFM analysis will be the bid offering the higher overall NPV (lower NPC) providing that the bid offers VFM relative to the reference bid. In determining whether a bid offers VFM relative to the reference bid both NPV and risk transfer issues will be considered.

**5.7 Sensitivity Analysis**

5.7.1 Both the VFM and affordability analyses will be subjected to sensitivity analysis to understand the likely impact of key uncertainties and scenarios.

5.7.2 The scenarios to be examined may include but will not be restricted to:

- length of contract variations;
- timing of service payments;
- approaches to technology refreshment; and
- treatment of inflation assumption.

**6.0 Qualitative Analysis**

6.1 As indicated at paragraph 2.2 above, this element of the BAFO evaluation will be used only if the other main elements of the evaluation process produce a close result.

6.2 This qualitative analysis will take into account a number of unquantifiable elements including, but not limited to, the following:

(a) quality of the BAFO response;
(b) relevant experience (both Public and Private Sector);
(c) estimating credibility;
(d) bidders' consortium experience;
(e) cohesiveness of the bid;
(f) partnership relationship with the Agency;
(g) company ethos;
(h) personnel policies;
(i) quality – bidder certification;
(j) responsiveness; and
(k) references.

6.3 Where appropriate the qualitative analysis will be informed by relevant parts of evaluations carried out in earlier stages of the procurement process, namely;

- Pre-qualification;

- High Level Statement of Service Requirement (HLSSR); and
- Statement of Service Requirement (SSR)

**7.0 Recommendation**

7.1 The evaluation process outlined above will be carried out by a "core evaluation team". This team will be comprised of key members of the PFI project's Project Board including:

- the project manager;
- a T&EA business user;
- an SSA business user; and
- the project's consultant team.

7.2 The core evaluation team will recommend a procurement winner to the "senior management evaluation team". This team will be comprised of the Agency's Chief Executive and all five of the Agency's Directors. The senior management evaluation team will meet to consider the recommendations put to it by the core evaluation team.

# ANNEX A: BAFO INVITATION

## TRAINING & EMPLOYMENT AGENCY

21 November 1997

**Training & Employment Agency IS/IT PFI Project**
**Invitation to submit a Best And Final Offer**

1. Thank you for participating thus far in the negotiations for the Training and Employment Agency's Private Finance Initiative procurement for IT Services.

2. You are invited by the Department of Economic Development, acting through the Training and Employment Agency (hereinafter referred to as the "AUTHORITY"), to submit your Best and Final Offer for the supply of the Services set out in the draft Contract and Schedules Version 8 dated 21 November 1997 ("the Draft Contract").

3. Should you accept this invitation, you must take note of and fully comply with the terms of this letter. Failure to do so may result in the rejection of your bid.

4. For bid purposes, the workload volumes for each of the Services outlined in Schedules 3 and 4 of the Draft Contract is shown at Annex A to this letter. Your bid should indicate how your proposed charging mechanism will cater for variations in volumetrics. These estimates are not guarantees of actual future workload volumes, but will be used to provide a like-for-like comparison between bidders. Optional Services are as defined in Schedule 25.

5. Your Best and Final Offer must contain the following:-

   (a) confirmation that the services offered are as described in the Draft Contract and Schedules referred to above;

   (b) acceptance of all conditions contained in the Draft Contract and Schedules including Schedules 1 to 26 thereto, final copies of which are attached;

   (c) firm charges for the provision of the services in the form of a completed response to this letter (the required format of the response is included at Annex C);

   (d) details and associated costings of any other services that are proposed to be included as additional items within the proposals;

   (e) your costed proposal for acquiring any assets which you wish to acquire from the AUTHORITY as part of this bid;

   (f) confirmation that the provisions of the Transfer of Undertaking (Protection of Employment) Regulations, 1981 shall apply in the event that the AUTHORITY subsequently wishes to enter into agreement with you, and the undertakings to be transferred are those specified in Schedule 26 to the Draft Contract (it is accepted that your Best and Final Offer will be based on the assumption that there will be no staff transfer);

   (g) confirmation that, in the event that the AUTHORITY subsequently wishes to enter into an agreement with you, you will execute an agreement which shall consist of the Draft Contract and Schedules, which may be modified slightly to reflect clarifications agreed between the parties, before the contract is signed; and

   (h) a figure for the transfer payment which you would require in the circumstances specified in Schedule 23.

7. In accordance with Schedule 11 to the Draft Contract, the charges quoted at Best and Final Offer will represent the only charges the AUTHORITY is liable to pay over the Contract term in respect of the Services set out in Schedules 3, 5 and 25. The overall criterion of the evaluation is to achieve best value for money, but in order to assist bidders in setting their charges more specific guidance is provided at Annex D.

8. The prices and charges offered must be denominated in sterling terms and must be shown net of VAT. The appropriate rate of VAT must be stated in respect of each item.

9. It is essential that 10 bound copies of your Best and Final Offer be provided, together with 1 unbound copy to facilitate further reproduction if necessary.

10. Your Best and Final Offer must be delivered in a sealed envelope, which does not display any indication as to the sender, and should be clearly marked:

    **Tender for the T&EA IT Services PFI Procurement**

    Due: Friday 12 December 1997

    To: Daryl Young (10 copies)
    Project Manager
    T&EA IS/IT PFI Project
    Adelaide House
    39-49 Adelaide Street
    BELFAST
    BT2 8FD

    not later than 3pm on Friday 12 December 1997.

11. The AUTHORITY does not bind itself to accepting the lowest or any Best and Final Offer.

12. The AUTHORITY accepts no responsibility for assumptions or estimates made of the resources required to supply any of the Services or to complete the Transition Plan detailed in the Draft Contract.

13. The AUTHORITY has no liability for any cost or expense incurred by you as a direct or indirect consequence of your bidding for the provision of any of the Services.

14. You are advised that nothing herein or in any other communication made between the AUTHORITY and any other party, or any part thereof, shall be taken as constituting a contract, agreement or representation between the AUTHORITY and any other party nor shall they be taken as constituting a contract, agreement or representation that a contract for services shall be offered in accordance herewith or at all.

15. No amendments to any of the terms of this invitation or to the Draft Agreement shall be valid unless they have been agreed in writing on behalf of the AUTHORITY and by the Bidder.

16. Please acknowledge receipt of this letter, confirm whether or not you intend to submit a Best and Final Offer and confirm that you will be able to do so by the date stated.

**DARYL YOUNG**

# ANNEX A
# STATEMENT OF ESTIMATED WORKLOAD

**TABLE 1: ESTIMATE FOR BUSINESS USAGE**

| | T&EA | SSA | 3rd Party Suppliers | | | | |
|---|---|---|---|---|---|---|---|
| | **Concurrent Users** | **Desktops** | **Total Users** | **Concurrent Users** | **Total Users** | **Concurrent Users** | **Total Users** |
| **Initial Services** | | | | | | | |
| TRANSIT | 250 | n/a | 513 | 200 | 470 | n/a | n/a |
| CSRS | n/a | n/a | 421 | n/a | n/a | n/a | n/a |
| TIMS/T&EA TIMS | n/a | n/a | 20 | n/a | n/a | n/a | 148 |
| ACE | n/a | n/a | 48 | n/a | n/a | n/a | n/a |
| CWP | n/a | n/a | 16 | n/a | n/a | n/a | n/a |
| **New Services** | | | | | | | |
| CMS Module 1 | 200 | Not est | 500 | n/a | n/a | n/a | n/a |
| CMS Module 2 | n/a | Not est | n/a | 200 | 470 | n/a | n/a |
| CMS Module 3 | 225 | Not est | 550 | n/a | n/a | n/a | n/a |
| CMS Module 4 | 25 | Not est | 50 | n/a | n/a | 50 | 150 |
| Total CMS users | 250 | 500 | 600 | 200 | 470 | 50 | 150 |
| PFW: Office Productivity Services only | Not estimated | 450 | 450 | n/a | n/a | n/a | n/a |
| PFW: Office Productivity and MIS ad hoc tool | Not estimated | 50 | 50 | n/a | n/a | n/a | n/a |
| SSA: MIS ad hoc tool only | n/a | n/a | n/a | 1 | 2 | n/a | n/a |
| General Technical Support Services | n/a | n/a | 875 | n/a | n/a | n/a | n/a |
| Helpdesk Services | n/a | n/a | 875 | n/a | n/a | n/a | n/a |
| CMS only Helpdesk Services | n/a | n/a | n/a | n/a | 470 | n/a | n/a |

**Note:** It should be noted that the key volumetrics for New Services in Table 1 are:

- 500 concurrent users of CMS (AUTHORITY & SSA & Suppliers)
- 500 desktops in the AUTHORITY's PFW business area
- 500 AUTHORITY office productivity users (including 50 users of MIS ad hoc tool)
- 600 total AUHTORITY CMS users

1. Your bid should contain sufficient information to allow the AUTHORITY to assess the impact of changes in volumetrics. Changes which may occur over the life of the contract would include situations in which the AUTHORITY may wish to:
   - close down offices;
   - open new offices;
   - reduce the number of users per office;
   - increase the number of users per office;
   - reduce the number of concurrent CMS system users;
   - increase the number of concurrent CMS system users;

- reduce the number of users with Office Productivity Services;
- increase the number of users with Office Productivity Services;
- reduce the number of users with MIS; and
- increase the number of users with MIS.

2. To allow the AUTHORITY to assess the impact of such changes, bidders are asked to identify the following charges and any "brands of charges" that would apply to any of the following specific situations:
   - service charges associated with closing one office – you should base any volume related charges on the profile of the South Belfast T&EA office {note: this example is PURELY for illustration only};
   - any service charges associated with opening a new office – you should base any volume related charges on the profile of the South Belfast T&EA office {note: this example is PURELY for illustration only};
   - any service charges associated with reducing the number of users in an office – you should indicate whether any charges would vary depending on location;
   - any service charges associated with increasing the number of users in an office – you should indicate whether any charges would vary depending on location;
   - any service charges associated with reducing the number of concurrent CMS users, where appropriate, for:
     - Module 1 – T&EA users;
     - Module 2 – SSA users;
     - Module 3 – T&EA users;
     - Module 4 – T&EA users and 3rd party suppliers; and
     - MIS users.
   - any service charges associated with increasing the number of concurrent CMS users, where appropriate, for:
     - Module 1 – T&EA users;
     - Module 2 – SSA users;
     - Module 3 – T&EA users;
     - Module 4 – T&EA users and 3rd party suppliers; and
     - MIS users.
   - any service charges associated with reducing the number of Office Productivity Service users; and
   - any service charges associated with increasing the number of Office Productivity users.

# ANNEX B
# ADDITIONAL INFORMATION REQUESTED

1. The AUTHORITY requires further information from bidders in a number of key areas. This Annex contains details of the additional information required.

2. Bidders must detail any material assumptions upon which their bid is based and highlight any financial impact associated with these assumptions.

3. Bidders must provide details of their approach to open book accounting.

4. Bidders must provide details of the approach, if any, which they are proposing to use to address the issue of European Monetary Union.

5. Bidders must provide details of the approach they are proposing to use to address the issue of Technology Refresh.

6. Bidders are invited to provide details in their BAFO of any improvements they can make over and above the Service Levels which are specified in Schedule 9.

7. The approach and tools to be used by bidders in measuring service levels should be explained.

8. To supplement the costing information for CMS development, which bidders must supply in response to paragraph 13 of Annex C, bidders should provide the following information for CMS development:
   - the estimated number of man days which will be used to develop each module of CMS;
   - separate costings for meeting those requirements which have been categorised as SSA only;
   - guidance on the proportion of CMS development effort which could be attributed to those aspects of CMS which will be shared between T&EA and SSA;
   - the estimating methodology used, if any; and
   - the development methodology to be used, if any.

9. Bidders should indicate the means by which they propose to enable 3rd party supplier access to CMS. Details of alternative options considered should be provided together with the reasons for selecting the preferred option. Costings should be provided for the main options considered (including the preferred option).

10. The AUTHORITY has a particular interest in quantifying the benefits associated with each of your proposed services. The AUTHORITY would encourage you to provide any additional information that you might be able to provide that identifies the benefits associated with your proposals, in particular where these benefits can be quantified. The AUTHORITY wishes in particular to encourage you to provide your benefit analysis, including any reference examples (quantified), regarding Office Productivity Services.

11. Bidders should indicate their approach, if any, to identifying and realising any alternative revenue streams which it may be possible to exploit as a result of this contract. Bidders should highlight the means by which the AUTHORITY may share in any of the benefits realised.

12. The AUTHORITY is currently considering whether it will need to consider encrypting the inter-office and CMS data networking. Based on the office and usage profile included in Annex C of Schedule 4, bidders should:
   - detail the technical solution that you would provide to this encryption requirement, identifying the benefits and limitations associated with your solutions; and
   - identify any charges associated with meeting this encryption requirement.

13. Bidders should provide details of the dates which are to be inserted in the “Due Dates” columns of Annex A and Annex B to Schedule 20.

14. Bidders should outline their proposed approach to training to supplement the costing information provided in response to Annex C.

# ANNEX C
# FORMAT OF RESPONSES

1. Best and Final Offers should be structured as follows:
   - Management Summary
   - Confirmations
   - Further Information Requested
   - Charges
   - Additional Information Supplied by the Bidder

**MANAGEMENT SUMMARY**

2. This section should summarise the key features of the bid and should be limited to a maximum of 9 sides of A4.

**CONFIRMATIONS**

3. This section of the Best and Final Offer should detail the bidder's response to the confirmations set out at paragraph 6 of the Invitation to Submit a Best and Final Offer.

**FURTHER INFORMATION REQUESTED**

4. This section should supply the additional information requested by the AUTHORITY at Annex B.

**CHARGES**

5. This section should detail the charges for the provision of the Services outlined in the Draft Contract under the following headings:
   - Annual Price Variation;
   - Initial Services;
   - New Services; and
   - Optional Services.
6. Bidders should provide charges for the Services required based on a contract length of 7 years. Bidders are also invited to indicate the impact on charges should the AUTHORITY decide to aware the contract for a period of 10 years.
7. Bidders should provide charges based on quarterly payments in advance. Bidders are free to propose alternatives to this approach but in doing so must highlight the advantages to the AUTHORITY.

**ANNUAL PRICE VARIATION**

8. Amendment to the Service Charges stated in this BAFO will be on an annual basis. Bidders should use the table below to detail any annual price variations (as a percentage of the 1997/98 figure) which are part of their bid. In addition, bidders should detail the basis upon which the figures for annual price variation have been calculated and explicitly state any assumptions made.

| | 1/4/99 | 1/4/00 | 1/4/01 | 1/4/02 | 1/4/03 | 1/4/04 | 1/4/05 |
|---|---|---|---|---|---|---|---|
| Initial Services | | | | | | | |
| New Services | | | | | | | |
| Optional Services | | | | | | | |

9. Bidders are invited to identify the price variation which will apply for the remainder of the contract should the contract be awarded on a 10 year basis.

**INITIAL SERVICES**

10. Bidders should provide details of the charges for the Initial Services, as specified in Schedule 3. Where possible, you should identify the charges associated with each of the following:
    - TRANSIT facilities management (FM) service;
    - TRANSIT application maintenance & enhancement services;
    - TRANSIT network services;
    - Other system support services;
    - Support for standard PC packages;
    - Other network services (excluding TRANSIT);
    - General technical support;
    - Hardware maintenance; and
    - Help Desk Services.
11. Bidders should provide an "open book accounting" breakdown of the charges for the Initial Services. In particular, the AUTHORITY wishes to understand:
    - the direct costs associated with providing the services;
    - the indirect (overhead) costs associated with providing the services;
    - the profit margin associated with providing the services.

**NEW SERVICES**

12. Bidders should provide details of the charges for the New Services, as specified in Schedule 4, based on the volumes outlined in Annex A of this BAFO Invite. Where possible, you should identify the charges associated with each of the following.
    - Client Management System (CMS) services;
    - CMS Delivery and Support Services;
    - Infrastructure Services;
    - Training Services;
    - General Technical Support Services;
    - Help Desk and Incident Management Services;
    - Audit and Security;
    - Contingency;
    - Hardware Maintenance;
    - Project Management/Contract Management; and
    - Technology Refresh.
13. Within the CMS headings the Best and Final Offer should identify the costs associated with the following:
    - development of CMS (based on the estimates provided in response to paragraphs 8 and 9 of Annex B);
    - the CMS Managed Service;
    - CMS Support and Maintenance; and
    - the CMS Enhancement Service.
14. Within the Infrastructure Service heading the Best and Final Offer should identify the costs associated with the following:
    - the hardware to be implemented;
    - any communications equipment;
    - the office productivity software;
    - MIS tools;
    - the OPS Managed Service;
    - OPS Support and Maintenance; and

- any other costs.

15. Bidders should provide an "open book accounting" breakdown of the charges for the New Services. In particular, the AUTHORITY wishes to understand:
    - the direct costs associated with providing the services;
    - the indirect (overhead) costs associated with providing the services;
    - the profit margin associated with providing the services.

16. Bidders are reminded that in providing details of their charges for the New Services they should take account of the "Estimate for Business Usage" provided at Table 1 in Annex A. Bidders should indicate how the proposed charging mechanism will cater for the variations in volumetrics specified in paragraph 2 of Annex A.

**OPTIONAL SERVICES**

17. Bidders are invited to include within their BAFO charges and charging models for the Optional Services specified in Schedule 25 of the Draft Contract. It is recognised that the charging basis may vary depending upon the nature of the Service required and that in some instances it may only be possible to provide man day rates. In such circumstances, bidders should provide details of the methodology, if any, which will be followed to arrive at a firm price for the service. Bidders are also invited to suggest any further Optional Services which they would want to add to Schedule 25, and to provide charges and charging models for these as appropriate.

**ADDITIONAL INFORMATION SUPPLIED BY THE BIDDER**

18. Bidders should use this section of the Best and Final Offer to provide any other information which they consider further explains any part of the proposed services or which they consider may be of interest to the AUTHORITY during the evaluation of Best and Final Offers.

# ANNEX D
# EVALUATION CRITERIA

1. The aim of the evaluation process will be to select the bidder whose Best and Final Offer (BAFO) provides the economically most advantageous solution to the AUTHORITY over the evaluation period. The evaluation period will be the seven years of the contract term, although sensitivity analysis will take account of the possibility of the contract being awarded on a 10 year basis.
2. The AUTHORITY reserves the right to conduct further sensitivity analyses on receipt of the BAFO in order to take account of uncertainty regarding certain parameters in the evaluation process.
3. The charges for services will be derived from the charges quoted in the BAFO and will be modified by any and all costs and savings attributable to the proposal. In order to reflect any additional risks associated with each bid a further sum may be added to the evaluation model. This will be based on an estimate of any additional resources required by the AUTHORITY in order to counter the perceived risks.
4. The appraisal will take into account receipts from the sale of AUTHORITY assets.
5. In the overall value for money judgement, at this stage in the evaluation the principal criterion is to select the most economically advantageous bid, but where the financial evaluation produces a close result, certain unquantifiables will be taken into account including, but not limited to, the following (in no particular order):
   - (a) Quality;
   - (b) Financial Viability;
   - (c) Relevant Experience (both Public and Private Sector);
   - (d) Estimating Credibility;
   - (e) Consortium Experience;
   - (f) Company Ethos; and
   - (g) Responsiveness.
6. The AUTHORITY does not intend to charge for the office accommodation at Adelaide House used in carrying out work on behalf of the AUTHORITY.
7. Bidders should note that the opportunity to the Bidder to utilise space in Adelaide House is limited to the delivery of services within the terms of the Agreement and that the AUTHORITY is seeking to minimise the use of space in Adelaide House as far as is possible.

# ANNEX B
# BAFO COMPLETENESS CHECK

**BAFO Completeness Checklist** **Bidder: ______________________________**

| BAFO Reference | Item | Information Provided | | | Comments |
|---|---|---|---|---|---|
| | | Yes | No | Partial | |
| **Letter** | | | | | |
| Para 6 (a) | Confirmation | | | | |
| Para 6 (b) | Confirmation | | | | |
| Para 6 (c) | Charges | N/A | N/A | N/A | See Annex C below |
| Para 6 (d) | Other services | | | | |
| Para 6 (e) | Acquisition of Assets | | | | |
| Para 6 (f) | Confirmation | | | | |
| Para 6 (g) | Confirmation | | | | |
| Para 6 (h) | Confirmation | | | | |
| Para 8 | Charges shown as:<br>- Sterling<br>- Net of VAT<br>- VAT Rate stated | | | | |
| Para 9 | - 10 bound copies<br>- 1 unbound copy | | | | |
| Para 10 | BAFO received on time | | | | |
| Para 16 | Confirmation of submitting BAFO | | | | |
| **Annex A** | Charging regimes for:<br>- closing an Office<br>- opening an Office<br>- reducing users per Office<br>- increasing users per Office<br>- reducing concurrent CMS users<br>- increasing concurrent CMS users<br>- reducing OPS users<br>- increasing OPS users<br>- reducing MIS users<br>- increasing MIS users | | | | |
| **Annex B** | | | | | |
| Para 2 | Assumptions | | | | |
| Para 3 | Open Book Accounting | | | | |
| Para 4 | EMU Approach | | | | |
| Para 5 | Technology Refresh | | | | See also Annex C Para 12 below |
| Para 6 | Service Levels – improvements | | | | |
| Para 7 | Service Levels – approach and tools | | | | |
| Para 8 | CMS Development:<br>- man days per module<br>- separate SSA costings<br>- T&EA/SSA apportionment<br>- estimating methodology<br>- development methodology | | | | See also Annex C Para 13 below |

| BAFO Reference | Item | Information Provided | | | Comments |
|---|---|---|---|---|---|
| | | Yes | No | Partial | |
| Para 9 | CMS and 3rd party suppliers:<br>- options<br>- reasons for preferred option<br>- costings for main options | | | | |
| Para 10 | Benefits | | | | |
| Para 11 | Alternative Revenue Streams | | | | |
| Para 12 | Encryption:<br>- technical solution<br>- charges | | | | |
| Para 13 | "Due Dates" | | | | |
| Para 14 | Approach to training | | | | See also Annex C Para 12 below |
| **Annex C** | | | | | |
| Para 2 | Management Summary<br>(maximum 9 pages) | | | | |
| Para 3 | Confirmations | N/A | N/A | N/A | See "Letter" Para 6 (a) to 6 (h) above |
| Para 4 | Further Information requested | N/A | N/A | N/A | See Annex B above |
| Para 6 | Charges provided for 7 and 10 year contracts | | | | |
| Para 7 | Charges:<br>- quarterly in advance<br>- other approaches | | | | |
| Para 8 & 9 | Annual Price variation:<br>- 7 years<br>- 10 years<br>- table completed | | | | |
| Para 10 | Initial Service Charges:<br>- Transit FM<br>- Transit maintenance & enhancement<br>- Transit Networks<br>- Other systems<br>- PC packages<br>- General Technical Support<br>- Hardware maintenance<br>- Helpdesk | | | | |
| Para 11 | Open Book Accounting | | | | |
| Para 12 | New Service Charges:<br>- CMS Services<br>- CMS Delivery and Support<br>- Infrastructure<br>- Training Services<br>- Helpdesk<br>- Audit & Security<br>- Contingency<br>- Hardware maintenance<br>- Project/Contract Management<br>- Technology refresh | | | | See also Annex C Para 13 below<br>See also Annex C Para 14 below<br>See also Annex B Para 14 above<br><br>See also Annex B para 5 above |
| Para 13 | CMS:<br>- CMS Development<br>- CMS Managed Service<br>- CMS Support & Maintenance<br>- CMS enhancement | | | | See also Annex B Para 8 above |

| BAFO Reference | Item | Information Provided | | | Comments |
|---|---|---|---|---|---|
| | | Yes | No | Partial | |
| Para 14 | Infrastructure costs:<br>- Hardware<br>- Data Comms<br>- OPS Software<br>- MIS tools<br>- OPS managed service<br>- OPS support & maintenance<br>- Other costs | | | | |
| Para 15 | Open Book Accounting | | | | |
| Para 17 | Optional Services:<br>(Schedule 25)<br>- Infrastructure<br>- MIS<br>- Business Consultancy<br>- System Development<br>- Financial Services<br>- HRMS<br>- Kiosk/Touch Screen<br>- Training Services<br>- External Interfaces<br>- SSA Services<br>- Other (suggested by bidder) | | | | |
| Para 18 | Additional Information | | | | |

# ANNEX C - APPENDIX 2

**IS/IT PFI PROJECT: MAJOR ACHIEVEMENTS**

The major achievements of the Department's IS/IT PFI Project over the past 4 years, in chronological order, can be summarised as follows:

- This was the first IS/IT PFI contract to be negotiated in Northern Ireland. Consequently, there was limited local knowledge. However, at that time, there was also considerably less guidance available in terms of model contracts, etc. The negotiation process, therefore, involved the establishment and management of a small team of consultants, including legal consultancy from one of the leading IT PFI law firms in England. The consensus was that a robust contract and a good "deal" had been negotiated.
- One of the *initial* implementation objectives of the PFI contract was to manage a "skills transfer" **from** the existing ISU and helpdesk teams **to** the service provider, in relation to the board range of legacy IT systems and support arrangements which were in place at the time. This was a complex and sensitive exercise which was conducted satisfactorily and with due regard to staff sensitivities.
- Phase 1 of the roll-out of the new IT infrastructure (including wide area and local area data communications networks, large central servers, local servers, desktops, printers, Microsoft based Office Productivity Software including e-mail, etc) to all Jobcentres (33) and to parts of the Agency's Headquarters was **completed on schedule** (by November 1998) but **to an increased requirement.** The initial requirement was for 500 desktops, but this had to be increased mid roll-out to around 600 desktops to take account of additional (and previously unplanned) New Deal activity. This additional requirement was accommodated within the existing roll-out timescales.
- A second of the *initial* implementation objectives was to make a number of legacy Jobcentre systems available to Jobcentre staff over the new IT infrastructure and hence through a single desktop – previously staff had to have at least two pieces of hardware on their desks ie TRANSIT dumb terminals, and PCs to run the CSRS and NVQ Database systems. A very diverse range of awkward legacy systems were successfully made available alongside the new Microsoft software, providing an **"early win" for Jobcentre staff**.
- This initial roll-out of IT infrastructure was successfully achieved with **minimal interruption** to the Agency's business.
- Phase 1 of the Agency's new Client Management System (CMS), which replaced a legacy system called TRANSIT, was implemented **on schedule** by February 1999. This represented a considerable achievement on the part of the project team and the service provider and user groups from the Agency's business who worked closely with the project team in *Prototyping* development workshops. Phase 1 (which was a substantial IT system in its own right) was specified, built, acceptance tested, and brought live (which included an extremely complex and difficult data migration exercise from TRANSIT to CMS) in the space of some 9 months.
- Initial plans were for CMS to be phased into Jobcentres perhaps over a 5 or 6 week period. This was reviewed, and Phase 1 went live through a "big bang" release over one weekend. Again **disruption to Agency business was minimised,** and the Jobcentre network was closed for just two days – a Friday and a Monday, the latter for final staff familiarisation with the new system.
- An added complication to the delivery of CMS Phase 1 as the fact that the Dungannon and Lisburn Pilots of the *Joint T+EA/SA Review* went live at the same time. This involved additional IT infrastructure roll-outs to these two Jobcentres but, critically, also involved some modest differences to the CMS software. This constituted a considerable set of problems and risks which were managed and overcome successfully.
- At the same time, CMS was successfully made available to all Social Security Agency Offices in Northern Ireland, although over the SSA's existing IT infrastructure.
- While the functionality within CMS was very good and supported Employment Service and Jobseekers Allowance business from day one, there were initial performance problems with the system primarily with respect to response times. As part of the solution to this, the PFI service provider put considerable

investment into installing additional memory in all desktops. Under *risk transfer* within the PFI contract this was achieved with additional cost to the Agency.

- Phase 2 of the IT infrastructure was rolled out to the "remainder" of the T+EA. This was successfully prioritised and achieved to ensure that Agency staff were not impacted by the Year 2000 date problem.
- Phase 3 of the IT infrastructure roll-out, which accommodated the additional staff who joined T+EA to form the new Department DHFETE, was completed on schedule. This constituted a major logistical exercise, which involved:
  - bringing a new large location (the Commercial Union Building) onto the IT infrastructure;
  - re-locating most of the users within Adelaide House as extensive renovation work and staff moves progressed;
  - bringing new DENI staff onto the IT infrastructure, including data migration of existing documents and providing continued access to existing IT systems;
  - similarly, bringing some "old" DED Branches onto the IT infrastructure; and
  - bringing OITFET onto the IT infrastructure, involving a new location and new IT requirements.
- CMS Phase 2, which replaced the legacy system CSRS to provide support to the Agency's Careers Service and to New Deal and Jobskills recruitment and management activity, went live at end May 2000. Like Phase 1, it was delivered "big bang" to all Jobcentres at once, it involved an even more complex and difficult data migration exercise, and was implemented with minimum disruption to Jobcentre business. With the exception of CMS Phase 3 which has required a new technical approach to be developed and which has been re-profiled with authority from Senior management, CMS Phase 2 was the only part of the PFI implementation to date which has "slipped" from original timescales. However, the delay should not detract from the actual achievement of what was a complex and very business critical IT system to deliver.
- All of the IT infrastructure roll-outs and Phases 1 and 2 of the CMS implementation, have been accompanied by extensive staff training activity. Three separate training courses (IT infrastructure, CMS Phase 1, and CMS Phase 2) had to be developed, agreed and delivered. In total, some 2,800 staff days of training were co-ordinated and delivered.
- Under the PFI contract the Department designed and implemented a vacancy Internet site (JobCentre Online) that now publishes all vacancies notified by employers to the Employment Service. This site is automatically "fed" with vacancy information from the main CMS operational database, virtually in real time. This was in addition to the original scope of the PFI contract, and was delivered through the contract's Change Control and Optional Services mechanisms.
- Associated with JobCentre Online, the Department is piloting the use of self service touch screen kiosk technology to make vacancy information available electronically to customers in JobCentres. There are plans to extend this service across all JobCentres under the PFI contract. This, and JobCentre Online, are good examples of how PFI has harnessed the innovative and technical skills available through a private sector partner.
- Phase 3 of CMS has just been implemented (March 2001) on a pilot basis, within the new timescales agreed for this aspect of the PFI project.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## DEPARTMENT OF REGIONAL DEVELOPMENT

8 May 2001

1. Thank you for your letter of 20 March. I attach a copy of the DRD's initial submission to the inquiry.

2. The Minister for Regional Development very much welcomes the review being undertaken by the Committee for Finance and Personnel into the use of Public Private Partnerships (PPP), including Private Finance Initiatives (PFI). The DRD (previously DOE) has piloted a number of what must be some of the earliest capital infrastructure PFI projects in Northern Ireland, with varying degrees of success. The Department is however conscious of the need to learn from these experiences and continue to pursue every avenue available including PFI/PPP to provide the best value public services to the people of Northern Ireland.

3. The Committee's inquiry is quite timely in that a number of high level Working Groups within DRD are due to present the findings of their reviews into the opportunities for private sector involvement in the provision of public services for which DRD has responsibility. Early indications from these reviews are that based on the experience of UK and Republic of Ireland projects there is considerable scope for private sector involvement in the areas of Water, Sewage, Roads and Public Transport. However any such involvement would need to demonstrate value for money compared to provision within the public sector. Furthermore, given the well-publicised under investment in these areas and the limitations on the availability of adequate PE to meet investment requirements, the DRD Minister intends to fully examine opportunities for private sector involvement, and is receptive to the consideration of quite innovative approaches, if appropriate.

4. DRD officials will of course provide every assistance with the inquiry. Obviously a more detailed examination of the issues highlighted in the Request for Information (2) for the inquiry will take additional time to compile.

5. The Minister looks forward to receiving a copy of the Committee's report in due course. A copy of this letter has been forwarded to the Clerk of the Regional Development Committee for information.

**SHEILA McCLELLAND**
**Private Secretary to Gregory Campbell**
**Minister for Regional Development**

## INTRODUCTION

1. In response to the huge funding gap arising from years of under investment in the physical infrastructure, DRD is actively examining new ways of working with the private sector to address the investment needs of roads, water and sewerage and public transport. There is, however, no single, easy, quick solution since an investment programme on a scale not seen before is required.

2. The following paper provides:-

   (a) a summary of the strategic context within which DRD is seeking to address this infrastructure deficit and the radical new initiative recently floated by the Minister for Regional Development;

   (b) a description of progress to date on PFI/PPP projects; and

   (c) responses to the specific questions posed by the Committee.

## A. STRATEGIC CONTEXT

3. It is widely recognised that Northern Ireland faces new economic opportunities and challenges. The challenge for DRD is to address with urgency the further development of the regional infrastructure, both to meet the needs of its customers, but also as a catalyst for economic growth, competitiveness and greater social cohesion. The current level of PE funding for water, roads and public transport will not simply bring about the required stepped enhancement required.

4. In the case of Water, an Asset Management Plan, scheduled for completion in 2002 will indicate a 20 year funding requirement in the region of £3 billion. This is needed to replace out-of-date infrastructure, meet the needs of new development, satisfy public health requirements and comply with EU directives on drinking water and waste water.

5. In recent years, there has been an emerging consensus at European and UK levels about the need for an integrated and sustainable approach to transportation and for significant inceases in investment. Very significant investment has been announced in GB and the RoI. On 27 June the Assembly gave unanimous support to the resolution “that this Assembly notes with concern the poor state of the public transport system in Northern Ireland and proposes that the Minister for Regional Development should urgently implement a comprehensive and integrated public transport policy to redress this problem”.

6. The Minister has initiated the preparation of a Regional Transportation Strategy. The strategic vision is to have a modern, sustainable, safe transport system which benefits society, the regional economy and the environment and which actively contributes to social inclusion and everyone’s quality of life.

7. The current condition of both our public transport and roads assets gives rise to grave concern. In February 2000, the A D Little Report revealed the need for expenditure of around £186m just to ensure that the existing rail network could operate safely. A NIAO Report on Structural Maintenance of Roads confirmed that funding was currently at around half the level required to maintain the network in a satisfactory condition – this is a deficit of more than £40m per annum.

8. A study conducted in 1999 by DOE(NI) on the funding needs for transportation suggested that an additional £2 billion was required over the next 10 years. This would mean doubling the amount of funding currently allocated to enable significant enhancement of the strategic roads network, maintain existing roads and enhance public transport, including the modernisation of the entire railway network and the brining to fruition a small number of innovative public transport initiatives such as E Way (guided bus corridor).

9. DRD is proactively examining the various opportunities for private sector involvement in the provision of capital investment in the physical infrastructure and the provision of public services. However, it is apparent that although conventional PFI/PPP approaches may have a part to play, they will not, by themselves, meet the huge funding needs.

10. In a speech to the Annual Dinner of the Institution of Highways and Transportation Northern Ireland on 19 March, the Minister for Regional Development dealt with the resource problems which he faced. He explained that he would continue to argue for an appropriate share of the Northern Ireland Block, including the Executive Programme Funds, and that he would support the case for an increased share of UK expenditure for Northern Ireland. However, he believed that the years of underfunding could not be reversed overnight by just tinkering with the existing system. Northern Ireland required, he said, substantial investment to redress the historical underfunding and to transform the economy.

11. The Minister went on to say:-

***"I have just returned from a visit to the USA where we were exploring radical solutions to our huge funding requirements for water, sewerage, roads and public transport.***

***Northern Ireland faces a bill of many billions of pounds over the next quarter of a century if we are to make good the under-investment of the last 25 years, and if we are to have the water and sewerage, roads and public transport services required in a successful UK and European region.***

***It is essential to explore thoroughly the scope for working in partnership with the private sector and with private sector finance.***

***This can take a number of forms from privatisation of major services, which few in Northern Ireland favour to increasing use of the private sector to provide specific functions on behalf of a public service.***

***The limited attempts to explore PFI options for roads and sewerage have not, to date, been very encouraging.***

***While the scope for significant private sector involvement in bus and rail services looks more promising, there are important lessons to be learnt from bus deregulation and rail privatisation in GB and the continuing debate about London Underground.***

***In my visit to 4 cities in the USA, I met with national, state and municipal representatives and with some private sector interests to learn about how these issues are being addressed, including the widespread use of bonds to raise finance.***

***I have also been following with interest the developments in Wales where it is being proposed that Welsh Water be acquired by a not-for-profit company.***

***Further investigation of the approaches in other countries will be undertaken over the coming months by my officials.***

***The way forward in addressing our needs in Northern Ireland depends upon finding new ways of accessing private funding in a way with which people in Northern Ireland are comfortable.***

***In particular, I am keen to explore the concept of a not-for-profit company, a Northern Ireland Regional Development Trust, raising money in the private sector to help us meet some of our infrastructure deficits to see whether it can offer us a solution which can incorporate private finance with public accountability.***

***I also envisage much greater scope for development of large scale Design, Build and Operate contracts.***

***I intend to set up a task force to study how we can address the historic underfunding.***

***I will welcome any input from the DFP Assembly Committee which has recently initiated an exploration of the use of private finance across all public services.***

***I will want to share the outcome of my work to assist the deliberations of the new working group to be chaired by DFP and the Economic Policy Unit officials announced by Mark Durkan last week."***

12. Within the DRD the task force has commenced work on the initial study and will over the coming weeks be bringing forward issues for Ministerial consideration. In particular, it will be seeking to develop further the possibility of a not-for-profit company funded by bonds playing a critical role in securing the stepped change in the resources available over the next quarter of a century to improve water and sewerage services, upgrade the strategic road network, maintain existing roads properly and provide a modern public transport system.

## B. DRD EXPERIENCE TO DATE

13. Since the introduction of PFI in 1992, DRD and its predecessor DOE (NI) have piloted a number of projects with varying degrees of success. Although only the two Water Service projects have come to fruition, a number of useful lessons have been learned which can be translated into future projects. These lessons centre on the transfer of risk, the accounting treatment, the scale of the projects and the high costs of external advisers and internal management.

14. Detailed below is a short summary of the projects undertaken with DRD.

15. **Water Services Projects**

15.1 Kinnegar Waste Water Treatment Plant

The initial PFI project incorporating both the Bangor and Kinnegar WWTW schemes, commenced in June 1995 and was expected to reach award of contract stage within 18 months. However, it was not until 1999 that a Concessionaire was appointed for the design, build, financing, and operation (DBFO) of the Kinnegar facility only, for a period of 25 years.

Some of the causes of delay in the procurement programme included:

- land acquisition and planning difficulties associated with the proposed facilities for Bangor (these difficulties eventually became insurmountable, resulting in the elimination of the Bangor facilities from the scope of the initial project and as a result, following intense negotiations, an ex-Gratia payment of £450K was paid to the contractor);
- additional project development requirements to establish the scope and criteria for tenderers;
- the need to establish a robust Public Sector Comparator;
- protracted negotiations with the preferred tenderer.

Despite this change to the scope of the project and the protracted negotiations, it is considered that the degree and extent of risk transfer embodied in the final agreement is at least that envisaged at the end of the project development stage. In the case of critical risks associated with operational failure it is considered that a greater degree of risk transfer has been achieved. The Best and Final Offer (BAFO) demonstrated marginally favourable value for money against the estimated Public Sector Comparator (PSC) after extensive negotiations which reduced the BAFO significantly. The capital value of the project is £13 million.

A follow-up review was undertaken in 1999 and recommended that a good PFI project in the water industry was likely to have the following features:

- project size of at least £30m;
- include a significant element of operational costs;
- offer substantial scope for private sector innovation, eg schemes in same geographic area offering potential for a variety of solutions; and
- sufficient private sector competition to deliver value for money

15.2 Oaklands/Silent Valley Hydro-electric Projects

In 1994, Water Service successfully bid for 13 generating licences under the Non Fossil Fuel Obligation (a national initiative aimed at reducing reliance on fossil fuels). Eleven of these were for sewage gas generators and two were for hydro-electric power.

Generation to the National Grid for commercial gain was deemed outside the remit of Water Service and the in-house project was halted. However the two hydro schemes were judged suitable for letting as a PFI project and were subject to a bidding competition. The concession was awarded in June 1999 and design and construction commenced thereafter. The capital value of these schemes is currently £0.9 million.

Minor modifications have been required at both sites to accommodate the schemes. Oaklands is ready for commissioning and completion at the Silent Valley is planned for June 2001. There is minimal income to Water Service over the contract period, but both schemes will be handed over to Water Service, free of charge, in April 2009.

## 16. **Roads Service Projects**

16.1 Motorway Communications and Control

The purpose of this project was to replace the existing emergency telephone network and extend the motorway control system. Legal, technical and financial advisers were appointed and the competitive process launched in 1997. The capital value of the project in 1997 was £5.5 million.

Four companies returned the pre-qualification document, three of which received Invitation to Negotiate status. At this stage, the Department became concerned whether there was sufficient risk transfer to ensure that the assets to be acquired would not appear on the balance sheet. It was concluded that the issues of risk transfer and favourable accounting treatment would be best secured by merging this project with the Westlink/M1 projects (see paragraph 6 below).

16.2 Westlink/M1 Project

In 1995 Roads Service commissioned an investigation into the scope of involving the private sector in the financing of road projects in Northern Ireland. The final report in February 1996 suggested that a M1/Westlink project would be of sufficient size to make it executable under the Private Finance Initiative (PFI). Technical, legal and financial Advisers were appointed in 1996. It was decided that the operational and maintenance element of the Westlink project would include the entire motorway network, except for the Ballymena by-pass. The competition was launched in 1997, having a capital value of £33.5 million. However, the Treasury Task Force advised that the Department should not let the DBFO contract until the necessary enabling powers have been secured.

As a result, the PFI process was suspended and the Department undertook to bring the project through the Statutory Planning Process. A decision on the method of procurement is still under consideration by the Department.

16.3 Strangford Ferry Project

Legal, technical and financial Advisers were appointed and the competition process began in 1997. The capital value of this project in 1997 was £2.7 million.

One of six companies which expressed an interest, withdrew from the process and a second did not pass the evaluation criteria threshold. In July 1997, Invitation to Negotiate Documents (ITN) were issued. A further company withdrew almost immediately, re-entering the process on 29 July 1997 and withdrawing again on 27 October 1997. Two further companies withdrew in 1997 and 1998. As a result, only one bid was submitted in 1998. An initial appraisal of the bid showed that the proposed operating costs of service by the private sector would be considerably greater than public sector costs.

The Best and Final Offer (BAFO) was received on 8 July 1998 and the Financial Advisers confirmed that the proposed project represented value for money and would be off-balance sheet.

In 1999, the preferred bidder decided to withdraw from the project. The reason given was an internal change of management.

## 17. **Public Transport**

A study of the potential for PPP's in public transport was carried out in 1999. This study envisaged the transfer of responsibility for all or part of the current bus and rail services to a private sector operator(s). This study superseded earlier PFI studies which had concentrated on the potential to procure capital projects under the private finance initiative.

The study also pointed out that proposed EU Regulations on Public Service Requirements and the Award of Contracts in Public Transport would require member states to hold a competition before awarding a contract which conveyed exclusive rights to provide public transport services. The existing enduring monopoly which Translink currently enjoys in relation to trains and most bus services could not continue. These proposed regulations would require major change to the way in which public transport services are delivered in Northern Ireland. However, a PPP would be compatible with the regulations.

The Outline Business Case concluded that a single operating concession for bus and rail services should be the preferred option, the next most attractive being separate concessions for bus and rail.

The award of such an operating concession to a private sector operator would transfer all responsibility for the management, operation and delivery of all aspects of the current NIR, Ulsterbus and Citybus services to the private sector under contract for a fixed period.

Initial implementation issues affecting the adoption and progressing of a PPP approach for public transport need to be addressed. These are:

- primary legislation is needed;
- human and financial resources must be obtained to allow the completion of the work in a timely manner. The report forecasted investment requirements in the region of £11 million for buses and £200 million for railways.

18. **Conclusions**

The Department recognises the contribution that the private sector can make to the provision of public services in Northern Ireland. For example, in Water Service, the total capital value of schemes identified with a potential for PPP/PFI is £187 million. This figure is significant, but must be set against the projected £3 billion capital requirement over the next 20 years. Furthermore there is a range of issues that need to be considered and these are outlined below.

A key consideration relates to the accounting treatment of the assets created. If these remain on the Departmental balance sheet, public expenditure (PE) cover must be found for the full cost of the asset up front. This means that such a PPP has no PE advantage over conventional procurement.

Another issue of concern is the level of resources required to bring forward a PPP/PFI project. Experience has shown that consultant costs can be high and the demands on internal resources, including senior levels, can also be significant.

The scale of the project is pivotal to its success. Projects must be of a sufficient scale to attract the right level of appropriate competition and secondly to facilitate value for money.

Over-riding these concerns are the issues of public acceptability in that PPP/PFI schemes should only be advanced in a manner which the community of Northern Ireland feel comfortable with and for which there is broad acceptance and a clear understanding of the benefits to be gained.

We conclude that in terms of our experience with PPP/PFI to date the idea of a not-for-profit company presents itself as perhaps a more appropriate way forward to tackle the huge funding gaps in roads, public transport, water and sewerage.

## C. RESPONSES TO SPECIFIC QUESTIONS POSED BY THE INQUIRY

19. The following is offered by way of a response to the questions posed in the Request for Information issued on 20 March.

**1. What do you see as the benefit of PPP/PFI?**

PPP facilities the accelerated delivery of a longer-term capital investment programme. This particular point is of the greatest significance given DRD’s inability to meet capital investment requirements out of the current PE allocation. Furthermore PPP creates a mechanism whereby there is a clear and firm commitment to a long term spending programme. Ordinarily, Departments are not in a position to commit to long-term capital expenditure programmes beyond the three-year budget cycle.

The main benefit of PPP/PFI is the ability to utilise private sector capital, expertise and commercial acumen and innovation in the provision of public services. However, it should be borne in mind that value for money has to be demonstrated before private sector funding can be utilised.

PPP recognises the importance of the partnership between the public and private sectors. The private sector already makes a significant contribution to the delivery of public sector services in Northern Ireland and there is scope for this to increase where improved value for money can be demonstrated. However, this approach should not be viewed as a panacea to all public sector problems. PPP also recognises the contribution of the public sector in terms of skills, dedication of workforce, assets, ideas and capital as well as intellectual property.

**Are there identifiable benefits to the public and stakeholders?**

The capital investment requirements in water, roads and public transport cannot be met from the current level of public expenditure in the required timeframe. The utilisation of private capital through PPP would permit the Department to better meet the challenges of infrastructure investment in the short to medium term rather than in the longer term.

Stakeholders would naturally need to obtain better quality public services that demonstrate best value for money, in a manner that is both affordable and publicly accountable.

2. **What do you see as the key factors for the successful application of PPP/PFI?**

Key success factors in the successful application of PPP/PFI must be:

- Ability to deliver better value for money as well as political and public acceptability of the process.
- The scale of the project in terms of attractiveness to the private investor.
- Appropriate transfer of risk to those best placed to handle them, enabling the project to be "off balance sheet".
- Availability of funding to meet the long-term costs of PPP/PFI projects.

3. **Are there any wider issues, limitations and constraints associated with the environment of PPP/PFI that have to be addressed?**

There can be a perception that PPP is a disguised form of privatisation, rather than a means of utilising the public assets (both physical and intellectual) to the best advantage in the provision of public services.

**Are there gaps in the supplier market base?**

The NI supplier base is limited, however experience from both the GB projects and the Republic of Ireland (ROI) projects indicates that there is considerable interest from international consortia in all areas of regional infrastructure. The ROI authorities have also indicated that a number of international organisations are interested in involving local companies in joint ventures.

The main types of roads and water scheme being investigated by DRD are design, build, finance and operate (DBFO). The experience in ROI indicates that there is significant interest at an international level with 11-12 expressions of interest in their two most recent projects. The GB scenario is also quite buoyant with an average of 6-7 expressions of interest in recent schemes from international interests.

Experience in the UK and in the ROI would therefore suggest that there is great interest from both the national and international stage in capital infrastructure projects in particular. Within DRD, officials are aware of a growing US interest in PPP approaches to the provision of Roads, Water and Public Transport in Northern Ireland.

**Are the skills and guidance available?**

A difficulty with earlier PFI schemes was the lack of in-house expertise. The cost of legal, technical and financial consultants associated with PFI/PPP deals can often be very high. It is essential that these costs are kept to reasonable levels. This could be through standard forms of contract and the building of expertise in-house, both in DRD and centrally.

4. **How should the strategic importance and prioritisation of PPP/PRI projects and the inter-relationship with other schemes, be assessed and managed?**

It must be possible to demonstrate that the option chosen represents better value for money than alternative options. To ensure that VFM is achieved, there must be a clear justification for the project and it must be subject to a competitive procurement process.

5. **Are there any particular social factors that should be assessed and managed and how have PPP/PFI schemes impacted them?**

All work within DRD is subject to the guidance on new TSN and Equality impact assessment as well as human rights considerations. PPP/PFI will be no different from this in that projects within DRD will have originated from the various capital works programmes and will be subject to the same level of assessment.

**6. What alternative procurement options do you believe should be considered?**

There are many different options available under the banner of PPP and analysis of them will normally form part of the economic appraisal process. These could include:

- Traditional Procurement
- Design, Build, Finance (DBF)
- Design, Build, Finance, Operate (DBFO)
- Leasing
- Franchising
- Joint Venture Companies

This list is, of course, not exhaustive.

**7. How do you suggest PPP/PFI should be brought forward in Northern Ireland?**

DRD believes that there is very significant scope for the private sector to be involved in public transport, roads and water. However, experience to date suggests that PPP and PFI projects by themselves will not resolve the huge funding needs of these services. New ways of raising resources have to be developed and are indeed essential if significant, long-term commitments are to be made to work with the private sector in delivering aspects of DRD's services.

**8. What are the feasible alternative forms and structures of financing?**

A number of investigations are under way within the Department to look at alternative forms of financing the capital investment requirement. These include bonds issue, joint venture companies, and "not-for-profit" trust companies. Of course, DRD will also explore every opportunity for the maximisation of PE as well as EU funding.

As indicated above, a particular initiative under investigation is the possible establishment of a not-for-profit mutual company, the "Northern Ireland Regional Development Trust", with the aim of raising money in the private sector to help DRD meet some of the infrastructure deficits.

**9. What do you see as the economic basis of PPP/PFI?**

The economic basis for PPP/PFI is several fold:

- To utilise the existing asset base and maximise value for money for the public purse.
- To meet the investment deficit of 30 years of under funding within the sector.
- To improve the efficiency of the service provided.
- To ensure that existing scarce resources are used to greatest advantage.
- To improve the condition of existing assets.
- To overcome the opportunity cost of not investing in infrastructure.

**10. How can value in relation to capital investment and service improvement best be assessed?**

Performance standards must be clearly defined in achievable and measurable terms as a basis for determining contract performance and payment. Early pilot project experience should be used to develop performance standard specifications which can then be tailored to individual contract needs.

Public sector comparators are used as the benchmark for the comparison of the bids. Competition within the private sector is also an essential element.

Crucially, an economic appraisal should confirm that the long-term benefits accrued to the overall economic performance of the region outweigh the costs of PPP arrangements.

**DEPARTMENT FOR REGIONAL DEVELOPMENT**
**Transport (Policy and Support) Division**

13 April 2001

Malcolm McKibbin has referred to your letter of 28 March 2001 to me to deal with the Public Private Partnerships questions.

I cannot send you the additional information you requested because it involves the results of a market sounding exercise and includes details of the public sector comparator. Information in the market sounding exercise was given by private sector firms in confidence and clearly we cannot breach those confidences. The details of the public sector comparator are also commercially sensitive because they could compromise the PPP procurement process.

In relation to the actions listed in paragraph 1.33 of the report, the PPP team has not yet been established and so the other action shave not been taken forward.

**R E AIKEN**

# PCA – 1ST REPORT - SESSION 2000-2001

## DEPARTMENT OF THE ENVIRONMENT, TRANSPORT AND THE REGIONS

### Case No A.2/01

### Refusal to release information about a London Transport project.

Mr D asked for the data that was available to DETR Ministers when making their decision to award the Prestige contract to an international consortium of companies known as TranSys. In particular, Mr D wanted the data that had been used in the evaluation that is known as the public sector comparator (PSC). DETR said that Prestige was a contract between London Transport and TranSys and DETR's role was solely to consent to the deal. In so doing, they did not consider detailed information on the PSC, which they therefore had no reason to see, but only advice from officials on the value for money aspects of the deal. They judged that information to fall within Exemption 2 of the Code. The Ombudsman accepted that DETR did not possess the raw data requested by Mr D. He also accepted that Exemption 2 had been correctly applied to the information that was available to DETR. However, having applied the harm test, he concluded that any harm to the frankness and candour of internal discussion that might be caused by the release of this information was outweighed by the public interest in making it available. He therefore proposed that the information should be released. DETR then provided further reasons for not releasing the information requested and cited three more exemptions: Exemptions 7, 13 and 14. The Ombudsman agreed that Exemption 13 applied to the information in question but criticised DETR for not citing earlier all the exemptions on which they were relying. However, he welcomed DETR's decision to provide Mr D with two documents, prepared by London Underground, that explained the reasons for the contract award. The Ombudsman saw this as a satisfactory outcome to a partially justified complaint.

2.1 Mr D complained that the Government Office for London, part of the Department of the Environment, Transport and the Regions (DETR), refused to supply him with information which should have been made available under the Code of Practice on Access to Government Information (the Code). I have not put into this report every details investigated by the Ombudsman's staff but I am satisfied that no matter of significance has been overlooked.

2.2 Mr D's complaint is specifically against the London Transport Division of the Government Office for London. That Division was transferred from the Government Office for London to DETR on 1 May 2000. To avoid confusion, throughout this report I therefore refer to the body complained against as DETR.

### Background

2.3 The London Transport Prestige project (Prestige) was commissioned to modernise the ticketing and revenue collection systems for both London Underground and the bus services provided on behalf of London Transport Buses. The key element of the project was the introduction of a smart-card ticketing system which would allow quicker, easier and more flexible travel in London. The contract for Prestige was subject to an evaluation known as the Public Sector Comparator (PSC). PSCs are used to appraise most projects under the government's Private Finance Initiative (PFI). They act as benchmarks against which value for money in undertaking such projects can be assessed. The private sector companies bidding for any particular public sector contract have to demonstrate that their bid represents better value for money than a traditional, publicly funded approach. In circumstances where there is limited competition in the procurement process, as in the case of Prestige (which proceeded to a single-bidder situation at an early stage), the PSC, in the absence of competition, becomes in effect the yardstick. On 14 August 1998 the Prestige contract was awarded to TranSys, an international consortium of companies who will develop, manage and install the advanced system.

### The complaint

2.4 On 15 November 1999, Mr D wrote to DETR to ask for information about Prestige. He said that the contract for the project had been subject to a PSC evaluation and he asked to be provided with the data that had been made available to the Secretary of State of DETR and his advisers when deciding to award the Prestige contract to TranSys. They said that Mr D's request fell under Exemption 2 of the Code, specifically that part of it relating to 'internal opinion, advice, recommendation, consultation and deliberation', on the basis that release of the information would harm the frankness and candour of internal discussions. The information was not therefore released. In accordance with their complaints procedure, DETR explained that Mr D could choose to have this decision reviewed.

2.5 Mr D wrote to DETR on 17 December to appeal against their decision not to provide the information requested. He argued that Exemption 2 did not apply because the data he sought was neutral and capable of more than one interpretation or projection. He did not seek the disclosure of the advice to Ministers on whether the TranSys bid represented value for money, and argued that the release of the data alone would not harm the frankness and candour of internal discussions, DETR replied on 28 January 2000. They quoted the third part of Exemption 2 of the Code, which covers 'projections and assumptions relating to internal policy analysis; analysis of alternative policy options'. They said that PSCs were developed on the basis of such information and to enable such internal analysis to take place. They concluded, therefore, that the data Mr D requested fell within this category and was thus exempt under the Code. They told Mr D that if he remained dissatisfied with the decision he could complain, through an MP, to the Ombudsman.

**The Permanent Secretary's comments**

2.6 Commenting on the complaint in a letter dated 23 May 2000, the Permanent Secretary of DETR said that the Prestige PFI deal was a contract between London Transport and the private sector TranSys consortium: neither the government nor DETR were party to it. DETR's role regarding Prestige was to give consent under the London Regional Transport Act 1984 to London Transport entering into the contract with TranSys. In giving their consent, DETR Ministers took account of official advice on the value for money aspects of the deal but did not themselves consider detailed information on the PSC. The PSC used was created and owned by London Underground and its detail was not therefore within DETR's control The information used to advise Ministers at DETR was base don a variety of key reports made to or shared with the department. These reports did not set out the detailed data used in the PSC exercise but reported on the results of the comparison of the bid with the public sector comparator. Most of the key elements of this information were provided to officials on a "confidential" basis and were not raw data. It was on that basis that the information was judged to fall into the third category of Exemption 2 of the Code and therefore not made available to Mr D.

**Exemption 2**

2.7 Exemption 2 of the Code is headed 'Internal discussion and advice' and reads:

***'Information whose disclosure would harm the frankness and candour of internal discussion, including:***

- proceedings of Cabinet and Cabinet committees;
- internal opinion, advice, recommendation, consultation and deliberation;
- projections and assumptions relating to internal policy analysis; analysis of alternative policy options and information relating to rejected policy options;
- confidential communication between departments, public bodies and regulatory bodies.'

Exemption 2 is subject to the harm test in the preamble to Part II of the Code:

***'References to harm or prejudice include both actual harm or prejudice and risk or reasonable expectation of harm or prejudice. In such cases it should be considered whether any harm or prejudice arising from disclosure is outweighed by the public interest in making information available.'***

**London Transport**

2.8 On 29 June 1984 the London Regional Transport Act 1984 transferred political and financial control of London Transport from the Greater London Council back to central government. London Transport is technically a statutory corporation but it is more commonly described as a nationalised industry. For the sake of completeness, I should make clear that in July 2000 all of London Transport's functions, except London Underground, were transferred for London, the new executive body under the London Mayor, which will deal with transport in the Capital.

Section 4(6) of the Parliamentary Commissioner Act 1967 reads:

***'No entry shall be made in respect of a corporation or body operating in an exclusively or predominantly commercial manner or a corporation carrying on under national ownership an industry or undertaking or part of an industry or undertaking.'***

The Ombudsman can only investigate those government departments or bodies that are listed in Schedule 2 to the Parliamentary Commissioner Act 1967. As a nationalised industry, London Transport is not listed in Schedule 2 and is not therefore within the Ombudsman's jurisdiction. As such, I cannot comment on the actions of London Transport.

**Investigation**

2.9 The Permanent Secretary, when commenting on this complaint, enclosed several extracts of documents relating to the PSC and the value for money aspects of Prestige. To obtain a clearer understanding of exactly what information was available to DETR when giving their consent to the Prestige project, the Ombudsman's staff asked them to provide copies of all the documents they had relating to this issue.

2.10 It was apparent from a summary of correspondence prepared by DETR that Mr D had communicated with them on several occasions before 15 November 1999, the date of the earliest of the letters forwarded to Mr D to this Office. During the investigation the Ombudsman's staff also obtained copies of this material.

**Assessment**

2.11 In assessing this complaint there are two aspects I have to consider: the general handling of Mr D's complaint, and the substantive issue of whether or not the information requested should be released. I turn first to the way in which DETR handled this complaint. I am pleased to note that all of Mr D's letters requesting information were answered reasonably promptly. Following DETR's decision of 16 December 1999 to refuse to provide the information requested, Mr D was advised o his right to have that decision internally reviewed. Having maintained their refusal following this review, DETR then advised Mr D of his right, if he remained dissatisfied with that reply, to submit a complaint, through a Member of Parliament, to this Office. It is clear to me that DETR handled this matter in full accordance with the requirements of the Code, and for this I commend them.

2.12 I turn now to the question of the information sought by Mr D. The Code gives an entitlement only to information, not to documents (although the Ombudsman's own experience has shown that the simplest way in which to meet a request for information is often to release the actual document concerned), and it is on that basis that Mr D's complaint has been examined.

2.13 DETR's role with regard to Prestige is described in paragraph 2.6. In fulfilling that role they saw a substantial amount of information about the project: this was mainly supplied by London Transport. Mr D's request was for the data that was made available to the Secretary of State to enable him to reach the decision to award the Prestige contract to TranSys. He subsequently explained that he was seeking only the "bare data" which was neutral and capable of more than one interpretation or projection.

2.14 DETR's argument for withholding that information was that the key reports provided by London Transport to DETR in support of their submission do not contain the raw data from the PSC but report only on the results of the comparison of the PSC with the bid. The raw data used during the PSC evaluation was not provided to DETR officials and it was not therefore possible to provide Mr D with it. The Code is clear that government departments are not obliged to provide information that they do not possess. I have looked very carefully at the documents held by DETR (see paragraph 2.17). The information contained in those documents reports on the outcome of the comparison between the TranSys bid and the PSC and draws conclusions about the value for money aspects of the project, based on certain specific assumptions. I am satisfied that this is not raw data of the kind requested by Mr D, ie data that is neutral and capable of more than one interpretation or projection.

2.15 I note that, in their letter of 16 December 1999, DETR told Mr D to contact London Transport if he required detailed information about the project and gave him the name and address of the relevant person to approach I consider DETR's advice to Mr D to have been the correct approach in this instance. (I understand that Mr D did ask London Transport for information about the PSC but that they refused to provide it on the grounds of commercial confidentiality. However, as stated in paragraph 2.8, I cannot comment on the actions of London Transport.)

2.16 In light of the above, I consider that it was entirely reasonably for DETR to tell Mr D that they could not provide him with the detailed information about the PSC itself. What I do not find to be reasonable, however, is DETR's failure to say why they could not provide the raw data that he sought. If they did not have that information, as they have now told the Ombudsman, then they should have explained that to Mr D rather than saying that they were withholding the information under Exemption 2 of the Code. Reasons for refusal of information need to be given in enough detail to explain the decision adequately, and I criticise DETR for their failure to do so in this case.

2.17 Having accepted that the detailed data in the PSC itself was not available to DETR to give to Mr D, I now turn to the question of whether or not DETR have correctly withheld from him the information about the value for money aspects of the Prestige project which they do possess. This information is contained in three different documents;

- Prestige Project Appraisal No 3 dated July 1997. This document was produced by London Transport to explain the latest TranSys proposal and help the London Transport Sub-Committee decide whether or not to proceed towards detailed negotiations with TranSys. The document contains two sections and two appendices which concern the value for money aspects of the project. These include assumptions and projections about the financial benefits of the deal as well as the results of the comparison between the TranSys bid and the PSC.
- A submission to DETR from London Transport dated 24 December 1997. This document provides an update on negotiations with TranSys and contains a section entitled "Financial Analysis". This includes an updated value for money comparison between the TranSys bid and the PSC.
- A submission dated 3 August 1998 seeking the consent of the Secretary of State and the Parliamentary Under Secretary of State to London Transport entering into the Prestige contract with TranSys. This document includes advice on the value for money aspect of the deal.

2.18 How much, if any, of this information is already known to Mr D? I have seen all the correspondence between DETR and Mr D (see paragraph 2.10). Within that correspondence there are references to the PSC and value for money aspects of Prestige. In their letter to Mr D of 26 November 1998, DETR said that, "as part of the contract, ticket gates will be installed at all Underground stations – greatly reducing ticket fraud, freeing up more money for investment in other projects. Smartcard ticketing will also create opportunities to raise additional revenue for LT through commercial agreements with third parties." In their letter of 16 December 1998, DETR told Mr D that; (i) the cost of Prestige is broadly equivalent to that which London Transport would have had to pay to achieve the same result in-house; and, (ii) the deal represents better value overall when other factors such as the accelerated timescale for the new investment are taken into account.

2.19 I now need to decide whether Mr D should be allowed access to the more detailed information related to the value for money aspects of the Prestige project, which is contained in the documents listed in paragraph 2.17. That information is, as far as I am aware, not known to Mr D. In refusing to disclose that information, DETR relied on Exemption 2 of the Code. In response to Mr D's first information request, DETR quoted the second part of that exemption. However, when Mr D asked them to review that decision, and he explained in more detail the information he was seeking, DETR quoted the third part of Exemption 2. Having now seen the information requested by Mr D, I believe that the second part of the exemption can be held to apply to the advice on value for money in the Ministerial submission, which Mr D accepts should remain confidential. The information in the first two documents consists largely of projections and assumptions relating to the financial aspects of the deal. The third part of Exemption 2 is clearly more applicable to this information and I have therefore considered whether the material was correctly withheld by DETR under that part of the Code.

2.20 Paragraph 3(i) of Part I of the Code commits departments;

***'to publish the facts and analysis of the facts which the government considers relevant and important in framing major policy proposals and decisions; such information will normally be made available when policies and decisions are announced.'***

The assumption here is that the factual and evaluative information which formed the basis for Ministerial decisions should be shared with Parliament and the public. This would indicate that there is a presumption in favour of releasing the sort of information requested by Mr D. However, the Codes does not commit departments to the disclosure of all internal analysis, projections and assumptions; it is recognised that departments need to be able to assess options or proposals which are not their preferred options, and to do so objectively and dispassionately. Wide disclosure of such information could limit the analysis of policy options within government.

2.21 How does this relate to Mr D's complaint? The information he requested consists largely of projections and assumptions based on a comparison of the TranSys bid with the PSC. Ministers used that information (as well as other aspects of the proposed deal) to decide whether or not to consent to London Transport entering into a contract with TranSys. As such, the information requested by Mr D relates to an analysis of alternative policy candour for its effectiveness, would be substantially less if it were thought that it would be made available to a wide audience. To that extent, I agree that any projections and assumptions relating to the scheme that were discussed before reaching the decision to award the Prestige contract to TranSys, and which come within the ambit of Mr D's request, were correctly identified as falling within Exemption 2 of the Code.

2.22 In some circumstances, however, it may be in the public interest to disclose analysis of alternative and rejected options and Exemption 2 incorporates a harm test which must be applied: would the harm that might be caused by disclosure of the protected information be outweighed by the public interest? There is a very strong public interest in any matters relating to public transport in London. Prestige, as London Transport and the government have been keen to affirm, is likely to revolutionise travelling for the public in the capital. I am of the opinion that the release of information of this kind can therefore only aid debate and facilitate public understanding of the government's decision on Prestige. It also seemed to me that the sensitivity of information of this nature would have reduced over the 2 years since the announcement of the contract for Prestige in August 1998.

2.23 I also note that HM Treasury's guidance about the release of information relating to PFI projects ('PFI Projects: disclosure of information and consultation with staff and other interested parties' – Taskforce Policy Statement No 4) refers to the importance of satisfying public accountability and assisting in the development of PFI. Section 4.4.1 of the guidance recommends that government departments provide a post-contract explanation of the decision to award any such contract. It recommends that the explanation should include the final assumptions used in the PSC, the estimated savings from using PFI and the benefits of any risk transfer. That is very much the type of information sought by Mr D.

2.24 Having taken all these matters into account I concluded that any harm to the frankness and candour of internal discussion that might be caused by the release of this information was outweighed by the public interest in making it available. I saw no reason, therefore, why the information sought by Mr D should not be disclosed, the simplest way being to release the relevant extracts of the documents to him. I so recommend to the Permanent Secretary.

**Further developments**

2.25 In reply, the Permanent Secretary said that although he accepted the need to provide as much information as possible on public transport issues in London, much of the provision of that transport was secured through contracts with the private sector. He said that if their commercial confidentiality in bidding for such contracts could not be assured, DETR would be hindered in the exercise of its sponsorship function in relation to bodies providing such services. He took the view that the material that was supplied in confidence to DETR could be exempt from disclosure under Exemptions 7 and 14 of the Code, which bear respectively on the department's ability to conduct its business efficiently and on the release of information supplied in confidence. He also said that some of the information recommended for release to Mr D was taken directly from TranSys's bid and protected by a confidentiality clause. London Transport believed they would be exposed to an action for breach of contract if this information were released to Mr D.

2.26 The Permanent Secretary went on to say that the purpose of the confidentiality clause was to prevent the release of commercially-sensitive information into a buoyant market for transport smart-cards in which TranSys were one of the competing companies. TranSys were currently pursuing similar contracts, both in the UK and abroad, and DETR understood that they were recycling some of the bid material from their Prestige bid into these new ventures. The Permanent Secretary said that he had been advised that the release of the information proposed, comprising pricing and technical material from TranSys's Prestige bid, could therefore significantly disadvantage TranSys in the market. For that reason he felt that the information recommended for release could also be exempt from disclosure under Exemption 13 of the Code, which relates to information that could harm the competitive position of third parties.

2.27 The Permanent Secretary accepted, however, a requirement on London Transport to comply with the terms of HM Treasury's guidance (see paragraph 2.23). He therefore asked London Transport to prepare a paper in accordance with that guidance, which would provide information on the PSC at the time the contract was signed.

**Further Assessment**

2.28 In the light of the further explanation now provided by the Permanent Secretary, I believe that the three additional Code exemptions cited by DETR are potentially relevant to the information sought. I turn first to Exemption 13, which is headed 'Third party's commercial confidences' and reads:

***'Information including commercial confidences, trade secrets or intellectual property whose unwarranted disclosure would harm the competitive position of a third party.'***

Exemption 13 is intended to protect from disclosure sensitive commercial information which would adversely affect those to whom that information relates. The Cabinet Office's guidance on the Code states that companies will need to be confident that the Government will apply its general commitment to openness in a way which does not damage their legitimate interests or undermine the trust they have placed in Government. On the basis that TranSys is competing for similar contracts relating to transport smart-cards in both the United Kingdom and abroad, I accept that the release of the information proposed could materially disadvantage them in that market. This information, which includes pricing and technical material obtained directly from TranSys's bid, could be useful to a competitor and could thus harm the competitive position of TranSys. I consider, therefore, that the information concerned is covered by Exemption 13.

2.29 However, Exemption 13 also has a harm test. I therefore also need to decide whether or not the public interest in disclosing this information, as outlined in paragraph 2.22 above, outweighs the potential harm to the competitive position of TranSys. On balance, I do not consider that it does. It is clear from what the Permanent Secretary has said (in his later comments) that the information concerned still remains sensitive and, while I continue to believe that there is a very strong public interest in all matters relating to public transport in London, I accept that it is outweighed on this occasion by the potential harm that could be caused to TranSys's present and future competitive position if that information were to be disclosed. I consider therefore that Exemption 13 can be held to apply to that information. As such, I see no merit in going on to consider whether or not Exemption 7 and Exemption 14 can be held to apply to that information.

2.30 However, as indicated by the Permanent Secretary in his reply, DETR have forwarded to this Office two papers prepared by London Underground in accordance with the requirements of HM Treasury's guidance on the release of information relating to PFI contracts. The first of the papers is made up of four sections: an explanation of the reasons for the contract award, the final assumptions used in the PSC, the estimated savings from using PFI and the approach to risk transfer. The second paper gives a summary of the key provisions in the Prestige contract. These papers were not available to DETR at the time Mr D made his requests for information. I therefore make no comment on their content in the context of this complaint other than to say that I believe they contain the type of information sought by Mr D. I very much welcome the Permanent Secretary's initiative in having these documents prepared by London Underground and providing them to him.

2.31 I have already (paragraph 2.1.6) criticised DETR for inadequacy of their earlier explanation to Mr D to justify withholding the information that he sought. I also note that, at a late stage, DETR have quoted three additional exemptions in order to support their case. If a department is relying on a number of exemptions in order to justify non-disclosure, I should emphasise that it is essential that these are all cited as early as possible.

**Conclusion**

2.32 I found that DETR were justified in refusing to disclose the information sought by Mr D but that their explanation for not releasing that information was inadequate. DETR have however agreed to provide Mr D with two papers containing information relating to the Prestige contract relevant to his concerns and to the PSC. This seems to me to be a satisfactory outcome to a partially justified complaint.

Total screening and investigation time – 30 week

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Prepared 24 January 2001

30 May 2001

We would like to express our warmest thanks to you, to the Committee Chair, Francie Molloy, and to the other members of the Committee, for taking the time to hear our oral submission in respect of the above inquiry. It was a great honour to be given the opportunity to put our case in person to the Committee and we hope those members who were present felt the meeting was a useful one.

**Request for further information relating to the PPP report**

Firstly, we wish to inform the Committee that we have just received a letter from Ronnie Spence, the Permanent Secretary at the Department for Regional Development. This letter was in response to a further request we made for fuller information relating to the PricewaterhouseCoopers report on Public Private Partnerships to which we referred in our submission. We have enclosed a copy of Mr Spence's reply. As you will see, Mr Spence is still refusing to provide this information. (The Ombudsman case to which he refers is the same case the details of which we sent previously to the Committee). However, at the time of writing to Mr Spence, we were not aware that the Health Minister had permitted full versions of *Outline Business Cases* relating to PFI proposals to be released to the Committee (with a request to inform the Department of Health of any intention to publish extracts which might impact on commercial confidentiality). We feel the DRD should do likewise with regard to this particular report.

We still believe that the public interest should outweigh concerns regarding commercial sensitivity in the case of the PwC report on PPPs for public transport in Northern Ireland. We would reiterate that it is vital that the public is allowed to assess properly any conclusions reached by the government and its advisors at this vital policy formulation stage. This can only be done if the full fact relating to analyses such as this are made publicly available. At the very best, we hope the Committee will ask the DRD for the full copy of this particular report. We hope also, however, that it will ask the DRD to make this report publicly available – and that it will recommend that the public interest should outweigh concerns of commercial sensitivity in such instances. On a practical note, the Parliamentary Ombudsman does refer to the fact that concerns of commercial sensitivity should not be so great where the information is not very recent.[1] This would surely apply in the case of the PricewaterhouseCoopers report which was published in December 1999. We intend to refer the refusal relating to our request to the Northern Ireland Parliamentary Ombudsman.

Mr Molloy asked us if we could suggest how one might deal with the problem of the issue of commercial confidentiality relating to PPPs. As we stated, we do not believe that there is an easy solution and this is one of the prime reasons why we are concerned about PPP options. It would seem that accountability would be far easier to achieve through one of the bond finance options which we proposed. However, we would also suggest that it might be worth looking at how this issue is dealt with in the United States where legislation regarding freedom of information appears to be stronger than in the UK.

**Revenue sources to support bond finance**

The Committee asked us to provide figures relating to annual sources of revenue to support a bond issue. We obtained information in this regard from Translink, the DRD and from Transport 2000's Director, Stephen Joseph.[2] I enclose a copy of the information provided by the DRD and by Stephen Joseph.

We suggested that revenue sources might include revenue from public transport fares, congestion charging and workplace carpark levies. Translink has confirmed that both the railway and bus operations currently operate at a loss. In the coming financial year, 2001-2, NIR is projected to lose £12.5m while Ulsterbus/Citybus are projected to lose about £1.3m. However, this situation could change markedly if the investment was put into both rail and bus to make them more attractive. Moreover, Translink does not receive the operating subsidies enjoyed by private bus operators in Britain[3]. If it did receive a similar operating subsidy, it might make a sufficient profit to enable fare revenue to be used to help support a bond issue.

As regards congestion charging, you will see from the enclosed letter from the DRD that it is presently of the view that £20m a year might be obtained through a Belfast-based scheme. If all the revenues were used to support a bond issue and Glaister et al. are correct in their calculations, it should be possible for this revenue stream to support a 30-year bond issue of £240m. This sum could be used to upgrade and expand the rail network to a

1 See end of para 2.22 in the copy of the Parliamentary Ombudsman's ruling sent to your Committee previously.

2 We would like to thank Ted Hesketh, Managing Director of Translink and Denis O'Hagan, Head of the DRD's Transportation Unit for their kind and prompt assistance in this regard.

3 Details can be found in General Consumer Council for Northern Ireland (January 2001) *Bus licensing in Northern Ireland: Background Paper for the Northern Ireland Assembly Committee for Regional Development (unpublished)*.

standard which would make a viable alternative to car travel for a much larger number of people. Part of this money could also be used to make faster progress on Quality Bus Corridors (and buses for these corridors) in Belfast, and to improve buses and bus services in rural areas.

The DRD's figures presumably relate to the greater Belfast travel to work area which has a catchment population of some 700,000. These figures may be on the conservative side if compared with the estimates drawn up for the greater Bristol area population 550,000, which suggest £30m-£50m a year could result from a cordon charge of £1.20-£1.90.[4] We would also stress the fact that the very act of charging automatically pushes up public transport revenues as people switch to public transport. Studies in Bristol and Leicester suggest a £5 charge produces a 15% modal switch to public transport.

However, these sums are small compared to the revenue which could be generated from workplace carpark levies. One study has suggested that a £250 annual charge per parking space would generate an annual revenue of £239m (or £197m if firms with less than 10 employees are excluded) in the West Midlands region in Britain.[5] If this is accurate, the revenues from workplace carpark levies could be used to support a really ambitious programme of investment in public transport in Northern Ireland which would permit it to reach the superior levels of speed, safety and comfort seen in the (publicly-owned) French rail system and many other European countries. Such funds would permit the development of light rail in Belfast in addition to significant expansion of the 'heavy rail' network throughout Northern Ireland and across the border.

Finally, we also enclose some information about the forthcoming report on PPPs from the Institute for Public Policy Research, and a recent *Guardian* article which highlights one PPP scheme which was not a success.

You will note that Denis O'Hagan of the DRD has expressed his willingness to assist the Committee with any further information it requires in respect of congestion charging. Likewise, our Director, Stephen Joseph, would be more than happy to assist the Committee with further information on likely revenues from both congestion charging and workplace carpark levies. He can be contacted at our London offices on 010 7613 0743 or E-mail: Moreover, please don't hesitate to contact me if I can be of further assistance.

We hope you will be good enough to circulate copies of this letter to Committee members, and to publish this letter as part of our evidence to the Committee's enquiry. We look forward very much to reading the Committee's report when it is published.

**LIZ FAWCETT (Dr)**
**Northern Ireland representative,**
**Transport 2000**

4 These figures were cited in a talk by Councillor Helen Holland, Bristol City Council, in 'Road User Charging: Policy in Bristol'. Paper presented at 1st Local Authority UK Chairs of Transport Conference, London, September 1998.

5 ECOTEC (February 2000) *Workplace Parking Charges: A Preliminary Study. Final Report to the Black Country Boroughs.*

## DEPARTMENT FOR REGIONAL DEVELOPMENT

29 May 2001

I refer to your letter of 30 April, which was received in my office on 2 May 2001 regarding your request for information pertaining to the PricewaterhouseCoopers report on Public Private Partnerships. I apologise that it wasn't possible for me to reply in advance of your meeting with the Assembly Committee for Finance and Personnel.

I regret that I am unable to provide the information you request. Information should be released unless the harm or prejudice likely to arise from disclosure would outweigh the public interest in making the information available. While I understand your view that public interest outweighs commercial sensitivity in this matter, I must advise that having fully considered Part II of the Code of Practice on Access to Government Information, there are three categories restricting the release of this information:-

1. Section 7, effective management and operations of the public service, precludes the release of information whose disclosure would prejudice the competitive position of a department or other public body or authority.
2. Section 13, Third Party's commercial confidences, refers to information including commercial confidences, trade secrets or intellectual property whose unwarranted disclosure would harm the competitive position of a third party.
3. Section 14, information given in confidence, applies to information whose disclosure without consent would prejudice the future supply of such information.

I have also considered the details of the Parliamentary Ombudsman case you enclosed. However, in this case, DETR cited Exemption 2, where information was not supplied on the grounds of internal discussion and advice. The Ombudsman found that Exemption 2 did not apply and criticised the Department for then citing further exemptions. I accept the view that under the terms of Exemption 2, public interest could be deemed to outweigh commercial sensitivity. However the further Exemptions I have outlined above are of more relevance to your request.

For these reasons, I must advise that the position remains as outlined in Mr Aiken's reply of 13 April 2001 to your initial request.

**R B SPENCE**

29 May 2001

**ROAD USER CHARGING**

You asked Malcolm McKibbin for information about possible revenue streams from congestion charging. Malcolm has passed it to me as Transportation Unit is leading the preliminary work in this area.

We are still at an early stage in our investigation of the concept, and there would be a range of options in relation to charging levels and boundary of any future scheme which would have an impact on the revenue.

However, to facilitate discussion a revenue stream of £20 million per year would seem to be a realistic aspiration for Belfast, if a scheme was to be introduced.

If you reference Transportation Unit as the source of the information, we can provide further details for the Committee if required.

As you know, there is no Government commitment to introduce Road User Charging in Northern Ireland, and the necessary legislation is not in place.

I hope this is helpful.

**D O'HAGAN**
**Head of Transportation Unit**

**From:** Stephen stephen@transport2000.demon.co.uk

**To:** ER.Fawcett@ulst.ac.uk ER.Fawcett@ulst.ac.uk

**Copies to:** Revenues

**Date sent:** Fri, 25 May 2001 13:17:57 +0100

In a short time I have been able to find just three studies on this.

London: The most recent study, which is the basis for Ken Livingstone's proposed charging regime, is "Road Charging Options for London: A Technical Assessment" (Stationery Office, 2000). This assesses: *a £5 charge (for an area licence for driving into central London 0700-1900): annual net revenues £230-270m *£2.50 charge: £110-140m pa net revenues *£10 charge: £450-350m Higher charges were assumed for HGVs. If the £5 charge for central London were supplemented by a £2.50 charge for inner London, net revenues would rise to £600-700 pa. On workplace parking, the study assessed a £3000/space charge in the central area, with annual revenues of £90-110 pa. A £1500/space charge would generate £50-70m. A £3000 charge with exemptions for firms with less than 10 spaces would have revenues of £75-95m.

Bristol: One of the main cities planning to introduce road pricing.

Population: 400,000, but greater Bristol is 550,000, and the former Avon county, which includes Bath, is 1m. So perhaps more comparable to Belfast. A 1998 talk by the lead councillor, Helen Holland, cites a study for the council which suggests a cordon charge of £1.20-£1.90 with revenue streams of £30m-50m pa. A point she makes, which is relevant to the revenue bond issue, is that the very act of charging automatically pushes up public transport revenue and use, so the revenue needed to support public transport falls. Studies in Bristol and Leicester with volunteers suggest a £5 charge produces a 15% modal switch to public transport. So the PPP finances should be compared, not just with a revenue bond from road charging revenues per se but to a revenue bond issue with road charging revenues plus higher direct public transport revenues.

Black Country/West Midlands: an ECOTEC study on workplace parking levy for the Black Country boroughs (Feb 2000) suggests a £250/space charge pa. Across the West Midlands this would generate £239m revenue pa or £197m if firms with less than 10 employees were excluded.

I hope this helps: let me or Susan know if you want more detail on any of these.

# COMMITTEE FOR FINANCE AND PERSONNEL
# INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## DEPARTMENT FOR SOCIAL DEVELOPMENT

19 April 2001

**PPP/PFI: SOCIAL SECURITY AGENCY - WELFARE REFORM & MODERNISATION**

**Introduction**

The Social Security Agency signed a PPP Agreement on 15 December 2000 with a consortium headed by Electronic Data Systems Limited (EDS) for the provision of strategic advice and operational support services. The agreement is for a period of 10 years with options to extend this by either 2 or 5 years. The advice service started on 15 December and EDS is currently developing the necessary processes and systems for the support service, with input from the Agency.

This submission includes general comment on PPP/PFI Projects and specific comments on the development of the Agency's Agreement with EDS. The paragraphs have been numbered to correspond with the paragraph numbering in "Request for Information (1)" and "Request for Information (2)".

**General Context of PFI/PPP**

1. (a) The main benefits of PPP/PFI are:
   - access to private sector capital investment, skills and relevant experience, brought together by the supplier for the purposes of delivering a service;
   - the allocation of risks on funding, design, development and operation of the services to the contractor;
   - the timescale to create the service is much shorter than the Agency could have achieved; and
   - the business impact and innovative use of with new technology is greater that would have been attempted in-house.

   (b) The identifiable benefit to the public and stakeholders is that there will be a better standard of service than would otherwise be the case.

2. We see the key factors for the successful application of PPP/PFI as:
   - appropriate transfer of risk;
   - involved commitment of senior management;
   - clear output specification;
   - suitable skilled procurement team with experienced and skilled technical, commercial, financial and legal advisers;
   - agreed and achievable timetables;
   - realistic expectations of technology;
   - shared aims and expectations with the contractor(s);
   - strong incentivisation arrangements with shared benefits;
   - sound change mechanisms and contingency reaction provisions;
   - robust performance model;
   - workable and trust relationships built at different levels;
   - involvement of the contract manager from early in the procurement;
   - achievable development and implementation programme;
   - suitably skilled and committed implementation management; and
   - effective contract management.

3. (a) A wider issue which should be addressed is the need for better co-ordination and co-operation across Government Departments in the UK in developing PPP/PFI contracts and to agree standard approaches/ positions in key contractual areas.

   (b) There are no obvious gaps in the supplier market base provided suppliers are willing to co-operate in consortia. The necessary skills and guidance for PPP/PFI projects are available but they are mainly GB based.

4. In assessing the strategic importance and prioritisation of PPP/PFI projects, and the relationship with other schemes, account needs to be taken of:
   - the type of service required;
   - whether or not the Authority wants to control the assets;
   - the availability of public funding;
   - timescales for completion of the project; and
   - availability of skilled in-house resources to deliver the project.

5. One of the main objectives of the Agency's PPP/PFI project was to improve the standard of service to those claiming and receiving Disability Benefits. Also an analysis of the impact of the PPP/PFI scheme on the promotion of equality of opportunity, under Section 75 of the Northern Ireland Act 1998, was carried out. Some impacts were identified but there was no need for immediate mitigatory action.

6. Other procurement options should be consider are:
   - In-house supply;
   - traditional procurement using public funding and with full responsibility remaining with the relevant Authority;
   - privatisation; and
   - outsourcing.

7. To take forward PPP/PFI in Northern Ireland we suggest that a central PPP/PFI unit should be established, similar to the Treasury Taskforce (now Partnerships UK). This would provide specialist advice – either from in-house or from suitably experienced consultants. Such a unit should:
   - extend national standard contracts to include standard variants for Northern Ireland Government positions on key areas of PPP/PFI contracts;
   - develop best practices on negotiation with the private sector;
   - assist in negotiations and facilitate the training of staff on conducting negotiations; and
   - provide a forum for sharing experience, developing best practices and addressing problems in the management of PPP/PFI contracts.

8. Our Contractor was able to self-fund all costs. We did not investigate alternative forms of financing.

9. We see the economic basis of PPP/PFI as being determined through the application of government standard economic appraisal techniques along with specific inclusion of the financial value of risk transfer.

10. We do not consider that value in relation to capital investment should be assessed. We are concerned about the standards of service received and the price to us of that service. This will be assessed against an agreed performance model, price variation limited by agreed formula and both quality of service and price will be subject to benchmarking.

## SPECIFIC PROJECTS

### Bid Process

1. The output objectives of the project were clear. The aim of the project was to procure a strategic supplier who, in partnership with the Social Security Agency, would help transform the Agency's business in line with Ministers' objectives for an active, modern and reformed welfare system. The needs had already been established in a Sourcing Strategy paper. The objectives did not stray into outputs and delivery mechanisms.

2. The project started the development and implementation phase in January 2001 and it is too early yet to compare the specification of requirements with implementation and operational reality.

3. The project benefited from initial enquiries into private sector interest. Six companies were initially contacted and five responded – all positively. The general view was that they were not enthusiastic about supplying general support services, ie typing, messengerial services etc. Their interest was in providing services for the end-to-end delivery of the Agency's benefits to customers. At that time the implementation of work management systems and modified working practices, supported by document image processing technology was discussed.

4. The following areas of risk transfer were identified:

| **Category** | **Description of risk** |
|---|---|
| Design and Development Risk | The risks associated with creating and maintaining a solution that effectively and fully delivers the specified services requirement. |
| Transition (Commissioning and Implementation) Risk | The risks associated with transferring responsibility for the initial services to the Contractor, including the take over of existing assets and service arrangements, the transfer of licences and responsibilities, the novation of contracts and transfer of staff. |
| Operation Risk | The risks associated with operating the services during the contract period, including those associated with the costs of unavailability and under performance of the services, damage or loss to equipment and property, third-party claims for compensation or damages and the impact of Force Majeure or Relief events. |
| Cost Estimation Risk | The risk that the out-turn costs of delivering the planned services over the life of the contract differ from those estimated at the outset, including the risk that the resources (staff, equipment, consumables) eventually needed to design, implement and deliver the planned levels of service differ from those assumed. |
| Category<br>Demand and Volume Risk | Description of risk<br>The risk that the costs and benefits of the contract differ from those estimated at the outset because demand levels for the services over the life of the contract vary from the levels assumed. |
| Change Control Risk | The risk that unplanned costs are incurred as a result of changes to the services requirements during the life of the contract. |
| Regulatory Risk | The risk that unplanned costs are incurred as a result of changes in law or regulation that affect the costs of delivering the services. |
| Technological Obsolescence Risk | The risk that unplanned costs are incurred because contracted systems or processes become technically inappropriate for purpose or unduly expensive to support or difficult to inter-operate with wider systems. |
| Termination and Residual value Risk | The risk that the costs and benefits of the contract differ from those estimated at the outset because the contract is terminated earlier than assumed. Also the risk that the residual value of the assets at the end of the contract differs from that estimated at the outset, including the risk that the estimated costs for disposal of residual assets, or maintaining their required operational life at the end of the contract, differ from those estimated at the outset. |

5. The following evaluation criteria were used:

- **Financial & Commercial assessment** – to confirm that the offer provides value for money in terms of the expected costs and direct benefits, taking account of risk transfers and sensitivities. Financial and commercial issues will be assessed separately within the business case.
- **Business Risks** – to confirm that the risk transfer proposed allocates risk to whoever is best able to manage it at least cost.
- **Technical Assessment** – to confirm that the offer supports the operational service obligations and long term strategic advice needs.
- **Business Impact** – to confirm that the offer provides a mix of business benefits in terms of the Authority's strategic priorities.

A formal evaluation process was carried out involving expert evaluators, independent of the project. The process produced an evaluation report with recommendations. The procurement concluded in negotiations with a single bidder so there was only one bid to evaluate.

6. The Full Business Case was completed in accordance with Treasury and PFI guidance. The key features were:

- Return on Investment
- Evaluation of Risk
- Accounting Treatment

- Net Present Value (NPV) of the deal compared with the Public Sector Comparator, a 'Do Nothing' option and a 'Should Cost' model. The 'Should Cost' model was necessary because the procurement concluded on a single bidder basis.
- Sensitivity Analyses
- Key Terms and Conditions of the Agreement
- Affordability

7. (a) A Public Sector Comparator (PSC) was completed. This identified the additional costs to the Agency, over and above its direct running costs, as a result of embarking on the project. It described a publicly funded option for providing a new technology-enabled business, combined with an in-house transformation of specified operational branches of the Agency, and in line with the specification of requirements. The fundamental principle was that the public sector would initiate and manage the project to deliver the above, but would procure relevant consultancy services at any stage of the project where it considered that the Agency had:

- insufficient knowledge of the scope of the overall possible solution; and
- insufficient technically skilled resource to complete specific tasks.

(b) The PSC was in the form of a spreadsheet calculation (financial), supported by a professional judgement by the project's advisors, in terms of timetable and business impact, on how the Agency could deliver a similar system.

(c) The features of the PSC were:

- the principle cost assumptions;
- detailed cost assumptions;
- savings assumptions – outlining the assumptions and figures used to represent the level of savings through manpower and reallocations expected to be achieved by the PSC; and
- risk quantification – the rationale and valuation for the degree of financial risk that needs to be added to the baseline PSC in order for it to be directly comparable to the risk-inclusive PFI costs.

8. The following skills and expertise were provided to the project:

| Skills | Provided by |
|---|---|
| Commercial and Financial | PA Consulting |
| Technical (eg risk assessment, business modelling, technology performance requirements | PA Consulting |
| Procurement | PA Consulting, Treasury Taskforce (now Partnerships UK) |
| Insurance | PA Consulting sub-contracting to Marsh UK Ltd |
| Legal | Beachcroft Wansbrough |
| PFI/PPP and Pre-Contract Review | Treasury Taskforce (now Partnerships UK) |

The consultants were recruited immediately following Ministerial approval to proceed with the project and before the development of the Invitation to Tender (ITT).

9. The key contractual issues were:

(a) Performance Model
(b) Payment Model
(c) Financial Model and Open-book Accounting
(d) Insurance requirements and Limits of Liability
(e) Compensation on Termination
(f) Authority Step-in
(g) Indemnities
(h) Changes in Law
(i) Authority's Requirements
(j) Precedence between the Authority's Requirements and the Contractor's solution
(k) Collateral Agreement

(l) Benchmarking
(m) Employee Redeployment and Verification Point
(n) Intellectual Property Rights

The standard PFI contract model was used as the basis for the Agreement so most of these key issues were identified from the start of the development of the ITT. Issues on the Limits of Liability, Precedence, Collateral Agreement and Employee Redeployment and Verification Point were identified during negotiations with the single bidder.

10. The timetable for the PPP procurement was set in the context of a competition. This competition was affected by the withdrawal of two bidders after the Invitation to Tender was issued. If the two bidders had remained it was likely that the timetable of one year would have been met. However having only the one remaining bidder led to the project become involved in protracted negotiations with that bidder and this delayed the timetable by six months. The bidder's involvement in parallel contract negotiations with the Benefits Agency in GB on a related IT service contributed to this delay.

11. The project is being self-funded by the Contractor.

The amount of payments by the Agency over the 10 years of the Agreement is £19.013m.

**Completed Deals**

12. The deal is sufficiently complete to answer the detailed questions in the Request for Information (2), 12-25.

# COMMITTEE FOR FINANCE AND PERSONNEL
# INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## NIAO

20 April 2001

1. I refer to your letter of 22 March 2001 inviting our views on Public Private Partnerships (PPP), including Private Finance Initiatives (PFI).

**General Background**

2. At the outset, I thought it would be useful to outline the role of the Comptroller and Auditor General for Northern Ireland (C&AG) and the Northern Ireland Audit Office (NIAO).

3. The C&AG, who is independent of the Executive, has two main functions:

   - the authorisation of the issue of public funds to Government Departments and other public sector bodies; and
   - the audit of central government finances.

   He is head of the NIAO, which assists him in the discharge of his functions. The primary aim of the NIAO is to provide independent assurance, information and advice to the Northern Ireland Assembly on:

   - the proper accounting for and regularity and propriety of expenditure, revenue and assets; and
   - the economy, efficiency and effectiveness with which public sector bodies use their resources.

4. The legislative authorities for the responsibilities of the C&AG include the Northern Ireland Act 1998, the Government Resources and Accounts (Northern Ireland) Act 2001 and the Audit (Northern Ireland) Order 1987. The 1987 Order precludes the C&AG from questioning the merits of the policy objectives of any body on which he is carrying out an economy, efficiency and effectiveness examination. You will appreciate, therefore, that it would not be appropriate for us to comment on the relative merits of the policy of using PPP/PFI although we accept that it is now a well-established form of procurement.

5. The remainder of this letter addresses the Office's role as an auditor of PPP/PFI and provides information on the work it has undertaken and plans to undertake on the initiatives.

**NIAO Approach to PPP/PFI**

6. Concerns have been expressed that public audit has inhibited progress on the implementation of PFI projects through fear of adverse reports and criticism. However, as a member of the Public Audit Forum (which was established in 1998 by the UK national audit agencies to provide a focus for developmental thinking about public audit), NIAO has stated that it will support well thought through risk-taking and innovation in the delivery of public services. It has applied such an approach to the PPP/PFI initiative, recognising that risk taking is essential if public bodies are to innovate and improve.

7. NIAO needs to have access to sufficient information to reach audit conclusions. It is important that such access is available to the records of contractors where this is necessary to verify or support payments under PPP/PFI.

8. There are three aspects to the Office's work on PPP/PFI:

   (1) the performance audit of individual projects;

   (2) the audit of the annual financial statements of bodies with PPP/PFI projects; and

   (3) without compromising its independent role, the provision of advice to public bodies on accounting for PPP/PFI projects.

The following paragraphs elaborate on these.

***Performance Audit***

9. The Office's approach, in line with that for any form of procurement, is to examine how well projects have been implemented and managed and whether good value for money has been achieved. Its approach broadly mirrors that of the National Audit Office, who have produced a number of reports on PFI (including 'Examining the value for money of deals under the Private Finance Initiative', August 1999, on which you have based 'Request for Information(2)'). We fully endorse the good practice promulgated by both the National Audit Office and the Westminster Public Accounts Committee.

10. Currently we are monitoring progress on a small number of PPP and PFI projects in Northern Ireland, including the Water Service "Aquarius" project and the Belfast Court Complex. Should the C&AG decide that there are issues which warrant a full review, he will report his findings and conclusions to the Assembly. For example, in his Report on the Appropriation Accounts for 1999-2000, he included a section on an ex-gratia payment of £450,000 which was made to a contractor when the Water Service decided not to proceed with a proposed PFI project for a Waste Water Treatment works in Bangor.

***Audit of financial statements***

11. Transactions and commitments relating to PPP/PFI should be recorded in the financial statements of those bodies having operational projects. These statements will be examined during our annual audit and are included in the scope of the audit opinion. Matters of audit interest relate to the accounting treatments for projects to ensure that they are in line with current guidance.

***Provision of Advice***

12. In accordance with the Treasury Taskforce Technical Note No 1 (Revised), NIAO can provide an audited body, if it so requests, with preliminary views on the accounting treatment of a PFI project during its procurement, without compromising the final audit opinion. Such advice has been sought in a number of cases and has primarily focused on whether the assets are on or off the public sector balance sheet ('on balance sheet' can imply poor value for money but this is simplistic and accounting treatment should not be used as a driver in the structuring of a project).

13. Ownership of accounting decisions ultimately rests firmly with the body concerned but NIAO has welcomed the opportunity to provide advice to ensure, as stated in the Technical Note, that there are no late 'surprises' in the proposed accounting treatment of PFI transactions.

14. I trust that the above will be of some assistance in your consideration of PPP/PFI.

**Janet Sides**
**Director**

# COMMITTEE FOR FINANCE AND PERSONNEL
# INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## 4PS

19 April 2001

**4ps response to Northern Ireland Assembly Inquiry into Public Private Partnerships**

I write in response to the Northern Ireland Assembly's request for information relating to Public Private Partnerships. The 4ps (the Public Private Partnerships Programme) is the organisation owned by the Local Government Association, established to assist local authorities in England and Wales to promote and pursue public private partnerships and private finance transactions. The 4ps works closely with all Government departments which have a role in sponsoring local government services or developing PPPs involving local authorities. The 4ps works closely with the DETR in relation to Government initiatives involving PPP and PFI for local government including the development of the Best Value legislative framework.

The 4ps has recently responded to a number of inquiries and reviews which have been undertaken by diverse bodies into the benefits and features of PPP and PFI and procurement in general. We attach to this response the following documents which we believe address many of the issues set out in your request for information:

1. 4ps response to the IPPR call for information on PPP and PFI in local government;
2. 4ps response to the Welsh Assembly's consultation exercise on PPP and PFI in Wales;

Further information about the 4ps and the products and guidance it produces is available from our web site www.4ps.co.uk along with links to other relevant web sites where information on PPP/PFI can be readily obtained. A copy of the 4ps/IDEA joint response to the LGA/DETR joint review of local government procurement chaired by Sir Ian Byatt (ongoing) is also available on our web site in the form of a free PDF download.

We trust these documents are of interest and go some way to meeting your requirements. We would, of course, be willing to meet you or your colleagues at a mutually convenient time for a discussion relating to the benefits and key factors involved in successful PPP/PFI transactions from our practical experience of working with local authorities on PPP/PFI schemes over the past 5 years, if that would be of interest.

**PETER FANNING**
**4PS CHIEF EXECUTIVE**

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27 June 2000

**Consultation on Public Private Partnerships and Private Finance Initiative in Wales**

1. I write on behalf of the 4ps in response to the letter from Edwina Hart AM of 9th June 2000 in which she requested observations on public/private partnerships and the PFI in Wales.

2. The 4ps was established by the predecessors to the Local Government Association (LGA) and Welsh Local Government Association (WLGA) to support Local Authorities in England and Wales develop and deliver public private partnerships. As you are aware, the 4ps has played an active role in supporting all the PFI projects that have received financial support from the Welsh Assembly. The 4ps experience is in Local Government public/private partnerships and PFI transactions and it must also be clear that the 4ps is a creature of Local Government and must first look to the interests of Local Government in Wales. While the 4ps is an independent professional body it would defer to the WLGA in matters of policy.

3. For convenience, I will group my comments under the headings from the Consultation Paper that accompanied the letter from Edwina Hart AM.

**How Can the Assembly ensure that public private partnerships/PFI across the public sector in Wales are undertaken within a strategic framework that supports the Assembly's priorities?**

4. There are great, unexplored mutual benefits from both linking projects within Local Government and between Local Authorities and other public bodies. For example, in England the London Borough of Lambeth hopes to procure a primary school in the Vauxhall area of the borough as part of a wider regeneration project which includes investment in public housing. In Dudley, the Local Authority Social Services Department and the local Health Care Trust have jointly procured property and associated facilities from which "joined up" services are delivered to the local community.

5. My understanding is that both of the projects mentioned emerged from local initiatives which were supported by Government Departments. This suggests anecdotal evidence at least that Local Authorities increasingly try to 'join things up' within their communities, but can be frustrated from doing so because they are very dependent on externally provided finance which is delivered down the 'silos' of various un-joined up funding regimes.

6. Clearly it will take time and a number of steps to move from the current position to the more focused strategic approach desired by the Assembly. I suggest that in developing a strategy the Assembly might consider the following processes.

7. Firstly, the Assembly should publish a strategy and implement it. The 4ps experience is that Local Authorities are very inventive in responding to the strategies and the associated funding regimes developed by Central Government. However, in the absence of a clear statement of Government priorities there are very considerable financial and other risks in Authorities developing 'speculative projects'. Therefore, much is to be gained from certainty as to the Assembly's intentions.

8. Secondly, it is difficult to understate the importance of deal flow – that is the orderly progression of projects from conception to operation. One of the reasons for the success of the PFI in England and also in Wales is that Local Authorities and their private sector partners are confident that there are a stream of well thought out projects at various stages of procurement. Therefore, investment in the technology of PFI and public private partnerships by managers in Local Authorities and their private sector partners is likely to generate some future return. Uncertainty over the Assembly's intentions, or the level of funding, or the processes for allocating funds to individual projects will disrupt the flow of transactions and dissuade both individuals, Authorities, and private companies from investing in the process. Therefore disruption in the deal flow is likely to result in higher costs to the public sector and also less overall innovation.

9. The link between the principles of clarity of the Government's purpose and maintenance of the deal flow is that once a flow of transactions is established it is easier for the Government to adapt its strategy in response

to experience and changing policy objectives. For example, the Assembly may choose to allocate funds to projects over the three years as a Spending Review on an annual basis. Local Authorities and other public bodies therefore will know that there are three separate bidding rounds and they will know the rules for the bidding rounds will be made clear in advance. The Assembly may choose to vary its priorities between bidding rounds, but this is unlikely to disrupt deal flow if Authorities, public bodies and their private sector partners know in advance that there will be projects and there will be clear rules for allocating money to individual projects.

**Within the context of a strategic framework approach, how can the Assembly best encourage 'cross boundary' co-operation?**

10. The Assembly can encourage 'cross boundary' co-operation by clearly stating that well founded co-operation will be one of the criteria used to prioritise projects and then prioritising projects where such co-operation is indeed well founded and meets the Assembly's wider policy objectives. For example, the Assembly may choose to support leisure projects where the catchment area of a sports facility extends beyond the boundaries of a Local Authority. Waste management is another example where there are natural 'cross boundary' synergies.

11. The Assembly may choose to encourage private sector suppliers who are seeking to build businesses in Wales and who are therefore in a position to combine the operations of different projects, even though the public bodies may not formally manage their procurement jointly. For example, a supplier of leisure facilities may end up delivering services to adjacent Authorities, yet each Authority may have independent contracts with the leisure supplier.

12. The Assembly require Authorities to explain why a stand-alone project is desirable in categories of projects where 'cross boundary' co-operation is likely to yield public benefits. Such categories might include transport and waste management projects.

**Should the Assembly continue bidding rounds of PFI credit support for Local Government projects? Should the idea of bidding rounds be extended to the Health Sector?**

13. The 4ps must defer to the WLGA's views on the general question of the allocation of resources by the Assembly to individual Local Government projects. However, our experience to date suggests that if Government generally is to allocate funding to individual projects then a bidding round with clear and transparent rules works well. Indeed, the 4ps have advised Central Government that a two stage bidding process as used for the English HRA Pathfinders and the DfEE's school projects, is emerging best practice.

14. The first stage of the bidding process, that is before projects enter formal procurement, would require Authorities to bid for support on the basis of a general statement demonstrating how their project best fits with the Assembly's priorities and why procurement of the project using PFI is likely to be the Best Value solution. The Assembly would then make its choice and require the prioritised projects to prepare formal Outline Business Cases. The understanding would be that all projects that have been prioritised would be funded, provided their Outline Business Cases were satisfactory.

15. The separation of the decision on prioritisation and the decision to formally support a project provides the following benefits:

- Local Authorities whose projects do not meet the Assembly's priorities will not have to incur the often considerable financial and other costs of developing an Outline Business Case, in vain

- Once projects have been prioritised then the Local Authorities can be encouraged to co-operate; and experience from the HRA housing pilots and '2nd Wave' Schools projects shows, that Local authorities do co-operate well when they are not competing for a limited pot of funds. They can all 'win' provided they all meet a quality standard.

16. Where this two stage process has worked, it has worked very well, but there is a risk that the Assembly will make its initial budgetary assessment on insufficient financial information at the first round of bidding.

17. There is a risk that once Authorities have developed their Outline Business Cases, the initial assessments may have been exceeded. However, with careful management such budgetary difficulties can be avoided.

18. As to whether the process might be extended to Health – it has worked in Local Government. I have no comment except to say it has worked in other sectors.

**How could public private partnerships/PFI be used to target disadvantaged areas across a range of initiatives e.g. Education, Housing, and Health?**

19. I refer to the comments on the above questions.

20. In addition, it needs to be clearly understood that the PFI is a shorthand for the "design, build, finance, and operate" procurement contact and their variants. As with any public sector procurement there is a real risk that the investment within a community does not join up to obtain the maximum social benefit. The key objective must be to join up thinking and policy in the public sector and then to ensure that investment by the public sector is co-ordinated within disadvantaged areas, however that investment is delivered.

**What options could be made available to Local Authorities for the use of public private partnerships/PFI and Social Housing?**

21. The Housing Green Paper recently issued by DETR in May 2000 identified PFI as one of the three options available to Local Authorities to bring new investment into their housing stock. The 4ps would be delighted to share its experience of the HRA Housing Pathfinders with colleagues in Wales.

**What can be done to ensure that jobs and profits generated by PFI contracts stay in local communities?**

22. Most PFI/PPP transactions, by their nature, provide additional job opportunities and economic regeneration advantages which can assist local people to find employment or can boost the local economy to the advantage of existing businesses and undertakings in the area. A number of completed PFI schemes in England have included economic regeneration/job creation targets in their output specification. Due to the long-term nature of PFI contracts, contractors will often explore the benefits of setting up regional headquarters or, in some cases, relocating in the authorities' area which itself can have beneficial impact on economic development and job creation in the region.

23. However, local authorities must comply with all relevant EU and UK legislation when entering into any procurement exercise. In particular, it is not possible under EU or current UK law to select contractors on the basis that those contractors must employ or use local labour or local sub-contractors since this would be in breach of both EU legislation on free flow of labour between member states and the prevention of discrimination and UK legislation (Part II of the Local Government Act 1988 non-commercial matters). Notwithstanding these issues, provided conditions are non-discriminatory, it is possible to explore with contractors the use of unemployed people who are potentially drawn from any member state who register as available for work. This may of course include local people who are unemployed and available for work in any new undertaking established as a result of the PFI/PPP transaction.

**What could the Assembly do to streamline the administrative process associated with the PFI?**

24. The 4ps experience is that Local Authorities and their private sector partners are more concerned with the certainty of the administrative processes rather than their simplification or their streamlining. As public money is being spent, the demands of accountability and equity require an administrative burden which participants usually accept. However, Local Authorities and their private sector partners are understandably frustrated in having to comply with uncertain demands and uncertain outcomes. Clear rules applied predictably, ultimately reduce costs. Rules can also be changed, but the changes should be clear.

25. As to the Assembly's repeal of the 'Contract Structure Test' in Regulation 40, I feel I must repeat the 4ps concern expressed during the consultation period that in our view, the overall effect is to weaken the negotiating position of Welsh Authorities compared to their English counterparts. In England, Local Authorities have a regulatory bulwark limiting the risk that they can accept in order for a transaction to comply with the Capital Finance Regulations. In Wales, the regulatory bulwark has been replaced by an administrative one.

**What should the Assembly's policy be on the issue of staff transfers associated with the PFI?**

26. The Assembly might have regard to developments in Local Government in England and, indeed within public sector generally with regard to policy towards employees and staff transfers. Central Government, following its policies on fair employment, have recently issued a statement of practice on staff transfers in the public sector which, amongst other things, makes it clear that TUPE will apply to staff transfers unless there are genuinely exceptional reasons for not applying TUPE.

27. Also, the 4ps are about to publish guidance to local government on employee consultation and disclosure of information in the context of a PFI/PPP transaction following on from Treasury Taskforce Policy Statement

Number 4 on the same issues for the public sector generally. This guidance will be available on our web site (WWW.4ps.co.uk) shortly.

**What should the Assembly do to help support public private partnerships – PFI schemes?**

28. The importance of a predictable stream of projects coming to market and reaching contract completion cannot be understated. The Assembly can ensure this happens by making funds available and setting up procedures to allocate funds to projects in a predictable and transparent way. The Assembly could develop its existing procedures or co-operate with the PRG process in England which has recently been taken over by Office of Government Commerce from the Treasury Taskforce.

29. As a corollary, investment in central support such as Treasury Taskforce or other bodies will have little overall impact if Local authorities and the private sector do not have confidence that there will be a stream of projects in the future.

**What can the public sector in Wales do to help themselves?**

30. The 4ps have found that the informal networks of Local Authorities working on similar projects at similar stages in their procurement cycle has been of great value to those involved. To date the 4ps run a north and south of England education network, the English HRA Pathfinder Projects network and ICT/corporate services network and a Social Services project network is being planned. In addition, the 4ps contributed to the creation of the Charging Development Partnership for English Transport projects. The 4ps operates a network for Welsh projects which to date has been primarily schools projects. This process might be extended across the public sector.

31. It is particularly helpful for an outside agency such as the 4ps to lead and facilitate these networks, but ultimately public bodies learn from the exchange of ideas between themselves.

32. In addition, the Assembly might require all public bodies to make their key documents available such as Ceredigion has done. However, the Assembly should take care in endorsing any particular project, as there is a real risk of setting a sub-optimal standard as know-how and expertise is continuously evolving and it is important to create a process whereby the very best of new ideas are continuously incorporated into new transactions. The essential point is to ensure that there is a free exchange of information within and between the public sector.

**What can be done to provide on public private partnerships/PFI to the public sector?**

33. Procurement is made using DBFO or PFI contracts are inherently expensive because they involve the negotiation of risk between the public sector purchaser and the private sector supplier. Therefore, public bodies are likely to spend more on professional advice prior to the commencement of PFI projects and traditional procurement. However, the expectation must be that the overall costs are likely to be lower.

34. The high costs arise because firstly Local Authorities and indeed their professional advisors have to go through a steep learning curve, and secondly because the process involves intense negotiation with real risks on the public and private side of the transaction. Costs across the public sector as a whole are therefore likely to be reduced with experience and the accretion of know-how. Investment in the Private Finance Unit at the centre will help, but it is still likely that Local Authorities and other public bodies will incur significant costs. The Assembly can reduce costs by accelerating the learning process, for example, by ensuring that know-how developed on one project be made available to all Local Authorities and other public bodies in a timely manner.

35. Partnerships UK is a new organisation and it is premature to make comment. However, Partnerships UK will be focusing its attention on the implementation of project – that is after the Assembly and a Local Authority have made the policy decision to commit to the project.

**What other ideas are there that would help progress public private partnerships/PFI in Wales and assist the Assembly to meet its priorities?**

36. As the public/private partnerships market grows, the costs of implementation will naturally fall as contractors and Local authorities become more experienced. This learning process is being accelerated by public sector initiatives including the Treasury Taskforce Guidance on the Standardisation of PFI contracts (now the responsibility of Office of Government Commerce), and guidance on Best Value, schools, housing and other Local Government specific issues published by the 4ps .

37. These initiatives have required investment and direction from the centre – the Treasury Taskforce/Office of Government Commerce guidance was supported by lawyers seconded to the Treasury Taskforce and on social housing, the 4ps has commissioned jointly with DETR and the Treasury Taskforce, the lawyers Pinsent Curtis to produce guidance and draft contracts based on the HRA pathfinders. Wales will benefit from these initiatives and the Assembly may will to use the approach to develop guidance/know-how that is of particular relevance to Wales. The 4ps stands ready to support similar initiatives taken by the Assembly with Welsh Local Government.

**PETER FANNING**
**Chief Executive**

## INTRODUCTION

A theme running through this response will be the interaction between 'political' language and 'technical' language. For example, the PFI is not about private finance or the disposal or privatisation of public services. It is a procurement technique where the supplier funds the capital costs of a supply to the buyer over a longer period than a more traditional procurement. Public private partnerships are not usually about partnerships as are understood in English partnership law. The term public private partnership is used to describe PFI contracts, companies in which the public sector has an equity stake, markets such as the pharmaceutical market in which the public sector has a major interest and many other arrangements.

This response will try to use 'technical' language precisely. So PFI will mean a 'design, build, finance and operate' procurement contract or one of its variants. A public private partnership will be defined by the context.

## SECTION I

### What are the problems that public private partnerships are trying to solve?

1. ***Do you agree with the above "building blocks?" What do you think are the key social, political and economic factors that you think have led to the growing use of public private partnerships?***

   Yes, but care should be taken in the use of the phrase "funding public services".

   The language of public private partnerships has caused great confusion in the past when loose language on financing created the illusion that services were provided to the public without being paid for by either the tax payers or users, but by "the private sector". Somebody always pays: the issue is who and how! The capital for a school procured under PFI is provided by the contractor but the capital is repaid with interest and the school building is procured using taxpayers money. A leisure centre will usually be funded partly by public monies, delivered partly by grant and partly by continuous subsidy and partly by income from the leisure centre users.

   Key factors include leading to the growth of public private partnerships include:

   - Increasing expectations from the public following the growth in the consumer-led economy.
   - Recognition by public sector managers (politicians and career civil servants) that their core skills are not necessarily in delivering services and that marketing, implementation and process management skills honed in competitive private sector markets complement the skills of public sector managers.

2. ***In general terms, what does the growing use of public private partnerships allow UK public authorities to achieve that would not have been possible if they had relied upon traditional methods of procurement, service delivery, and problem solving?***

   PFI in particular enables public authorities to procure without a directly applied constraint on capital thus enabling the optimum balance between initial capital investment and downstream financing. This arises because the public sector is cash constrained, whereas the private sector is return constrained.

   In PFI procurement, the public sector purchaser can transfer or at least share many ownership risks with the private sector which it would otherwise have had to bear "on balance sheet".

3. ***What do you think the core competencies of government are whether at a national or local level?***

   Central Government and Local Government core competencies should include the identification and creation of a consensus on the 'public interest' and then ensuring that the public interest is delivered through the public private partnership or any other vehicle.

   In practice this means that Government should, for example, develop as a core competency its ability to create a consensus that a new school should be built at a particular site to deliver a range of education services to a defined community. The public sector should also be good at procuring a facility and all the associated services which deliver these outcomes on behalf of the community. It is not necessarily part of the public sector's core competency to design the school building or to source the individual components from which the building is made. It is not a core competency for the public sector to balance the cost of investment in say thermal insulation against the cost of heating a school.

   Both Government and local government should set strategy, provide clear policy direction and decide on their approach to the issue of whether they are 'procuring or providing' services and other functions.

## SECTION II

### How do you define partnerships?

3. Do you think that a definition of public private partnerships should include:

- Some element of risk sharing between partners (whether this is financial risk or a wider definition of risk, e.g. reputational risk)?
- A consideration of whether the organisations have shared objectives (or are some partnerships an effective way of managing divergent interests)?
- A consideration of the length of time over which partnerships are sustained?
- The process, and management style, used in partnerships?

Yes - all the above – but an additional important aspect is procuring a partner with complementary skills adding value through developing a 'fit' with the public sector

***4. Do you have a working definition of a PPP and how would you distinguish a partnership relationship from traditional procurement, contracting out or privatisation of a public service?***

DETR, when procuring research into PPP for local government through Newchurch and company, produced a definition of PPP (see Newchurch web site).

The 4ps generally regard PFI partnerships as fulfilling the statutory definition of a private finance transaction and risk transfer test as set out in the Local Authorities (Capital Finance) Regulations 1997 most if not all of which are design, build, finance and operate contracts for asset intensive services. Partnerships established through the medium of a company or other corporate vehicle are also easy to identify (although because of current legislation are not always as common as they might otherwise be).

There are a range of options for local authorities considering how to approach service delivery and fulfillment of their functions ranging from outsourcing/privatisation/contracting out on the one hand through to in-house delivery on the other. In between are options which fall short of the two extremes such as PFI where the function and control of the quality of services delivered by private sector contractors remains with the LA - or companies, where there is a sharing of risk and responsibility depending on equity involvement.

## SECTION III

### The public finances, value for money, and contract design

***5. In your view does the use of public private partnerships allow higher levels of total investment than would otherwise occur? If so, why?***

At the macro level, in the early days of PPPs the answer would be "yes" because with emphasis on the control of PSBR, PFI was an attractive means of increasing investment without undesirable public spending consequences. Since the introduction of a new fiscal framework in 1998 this is not so evidently the case. Golden rule and sustainable investment rule could still be met if all current PFI schemes were publicly financed. Government says now that value for money is the "primary rationale" for PFI (Government response to Treasury Committee report on PFI, July 2000). But Government still acknowledges that private finance is additional, "the Government is using private finance and other types of public private partnerships to add to and complement this additional public sector investment……. This can relieve the pressure on public finances, allowing the Government to concentrate resources on other public services." (Para 18, Public Private Partnerships, The Government's Approach).

Importantly local authorities believe PFI investment to be additional. If there were no PFI, borrowing approvals would not increase by a corresponding amount.

However, there is also an effect at the micro or project level where the use of public private partnerships can allow high levels of higher investment than otherwise would occur because:

- The public sector is always cash constrained and therefore there is always downward pressure on the total initial investment irrespective of the value for money of the project over its entire life. The private sector is less cash constrained and more able to consider whole life costing, thus enabling high levels of initial investment.

- The competitive pressures in the private sector generates cost savings which have the potential to generate overall high levels of investment.

6. ***Do existing Treasury borrowing rules allow for a level playing field between public private partnerships and conventional financing option? If not, why not?***

Conventionally financed investment counts against local authorities' borrowing limits (issued by way of credit approvals). PFI investment does not count against these limits. In such circumstances local authorities will always aim to maximise PFI investment.

However, the term 'level playing' field is unhelpful in that it is imprecise. Public private partnerships and conventional funding provide different outcomes and so there are limits to a like for like comparison.

The present and previous Governments have provided additional capital resources to Local Authorities that wish to use the PFI/DBFO procurement route. This has created a 'unlevel playing field' in that the choice of procurement method influenced the procurement. However, as Local Government PFI accounts for around 17% of Government funded capital expenditure the scale of the 'bumps' in the playing should not be exaggerated.

7. ***Should publicly sponsored investment undertaken under PPP/PFI contracts count as part of public borrowing so as to ensure a level playing field?***

No. Choices on procurement options should not be influenced by accounting requirements/public spending definitions. The key test is what provides best value for money. The main determinant on volume of transactions should be the funding provision made via the annual budget process.

As explained above, public private partnerships and PFI produce different outcomes to traditionally financed public sector capital expenditure.

For example, the issue of risk is often forgotten in arguments over Treasury and commercial accounting rules. In practice a risk cannot be transferred from one balance sheet to another simply by altering the way that risk is accounted for. Experience in the PFI/public private partnership market suggests that there is great merit in identifying the risks in an investment, for example in the development and procurement of a school project. These risks between the public sector and the private sector. The accounting allows users of the accounts to clearly identify the financial consequences of this risk allocation process. If a school is procured by the PFI the risks to the public sector are very different to those arising in a school procured traditionally, therefore, the accounting should reflect these different risks.

8. ***Will resource accounting and budgeting make PPP/PFI deals more or less likely?***

Resource accounting and budgeting are more likely to encourage rather than discourage public private partnerships/PFI transactions.

PFI forces the public sector purchaser to have regard to the whole life costs of the procurement, in contrast to traditional procurement where the focus tends to be on the initial capital outlay. Also in traditional procurement, the public sector purchaser is able to cut maintenance expenditure in contrast to PFI transactions where the public sector is required to pay to maintain assets, provided the private sector delivers the underlying asset as required in the contract.

Local Authorities draw up balance sheets and are used to having regard to the value of their assets. Resource accounting will extend the consideration of asset values into central Government departments and requires civil servants to have regard to the value of their assets. Over time the public sector as a whole will be under more pressure to maintain assets as well as simply procure them.

9. ***How, if at all, do you think the current financial control framework should be reformed to ensure that public private partnerships are used in the appropriate circumstances?***

Speaking on behalf of Local Government, the LGA advocates that controls on local authority borrowing should be abolished and a system be introduced which has as the main influencing factor on capital investment the disciplines imposed by the revenue budget. Local authorities would have regard to certain prudential ratios in framing their investment strategies, relating to increases in debt, borrowing etc. Under such a system Treasury borrowing rules would not be influencing factors in the type of procurement. Local authorities would take decisions on the basis of value for money alone.

The 4ps are in regular discussion with DETR and other Government departments on enhancements to the existing arrangements against the general framework for reform set by the LGA. In particular the 4ps are discussing changes to the framework governing local authorities use of joint venture companies or the use of client side procurement agencies such as agency companies or joint boards to facilitate cross boundary procurement initiatives by local authorities acting jointly.

Hopefully the new Best Value regime will further encourage cultural change in some local authorities and will encourage all authorities look at the most appropriate way of providing services (both capital intensive and otherwise) to the local electorate.

***10. Some recent studies have found typical expected efficiency savings under PFI of 10-20%. Based on your experience/research what do you think of these estimates? In your view what are the key drivers of value for money? (see questions in section VII on pay and conditions and value for money).***

Based on our work with some 50 completed local authority PFI transactions we believe that savings of at least 10% are often achievable. However, a number of the smaller PFI projects have not always achieved this level of saving and it is important that the all parties continue to look at the opportunities for standardisation, and possibly bundling, to optimise the savings available.

The key drivers for value for money are considered to be the following:

- Whole service and whole life approach to the provision of the service and associated investment needs.
- Focus on outputs, what is required and not how.
- Private sector innovation.
- Private sector efficiencies, management of risk and opportunities for flexibility in service delivery.
- Competitive procurement.

***11. How should 'risk transfer' be dealt with in PFI? What elements of project risk are best transferred to the private sector and which should the public sector bear?***

The 4ps encourage local authorities to include an early assessment of risk in the Outline Business Case. As part of the options appraisal and business planning local authorities should identify, cost and make a preliminary allocation of at least the key risks associated with the project. This initial assessment should be refined as part of preparing the tender documentation (ITN) with a more comprehensive 'public sector comparator' being prepared before any bids are invited.

As regards the individual project risks that should either be transferred or retained by the local authority, this will inevitably vary from project to project, and it is important that a detailed assessment is made for each project. Obvious risks best retained by the authority are political risk and those risks that cannot be transferred because of statutory obligations on the authority, such as certain health and safety issues (see section 4 of the draft 4ps local authority contract guidance on our web site). Other risks best retained by the local authority may include those risks that the operator is not able to directly control or manage, such as the statutory planning process for a light rail scheme or planning consent for the siting of an incinerator in a waste scheme.

***12. What are your views on the current methodology used in the construction of public sector comparators (public sector comparators)?***

The science of costing risk is at present under-developed and reliable models and further practical guidance would assist. The approach taken by local authorities in the construction of the PSC and PFI reference project tends to vary considerably. The methodology put in place by the TTF is generally sound and some local authorities have a good record of producing reliable and justifiable cost estimates for their PPP and PFI projects. However, there are still too many local authorities that seek an increase to the original funding request and there must therefore be scope for improvement in the development of the PSC and PFI reference project. 4ps are examining information derived from completed PFI schemes to see if lessons can be derived from existing data for the benefit of future schemes.

In some instances it will always be difficult to provide a completely reliable estimate given that the authority will be guessing at the solutions to be put forward by the bidders. The preparation of the PSC will also depend on the quality of the base data and the skills and experience available in the project team to evaluate that cost data and the risks associated with the project.

***13. How important is the use of public sector comparators in ensuring value for money compared to other factors such as the competitive pressure of bidding for contracts? Do you think it is always necessary to use a PSC?***

Public sector comparators and the PFI reference project are essential tools in the tendering and evaluation process for PPP and PFI projects. However the limitations of the public sector comparator process need to be understood. A constructed price developed against an artificial reference project is subsequently compared with a real price on a real project arising from the competitive process. Provided the public sector comparator and PFI prices are broadly similar, then public sector managers will have confidence in making the choice of procurement on other grounds. If the figures are very different then further analysis needs to be undertaken as part of the evaluation of tenders.

***14. Is the appropriate discount rate being used in the value for money calculations?***

Local authorities are only required to use the Treasury test discount rate of 6% for the value for money comparison when seeking central government support towards their PPP/PFI projects. The 6% discount rate is considered to be a reasonable starting point although we do recommend to local authorities that if they consider this rate to not be appropriate to local circumstances for the value for money comparisons, that further sensitivity tests should be undertaken using other discount rates.

***15. Are you aware of potentially beneficial PPP models which have not been properly exploited within the British context? Are there innovative pilot models which you think we should be aware of?***

PPPs are largely about creative thinking and, from the public sector, accepting that there are huge gains to be realised from working with others rather than in isolation: it’s often about an outward looking attitude rather than particular models. One London Borough is pursuing an innovative approach to regeneration on an authority owned housing estate involving sharing the benefits from unlocking the intrinsic value of the underlying assets. A private sector consortium will, it is hoped, provide high quality social housing without the need for any public sector input over and above the value of the land. A new school procured through the PFI will sit at the heart of the estate.

In the PFI schools context Dudley BC has managed to include contractual objectives based around educational outcomes and 4Ps are undertaking further work to promote this approach with the private sector and Government.

In the leisure field a number of authorities (notably Westminster and Wokingham) are working in partnership with commercial operators to realise the potential of their leisure portfolio. In return for significant capital investment, which is used to modernise existing facilities, the operators receive long term management contracts. The authorities benefit from better facilities, reduced subsidies and a share of future income streams. The 4ps are currently working with a number of authorities to explore the potential for extending the model into more deprived communities and into less commercially attractive services, such as libraries.

***16. What is the potential for greater innovation in service delivery if the private sector is allowed to provide a wider range of services in PPP deals?***

The potential is unknown but the pathfinder process developed in Local Government PFI could be used to stimulate innovation.

For example, there is at least some anecdotal evidence that the private sector would be willing to incorporate educational performance measures in the payment mechanisms of schools PFI projects where the private sector contractor does not actually deliver the educational service (that is employ the teachers). Subject to the accounting issue of separability, the 4ps are working with private sector providers and their public sector clients to explore the potential for linking an element of contract payments for the delivery of services such as ICT, catering, extra-curricular activities and maintenance to measures of educational attainment.

One of the major weaknesses in the current PFI programme is the lack of engagement between the leading opinion formers and visionaries on front line services and the private sector. Projects tend to be ‘run’ by banking, finance and resource technicians on both the buyer and the seller side. Directors of Education, Directors of Transport, or Directors of Social Services, are not generally leading projects, nor are they seeking to shape the markets from which their projects emerge. This is a great barrier to innovation.

***17. What would be the costs and benefits of experimenting with DBO (as opposed to DBFO) public private partnerships?***

While the DBO procurement approach has superficial attraction in that the cost of finance may be lower, it should be understood that firstly the marginal cost of finance is only a few percent of the whole life costs of the transaction and secondly, it is unlikely that designers would be willing to take full design risk if the funds that they had available to invest in the design and construction of the underlying asset were constrained.

In practice, it is likely that capital provided by the public sector would be more constrained than capital provided by the private sector for the reasons mentioned above.

In DBFO projects the private sector's finance is at risk and the PFI contractor is incentivised to take a long-term view of service delivery and what is required to deliver quality services using the assets supplied for the duration of the contract term.

***18. What are the arguments for and against the ownership of assets reverting to the public sector after a PPP contract has ended?***

In most local authority PFI deals the ownership as such does not transfer. The residual value of the asset becomes an important issue for negotiation, dependent largely on the affordability of various options. In most property-related PFI deals, a period of at least 10 years "life" at standards similar to those in force during the operational period is agreed. The length of this period will be influenced by the procurers assumed need for the asset at that point, and the levels of uncertainty regarding the nature of the service needed in 25 years time. Most property-related schools projects are procured on a licence granted to the provider, with lease and leaseback being another mechanism often used. The lease or licence terminates at the same time as the contract.

***19. Are new forms of PPP impeded by current laws/regulations (e.g. EU procurement rules)? If so, how do you think that these laws/regulations should be reformed?***

There remain some legislative obstacles to PPP arising from both domestic and EU legislation. We understand the EU procurement rules are currently subject to substantive review by the Commission and a consolidation of the three main directives currently governing the procurement of services, supplies and works is a possibility, together with a rationalisation of derogations for using the negotiated process (currently the rules on using the negotiated process differ according to the type of directive used which can cause difficulties/uncertainties).

The Environmental Protection Act 1990 has also been a source of difficulty for PFI waste schemes on the basis that the EPA legislation contains a regulated process for procurement which does not fit well with the negotiated process most other PFI services utilise. We understand the DETR is proposing to repeal various EPA provisions using best value powers (Section 16 of the 1999 Act) to remove these difficulties.

The current legislation and powers relating to the establishment and participation in local authority companies is under review and 4ps are contributing ideas to DETR on the way in which this particular form of partnership working (whether through company agencies or joint ventures) can be facilitated in future.

In the wider PPP context we are aware that there are sometimes conflicts and difficulties between different funding routes for PPP such as the National Lottery which prevent or frustrate initiatives seeking to procure using two or more different sources of funding. Under most lottery funded schemes for example, applicants are required to work up design to quite an advanced stage as compared to most PFI schemes which require significantly less detail on design at the initial 'indicative funding' stage, an approach which encourages innovation and competition from the private sector at a later stage.

Finally, the DETR's recent draft consultation paper on the proposed removal of prohibitions on workforce matters will help remove further difficulties and uncertainties existing under current legislation.

## Contract design

***20. How can long-term contracts be designed which allow for sufficient flexibility to ensure that the parties are not locked-in to outdated forms of service provision? What type of governance and review arrangements can be built into contractual arrangements to ensure greater flexibility during the life of the contract?***

The 4ps has had to give detailed consideration to precisely this issue when working up the supplement to the Treasury Taskforce 'Standardisation of Local Authority Contracts' publication for local government. A draft of the guidance can be found on our web site at www.4ps.co.uk . See in particular section 3 of the draft guidance. 4ps are in the process of considering responses from all sectors (public, private, voluntary and finance sector) to the approaches recommended, although the draft itself has been worked up in conjunction with leading practitioners and in the light of experience gained from completed transactions. The guidance covers, inter alia, the need for flexibility in long term contracts to reflect best value obligations and changing circumstances, user involvement in setting performance standards and for the ongoing monitoring of contracts, contractor input into continuous improvement, contract change mechanisms and the use of National and Local Performance Indictors when setting performance criteria.

On governance and review the establishment of benchmarking clubs and quality checking procedures across local authorities or regionally would be a good idea. We are aware that some service areas are further ahead than others e.g.highways maintenance benchmarking clubs are in the process of development. Benchmarking of cost and quality is a science very much in its infancy in local government and more could be done to help encourage the development of sensible comparisons to be made and to monitor VFM in service delivery.

***21. Is the current contracting process successful in maximising the opportunity that the private sector has to innovate in the design of services? If not, how could this process be improved? Do current EU procurement rules inhibit this?***

PFI offers the opportunity to innovate via output specifications but further work/training is required to make the use of good quality output specifications more widespread. 4ps has issued guidance on the drafting of output specifications in the context of schools PFI (see our web site).

There are some PFI service areas such as public transport schemes or waste management projects where design and planning will always need to be quite far advanced before going out to tender which leaves little room for innovation. Consideration could be given to finding ways of encouraging private sector participation at an earlier stage in these types of large scale, high environmental impact projects.

***22. What criteria should be used to determine the life span of PPP contracts? What examples can you provide of (in)appropriate contract lengths? What are the strengths and weaknesses of using shorter contracts for the maintenance of service provision as opposed to relying on 'periodical reviews' in long-term contracts?***

The considerations that we believe need to be taken in to account in determining the life of a PPP/PFI contract include life of the asset, residual value considerations (such as opportunities for alternative use), debt financing periods and availability of contract templates for the proposed project.

We do not believe that there are any significant benefits in using shorter contracts for the maintenance provisions within a long-term partnership contract. The focus in PPP and PFI contracts should be on the whole service and whole life approach to the provision of a service. Adopting such an approach has the potential to break the link between the provision of the asset and the services associated with maintaining that asset to the levels required in the Output Specification. This approach may also introduce an element of separability in to the contract making it more difficult to satisfy the accounting requirements for PFI transactions.

***23. In any capital project in which a new asset has few alternative uses there is always a risk that changing circumstances will reduce value of the initial investment decision. How much worse is this problem in long-term PPP contracts compared to projects which rely on conventional procurement methods?***

Not necessarily a problem for long-term contracts if a good Business Case has been produced to ensure that PFI/PPP is appropriate. For example, where there is significant uncertainty about the environment in which the project will operate, a risk analysis for the client should show up whether these are risks worth taking. Conventional procurement generally does not require such analysis or any iteration during procurement, so it could be argued that more risk is taken in conventional projects. The life of the asset is not the issue in long-term contracts, it is the need for the service that must be assessed, and this is no more in question as a result of using PPP than otherwise. Under best value in local government a best value review will generally be needed before procurement options are decided upon followed by an outline business case with a proper analysis of risk.

***24. If PPP deals allow for more scope for contractual renegotiation and flexibility will this tend to endanger value for money?***

Not necessarily, particularly if the contract is structured and includes terms that follow best practice as set out in the OGC/TTF standardisation and the 4ps/OGC standardisation for local government.

***25. What would be the advantages of developing more public private partnerships which 'bundle' together various investment projects within one PPP deal? What are the obstacles to this type of PUBLIC PRIVATE PARTNERSHIPS deal? Does this approach inhibit the ability of smaller firms to bid for PPP contracts?***

'Bundling' is an approach where there appears to be obvious advantages, potential efficiencies and economies of scale to be harnessed but little hard evidence of current or completed 'bundled' projects from which to make comparisons. One of the reasons for this is the lack of powers or incentives locally to encourage the 'bundling' of schemes together or 'investment' opportunities.

Bundled schemes may have considerable potential to deliver better value for money than single projects, but there are significant resource implications for both the procurer and bidders . In most cases the number, and potential incompatibility, of stakeholders is increased in bundled schemes. The danger exists that the project can be overcome by difficulties arising from one or more components of the bundle. The problems are limited if, as with LEA schools, there is effectively one contract signatory, although the numerous boards of governors will wish to be closely involved with the process. In cases where more than one authority or client body is to be involved, the potential for conflicts within negotiating positions is greatly increased. Generally, only bidders with a planned portfolio of PFI bids will be prepared to engage with these more complex projects. It should be reiterated, despite the above, that the advantages to the public purse from a successful outcome to a bundled project may be considerable.

Some PFI projects are taking an approach to bundling within a service area and within an authority, such as the Stoke schools PFI project where Stoke are procuring services for the whole of its schools estate. There is no evidence that we are aware of that bundling provides obstacles to smaller firms bidding for PPP contracts – it may, of course, provide additional opportunities if not as prime/main contractor then as sub-contractors to the SPV. The first grouped school schemes only recently signed and it is too soon to identify as to whether local companies are winning sub-contracts for such bundled schemes.

***26. When do you think that profit-share arrangements in PPP contracts work effectively? Should they be introduced into more PPP contracts?***

Profit/income share arrangements should be standard in any PPP contract which generates, or has the potential to generate, third party income. Such arrangements are essential to guard against a commercial operator realising 'excessive' financial gains from a contract, whilst at the same time ensuring both parties are incentivised to maximise income from a contract (but not at the expense of delivering other objectives, such as widespread access to a service). Profit/income share arrangements are a standard feature of leisure management contracts and the 4ps encourage such clauses to be incorporated where-ever there is the potential (however remote) of excessive profits being generated in a PFI service contract.

***27. Do you think that the private sector should be encouraged to specialise in the skills of turning around under performing organisations? What are the strengths and weaknesses of this approach? Do you think this 'provider of last resort' model should be tried out in other areas of the public services?***

It is not yet clear whether the involvement of the private sector in these situations will achieve expectations. The long-term nature of much public sector service delivery requires a high-performing client, capable of setting standards and making and reviewing strategic policy changes. Generally this is required within the framework of an accountable democratic structure, in which there is an "intelligent client" core, that can advise elected representatives and engage in debate about issues and priorities. There is a very real need for this, often highly sensitive, facility to be "owned" directly by the client organisation.

***28. What types of contractual arrangements are best suited to the challenge of turning around under performing public services?***

Clearly some type of contract that has improved performance as its key outcome, but this could include consultancy (i.e. success fees) as well as various types of outsourcing.

29. ***Are there innovative public sector solutions which could be used to improve under performing public sector organisations? Is enough effort being made to find these public sector solutions? What are the differences in incentive facing public, private, voluntary or community managers seeking to turn around under-performing public sector organisations?***

**Core-ancillary distinction**

Another way of establishing distinct areas of activity for the public and non-public sectors has been on the basis of whether services are seen to be 'core' or 'ancillary'. One view of the core-ancillary distinction is that it is a useful and pragmatic way of benefiting from private sector contract management skills without undermining the essential nature of the public services. Others argue that this approach excludes the private and voluntary sectors from the areas where there is most scope for innovation and quality improvements. In some sectors, such as prisons, this distinction has been removed as the private sector is already managing key services. Even in other areas where the core-ancillary distinction is still said to exist the picture is more complicated that is often realised. Indeed, the private/voluntary sectors have for some time provided key services in niche markets (psychiatric hospitals, special needs schools).

With failing LEAs there is real value in a number of central bodies in local government providing a support network. This is currently being developed by 4Ps, LGA and IdeA.

30. ***Are there some areas of the core public services - 'no go areas' - which should be ring-fenced for exclusively public sector providers or do you think that private/voluntary providers should be allowed a role in all areas of the public services?***

The 4ps do not perceive any advantages in ensuring the public sector is the sole provider of certain services and that markets should be encouraged to develop in all areas of public services.

31. ***Do you think that the existence of the profit motive within the public services undermines the values on which public services were founded? If so, why? Can you give examples of how the profit motive has affected the nature of the service delivered?***

The profit motive should not undermine the public good, provided contracts with the private sector clearly specify the desired outputs and outcomes, are managed effectively and can demonstrate best value. Within the leisure field some of the early CCT contracts did not adequately specify sports development objectives and outputs. As a result operators, both in the public and private sector, often prioritised income-generating activities at the expense of sports development to the detriment of priority groups, such as young people and ethnic minorities.

32. ***Do you think that the public sector has a unique service ethos which means that it is better placed to provide core services?***

33. ***What are the benefits (if any) that you think could be gained by allowing the private or voluntary sector more freedom to provide core services?***

34. ***What are the advantages/disadvantages of the core/ancillary distinction? Are there problems in having the public and private sectors supplying different elements of what should be an integrated service?***

35. ***Do you think there would be gains from more competition between a diversity of public, private and voluntary providers in more areas of the public services? Can you give examples of areas which have benefited from having a diversity of providers? Alternatively, what do you think would be the advantages of ensuring that the public sector is the sole provider of core publicly funded services, such as health, education and prisons?***

Wider choice and better quality services are the main objectives for increasing competition between providers. A pluralist system of provision already operates in some areas within leisure. For instance, private member clubs, school dual use facilities and voluntary sports clubs are complementing local authority run facilities. Whilst traditionally these providers have served distinct segments of the market, there appears to be increasing direct competition between the public and private sector.

There would be gains from more competition between a diversity of public, private and voluntary providers as the different organisations will introduce different methods of service delivery and develop innovation and best practice. The social housing sector has benefited from the diversity of providers. The increased funding awarded to housing associations in the early 1990s and large scale voluntary transfer meant that there was a group of voluntary providers who could address specific housing needs such as those of the black and ethnic minorities and client sensitive homes for those with special needs. These organisations were smaller than the local authority and therefore were claimed to be more sensitive to the needs of their tenants and more inclined to Implement tenant consultation. The diversity of providers not only meets different needs in the community but the notion of competition will enable the market-testing of price as well as quality and should keep some stability in prices charged.

***36. What distinction (if any) would you make between the suitability of the voluntary sector and private sector to provide core services?***

There should be no distinction in the suitability of either sector to provide core services. There does often appear to be a preference for the public sector to work with non-profit distributing bodies (NPDBs) partly because of the certain fiscal advantages (with regard to NNDR, tax and borrowing funds) but also because they do not have shareholders to answer to. However, NDPBs are independent of the public sector and therefore cannot be controlled by officers or members and must pursue their objectives. Good contracts which reflect the public sectors aims and objectives are key to ensuring successful partnerships with the voluntary and private sectors.

The voluntary sector is established on a charitable basis where the premise is that there may be surpluses made from the provision of a core service; however these surpluses are not distributed to the directors/committee members of the voluntary body. In certain cases they are suitable to provide core services such as care homes in social services, social housing and the educational trusts. The private sector can also provide these core services but they do so with the expectation of obtaining a profit. There are positive outcomes for service delivery when they also provide services. They bring different type of management skills and they usually have to be innovative, keep costs down and introduce new methods of service delivery to ensure this maintained their competitiveness and in the long term the contract for the service.

***37. Does involving the private sector in the provision of key services expose the State (who still funds these services) to the risk of being overcharged (e.g. in areas such as health)?***

**Regulation**

***38. If the private or voluntary sectors are to provide key services what regulatory safeguards need to be used to ensure that provision is equitable and accountable? Does the current nature of the purchaser-provider split in the area of your interest help or hinder the safeguarding of these values? Is there sufficient regulation in areas where the private/voluntary sector already plays a central role (e.g. long term care, prison management, provision of LEA services)?***

Regulatory ’ safeguards over and above those which already exist should not be required. The quality of the procurement process, the promotion of standardisation and best practice, and adequate client monitoring are critical to ensuring the public good is served in the delivery of key services. The process of developing the output specification for a long-term contract allows the public sector to focus on the most important issues of equity and accountability.

**Governance Partnerships**

A further dimension of partnership is at the level of strategy and governance; where the private and voluntary sectors are increasingly being involved in decision making and agenda setting in key public service areas. An example would be Education Action Zones.

***39. What, in your view, have been the strengths/weaknesses of these initiatives? What have the private and voluntary sector added to the partnership? Could partnership organisations, such as EAZs, have a further role in commissioning services for schools or in appointing school management?***

The private and voluntary sectors have much to offer the public sector in both contributing to the setting of strategic and policy objectives and in providing services to deliver such objectives. All sectors have a vested interest in ensuring the UK has an adequate infrastructure of core public services. The strength of involving the private and voluntary sectors in the scoping and planning of public services, ‘partnering’, is that they can contribute a different perspective from knowledge of wider markets/services. A weakness of such partnerships is that they often fail to connect with the communities they were set up to serve and support.

## SECTION V

### Local partnerships

It is at a local level that many public private partnerships are best established and have the most potential to improve the quality of life of citizens and communities. Over recent years there has been a growth in the nature, scope and purpose of these partnerships. Here we divide 'local partnerships' into two overlapping categories: those which exist to deliver local services, and those whose primary purpose is to promote the regeneration of communities and neighbourhoods.

### Regeneration partnerships

Many partnerships have been created in response to central and local government initiatives, often in order to bid for funds. The nature of these partnerships varies considerably. 2 In some cases these partnerships come in the form of legal bodies who raise and allocate regeneration funds. Other partnerships seek to determine local priorities and co-ordinate the strategies of local organisations from the public, private, voluntary and sectors. In addition, many 'bottom-up' partnerships have emerged spontaneously to provide homegrown solutions to local problems. Despite all this partnership activity our understanding of the performance of different types of PPP arrangements is still limited.

***40. Where and when do you think public private partnerships are the appropriate vehicle for promoting regeneration? What models of PPP do you think have worked in helping regenerate your locality?***

In circumstances where a holistic solution to the problems of an area demands a cross service and cross tenure approach, a single agency is unlikely to have the breadth of vision nor the resources to develop an effective response. The public sector will often have the strategic remit but will lack the full range of skills to deliver on every front.

***41. How hard is it to secure private, public, voluntary and community sector involvement in partnerships? What are the motivations of those private, voluntary and community sector organisations who do get involved in public private partnerships? How can the quality of representation of all these sectors be improved?***

The public sector will be motivated by a desire to seek a solution which is beyond their grasp alone; the private sector will be motivated by business opportunities: the two often co-exist in which instances partnerships are not difficult to establish in principal although the devil is always in the detail. Engaging customers or end users is often a real challenge. Perversely the level of involvement is often influenced by the depth of the current problem: a robust response is often due to complete dissatisfaction with the way services are currently provided. User involvement can be encouraged by an emphasis on empowerment and participation rather than merely consultation; independent sources of advice are often very helpful. One model for this is the role commonly played by 'tenants' advisers' on housing projects.

***42. How have funding mechanisms impacted upon the success and durability of partnerships? How could they be improved?***

A barrier to success is the multiplicity of funding sources and 'challenge' type initiatives, many of which could support aspects of the regenerative process but which are all subject to their own bidding, monitoring and financial regimes which are difficult to sew together effectively. The 'silo' mentality of many local authority (and government) departments is also difficult to counter-act. The move to a single capital pot should help but joined up thinking on the part of officials and authorities needs to be improved together with flexibility across budgets at both levels.

***43. To what extent is there a danger of 'partnership-fatigue' as a result of overlapping area-based partnerships being set up to address interconnected problems? What public policy initiatives could promote more joined-up partnership working at a local level? What role do you think that 'local strategic partnerships could play in this regard?***

LSPs are an important step towards finding local solutions to local problems but the relationships established by the partners need to be sustainable and the LSPs need to be adequately resourced. Consultation and participation structures will need to be effective and not remote and the community must have a real sense of influencing outputs and outcomes.

***44. Are regeneration partnerships integrated closely enough into mainstream service provision? Are there areas of mainstream provision that could be provided more effectively through partnerships? Do you***

***think that partnerships should have more power to 'bend' mainstream budgets or lever in external sources of private finance?***

Yes and no. Partnership arrangements are still seen as the exception rather than the rule in some instances and are dealt with as 'special initiatives' with all that that implies. In some cases however the emphasis is rightly on the partnership arrangement being a different way in which the same core services are delivered; the relationships and the funding might be different but end users should simply perceive the delivery of high quality and effective services. 'Bend' is probably an unfortunate turn of phrase; its about budget flexibility. An effective partnership arrangement should have the ability to lever in private finance; it would be a prime objective.

*2 Though some of these are 'public-public' partnerships (which fall outside of our terms of reference) many others involve the private and/or voluntary and community sector.*

*3 As proposed in the Social Exclusion Unit's National Strategy for Neighbourhood Renewal see www.cabinet-office.gov.uk/seu*

***45. Do some regeneration partnerships face a conflict of interest as they are distributing funds to groups who are themselves represented on the partnership? How is accountability and probity best ensured in local regeneration partnerships?***

Possibly, although presumably no representatives from any particular quarter will hold the balance of power in the decision making process if decisions are taken by a properly constituted Board or some other appropriate structure.

***46. Do you think local people have enough opportunity to influence the priorities of local regeneration partnerships? If not, what reforms would you advocate?***

Local regeneration partnerships should, as the name implies, be a partnership of equal parts; one being local people or the local community. An arrangement which doesn't give local people an effective voice isn't going to be wholly successful. Its not necessarily a matter for reform but of being clear about objectives in the first place and making effective arrangements for consultation, participation, representation and decision making. Many agencies are very effectively customer focussed; in some cases private sector partners feel too much emphasis is placed on users' views.

***47. Are policy makers aware of the opportunity costs of creating and sustaining effective partnerships? What sort of evaluation techniques do you think should be used to determine the effectiveness of local partnerships?***

Yes, without doubt effective partnerships are resource intensive and challenging to establish and sustain, but the outputs and benefits can be significant. The effectiveness of the partnerships could be measured through an analysis of outputs achieved against a agreed business plan established at the partnership's inception.

***48. Are there lessons that you have learnt from your experience of local regeneration partnerships that could be transferred to other localities?***

There are always lessons to be learned and knowledge to be re-cycled, the challenge is to find ways of achieving this so that the process for those that follow can be shortened and the costs involved reduced. One way in which this can be assisted is through the publication of guidance or case studies based on experience and replicating best practice. Alternatively networks can be established through which partnerships can compare notes and jointly solve problems; such networks can often be effectively managed, promoted or facilitated by central bodies; government departments or organisations like the 4ps for instance.

**Local service delivery**

Over recent years increasing attention has been given to the role of local government as 'enabler' rather than direct provider of services, a trend which is likely to be reinforced by the new Best Value regime. If partnerships are to play a greater role in the delivery and strategic planning of local government services this raises major questions about the skills that local government need to acquire if it is to stimulate a vibrant market of local service providers.

***49.*** ***Are there particular types of local service that you think are best provided by partnerships? Alternatively, do you think that the private sector is best to perform general types of activity (e.g. payroll and administrative functions) which cut across different services?***

There are no particular services that should be more appropriately delivered by a partnership arrangement, what matters are what works best. The public services delivered by a local authority are generally in a good position to be delivered in a partnership arrangement. This could be with the private or voluntary sector. Housing, social services and leisure all have extensive partnership arrangements operating effectively. The involvement of the private sector in certain service particularly corporate services does not necessarily mean this will be effective. There has been a lot of evidence recently that the involvement of private contractors in the delivery of revenues and benefits service has not always improved performance in comparison to the performance of a service delivered by an in-house team.

***50.*** ***What impact do you expect the new best value regime to have on the use of partnerships in the delivery of local services? Do you think that further incentives or regulations are required in order to encourage public sector commissioners to enter into public private partnerships for service provision?***

New legal powers to remove obstacles and to facilitate best value under Section 16 of the LGA 1999 will undoubtedly help to encourage more and more diverse PPPs. The new powers to promote well-being in the Local Government Bill may also assist, although there is a question mark over the precise relationship between the legislation promoting best value and the legislation promoting well-being. The review of legislation governing local authorities' interests in companies may also help to demystify partnerships via this route and the 4ps are working with DETR (and other bodies) on proposals for amendment of Part V of the Local Government and Housing Act 1989 and associated regulations.

Undoubtedly, in our view, the single most important aspect of encouraging the current interest and healthy deal flow of PFI schemes has been the additional resources provided to local government (via PFI credits) coupled with a more transparent administration and process for obtaining PRG approval to schemes before going out to the market. Replicating the benefits of the PRG system but targeted at other types of PPP, together with some additional funding to generate interest and contribute towards development costs, might be a method of promoting deal flow, PPP pilots or pathfinder projects and the preparation of templates therefrom for future schemes to follow. The 4ps have made suggestions along these lines to the Government and remain ready and willing to play a role in any such initiative.

***5.1*** ***How could the private and voluntary sectors be encouraged to be proactive in approaching local government with ideas, skills and knowledge that could help externd and improve local public services? Is there a lack of 'market intelligence' in local government about the types of private and voluntary sector partners on offer?***

The private and voluntary sector would work in more partnership arrangements with local authorities if in certain instances the authorities would be willing to input development/procurement funding for the implementation of the project. Also, there is the belief by the private and voluntary sector that local authorities wish to enter into partnerships with the former taking the majority of the risks but they do not want these organizations to 'make' a sufficient margin/profit on the partnership. Also there is a view that this may not be a true partnership as if there are problems with service delivery the political dimension of local authorities and the need to 'answer' to the local electorate means that publicly the provider will be 'blamed'. There is a general lack of understanding about what the different partners can provide. Evidence suggests this is more prevalent in the districts than other types of authorities.

***52.*** ***How could local government make itself a more attractive customer for leading edge business? What examples do you know of local government successfully fostering new markets for service provision? Do you think that the Government Offices for the Regions could also play a market making role?***

We believe that local government could make itself a more attractive customer in the following ways:

- Sharing experience and local experts, particularly finance and legal experience. For example, we are aware of a fire authority that has successfully procured a fire station but other fire authorities are not taking up the project management experience developed in the authority.
- The setting up of 'centres of excellence', perhaps based on the experience and expertise now available in some of the core cities.

- Government departments making available, as part of the allocation of PFI resources, realistic procurement budgets to allow local authorities to utilise good advisors in the development and procurement of their PPP and PFI projects.
- Development of good project management and procurement skills. The lack of these skills in some authorities could be addressed through training courses but again the level of resources available for such training limits local authorities.
- Some local authorities need to re-assess the delegation arrangements in place for the development and procurement of projects. Where local authorities have put sensible delegation arrangements in place at the commencement of the procurement process we have found that the overall procurement has been significantly better run.
- Liaison at senior level, for example with private sector representatives, financiers and 'trade' organisations such as the BBA.

We believe that the Government Offices for the Regions could usefully play a part in this by encouraging local authorities to work together, helping develop funding packages, supporting the allocation of procurement budgets for local authority PPP/PFI schemes and perhaps facilitating the bundling of projects. There is, however, also a training need within many of the Government Offices if they are to be in a position to properly support local authority PPP and PFI schemes.

***53. Should measures be taken to ensure that service contracts are tendered in a way that encourages small and medium sized companies to enter the market?***

Encouraging a diversity of providers should help ensure a competitive market and encourage innovation. However, the EU Procurement Regulations and the public sector's evaluation criteria for tendering contracts tend to favour the larger, more experienced providers. Nevertheless, the growth of PPPs should provide small and medium sized companies with more opportunities to enter the market through the sub-contractors route.

Furthermore, the development of standardised contracts for PPPs, one of the key aspects of the 4ps work, will reduce the costs of procurement on both sides and help smaller companies win contracts, particularly for low value contracts and in specialised and developing public service markets. For example, in Kingston Upon Hull a local construction company won the 25-year contract to DBFO a new primary school, the capital value of which was only £3m.

***54. Do you think the current legal and regulatory framework inhibits the creation of some forms of public private partnerships (e.g. joint ventures in which the local authority is the junior partner)? If so, what reforms would you propose?***

Yes. Current legislation governing local authority interests in companies and joint ventures is far too complex and confusing. We are currently preparing detailed suggestions for reform of regulations governing influenced companies under the Local Authorities (Companies) Order 1995 (as amended) for DETR and believe there are ways in which the current regime can be simplified in line with private sector accounting and company law practices.

Careful consideration also needs to be given to powers of local authorities to establish or participate in companies for the performance of their functions and the difficulties this presents with delegation of LA functions and protection of third parties dealing with entities other than local authorities (e.g. limitations of the Local Government (Contracts) Act 1997).

***55. Do you think that there is a case for formalising the role of the local business and voluntary sector within the local policy making machinery? If so, how should this be done?***

The Best Value regime requires local authorities to consult with stakeholders, which includes the local business and voluntary sector, in the planning and delivery of services. In engaging with their business communities authorities will have regard to the recently published DETR guidance, "Doing the Business". This encourages authorities to strengthen their links with businesses through partnership working, consultation exercises and information dissemination. The Government has stated strongly that it is a prerequisite of authorities having the power to raise a supplementary rate for there to be strengthened arrangements for engaging the business community"

## SECTION VI

### Making partnerships work

Discussions of public private partnerships tend to focus on formal structures - legal models, financing mechanisms, and contractual terms. Getting these issues right is a vital element of successful partnerships, but it is only part of the story. Just as important are motivated and appropriately skilled staff, an appropriate management style, and a collaborative rather than adversarial approach towards resolving difficulties. In the right circumstances partnerships seem able to bring together the best of the public, voluntary and private sectors - for example, combining the public service ethos with more freedom to innovate. But experience has shown that if trust breaks down partnerships can easily degenerate into mutual recrimination and adopt a culture of minimal compliance. Identifying how public, private, and voluntary organisations can learn the soft skills of partnership is one of the most elusive but critical elements of a new policy agenda on public private partnerships.

***56. What are the skills that organisations need to learn to make partnership agreements work? Are these currently in short supply in the public, private and voluntary sectors? If so, how should this skill shortage be addressed?***

Project management skills are often needed in local authorities such as: effective teamwork; lateral thinking; networking with other authorities; developing trust in dealing with the private sector; thorough assembly of information.

In the private sector: effective merging of the component parts of a bidding organisation; understanding of public service ethos and particular high priority issues such as best value;

The extent to which these are missing on both sides varies enormously. Small unsung authorities can be brilliant, and large plc's can be dreadful.

***57. What are the components of the management style and working practices which foster successful partnerships? What triggers the adoption of these approaches and how can they be disseminated?***

Openness and transparency, inclusiveness, professionalism, thoroughness, proper delegation, ability to do the deal and the right skills in the project team are all important components.

Often a key individual- the sponsor - can trigger adoption of the right set-up, but others providing excellence are necessary too. Giving the team and the project a clear and separate identity seems to help.

***58. What forms of governance arrangement do you think work well in public private partnerships? What role should there be for 'partnerships boards?'***

In our draft guidance supplementing the Treasury taskforce General Guidance 'standardisation of PFI Contracts' we have stressed the importance under best value of engaging users and other stakeholders in the scoping of contracts and the ongoing monitoring of targets and objectives. In our guidance recently released on employee consultation and disclosure of information we have encouraged systematic and regular consultation with stakeholders. The establishment of partnership boards with all parties contributing should help to minimise misunderstandings and promote harmony among the partners to a PPP or parties and stakeholders affected by a PFI transaction. Partnership boards are a common feature of PFI.

***59. What examples do you know of public/private sector organisations successfully managing the transition into a partnership arrangement? Do you know of public private partnerships which have benefited from the use of conflict resolution procedures?***

The Essex County Council/ WS Atkins "hosting" contract for property services (1994-1999) had a good initial partnership arrangement, but because the service departments were not closely enough involved in monitoring performance, this started to break down after about three years (out of five). A conflict resolution process was attempted through use of facilitated workshops, but because a key individual on the client side didn't support the process it did not succeed.

***60. At what level of your organisation does involvement in public private partnerships have the most effect? Do attitudes towards involvement in partnerships vary at different levels of the organisation?***

Speaking for local authorities, there is no doubt that if chief officers are not engaged and strongly in support, the partnership is very likely to go wrong. People "on the ground" are often sceptical about partnerships because they are used to more confrontational contractual relationships. Managers are more prepared to experiment with new ideas but are open to criticism from the practitioners for being out of touch with the real world. In this situation only successful outcomes will remove the scepticism.

## SECTION VII

### Cross-cutting issues

Public private partnerships by their very nature raise a whole host of complex issues which transcend conventional forms of categorisation. Many of these issues - the impact of partnerships on accountability; the treatment of transferred staff; and the potential for greater cross-departmental working - are critical to the whole debate on the potential of partnerships.

### The transfer of employees

One area of the debate on public private partnerships that has been the focus of intense debate is the transferal of staff. One aspect of this concerns the regulatory framework used to protect the terms and conditions of staff who move across sectors. In addition, there are wider issues which need to be considered such as the opportunities that exist for career development and training and the impact of transferal on employee morale and motivation.

***61. What are you views of existing TUPE arrangements? Do they provide adequate protection for employees? What other safeguards would you propose?***

We understand that TUPE is in the process of amendment in the light of amendments made to the Acquired Rights Directive and that the DTI are currently consulting on the extent and nature of those amendments to protect employees on transfer not only on first round tendering but also on subsequent bids. Moreover consideration is being given to including pensions within TUPE. All these factors, together with other measures being taken by the Government under the Fairness at work policy initiative will help remove concerns of staff and representatives over orrganisational change.

***62. According to your experience/research what has been the experience of employees transferred between sectors as the result of public private partnerships (in terms of wages and conditions, pension rights, and motivation)? Have transferred staff experienced more/less opportunity for career development and training? What has been the impact on morale and motivation?***

This, inevitably will depend on a case-by-case analysis. In some instances changing employers from public to private had provided greater opportunity for development, training and remuneration than previously for employees, in others the opposite may have been the case. 4ps hosted a conference on people issues in the context of PPP/PFI recently at which the three main Unions in local government were represented. Unison representatives indicated that they had undertaken a survey of transferred staff which indicated (in broad terms) a general reduction in terms and conditions of staff following transfer to the private sector. Overall, however the three union representatives were optimistic as to the future of PPP in the light of changes that are being made and the co-operation between the Government and the social partners (CBI. Unions, LGA etc) in local government. The 4ps guidance on employee consultation and disclosure of information was launched at this conference which will assist with placing employee issues at the heart of any considerations over future service delivery options including by way of PPP/PFI.

***63. From your experience/research what proportion of any efficiency gains that have resulted from public private partnerships that you know of have arisen from changes in employee terms and conditions?***

We do not have access to detailed information on this but we would be very surprised if efficiency gains in PFI projects were wholly or substantially derived from changes to workforce conditions. There are many other aspects which contribute to efficiency under PFI such as the length of the contract, the whole life nature of the services provided, the size of the contract, the opportunities to obtain further work in local government PFI market and so on.

### Accountability, responsiveness and innovation in partnerships

It is often argued that public private partnerships challenge traditional forms of accountability within the public services by diminishing the role of public sector employees. Different types of public private partnerships raise different issues. Others reject the idea that political accountability is diluted when key services are run by the private or voluntary sector. They argue that public private partnerships enhance accountability by increasing transparency and making explicit expected standards of service provision.

***64. How do you think the use of public private partnerships affects the accountability of service managers to elected representatives, citizens and regulators?***

Provided a PPP has been properly procured (with sufficient consideration given to the services to be delivered through a long term contract) and that stakeholders have been consulted and involved, there should be more accountability for service managers through the management and performance monitoring of the contract. The payment mechanism enables the client to manage the performance of the contractor and the focus on outputs and outcomes provides both the client and other stakeholders with the evidence from which to judge service delivery. Furthermore, the incorporation of Best Value clauses within a PPP contract allows the partners to refine a contract in order to seek continuous improvement.

***65. Do current models of public private partnerships allow enough scope for citizens and the users of services to influence key issues such as: whether or not a PPP should proceed; the nature of performance targets set in partnership agreements; the monitoring and evaluation of whether these targets have been achieved? How willing do you think the private and voluntary sector would be to operate in partnerships where users have more influence over these issues?***

The views, and ultimately the support, of stakeholders and the wider public should be obtained and reflected in the development of any PPP contract. If the stakeholders are not supportive of a PPP the proposal should not progress. Where stakeholders are supportive they should be fully involved in the PPP process, including the setting and monitoring of performance targets. The Best Value regime requires consultation with stakeholders as a means of obtaining continuous improvement and such an approach is being increasingly included in PPP contracts. The private sector is comfortable with stakeholders and users being involved in the setting and monitoring of performance targets, provided the contractor can manage the relevant service areas. For instance, a school PFI operator will not take anything more than a very small proportion of a payment being dependant on exam results, as they are not responsible for delivery of teaching services. The private sector is however wary of too much of a service payment being dependent on qualitative assessments of performance, such as user satisfaction surveys. They prefer a balance of quantitative and qualitative measures whereby only a small element of payments is dependent on factors such as user survey satisfaction.

***66. Do you think that existing approaches towards accountability unduly inhibit innovation and risk-taking in public private partnerships? If so, what reforms would you propose?***

**ICT and electronic service delivery**

Over recent years there have been a number of large-scale and high profile information communications technology (ICT) based public private partnerships. Whether the problems which some of these have encountered can be attributed to the PPP contract (or whether there is wider problem with ICT procurement) is still a contested issue. Nonetheless, it is clear that ICT will remain an important component of many public private partnerships and that electronic forms of service delivery and access will continue to grow in importance in partnership agreements.

***67. Where and when are public private partnerships the appropriate means of delivering improvements in ICT in the public services? How can the dangers of using long-term contracts in ICT public private partnerships be minimised? What lessons have been learnt from ICT public private partnerships over recent years?***

- This is an opportune time for public services to consider PPPs given the demands of the electronic service delivery agenda set by central government. The partnerships are appropriate in all type of services particularly those which are a repetitive processing activity, where there is the need to collect uniform information and areas where a response is needed that can be self selected from a series of options. This has been the reason for the growths in call centres. The dangers of using long term contracts In PPPs can be minimized with more know how products. There is presently insufficient sharing of best practice and lessons leant from projects which were not implemented as smoothly as proposed. The lessons that have be learnt over recent years from ICT PPP projects are the following;
- there needs to be a project team to manage the project, the project team should work within the structure of proper project management principles such as PRINCE,
- the re needs to be a robust communications strategy for internal and external use,
- do not see the implementation of this initiative as a cost saving exercise it should be seen as one to increase service delivery,
- the leaders of the project must support its' implementation 100%,
- the implementation timetable should be generous and allow sufficient time for testing the system and parallel running of old and new systems
- thought should be given to technology refresh

- Market testing and if unsuccessful, followed by a program of market testing throughout the contract term needs to be developed.

68. ***When does it makes sense to integrate ICT with public private partnerships for the maintenance of buildings and facilities?***

This should be undertaken if this will be the most cost effective solution for the service. If there is to be provider it makes sense to see if there could be one or a consortium provider.

69. ***What is the scope for more innovative use of electronic service delivery in public private partnerships?***

This is the area in the PPP field presently that has the greatest potential for joint working not just in a PPP with one public body but there is the possibility for a number of public bodies to jointly procure such a service. Many public authorities are examining this area as part of their best value plans as they see innovations in electronic service delivery will be the driver of change to 'modernise' their service delivery. Many authorities have insufficient funds to introduce electronic methods so would welcome a partnership arrangement with the private sector that can design, build fund and operate such a development. Also they recognize that any strategy to meet this cannot be delivered by an in-house team in today's environment and with the demands of then consumers.

70. ***How can rapid rollout of electronic service delivery be combined with a need for flexible, innovative and interoperable IT public private partnerships?***

Rapid roll-out of such services would occur if the market had confidence that all partners were interested in achieving high levels of service delivery,. Also, there needs to be more examples of successful schemes promoted as best practice and the lessons learnt disseminated.

**Cross-sectoral public private partnerships**

One of the strengths of public private partnerships is said to be that their collaborative and project-based focus makes them an ideal way of addressing challenges, which transcend different government departments. An example of this would be a PPP project signed by a LEA and a housing association, which would lead to a new primary school being built within a housing development. Because partnerships are thought to be a way of breaking down departmental barriers they often figure prominently in discussions of joined-up government. To date, however, relatively few cross-sectoral partnerships have been agreed.

71. ***What are the areas of public policy/public services where you think that cross-sectoral public private partnerships have a significant role to play? What are the barriers to the creation of cross-sectoral public private partnerships in these areas?***

Cross-sectoral partnerships have a significant role to play in all public service areas. The key criteria are social inclusion and attempting to meet the diverse needs of a person in a one-stop shop environment/operation. The obvious areas of housing, social services and education are always identified but authorities are now widening there thoughts to consider the co-location of services such as a library within a supermarket and a social services office in a NHS trust medical centre. The barriers to such PPPs are the lack of knowledge by funders who are not always comfortable with multi-public sector projects. Also the lack of understanding that such developments will only be successful after major cultural change and business re-engineering programs. Also many senior staff in these organisations will not help them be successful as they see their power base, influence and 'baronies' disappearing.

72. ***Does government currently have a 'joined-up' approach towards evaluating the benefits of public private partnerships? If not, how could a more holistic approach be devised for gauging the benefits of cross-sectoral partnerships?***

The Government has generally been very supportive of "a joined up" approach towards public private partnerships in Local Government. For example, during 1999/2000 the Treasury announced a separate budget of PFI credits for "joined up projects". This was introduced on a trial basis and is still being reviewed. In the 4ps experience many projects and arguably an increasing volume of projects developed by Local Authorities begin as being generally joined up. For example, Social Service projects can naturally involve Health Care Services as well as personal Social Services. Dudley Metropolitan Council and the local NHS Trust jointly procured a facility from which personal Social Services, Health Services and also some leisure services are delivered. The London Borough of Lambeth is procuring a secondary school in Vauxhall as part of an area regeneration project which includes investment in Social Housing.

The 4ps is seeing an increasing number of projects where investment in a school procured through PFI is associated with investment in community based leisure facilities as part of the same project.

However, there is a perception that there is insufficient 'joined-up' working by government to evaluate these bids. A more holistic approach could be achieved by creating a 'gateway' approach for all such government sponsored projects. This has worked successfully for the Project Review Group process that approves al local authority PFI schemes to be sponsored and funded by central government.

The example projects above will undoubtedly deliver joined up services to the communities they serve. However, the merits of developing a measure of "joined-upness" needs to be further demonstrated. The more immediate problem is to remove barriers to encouraging more projects which bring together the services to come forward.

The main reason for the success of the PFI programme in Local Government has been the deal flow that has evolved over the past three years. This deal flow has been supported by both a substantial budget and a transparent and predictable process for allocating money to individual projects. However, projects still need to comply with the boundaries of departmental responsibilities. For example, whatever the merits of a community based sports facility, at present there are no incentives for DfEE to support the project as their priority is to support educational attainment rather than sport and leisure. Similarly, even within the same department, the priorities for Health Trusts may not fit with those supporting investment and personal Social Services. In consequence, in 4ps experience, there is a tendency for projects to be fitted to budgets rather than budgets fitted to projects.

It is not entirely clear whether an index of 'joined-upness' which measured the benefits of cross cutting partnerships would contribute much. There is also the real risk of perverse incentives where projects are supported because they are joined-up rather than because of their inherent benefits.

***73. What steps need to be taken to encourage successful models of cross-sectoral public private partnerships?***

The steps that might be taken to encourage successful models of cross-sectoral public private partnership are discussed elsewhere.

The success of the PFI programme in Local Government suggests that the most effective strategy is to encourage the development of a pipeline of cross-sectoral public private partnerships. While the overall experience of PFI in Local Government is of value, it is worth focusing on the experience of PFI and housing which started "behind" other sectors, but has developed best practice in part based on the experience schools etc.

The essential features are:

- A clear statement of Government intention – this might require for example Secretary of State for Education and Employment to jointly agree with the Secretary of State for Culture, Media and Sport to support projects which join together schools and leisure and culture facilities.
- A clear budget to support projects which meet Government criteria
- A clear process for allocating finances to individual projects. The two staged process used by DETR's housing department is of particular value.
- A clear process for generating and recycling the know-how generated from the cross sectoral projects. For example the two stage process in housing enabled the eight pathfinder authorities to work co-operatively in the knowledge that they were not competing for a fixed pot of funds. The 4ps and others procured technical guidance on the development of PFI housing contracts and also managed a process whereby the know-how generated on individual projects was pooled and is being recycled into the wider community.

This basic approach can be applied across a variety of different service areas. The importance of the pipeline cannot be understated. Once the pipeline is established, criteria for allocating resources to individual projects can be reviewed and altered and know-how can be recycled back into the community to generate either more projects or alternatively different sorts of projects. In addition, careful management of the pipeline can reduce the effort expended on projects which are or are likely to be aborted because either they did not fit with Government or Local Government priorities or because they are not deliverable.

The government should support a 'pathfinder' approach to such projects. Also those that are supported should disseminate best practice and lessons learnt from their implementation.

### Learning partnerships

If public private partnerships are to fulfil their potential policy makers need to ensure that the lessons from both successes and failures are learned. This will mean finding way of spreading best practice across a wide range of issues such as contract design, staff transferal, and effective consultation procedures.

***74. Is there an adequate central database which pools information on the performance of all partners? If not, what ideas do you have for how this resource should be made available to all public managers involved in procurement?***

There are lots of “Central Bodies” both in the public and private sector which pool information either formally or informally on the performance of all partners. The 4ps performs this role in Local Government for capital intensive services, procured using PFI and also for a variety of other, mainly capital intensive, public private partnerships. The Improvement and Development Agency (IDEA) generates best practice guidance on procurement generally as do professional organisations such as the Society of Purchasing Officers and its affiliates.

There are similar agencies in other parts of the public sector and a publishing industry has grown up off the back of the overall PFI initiative which provides information on many aspects of PFI, public private partnership and the wider procurement. If anything, procurement managers in individual public authorities are in danger of being overwhelmed by a volume of data. Indeed, the volume of data available creates the difficulty of being able to distinguish what is “official” and what is “not official” and indeed what is good and what is bad.

Experience suggests that there are very great practical difficulties in the public sector in establishing central authorities. In practice, central authorities are not omnipotent and spend considerable time and resources either explaining what they do and what they don’t do and in protecting and extending the boundaries of their “territory”. For example, the Treasury Taskforce had less administrative influence in Local Government than in Central Government. Within Central Government, some Departments were more open to the involvement of the Treasury Taskforce in projects than others. The relative size of the Private Finance Units in the NHS and the Ministry of Defence meant their relationship with the Treasury Taskforce would inevitably be different to its relationship with say DETR. It is instructive that the remit of the Office of Government Commerce is focused on “civil”( non-military) Central Government procurement (excluding the NHS).

Rather than focus effort on defining Central Bodies or agencies, experience suggests there is merit in identifying specific problems and then developing strategies to deal with them. For example, a major problem faced by the Treasury Taskforce in supporting projects was that as a public body, essentially a department of HM Treasury, its resources were fixed. Therefore, in practice it was unable to devote resources to individual projects commensurate with their needs. Another problem faced by the Treasury Taskforce was that authority to intervene depended entirely on its location in HM Treasury. In practice this is a blunt instrument as Spending Ministers and their Civil Servants are understandably protective of the project for which they have to account.

Even though its writ did not extend throughout the public sector, the Treasury Taskforce acted as a point of authority and arguably one of its most important legacies will be the guidance on the Standardisation of PFI Contracts or the ‘black book’ published by Butterworths. The responsibility for the guidance is now being taken over by the Office of Government Commerce who will rely on the expertise of Partnerships UK for a transitional period.

However, important though the Standardisation of PFI Contracts was, it must be noted that it incorporates guidance produced by the NHS Private Finance Executive and guidance for Local Government produced by the 4ps. This demonstrates a recognition that a single body, in this case the Treasury Taskforce, could not in practice develop detailed and extensive guidance which could serve as best practice on PFI and public private partnerships for the public sector as a whole. There were other sources of expertise and also authority.

The Treasury Taskforce produced its guidance following an inclusive process whereby the different sources of expertise and the different interest groups such as contractors and financiers were all involved in the production of the guidance. The mutuality of interest was to produce authoritative guidance which commanded widespread support. The experience suggests that this objective is predicated on an inclusive process which recognises the multiple sources of authority and expertise rather than a single Central Body seeking primacy.

The 4ps has produced guidance on the Standardisation of Contracts in Local Government generally, but also in Housing and has produced guidance on a variety of topics including most recently the disclosure of information and employee issues arising in PFI contracts. All of this guidance has been produced following an inclusive process and where possible has been jointly badged with other authorities such as Government Departments and or the Treasury Taskforce.

It is also worth noting that the private sector is very efficient at disseminating know-how. For example, there is anecdotal information of negotiators on the public sector side making a concession in relation to a particular contract and finding that the concession is known throughout the market place within a very short space of time. This and other experience suggests that the processes that market forces are usually very efficient in the spread and transition of valuable know-how. The role of the public sector is to ensure that its interests are protected and that good decisions are widely disseminated. For example, the Standardisation of PFI Contracts represents in practice the settled public sector negotiating position on a very wide variety of detailed issues arising in PFI contracts.

Therefore in answering the question the issue is not the spread of best practice but what gaps are there in the public sector market.

***75. Do you think that enough effort is being made to spread best practice on the design, management and evaluation of public private partnerships? What role do you think organisations such as Partnerships UK or the Office of Government Commerce should play in this regard?***

**SECTION VIII**

**Better government?**

Views on the potential of public private partnerships to deliver a step change on public services vary considerably. Some argue that the most we can expect from the greater use of public private partnerships is small-scale efficiency savings - and even these are sharply contested. Apart from this they will have little impact on policy outcomes and service standards. At the other end of the spectrum, it is argued that the growing use of partnerships could help to transform the quality of public services and change our traditional understanding of the 'public' and 'private' sectors. For instance, partnerships might:

- create a new hybrid 'partnership sector'- with its own ethos and motivations – which draws on and involves elements of public, private and voluntary sectors;
- make it easier for new career paths to emerge in which employees move flexibly between sectors thereby reducing the tendency for people to think of themselves as either a 'public' or 'private' sector worker.
- challenge assumptions often made about the core competencies of both the public and private sectors.

**The implications of partnerships for the future of public services**

***76. In the medium to long term, what potential do you think there is for partnerships to transform the public services in this way?***

***77. Are you concerned that the growth of partnerships may at some point erode the capacity of government to effect social and economic change? Alternatively, do you feel that that public private partnerships have the potential to increase the ability of government to successfully guarantee desirable social and economic outcomes?***

This question highlights the most important facing public bodies as they develop public private partnerships. Arguments over value for money and costs of capital can become very arcane and presuppose a definitive outcome. However, of greater importance is to consider how the public sector might cope with everything from civil emergencies to major changes in the service requirements such as change in school curriculum without having substantial operation control over some or all of the services that are provided. Is it sufficient to have contractual and financial levers or are more direct administrative controls necessary. This is where the debate should focus.

# COMMITTEE FOR FINANCE AND PERSONNEL
# INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## THE NATIONAL ASSEMBLY FOR WALES

24 April 2001

Thank you for your letter of 22 March inviting the National Assembly for Wales ('the Assembly') to contribute towards the inquiry into Public Private Partnerships in Northern Ireland.

As you are aware, the Assembly has recently undertaken its own consultation with public and private sector partners in respect of Public Private Partnerships and the Private Finance Initiative (the 'Consultation') in Wales. Mrs Hart announced the initial results in plenary on 5 December 2000.

The proposals are currently progressing forward via the appropriate subject committees and I anticipate Mrs Hart making a further announcement during the summer. I attach a copy of both the consultation paper and the plenary narrative for your attention.

The Assembly is currently supporting almost £60 million of PFI projects within the local authority sector with further schemes estimated at £233 million are under development. Some £115 million of projects have reached financial close in the health sector and the Assembly's two 'in house' projects, the dualling of the A55 in north Wales and the OSIRIS IT system are both operational.

To date, PPP/PFI has delivered tangible benefits to the public sector in Wales. Whilst ensuring that value for money remains the primary driver, PPP/PFI encourages robust forward planning in respect of operational needs, planned maintenance and service delivery. This is in contrast to traditional procurement practices where long term service delivery often suffers as a consequence of securing short term goals. The creation of a successful PPP/PFI contract entails a significant amount of time and effort. In negotiating 25 or 30-year terms, it is essential to address every realistic eventuality at the earliest possible stage and to follow existing standards of best practice. In Wales, it is clear from the projects signed to date that reduced procurement times and less complicated final negotiations can be achieved through a more conscientious approach to the early stages of PFI procurement. We are particularly looking at ways in which to improve the initial project selection criteria to improve standards in this area.

To date, the Assembly has been successful in encouraging the sharing of expertise within the public sector. We have found that Authorities take a genuine pride in their achievements in securing PFI contracts and are keen to share information and experiences. This is an invaluable source of skills and we are keen to take this further with secondments or staff 'loan' arrangements. Indeed the project manager for Hondda Cynon Taff County Borough Council is on loan from Pembrokeshire County Council following financial close at Pembroke Dock Primary School last summer.

Whilst the results of the Assembly's own Consultation continue to be progressed, it may be inappropriate to give specific views as to the development of PPP/PFI in Northern Ireland. It is clear that there are improvements to be made in streamlining the current position for the public sector in Wales especially in respect of cross-boundary and cross-sector schemes, but many of these initiatives will take time. The Assembly is committed to providing access to as much information and guidance as possible and I hope that we can achieve the latter through the launch of a dedicated PPP/PFI web-site in the early summer.

**L A PAVELIN**
**Head of Financial Accountability Division**

**Edwina Hart:** I propose that

*the National Assembly*

*notes the proposals set out in the paper 'Public Private Partnerships and the Private Finance Initiative in Wales' which was circulated to Members by e-mail on 28 November 2000;*

*agrees to refer relevant issues in the paper to the Local Government and Housing Committee and the Health and Social Services Committees for further discussion;*

*agrees that the Minister for Finance, Local Government and Communities should bring a further progress report to the National Assembly.*

The first part of the motion asks that the Assembly notes the proposals set out in the paper. The Assembly has not been asked to come to any conclusions on this, simply to note and discuss its contents.

The second part of the motion proposes that the Assembly refers the issues to the Local Government and Housing Committee and the Health and Social Services Committee so that they can be subject to further, detailed scrutiny and deliberation. The last part of the motion requires that I bring back a progress report to the Assembly once I have considered today's discussion and the Committee's work.

In Wales, there is large-scale investment into public assets, by various forms of private funding. It is essential that we take time to review our experience. I ask the Assembly to reject all the amendments that have been tabled to this motion. This is not because there is no merit in them, it is simply because we should continue this important review process. We should consider the views expressed today and consider the Committees' work before we reach any conclusion. The problem with the amendments is that they seek to finalise a review that is still in progress.

Last summer, pubic and private sector organisations involved in the partnerships and PFIs in Wales were invited to participate in a consultation exercise. The purpose of the exercise was to identify strengths, weaknesses and areas for development. Responses were received from 45 per cent of those approached and the following areas were highlighted for further development. First, the need to formulate a distinctive policy to tackle any possible transfer of responsibility for activities indirectly associated with the facility in so-called soft facilities management. Secondly, to evaluate the merit of the bidding rounds in local government where they already exist, as well as in the health service. Finally, to consider the procedures associated with PFI, eliminating bureaucracy wherever possible and investing in an Assembly support system where appropriate.

First, let me update you on the progress of some current PFI projects in Wales, affecting all sectors of society. PFI partnership has resulted in the development of many schemes in the health sector. These projects include the Chepstow neighbourhood hospital, Nevill Hall hospital, the Baglan general hospital, St David's community hospital and the staff residences at the Royal Glamorgan hospital. In addition to progress in the health sector, the Assembly is currently committed to providing PFI credit support to 10 local authorities in a total of 13 schemes. These include primary and secondary schools, a waste management system, two strategically significant roads and civic facilities in Ruthin. These developments would not have gone ahead as quickly, if at all, without the use of private finance and partnership agreement.

There will be occasions in the future when we should use our experience in Wales to conduct a dialogue with the Treasury on its policies on capital finance. However, at present, we must recognise that without private finance we would not be able to put in place the essential forms of infrastructure that I have catalogued. With the assistance of the Assembly's Committees, I shall consider how the Assembly can improve the quality of its administrative procedures and assistance for private finance in Wales, providing better and more acceptable advice and guidance.

**Gwenda Thomas**: Will you confirm that it is not your intention for the Local Government and Housing Committee to undertake a policy review, but that the Committee will be asked to consider a paper on the various proposals prepared by you, and that your department will undertake the consultation exercise mentioned in today's paper?

**Edwina Hart:** That is right, Gwenda. The report that I have already undertaken will come to the Committee for consideration and it will be up to the Committee whether it wishes to take further views from organisations, such as trade unions and the Welsh Local Government Association, to impact into further work. With the assistance of the Assembly's Committees –

**Cynog Dafis:** You mention that there is no choice at present to use PFI schemes for important developments, and I acknowledge you that it is true. Do you agree that it is regrettable that the policy framework that the United Kingdom Government imposes on us forces us into this channel? That could be different if the attitude of the United Kingdom Treasury towards the public sector borrowing requirement and its definition was different, and if central Government took a different attitude to public expenditure and allow us to use the money raised by taxation for investment in all kinds of capital developments?

**Edwina Hart:** The trouble is, Cynog, that I have to deal with the reality of the Treasury's policy in my discussions on PFI and public-private partnerships. It would be nice to be able to comment on what I regard as the economic management of the country, but that would be inappropriate. I must look at what we can do in Wales now in the context of national Government policy.

With the assistance of the Assembly's Committees, I shall consider how the Assembly can improve the quality of its administrative procedures and assistance for private finance in Wales, hopefully providing better and more accessible advice and guidance. As part of this initiative, officials will design and maintain a website dedicated to public-private partnership issues. In the medium term we need a clear statement about future PFI credit bidding rounds. The existing uncertainty hinders the progress of possible schemes, and clear guidance from the Assembly is essential. At present PFI credits are only available to local authorities. I would like to investigate whether a similar arrangement should be extended to the health sector. The Assembly will work with the health sector to investigate the potential benefit of taking this forward within the developing capital planning framework. It is an entirely appropriate matter for the Health and Social Services Committee to discuss.

*3.50 pm*

Clear guidance is needed to deal with the transfer of soft facilities management, employed in some PFI contracts. That tends to affect staff such as cleaners, porters and ancillary staff. There have been schemes where such indirectly-associated responsibilities, and the staff involved, have been transferred to the financier. We will work with our partners to clarify the issues involved in such transfers. Within the value for money framework, I am keen to look favourably on bids that exclude the inappropriate transfer of staff. I am also aware that it has caused great consternation in some projects in Caerphilly, Rhondda Cynon Taff and other local authority areas, where staff may have been involved in the transfer. There have been concerns about staff being involved in the transfer of these assets.

The Local Government and Housing Committee is continuing its review of the capital financing of council housing. As well as evaluating stock transfers and options, the Committee will consider the benefits or otherwise of PFI in financing capital investment in council housing stock. There are currently eight authorities in England with housing pathfinder projects supported by the Department for the Environment, Transport and the Regions. We will review the evidence from these projects and consider the merits of any pilot schemes in Wales.

We need to streamline the bureaucracy associated with these projects. The time, cost and effort of developing these projects is significant. Through reducing bureaucracy and improving access to information, the Assembly can assist in cutting down on cost. The public sector in Wales is keen to develop the principle of joint working, although at the moment there are legal, stakeholder, and, of course, political issues that complicate schemes. The Assembly will consider several areas where there is potential for cross-sector co-operation and will see where we can adapt guidance and legislation to reduce bureaucracy.

We need to develop a strategic framework for public-private partnership and PFI projects in Wales. At present, the majority of capital projects are undertaken at a local level, based on local priorities. The Assembly is sometimes in a position to see possible links across sectors and to encourage cross-authority co-operation. If the Assembly supports the motion, the review into private finance will be continued by the two identified Committees. In addition, I wish to continue the dialogue with our partners on this issue. I will, therefore, establish a working group of partner organisations to advise on the means whereby the Assembly can provide co-ordination and assistance.

# CONSULTATION PAPER ON PUBLIC PRIVATE PARTNERSHIPS AND THE PRIVATE FINANCE INITIATIVE (PPP/PFI) IN WALES

The purpose of this paper is to seek the views of interested parties on how the Assembly can best use PPP/PFI to help meet its priorities. Listed below are the areas where we would particularly welcome your views.

**1. How can the Assembly ensure that PPP/PFI projects across the public sector in Wales are undertaken within a strategic framework that supports the Assembly's priorities?**

The Assembly has inherited a situation whereby most PPP/PFI projects originate in local authorities or NHS Trusts which then, in the majority of cases, seek support for them from the Assembly. The problem with this is that need should be measured against a wider backdrop than that of an individual administrative unit, so that the overall needs and priorities of Wales as a whole are considered. The Assembly therefore wishes to move towards a focused strategic approach over expenditure on all significant PPP/PFI projects.

**2. Within the context of a strategic framework approach, how can the Assembly best encourage "cross-boundary" co-operation?**

There are some early signs that some public sector bodies (for example, local authorities working together on PFI schools and waste management projects) are looking beyond their administrative boundaries to co-operate on PPP/PFI projects. This is an approach that the Assembly wishes to encourage.

**3. Should the Assembly continue bidding rounds for PFI credit support for local government projects? Should the idea of bidding rounds be extended to the health sector?**

In the local government sector there have, to date, been two bidding rounds for PFI credit support. This control of support provides the Assembly with the flexibility to direct resources towards projects which best address its priorities, such as those in the education sector. Were there to be future bidding rounds the Assembly could promote its priorities via this mechanism.

Indeed, should such a mechanism be extended to the health sector?

**4. How could PPP/PFI be used to target disadvantaged areas across a range of initiatives, eg education, housing and health?**

The Assembly has a range of strategic objectives set out in its draft Plan "Better Wales". The Assembly would welcome ideas on how PPP/PFI might be used to assist disadvantaged areas across the public sector in Wales.

**5. What could be done (to the extent allowable under the European Public Procurement Regulations) to ensure that jobs and profits generated by PFI contracts stay in local communities?**

The driver for PPP/PFI schemes is and will remain, value for money. Nevertheless, to the extent allowable under European Public Procurement Regulations the Assembly would like to consider ways in which we ensure that jobs and profits resulting from PPP/PFI schemes stay in local communities.

**7. What could the Assembly do to streamline the administrative processes associated with the PFI?**

The Assembly would like where appropriate, to consider how it might reduce the bureaucracy associated with PPP/PFI. The Assembly has already taken steps to simplify the capital finance regulations that apply to PFI in local government by repealing the "contract structure test" in Regulation 40, and has also approved the payment of PFI Credit support to correspond with actual contract length. A further example of streamlining the administration of the PFI may be to increase the delegated limits over which NHS Trusts must obtain the approval of the Assembly to proceed with a PFI project. Such an increase in the limits would, however, reduce the Assembly's ability to influence PFI projects.

**8. What should the Assembly's policy be on the issue of staff transfers associated with the PFI?**

PFI/PPP transactions regularly involve the transfer of staff from the public to the private sector and whilst this is an important element of the contract – ensuring optimum risk allocation and best value for money for the public purse – staff transfers remain a sensitive issue. Steps have been taken by Central Government to improve the protection of benefits afforded to transferring staff and the Assembly is considering whether certain ‘Soft FM’ services, such as porters and caretakers, could reasonably be excluded from PFI transactions whilst still ensuring value for money.

**9. What can the Assembly do to help support PPP/PFI schemes?**

To maximise the potential of PPP/PFI schemes it is important that public sector bodies are able to share ideas and experiences and receive good advice and guidance. Support is currently available from: The Assembly’s Private Finance Unit; the “4 Ps” (for local government) and the Treasury Taskforce (for “Significant projects”). The Assembly would welcome ideas on how the support offered for PPP/PFI schemes could be developed.

**10. What can the public sector in Wales do to help themselves?**

Self-help is an acknowledged way of developing skills. Some of the authorities involved in the early PFI Pathfinder projects are providing help and advice to colleagues working on more recent schemes, for example Ceredigion CC has a web site which includes certain key documents relating to their Penweddig secondary school PFI project. What more might be done?

**11. What could be done to reduce the cost of advice on PPP/PFI to public sector bodies?**

One of the most significant disincentives to public sector bodies contemplating a PFI scheme is the high cost of professional advice. The Assembly would welcome ideas on how this cost could be reduced. One option would be for the Assembly to increase the level of support it provides via its Private Finance Unit. Another option would be to wait to see if the new body (“Partnerships United Kingdom”) being created to develop the project support work of the Treasury Taskforce will be able to provide cost-effective assistance.

**12. What other ideas are there that would help progress PPP/PFI in Wales and assist the Assembly to meet its priorities?**

The above list is not exhaustive and the Assembly would welcome any other thoughts and comments related to the PPP/PFI in Wales.

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## NATIONAL AUDIT OFFICE (NAO)

**Introduction**

1. The Comptroller and Auditor General, Sir John Bourn, is the head of the National Audit Office employing some 750 staff. He and the National Audit Office are totally independent of Government. He certifies the accounts presented to the Westminster Parliament by Government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

2. To this end the National Audit Office has, to date, published 21 reports in respect of the Private Finance Initiative (PFI) or other forms of Public/Private Partnerships (PPPs). A list of these reports is set out in Annex 1. These reports may be accessed at the National Audit Office website www.nao.gov.uk.

3. The PFI deals examined reflect the wide range of uses to which the PFI/PPP has been put. Thus the reports cover the first deals for the provision of roads and other transport infrastructure, vehicles, prisons, hospitals, office accommodation, telecommunications, and IT systems. The size of the deals examined ranges from the £19 million contract for the provision of non-combat vehicles for the Royal Air Force to the £4 billion Channel Tunnel Rail Link project. In addition, the National Audit Office has published a general report "Examining the value for money of deals under the Private Finance Initiative" (HC 739, 1998-99).

4. The other forms of PPPs which the National Audit Office has examined include a joint venture arrangement entered into by the Radiocommunications Agency for the provision of IT services to the Agency and the exploitation of the Agency's intellectual property, and the methodology adopted for the value for money comparison of bids for the London Underground PPP contracts. In addition, the National Audit Office previously published a range of reports on privatisations and also published a report on the award of the first three rail franchises.

5. This paper addresses the questions raised by the Committee under the heading **"General Context of PFI/PPP".**

1. ***What do you see as the benefit of PPP/PFI? Are there identifiable benefits to the public and stakeholders?***

1.1 The PFI and other forms of PPP have the potential to deliver identifiable benefits for public services. Whether individual projects will deliver these benefits depends on how they are taken forward and whether key issues affecting value for money are well thought through. We have identified below what we see as the potential benefits for each of the stakeholders normally involved in PFI or PPP projects. In most PFI or PPP deals the private sector's cost of capital is more expensive than the cost of government finance that would be used in conventionally funded public projects. That does not mean, as some people seek to argue, that PFI or PPP deals can never represent value for money. Any assessment of the value for money of a PFI or PPP deal compared with a conventionally funded project must weigh the expected benefits from using these new arrangements against the higher financing costs that they may involve.

<u>Potential benefits to the procuring authority</u>

1.2 There are a number of potential benefits to a procuring authority from using a PFI or PPP approach:

a) A key focus of the PFI and other forms of PPP is that the private sector is asked to deliver a service specified in output terms. So, for example, in PFI prison deals the private sector has been asked to provide and manage new prisons for a specified contract period. This has required the private sector to design, build, finance and operate the new prisons. Better value for money can arise from the synergies that occur between the design of new assets and their operation. One party, the private sector supplier, is made contractually responsible for both and is therefore incentivised to seek an efficient solution. In addition, in the past, the public sector often invested capital in a new asset without a clear commitment to adequate future spending on maintenance. This often resulted in poorly maintained assets, high running costs, inefficient service provision and premature replacement.

b) The PFI and other PPPs also have the potential to deliver improved value for money, in terms of lower costs and/or improved quality of service, as a result of innovation and improved management on the part of the private sector.

c) In PFI and PPP contracts standards of service delivery for the duration of the contract can be agreed and specified clearly in the contract.

d) Other things being equal and provided the private sector supplier performs to the standards in the contract, there can be greater cost certainty over the life of a contract as the charge payable under it can be, to a large extent, fixed.

e) The use of the PFI or PPPs can relieve the procuring authority of responsibility for the direct management of non-core activities, allowing it to concentrate on its core business activities. Examples of this are the PRIME PFI project where the management of the property estate of the Department of Social Security was transferred to a private sector consortium, or the Ministry of Defence PFI contract with BT for the provision of fixed telecommunications services for the whole of the Ministry.

f) PFI and PPPs can enable the procuring authority to transfer to the private sector supplier risks which it itself is not best placed to manage but which the supplier is.

g) PFI and PPPs can result in faster construction times as the private sector supplier is incentivised to work quickly because it does not receive any payment until the required services are being delivered. Faster construction, compared with conventional procurement, has been achieved on a number of prisons, hospitals and roads projects. For example, the National Audit Office's report on the Bridgend and Fazakerley PFI prison contracts noted that these prisons were expected to open 45 per cent more quickly than a sample of prisons previously examined by the National Audit Office.

Potential benefits to the users of service / taxpayer

1.3 The PFI/PPP has the potential to deliver improved services for the public. For example, the use of the PFI in the health sector is enabling the delivery of a large hospital modernisation programme to move forward. These service improvements arise from the increased investment that is a consequence of the award of such a contract, and the innovation that a private sector supplier can bring. Private sector suppliers may be thought to have a more customer-oriented culture than the public sector since their customers can go elsewhere if not satisfied. The user of the service should be able to derive assurance that the standard of the service should be maintained for the duration of the contract period because the required standard will have been specified in the contract and the payments to the private sector supplier will be reduced if this standard is not achieved.

Potential benefits to public sector employees

1.4 The use of the PFI and PPPs can result in improved facilities and a better working environment for staff although there may also be some risks for employees. In terms of facilities, PFI hospitals, for example, have enabled modern facilities to be introduced more quickly than under conventional procurement which has benefited the clinical staff employed by the public sector who work in the hospitals.

1.5 Some existing public sector staff may also transfer to the private sector supplier under PFI or PPP arrangements. In some situations this may be a benefit to the employee. For example, if the employee had been involved in an activity that was not a core activity for the public sector department but transfers to a private sector supplier for whom the activity is their main business then the employee may enjoy better career opportunities. The National Audit Office's report on National Savings' PPP with Siemens Business Services noted that Siemens expected to re-deploy staff more quickly than National Savings and that Siemens' bid was priced on the basis that at least 1200 jobs would be created for former National Savings staff on third party work. There may, however, also be risks associated with transferring to a private sector employer. For example, the private sector supplier may choose to make staff reductions to generate cost savings on particuar projects and may not always be able to redeploy those staff. In the vast majority of cases, the terms of employment are, however, protected by the Transfer of Undertaking (Protection of Employment) Regulations 1981 ("TUPE") (see paragraph 5.3).

Potential benefits to the PFI contractor

1.6 The use of the PFI and PPPs presents potentially attractive business opportunities for private sector contractors. The availability of private finance has enabled more public projects which include the provision of new capital assets to move forward. This has created additional business opportunities for the private sector. It has also enabled some private sector companies to build up portfolios of PFI or PPP projects which enables risks to be spread across a number of projects and management efficiencies to be introduced.

1.7 For construction contractors, there is added clarity under PFI or PPP arrangements. As the private sector is generally given the responsibility for deciding how the required service will be delivered there should be less scope for expensive disagreements between the supplier and the procuring authority over the design and progress of the construction work. The private sector is empowered to take on risks it is best placed to manage and is given the opportunity to achieve a reward commensurate with accepting these risks. Some private sector contractors have said they can earn higher profit margins as a result of these new working arrangements.

1.8 The private sector also benefits from the long term cash flows that are inherent in the long term nature of most PFI or PPP contracts. The maintenance of these cash flows at the expected levels is, however, dependent on the private sector's performance in delivering the required services.

2. ***What do you see as the key factors for the successful application of PPP/PFI?***

2.1 The successful application of the PFI and PPPs depends on a complex mix of inter-relationships. There are a number of key characteristics which set good deals apart from those that have been less successful. These characteristics, and the key elements of good practice for the successful procurement and management of these projects, are set out below.

Key characteristics of successful deals

2.2 In examining PFI and PPP contracts, we have identified the following characteristics for a successful deal:

a) An effective competition for the appointment of the private sector supplier.

b) The allocation of risks to the party best placed to manage them.

c) Opportunity allowed for private sector innovation, as the private sector supplier is given flexibility over the design of the assets and the operational procedures.

d) The linking of the regime for the payments due to the supplier to the supplier's performance.

e) The alignment of the interests of the procuring authority and the private sector supplier or joint venture partner.

f) Scope given for the private sector to use its business and management skills in the areas of managing complex capital projects to time and budget, the effective delivery of services and the exploitation of commercial opportunities arising in parallel with the provision of public services.

Key elements of good practice for a successful procurement

2.3 We have identified four pillars to the procurement of a successful PPP/PFI deal by the public sector. Details on these are contained in our report "Examining the value for money of deals under the Private Finance Initiative" (HC 739, 1998-99). In many cases the elements of good practice in procuring a PFI deal are the same as for the procurement of publicly financed projects. In summary:

*a) Setting project objectives*

i) Selection of projects which meet the procuring authority's real business needs.

ii) Setting of objectives for the project which are in line with the authority's business needs.

iii) Consideration of alternative methods of meeting these needs.

iv) Compilation of a proper business case in support of the investment decision.

*b) Ensuring proper processes*

i) Proper planning by the procuring authority at the start, including:

- the assignment of adequate resources to the project team within the procuring authority which is responsible for the procurement;
- the identification of the skills and expertise necessary for a successful procurement and its supply either from an in-house resource or from good quality external advisers; and
- proper project management.

ii) Consideration of how an effective competition will be held for the appointment of the private sector supplier.

iii) Use of an output specification to give the supplier flexibility over the design of the assets and the methods of service delivery and thus allow scope for innovation.

c) Selecting the best available deal

i) Selection of a supplier as preferred bidder whose proposals offer the best value for money, that is, the best combination of cost, risk allocation, and quality of service.

ii) Strong negotiation by the procuring authority with this bidder in the period between its selection as preferred bidder and the final award of the contract.

iii) Intelligent use of the public sector comparator[1] *by the procuring authority to protect its position in negotiations.*

d) Ensuring the deal makes sense

i) Consideration of whether the deal on the table still meets the procuring authority's objectives.

ii) Comparison of the PFI or PPP bid with the public sector comparator to ensure value for money.

<u>Key elements for the successful management of the relationship</u>

2.4 The public authority will need to manage its relationship with its chosen private sector supplier once a PFI or PPP deal is agreed if that contract is to continue to provide value for money over its lengthy duration. We have identified the following key elements for the successful management of this relationship:

a) Assignment of adequate resources and expertise (either in-house or from external consultants) to the team within the procuring authority which is responsible for managing the contract.

b) Partnership working between the procuring authority and its private sector supplier.

c) Proper management of changes in the procuring authority's requirements over the course of the contract.

d) Recognition of the continued importance of proper risk management by the authority.

e) Monitoring of the private sector supplier's performance and adjustments to payments to the supplier in line with this.

d) Benchmarking of the supplier's performance in terms of cost and quality.

e) Proper and timely management of the procuring authority's eventual exit from this contract and, if appropriate, of the appointment of a successor supplier.

3. ***Are there any wider issues, limitations and constraints associated with the environment of the PPP/PFI that have to be addressed? Are there gaps in the supplier market base? Are the skills and guidance available?***

3.1 A potential constraint to the development of the PFI and PPPs are the reservations that some people have about the desirability of these forms of procurement, with their integral role for the private sector, in the delivery of public services. For example, the use of a PPP approach for the refurbishment of London Underground's infrastructure has attracted political opposition, resulting in delays to the award of the contract. The use of the PFI for hospital redevelopment has also had critics despite the attraction of more new hospitals being able to go ahead under the PFI than was possible under conventional procurement.

3.2 A constraint in the early days of the PFI was that deals took a long time to develop and bid costs were high as the public and private sector had to get used to working with each other on these forms of deal. Consequently, some potential private sector bidders were put off from entering the market. It is expected that these problems

[1] The Public Sector Comparator is a realistic, publicly funded alternative option for meeting the procuring authority's requirements

should decrease in the mainland UK as the procurement processes to be applied here, and the detailed contract terms of deals, have become increasingly standardised.

3.3 Lack of expertise within the public sector was also a key issue in the PFI's early years. This lack of expertise is being addressed by a series of training courses and guidance notes on the use of the PFI which have been developed by the Treasury Taskforce (now part of the Office of Government Commerce). However it is still a problem among smaller public sector bodies who may only ever procure one PFI project. The lack of this expertise is therefore also likely to be a major problem in Northern Ireland which is relatively new to the PFI.

3.4 The lack of such expertise means good external advice is essential. Care is needed, however, in appointing and managing advisers as we have been frequently told that there is variation in the quality of external advice. It is also important that the public sector works hard at building up its own expertise and then looks to deploy effectively the expertise it has acquired.

3.5 A constraint on the use of the PFI and PPPs is that the procuring authority may have less flexibility for dealing with the situation where the contracted service or underlying asset is no longer required. Under the PFI and PPPs the authority is contractually committed to continue to pay. In contrast, under a publicly financed procurement, the procuring authority can simply cease the service involved and dispose of the assets. However, under such a procurement, the authority would have already paid in full up-front for these assets and may encounter difficulties in disposing of them. The ease with which these assets can be disposed will vary, depending on their location and condition, and their nature. For example, generally it will be easier to dispose of unwanted office accommodation than a surplus prison.

3.6 The use of the PFI and PPPs can also result in a lack of budgetary flexibility for the procuring authority when faced with the requirement to limit its expenditure generally. In PFI and PPP deals there is a long-term contractual commitment to pay the private sector supplier for the contracted services. Consequently, if the authority is seeking to cut back its expenditure, it will either have to do this in those activities which lie outside the PFI or PPP contract's scope (usually the authority's core business activities) or it will have to negotiate a change to the PFI or PPP contract. This contrasts with past practice under traditional procurement where authorities have been able to make savings in their non-core activities.

3.7 As for gaps in the supplier market base, there are few such gaps in the rest of the UK for what might be termed more "standard" PFI projects. The public sector has no problems in attracting bids from private sector suppliers for those PFI projects where markets have now been established (for example, in the prisons, health, education and accommodation sectors). Potential problems, however, remain in terms of the numbers of suppliers willing and able to become involved in more complex and novel projects.

3.8 Potential gaps in the supplier market base can also occur when the private sector supplier seeks to raise the necessary funding. In a new PFI and PPP market private sector bidders may find it difficult to secure funding at a reasonable cost until funders can see that this market is being successfully developed. This is less of a problem now in the parts of the UK where the PFI and PPP have been seen to be generally successful. However, in an immature market, the private sector needs to be encouraged to take an interest. A steady flow of good deals coming to the market will help this.

3.9 The PFI has been less successful in delivering information technology (IT) projects than other types of project. There have been some well publicised major difficulties with PFI IT projects for the new National Insurance Recording System, the Department of Social Security's Benefits Payments Card, the Passport Agency and the Home Office Immigration and Nationality Directorate's Casework Programme. We cannot conclude, however, that these failures are attributable to the use of the PFI as IT projects have previously also been subject to major problems under conventional procurement. Conceptually, IT projects should be suited to the PFI under which the procuring authority states what service is required and leaves the private sector supplier to devise the solution. But, whatever form of procurement is used, IT projects need careful consideration at the planning stage and need to be well managed during the development phase. There is now considerable guidance available, including new Treasury guidance issued in January 2000 and a report on IT procurement from the Committee of Public Accounts[2], which public authorities should consult when undertaking PFI IT projects. A particular issue on PFI IT projects is that they have often been funded directly by the private sector contractors rather than through new project specific private finance from banks and other funding institutions who can often bring valuable due diligence and control disciplines to projects.

[2] Committee of Public Accounts report "Improving the Delivery of Government IT projects"(HC 65 1999-00).

4. ***How should the strategic importance and prioritisation of PPP/PFI projects, and the inter-relationship with other schemes, be assessed and managed?***

4.1 The assessment and management of the strategic importance and prioritisation of a project should be the same, regardless of whether it is privately or publicly financed. A procuring authority should divorce its identification of the need for new investment in a service or asset from its consideration of the alternative mechanisms by which this investment can be obtained. An authority should first identify what its business objectives and needs are, and then consider whether these needs are best met via new investment, as part of its normal strategic planning process. Since it is possible that such planning may identify many potential projects, not all of which could be met from the authority's resources, the authority will need to prioritise its potential projects in accordance with criteria which reflect its policy and programme objectives and overall business strategy. This should ensure that its priorities are not distorted in favour of those projects which are capable of progressing under the PFI.

4.2 Only once the procuring authority has established that there is a clear need for the services eventually procured and that these are of a sufficiently high priority should the authority look at alternative ways of procuring the necessary service, including via the PFI and PPP and a publicly financed project.

4.3 The PFI and PPP approach can enable procuring authorities to undertake projects which they would be unable to finance conventionally since, under the PFI and PPPs, the private sector finances the construction of a major physical asset, operates it, and recovers the cost over time through charges for services to a department. This means that the procuring authority does not need to find all the money for the capital asset up-front during its construction as it would have to if the project was procured using public finance. For this reason, PFI and PPP projects can be very attractive to authorities who consequently may decide to pursue a lesser priority project precisely because it is PFI-able, while higher priority ones are not. The application of the proper planning processes outlined above is intended to reduce the risk of priorities being distorted by the relative availability of different financing mechanisms.

5. ***Are there any particular social factors that should be assessed and managed and how have PPP/PFI schemes impacted on them?***

5.1 In many areas of Government business, there may be policy or regulatory issues which place constraints on the way in which a particular service is delivered. Therefore if social factors, such as the impact of the proposed scheme on the environment, are an important policy consideration for the procuring authority, it should include these factors in the specification of its requirements that it gives to bidders. It should also include them in the criteria it uses when assessing the PFI bids received and when evaluating whether to use the PFI or publicly financed procurement.

5.2 As with privatisation, one important social factor is the treatment of existing public sector staff who may transfer to the private sector supplier once a PFI or PPP deal is signed. The Government has stated its belief that dedicated and committed staff are central to the long term success of partnerships.[3] Consequently, it recommends that procuring authorities consult with staff affected by a potential PFI deal and gives practical guidance on how to do this.[4]

5.3 A key concern for such staff is the maintenance of their employment and pension rights under their new employer. In the vast majority of cases, the terms of employment for transferring staff are protected by the Transfer of Undertaking (Protection of Employment) Regulations 1981. It is also the Government's policy that their pension rights are protected as the new employer has to provide a pension scheme which is broadly comparable with the scheme the employees are leaving.[5]

6. ***What alternative procurement options do you believe should be considered?***

6.1 The PFI and other forms of PPP are a means to an end and may not always be the solution which offers best value for money. Therefore a procuring authority will need to consider a number of options for meeting the requirements that it has identified. These options include:

PPP

- Privatisation
- Contracting out

[3] "Public Private Partnerships: The Government's Approach" (2000)

[4] Treasury Taskforce Policy Statement No 4 "Disclosure of Information and Consultation with Staff and Other Interested Parties" (1998)

[5] Treasury Taskforce "Staff transfers from Central Government: A Fair Deal for Staff Pensions" (1999)

- Concession
- Franchise
- Private finance initiative
- Joint ventures

Conventional (ie publicly funded) procurement

- Partnering and framework agreements
- Prime contracting
- Single contract for design and build (and maintain and operate, where appropriate)
- Separate contracts for design, construction and operation

7. ***How do you suggest PPP/PFI should be taken forward in Northern Ireland?***

7.1 We do not see it as our role to comment on whether or not the PFI and other forms of PPP should be taken forward in Northern Ireland. We recognise, however, that these new ways of carrying out public projects do offer the potential for improved value for money, if structured, procured and managed properly.

8. ***What are the feasible alternative forms and structures of financing?***

8.1 There are a number of ways open to the public and private sectors to raise the necessary finance.

Procuring authority

- General government resources financed through taxation
- Direct charges levied from users
- Borrowing through the capital markets, for example in the form of “gilts”

Private sector supplier

- From its own internal resources[6]
- Shareholder equity
- Subordinated debt
- Mezzanine finance
- Bank loans
- Bonds

8.2 Traditionally a PFI or PPP consortium includes financiers who provide the necessary financial backing once the PFI or PPP contract is awarded. The choice of the financiers is usually left to the consortium itself and takes place during the competition for the PFI or PPP contract. However, in an attempt to improve the value for money offered by the PFI approach, the Treasury has been examining alternative ways of levering private finance into a PFI deal. For example, for the refurbishment of its own headquarters building in Whitehall the Treasury insisted that the winning bidder should invite competitive open market bids for the financing for the project at the end of the procurement. This is the first time that this has been done in the public sector.

8.3 When considering the finance package proposed by a PFI or PPP bidder, the procuring authority will need to ensure that the capital structure of a proposed deal is consistent with the risks involved in the project. If the proportion of risk or equity capital is too low, the project will not be financially robust in the face of lower than expected revenues. Moreover, having a low level of investment at risk from the project’s potential failure may provide insufficient incentive for the private sector shareholders to tackle business problems with determination. Either way, the impact of proceeding with too little risk capital is likely to be a call on the public sector for increased financial support, as happened in the case of the Channel Tunnel Rail Link and the Royal Armouries. A procuring authority should therefore take a close interest in the private sector’s proposals as regards the capital structure of the PFI or PPP deal. If the market is unwilling to subscribe sufficient equity capital, it is a clear signal regarding the riskiness of the project, the implications of which need to be thought through by the authority. If it is necessary to proceed with a project in the absence of adequate levels of equity capital, the procuring authority needs to plan for the contingency that extra funding will be required.

[6] On IT PFI or PPP projects it has been common for the private sector supplier to be an existing company which chooses to finance the project from its own resources. On other projects, the supplier is a consortium (or “Special Purpose Company”) which has been specifically formed by a number of other companies for the purposes of carrying out the specific PFI or PPP contract.

8.4 A procuring authority will also need to be aware that its private sector supplier may be able to restructure its financing package on more advantageous terms at a later date. Our report on the Fazakerley prison refinancing highlighted the large gains which can accrue to the private sector as a result of such a refinancing. Concerns have been expressed that these are, to a certain extent, windfall gains arising, for example, from a general lowering of interest rates rather than from the successful management of risk by the private sector supplier. A procuring authority may not have any rights to share in these gains unless arrangements for some sharing of these gains are set out in the PFI or PPP contract. The results of a recent survey of departments by Alan Williams MP[7] showed that in only 24 per cent of PFI projects did departments have rights to share refinancing gains. New guidance is expected from the Office of Government Commerce which will require procuring authorities to have some form of sharing arrangement in new PFI or PPP contracts.

9. ***What do you see as the economic basis of PPP/PFI?***

9.1 The economic benefits of the PFI and other forms of PPP stem from the scope they give for innovation, for improved risk management and for a through-life approach to projects. It is widely recognised as good practice that a procuring authority should only select a PFI or PPP approach if it offers the most economically advantageous solution for meeting the authority's objectives. In this instance the "most economically advantageous" option is not that which offers the lowest price or the lowest price subject to technical compliance with the service specification but rather the option which provides the best combination of price, risk allocation and the quality of service proposed. Quality of service issues will include not only the design of the assets and the proposals for actual service delivery but also the extent of innovation offered by the bidder and their track record in delivering other projects. Consideration of price will include not only an examination of the up-front capital costs in developing assets but also the whole-life costs arising from the maintenance and operation of these and the delivery of other support services.

10. ***How can value in relation to capital investment and service improvement best be assessed?***

10.1 The assessment of the value achieved from the capital investment arising from the use of the PFI/PPP approach is no different from the assessment of such investment on a publicly financed project. Both should involve the performance of a proper investment appraisal, which assesses the value arising from alternative investment options, before the procuring authority gives its formal approval to the project concerned. Guidance on performing these appraisals is given in the Treasury's Green Book "Appraisal and Evaluation in Central Government".

10.2 Specifically, in reaching a judgement on whether a PFI or PPP contract will offer value for money, the procuring authority should compare the contract with an assessment of the alternative of public sector financing and management – the Public Sector Comparator - to inform its view of which option offers best value for money. This value for money comparison should include a comparison of both financial and non-financial factors. The financial comparison will involve the discounting of the different cash-flows involved in the two options to give a single net present cost figure for each. If the PFI or PPP contract appears cheaper, this demonstrates that the higher financing costs that usually arise under PFI or PPP procurement are expected to be more than compensated by private sector efficiencies. The comparison also helps to highlight the relative risks which the public and private sector parties will bear under the alternative options and the effect that this has on the price of the different options.

10.3 It is important, however, that public authorities recognise that these financial comparisons are based on estimates of costs that are expected to arise over long time periods. The public sector comparator calculations in particular are often highly complex and incorporate a range of assumptions about the costs that might have been expected under conventional procurement including the risks of cost overruns. Our experience shows that the complexity of these public sector comparator calculations brings with it a clear risk of errors. For example, our examination of the Dartford & Gravesham PFI hospital contract identified two previously undetected errors in the public sector comparator calculations which, when corrected, reduced the expected savings from the PFI project by two-thirds, from 9 per cent to 3 per cent.[8]

10.4 Because of the complexity and degree of estimation involved it is inappropriate for public authorities to place undue weight to any single cost figures that are produced by these calculations. Excessive amounts of time spent producing very precise calculations may not be justified because the actual outturn is likely to vary from the estimate. In practice, consideration of the possible range of costs that may arise under the different

7 Referred to in the Committee of Public Accounts' public hearing in November 2000 on the National Audit Office's report on the refinancing of the Fazakerley PFI prison contract.

8 Figure 11, page 44 of the National Audit Office report on the PFI contract for the new Dartford & Gravesham Hospital (HC 423 1998-99).

procurement options may be more meaningful. Public authorities should certainly not, as some have, use the results of single figure calculations as a pass or fail test. The results of the comparison of both financial and non-financial factors should be used as an aid to understanding the potential costs, benefits and risks of each alternative form of procurement. This information should then inform decisions about the value for money of each option. Further consideration of the issues which public authorities need to bear in mind when carrying out these value for money comparisons is set out in our reports "Examining the value for money of deals under the Private Finance Initiative" (HC 739 1998-99) and "The financial analysis for the London Underground Public Private Partnerships" (HC 54 2000-01).

10.5 As for assessing service improvement, this may be difficult because, where the services were previously provided in-house, the public authority may not previously have set down explicitly the standards of delivery that it expected or recorded accurately the level of performance actually achieved. It is, therefore, good practice for the public authority to compile data on existing service levels when it is preparing for a PFI or PPP project consulting potential bidders on bases of measurement and assessment. However, once the PFI or PPP contract is signed, monitoring of service delivery should be ongoing as the level of the monthly payment due to the supplier will depend on the supplier's performance in meeting these performance indicators. The existence of these indicators should also enable the authority to benchmark its supplier's performance in terms of cost and quality with those of other suppliers on other contracts.

# ANNEX 1

## NAO : PFI/PPP Reports

The National Audit Office has published 21 reports on PFI/PPP subjects:

| Title of Report | Date published | Reference | Deal Value £m |
|---|---|---|---|
| Skye Bridge | 23 May 1997 | HC 5 97/98 | 24 |
| NIRS2 | 29 May 1997 | HC 12 97/98 | 44 |
| 2 DCMF prisons | 31 October 1997 | HC 253 97/98 | 513 |
| The first 4 DBFO roads | 28 January 1998 | HC 476 97/98 | 560 |
| Home Office IND Casework Programme | 24 March 1999 | HC 277 98/99 | 77 |
| A74(M) Motorway | 9 April 1999 | HC 356 98/99 | 214 |
| The PRIME project | 23 April 1999 | HC 370 98/99 | 2,000 |
| Dartford & Gravesham Hospital | 19 May 1999 | HC 423 98/99 | 177 |
| Berlin Embassy | 30 June 1999 | HC 585 99/00 | 50 |
| Examining the vfm of Deals under the PFI[9] | 13 August 1999 | HC 739 98/99 | - |
| RAF Non Combat Vehicles | 13 August 1999 | HC 738 98/99 | 19 |
| UK Passport Agency | 27 October 1999 | HC 812 98/99 | 240 |
| Newcastle Estate | 25 November 1999 | HC 16 99/00 | 241 |
| MOD Fixed Telecoms | 23 March 2000 | HC 328 99/00 | 612 |
| National Savings | 25 May 2000 | HC 493 99/00 | 635 |
| Fazakerley prison refinancing | 29 June 2000 | HC 584 99/00 | 11 |
| DSS: Benefit Payments Card | 18 August 2000 | HC 857 99/00 | 1,000 |
| Radiocommunications Agency | 8 December 2000 | HC 21 2000/01 | 52 |
| London Underground PPP | 15 December 2000 | HC 54 2000/01 | 12,500 |
| Royal Armouries | 18 January 2001 | HC 103 2000/01 | 80 |
| Channel Tunnel Rail Link | 28 March 2001 | HC 302 2000/01 | 4,000 |
| | | | **23,049** |

These reports can be obtained from The Stationery Office (their London Bookshop is 123 Kingsway, London WC2B 6PQ), the Parliamentary Bookshop (12 Bridge Street, Parliament Square,London SW1A 2JX) or they may be accessed at the National Audit Office website www.nao.gov.uk.

9 This is a general report setting out an issue analysis framework to assist the development, and review of, PFI deals.

# COMMITTEE FOR FINANCE AND PERSONNEL
# INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## DORSET COUNTY COUNCIL

### INTRODUCTION

1. The following evidence is prepared in response to a request by the Northern Ireland Assembly's Committee for Finance and Personnel in a letter dated 22 March 2001.

2. Dorset County Council was one of the first local authorities in England to use a Public Private Partnership (PPP) arrangement, in the form of the Private Finance Initiative (PFI), to design, build, finance and operate one of its secondary schools – the Sir John Colfox School, Bridport – which opened in September 1999.

3. As a pathfinder project, this PFI scheme also contributed significantly to the development of PPPs in England leading to :
   - changes in capital finance regulations,
   - standardisation of local authority PFI contracts,
   - changes in the central government PPP/PFI approval process and
   - informing an Audit Commission management paper ("Taking the Initiative") aimed at helping members and chief officers consider the strategic and control issues.

4. In addition, officers and advisers involved in the project have shared their experiences with other local authorities within the United Kingdom and abroad through hosting visits, holding seminars and generally disseminating information on the Council's experience of the project, both during the procurement phase and subsequently. This has included the Department for Education in Northern Ireland (DENI) and head teachers, officers and board members involved in the Belfast schools PFI project.

5. By way of background, a copy of the case study on the Colfox School PFI project (Appendix A), together with a guide to the documentation for the project (Appendix B) is enclosed with this evidence. Further detailed information can be obtained in electronic format from the 4Ps, 6th Floor, 83 Victoria Street, London, SW1H 0HW or on the Treasury Taskforce web site www.treasury-projects-taskforce.gov.uk.

6. Contributors to the evidence submitted include:

   Paul Kent, Project Leader and Head of Financial Services, Dorset County Council

   Chris Mason, Headmaster, The Sir John Colfox School, Bridport

   Terry Thomas, Head of Procurement and Facilities Management, Dorset County Council

   Rebecca Gray, Building Management Division, Dorset County Council.

7. All the above named were members of the Colfox School PFI Project Team and involved in all stages of the procurement process. In addition, Chris Mason and Terry Thomas have first hand experience of the management of the contract and the performance of the private sector providers since the school opened in 1999.

8. The school's response is submitted in its entirety as Appendix C.

## REQUEST FOR INFORMATION (1)

### General Context

9. The major benefits of a PPP/PFI approach can be summarised as:
   - The ability to address the need for new or replacement assets where restrictions in capital resources would make it difficult or even impossible in the short term do so by other means;
   - Reduced overall cost to local tax payers as a result of financial support from central government;
   - Greater certainty of cost over time through appropriate transfer of risk to the private sector;
   - Improved quality of facilities and services to specified standards which are contractually enforceable;
   - Consequent improvements in service delivery e.g. in the case of The Sir John Colfox School, the high quality of the school and its equipment has contributed greatly to the learning gain obtained by students and to the facilities available to the community.

10. The key factors for the success of PFI are:-
    - Commitment on all sides to a partnership approach;
    - Willingness and capability of the local authority and the private sector contractors to adopt such an approach;
    - Each party bearing the risks most appropriate to them.

11. However, PFI should only be pursued as an option if 'value for money' can be demonstrated over the life of the project. In the case of the Colfox School PFI project comparison was made against the costs and risks associated with traditional procurement (i.e. against a public sector comparator which was independently audited). This indicated that the PFI solution was 2% cheaper than traditional procurement over a 30 year period.

12. At the time of letting the Sir John Colfox School PFI contract, and for some 12 months after the commissioning of the actual service, the market was still relatively immature. However, it is believed that the market is now much more mature and better understands PFI – particularly in the context of a school. From our experience we believe that private sector providers would advance their cause and the quality of service provided if, from the inception of the contract, they employed staff with direct experience in running similar facilities e.g. schools.

13. Strategically, there are issues that need careful consideration in assessing the relative importance of PPP/PFI projects. Firstly, PFI is a procurement method and should not of itself influence the relative priority of projects – even if certain projects might be more likely to obtain greater interest from the private sector than others. Priority for capital investment should continue to be determined by need and reflect both the state of existing assets as well as the views of the community.

14. Secondly, it is important to acknowledging the long-term nature of the financial commitment and the fact that a PFI contract will commit the authority for many years to come, often with an increasing impact on the revenue budget. Authorities must be clear about how this commitment is to be financed and how this may restrict the number and value of PFI projects in the future. Management of this commitment must be provided for in financial plans and strategies and elected members must be made aware of what this means for the authority over the life of the PFI contract.

15. Thirdly, in assessing PPP/PFI projects all practical alternatives should be considered including the 'do nothing' option. In Dorset's project a full feasibility study was carried out on the alternatives of extension and adaptation rather than new build, but because of restrictions in the original design of the old Colfox School (which in 1956 was built for 650 pupils rather than the expected number of 1060 by 2001) and difficulties with the site layout (which was unsuitable for community use), none of the alternatives was either physically or economically viable.

16. Fourthly, alternative forms of finance should be considered in calculating the public sector comparator. As a debt-free authority Dorset County Council considered the whole life cost of the PPP/PFI option against an up-front capital cost plus operating costs and an analysis of risks based on previous experience and advice from our financial advisers. All cash flows were discounted to present values to enable valid comparison to be made.

17. Social factors may also influence the choice of PPP/PFI as a procurement option. This may include the opportunity to change the nature of facility to reflect local needs or increase community use of the facilities. In the case of the Sir John Colfox School, the PFI project provided an opportunity to consider a change to specialist school status as a language college with the private sector partner (Jarvis Colfox Ltd) organising the necessary

sponsorship in order to secure government grant support. The specialist facilities were then included in the main building works securing the benefits of a properly integrated facility and economies of scale.

18. In addition, the facilities management (FM) partner for the school has initiated a partnership with the local sports centre (run by the West Dorset District Council) in respect of the sharing of sports facilities and booking systems. Invitation to Negotiate (ITN) documents at the procurement stage may include a requirement to work with the local community but it is very difficult to prescribe the sort of relationships that should exist. This is more likely to depend upon the capability and willingness of the successful bidder. In Bridport's case the outcome of shared sports facilities is a very good solution to local needs.

19. Alternative procurement options considered by Dorset County Council are mentioned in para 16 above. Other options, which may depend upon the nature of the building or facility, would be loan finance or leasing finance, subject to the restrictions imposed by capital financing regulations, or may include contributions in the form of capital receipts or capital grants.

20. It would be presumptive to suggest how PPP/PFI should be taken forward in Northern Ireland since in our view different needs require different solutions. No one procurement method can be favoured as it depends on so many factors, not least the extent of competition in the market place, the alternative cost of borrowing, government restrictions and regulations and the nature of the facility required. The experience in Dorset is that PFI has provided a clear financial advantage to the County Council both in terms of value for money and in terms of cost to the local tax payer.

21. Whilst high priority projects continue to attract government support through additional notional credit approvals (which translate into specific grant or an increase in the Council's Standard Spending Assessment (SSA) and revenue support grant) then PPP/PFI projects will continue to be an attractive option. The downside is the long-term financial commitment that such projects generate (see para 14 above) which may necessitate a selective approach favouring the larger and perhaps more strategic projects.

22. Assessment of service improvements is a difficult area. Dorset County Council has developed its own computer package to monitor the PFI FM contractor's performance and the availability of 'zones' in the school. This system automatically amends the monthly 'unitary' payments to the contractor and keeps records of the history of the project. This information is available (via passwords) to the contractor over the Internet. The system also has a searchable copy of the Principal Agreement and minutes of review meetings since the school opened in August 1999. This has been an extremely valuable tool in tracking performance and financial transactions and provides total transparency for the County Council and the Provider.

23. Service improvement can be achieved through joint training of the Provider's and the Council's staff on monitoring of performance and methods involved in service delivery. For example, if the Provider or the Council discover more efficient or effective ways of providing a service in other spheres of operation or at other non-related sites, this experience should be applied to the PFI project. However, it should be appreciated that, realistically, continuous improvement is most likely to have only a marginal effect on the contract as a whole and that to obtain performance to contract standard throughout the life of the Agreement would be a very satisfactory outcome.

**REQUEST FOR INFORMATION (2)**

**Specific Projects and Programmes**

**Name of Specific Project:**
**The Sir John Colfox School Bridport, Dorset PFI Project.**

24. This project was the first significant school provided under PFI in the UK and Dorset County Council was a 'pathfinder' authority. Much of the negotiation took place before there was any clear guidance from central government sources and ahead of legislation which gave local authorities and the private sector some degree of comfort about their position should, at any stage, the legality of the transaction be challenged. However, by the time the contract was signed in November 1997 all necessary legislation was in place.

**Bid Process**

25. The bid process followed the 'negotiated procedure' under the European Union procurement directives. A Prior Information Notice (PIN) was submitted to OJEC in May 1996, which alerted potential bidders to the forthcoming advertisement, and to the Contractors Briefing Day that was to be held on 10 July. The OJEC advertisement was submitted on 1 July and published on 12 July.

26. The key stages in the procurement process are set out in Table 1 below:-

**Table 1 - Key Stages in the Procurement Timetable**

| | |
|---|---|
| Feb - April 1996 | Initial discussions with DfEE and decision to use PFI route |
| April 1996 | Formation of project team (including advisers and PFPE) |
| July 1996 | OJEC advertisement |
| 10 July 1996 | Contractor briefing day |
| August 1996 | Prequalification responses |
| September 1996 | Short-listing and issue of ITN |
| December 1996 | Receipt of bids |
| February 1997 | Announcement of preferred bidder and reserve |
| July 1997 | Commercial terms agreed |
| November 1997 | Financial close and start on site |

27. The output objectives of the project were clear viz.: a replacement secondary school (including FM services) for the then Colfox School, Bridport within the Authority's time-scale and which could accommodate 1,060 pupils. During the procurement process Council officers and their advisers took pains to avoid specifying inputs or delivery methods. The governors, staff and students, the community and the Authority are delighted with the high quality school and services that have been achieved.

28. The County Council's standard specification for support services such as cleaning, catering and grounds maintenance (outcome orientated) were used as part of the FM specification. However, detailed input specifications were prepared for both fixed and loose furniture and equipment. For Information and Communications Technology (ICT) services a detailed specification was prepared although future replacements/upgrading were linked to objective external standards. ICT prospective vendors were interviewed jointly by Council and Provider staff with the Provider making the decision on the award of contracts. Both the application of the Authority's standard support service specifications and the detailed furniture and equipment and ICT specifications were provided at the request of the Provider who, at that stage in the PFI market, had little or no experience of providing services to a school. Even though the PFI market for schools is now more mature, it is thought that more detailed specifications, might be needed to provide clarity of need and certainty in the contractual relationship.

29. The Authority had previously considered building the school by a conventional route and, in the process, had held a competition for the design of the new building. The successful PFI bidder adopted this design which, as a matter of course, met the Department for Education and Employment (DfEE) standard requirements. The specifications for the FM element have entirely met the requirements of the service and have not been

changed in any way. The schools view is that the specifications certainly led to operational reality. Clearly at the school level there had to be a lot of dialogue in the latter stages of the building work as all parties to the partnership desired a good quality outcome, both for themselves and for each other. The specifications therefore received more detailed definition during this stage but were not compromised.

30. During the procurement process there was much anticipation of benefits arising from innovation both in relation to the building design and in relation to improved community use. In fact the preferred bidder identified 14 variant bids involving additional sports facilities, links with the local tertiary college, a business centre, alternative energy/power options and scope for increased community use. In reality much of this did not come to fruition, either due to the additional cost involved or due to competition with other similar facilities in the area.

31. In respect of FM services, innovation was expected on the generation of third party income but, so far, this has not materialised. It could be that aspirations were too high – the building is after all a secondary school situated in a relatively small community. These facts alone make innovation very difficult. However, some good work has been done with the local sports centre on the use by the public of facilities in the school (see Part 1 para 18 above).

32. In risk transfer terms, the following table illustrates the allocation between the private and public sectors:

**Table 2 – Sir John Colfox School PFI Contract Risk Allocation**

| **Private Sector** | **Public Sector** |
|---|---|
| Planning | Education |
| Building Design | Administration of the school |
| New Build | Pupil numbers |
| Operational Risk | Inflation (Revenue only) |
| Furniture & Equipment (incl.ICT) | Legislative (where targeted to schools or the education sector) |
| Financing | End of contract arrangements |
| Inflation (Capital only) | |
| Legislative (General only) | |
| Existing Third Party revenues | |

33. In respect of the provision of FM services, the Provider is not allowed to use the Authority's direct service organisation for core parts of any service as this would have transferred some risk back to the county council. However, where joint working was thought best for the school and the Provider this was agreed – the support provided by the County Council IT Services team on the school's administrative system (SIMS) is the major example.

34. Allocation of risk reflected a judgement as to which party was best placed to take the risk, reflecting the price that the private sector would charge for taking a risk, taking into account:

- their ability to influence or control an event and its impact,
- the probability of that event occurring and
- the estimated cost if it did occur.

35. At the Invitation to Negotiate (ITN) stage all prospective bidders were asked what risks they were prepared to take and how this would influence their bid. In practice, the real implications of risk allocation only emerged during the negotiation stage where not only the preferred bidder but also their financiers were involved.

36. Overriding all of this was the crucial requirement (for the scheme to qualify for government funding) that sufficient risk transfer should take place to satisfy the 'contract structure test' whereby at least 20% of the payment to the contract was at risk of retention for non-performance or poor performance by the operator. In the case of the Colfox School PFI project this requirement was met comfortably.

37. Key features of the Business Case were:

- the ability of the project to meet the Council's and the School's objectives;
- the fact that the facility and services could be provided at 2% less cost than the public sector comparator;

- a contractual structure which gave every incentive to the building contractor (Jarvis Construction UK plc) to provide a quality building to be operated by the FM provider (Jarvis Colfox Ltd)
- a payments structure that met comfortably the government's requirements for risk transfer under the 'contracts structure test'
- monitoring and review arrangements which promoted a partnership approach but at the same time enabled the County Council to ensure that standards set out in the Operating Specification would be adhered to.

38. As a debt-free authority Dorset County Council considered the whole life cost of the PPP/PFI option against an up-front capital cost plus operating costs and an analysis of risks based on previous experience and advice from our financial advisers. All cash flows over a 30 year period were discounted to present values to enable valid comparison to be made. The spreadsheet used to produce the comparator was independently audited and made available to the DfEE and the Treasury Taskforce along with all the other documentation associated with the PFI contract.

39. From the outset the Council appointed a core team of six officers assisted by external consultants in finance (lead consultants Coopers & Lybrand – now PricewaterhouseCoopers) and commercial law (Eversheds) and a representative of the Private Finance Panel Executive (PFPE), later to become the Treasury Taskforce, in a role now performed by the 4Ps and Partnerships UK Limited. The six officers were:
- a Project Leader (Head of Financial Services);
- a representative of the client department (Education Planning and Development Officer);
- the Headteacher of Colfox School;
- a technical expert to lead the 'fabric' aspects of the project (a senior quantity surveyor);
- the County Solicitor;
- the Head of Procurement to lead the FM aspects of the project

40. From time to time other officers with particular expertise were seconded to the team e.g. the County Valuer and Estates Officer. At all stages the Council's external auditors were kept informed of developments.

41. In addition to the officer team, the Council set up an Ad hoc Sub-Committee of the (then) Policy and Resources Committee of the Council to oversee the project. This group comprised 7 elected members of the Council drawn from all political parties together with co-opted members including the Headmaster of Colfox School and its Chairman of Governors. Regular meetings were also held with school governors to keep them informed and put issues forward for decision/consideration e.g. the building design, the school's contribution to the unitary charge etc.

42. The key contractual issues to emerge during the negotiations were:
- legal power to justify procurement under the PFI route;
- the strength of covenant of the public sector; (both of these issues were resolved by the Local Government (Contracts) Act 1997)
- responsibilities of the school governors;
- liquidated damages;
- the design and operation of the payments structure and the scale of deductions for non or poor performance;
- the length of the contract;
- the transfer of employees under TUPE arrangements (only the caretaker, a technician and two mid-day supervisors were involved);
- whether market-testing and benchmarking were permissible under the Capital Financing Regulations (since resolved);
- procedures for variations in the contract;
- step-in rights;
- legal and commercial grounds for termination and the avoidance of 'guarantees'
- payments due in the event of Council or provider default;
- use of a 'provisional sum' set aside to purchase the prescribed list of furniture and equipment;
- service monitoring and review.

43. NB A more comprehensive list in the form of questions and answers is provided in the attached 'Guide to Dorset County Council's Colfox School Documentation' at Appendix B.

44. The procurement timetable spanned 16 months from OJEC advertisement to commercial close. Essentially the project was delivered in accordance with the timetable, apart from around two to three months delay in the spring/summer of 1997 caused by the General Election and the late involvement in the negotiations of the provider's bankers. However, these delays did not impact upon the opening of the new school which opened as planned in August 1999. Generally the procurement timetable and the tendering arrangements were quite realistic and achieved on time.

45. The project itself was funded by the Provider (Jarvis Colfox Ltd) entirely by external debt with no equity contribution. However, whilst normally one might expect around 10% equity to cover performance deductions or any lack of profitability in early years, this was in effect provided by parent company guarantees from Jarvis plc. In 2000 the Provider re-financed the project to take advantage of lower interest rates, part of the benefit of which was shared with the County Council who had to give its permission under the Principal Agreement.

**Completed deals (from 5.8.99)**

**Performance Management**

46. The Council has a long history of working with the private sector on the provision of support services to schools – both under CCT and now Best Value. The output specifications used for the provision of services under CCT were not all used in the initial stages of this project. Instead, an attempt was made to provide just a minimal outcome orientated specification. However, this proved to be inadequate for the Provider (who required more detail) and the 'standard' specifications were provided at his request. The issue at this point was not, therefore, a lack of innovation but rather the Provider's need for certainty. Since the service targets within the PFI contract are similar to the targets set for private contractors under conventional contracts, it can safely be said that the standards required are reasonable.

47. As a 'pathfinder' project there was at that time no requirement to submit a business case for approval prior to the commencement of the procurement process. (Although we believe this is a very positive development which emerged from the experience with this project!) The business case for the Colfox School project was made in the Spring of 1997 by which time negotiations with the preferred bidder were well advanced. As a consequence the assumptions made in the business case were fairly accurate, with the final figures close to the figures include in the bid to DfEE. The only exception to this was in the area of furniture and equipment where a provisional sum and a list of items had been agreed only to be affected by different interpretations of the requirements and differences in actual and anticipated procurement costs. This was only finally resolved over a year later when the Provider re-financed the project.

48. The Authority had wide experience of procuring support services from the private sector and this experience was applied in the preparation of the business case.

49. Demand forecasts for pupil numbers have proved to be very accurate. The demand forecast for services was accurate with the exception of the initial implementation of ICT at the school. The provider seriously underestimated the extent of support required in the setting up and operation of the ICT network. This took some three months to rectify and caused the school great difficulty.

50. The performance measurement system is described above (see Part 1 para 22) and this system, with automatic links to the payment system, has proved to be a major contributor to the success of the PFI project. The performance/payment regime itself has also been effective in ensuring that the school obtains the level of service specified under the contract. Examples of this are the monetary deductions made for non-compliance on ICT in the early months of the contract (see para 49 above) and the under performance of one sub-contractor (as judged by the Council) which resulted in the Provider replacing the sub-contractor.

## Financial

51. The capital value of the project was £12M with a whole life cost (expressed in present value terms of £22.1M). The public sector comparator was £22.5M broken down as follows:-

**Table 3 - Breakdown of Colfox PSC**

| | NPV £M | % |
|---|---|---|
| Capital | 11.98 | 53 |
| Revenue | 7.18 | 32 |
| Risks Transferred | 3.31 | 15 |
| **Total** | **22.47** | **100** |

52. As far as we know the financial model and the assumptions made proved to be reasonably accurate, although the major risks associated with the building construction are down to the operator and we know not whether there was (for example) a cost overrun or otherwise since these are matters for the Provider.

53. Of the risks allocated to the Council, none of these has so far caused any financial problems. In fact the largest of these in relation to inflation on the revenue elements (e.g.operating cost component of the PFI fee) is actually less than anticipated due to lower figures for the GDP Deflator and the alternative RPI index. So far there has been no call on the provider's reserve for legislative risk nor on the contribution set aside by the County Council (£10,000 per annum) in reserves for this purpose. The PFI fee has if anything been slightly less than anticipated.

54. The relevance of the Public Sector Comparator costs to the PFI deal were only really in the context of the value for money assessment for approval purposes. We have made no attempt to quantify whether assumptions made at the time were in fact accurate, since the outcome was a contract with a PFI provider who now bears or (in the case of the building construction) has already borne most of the risk.

55. Neither have we attempted to compare the rates of return payable by the Provider to the banks with returns on other projects since this is only one element of the PFI deal (which is in any case fixed from the outset) and our concern is with the overall cost to the County Council. We are however keen to exercise benchmarking and market-testing which may lead to economies in the operating cost subject to the provision for contract variations set out in the Principal Agreement.

## Contractual

56. The matter of enforceability of the contract has arisen solely in relation to the provision of support services since the start of the contract. One small matter was disputed by the Provider (whether or not some consumables in respect of teaching were included in the contract) but this has been settled satisfactorily and amicably. The enforcement of monetary deductions for performance less than contract standard has also worked well. The major and early difficulty centred on construction related work which had not been achieved when the contract started. This difficulty related to relatively insignificant matters (to the project as a whole though not to those affected in the school) surrounding, for example, inadequate storage cupboards in the art department. The performance of the FM contractor was adversely affected and monetary deductions were made on this basis – the FM provide was required to negotiate remedial action with the construction company. In the case of Colfox School, this was not that difficult as the FM provider and the construction company is part of the same group. There have been some variations to the contract but these stem from additional requirements (e.g. Language College status being finally obtained after signing of the contract and additional ICT equipment required) rather than from any inadequacy of the original specification.

57. There remains an issue over responsibility for damage to the building and consequently who should make payment under the different terms of the contract: Examples are damage done:

(a) during the day by pupils

(b) in the evening

(c) as a result of wear and tear or the failure of fittings

58. The school retains the risk for costs of damage done by pupils whilst under the direction of the school. The contract between the school and the Authority does not, however, allow a budget for this responsibility.

59. For allocation of risks see paras 32 to 36 above.

60. The school has recently received a school achievement award from the Government ie a bonus payment to be allocated to staff employed during the period that results were significantly improved. Issues such as who should pass on such a bonus to staff employed at that time by the school but now employed by the provider were not and could not have been foreseen. Unions and personnel concerned were kept clearly informed about intentions before handover time. Some fears were expressed but the transition appears to have been effected to everyone's satisfaction.

**Social**

61. The school was previously provided with support services for catering and cleaning by the private sector so only a few staff were directly employed. Those that transferred under TUPE were the caretaker, the ICT technician and two dining room assistants. All other administrative and technical staff remained in the employ of the Authority. Grounds maintenance staff were not subject to TUPE as there were none who could be identified i.e. this service was provided on an area basis. Full consultations were undertaken with all stakeholders. No problems were encountered in the transfer of staff under TUPE.

**Property**

62. There were no property disposals or gains in connection with this project. The size of the school site was sufficient for the new school to be built adjacent to the old one, with the old school being demolished thereafter. An all-weather pitch was provided in November 1998 – 8 months in advance of the completion of the new building as a 'quid pro quo' for the loss of open space – the school using other local playing fields until the grassed pitches were available (planned for December 2001).

**Construction**

63. Construction costs were a Provider risk item. Realistic estimates were included in the PSC and the Provider's bid was within the public sector comparator. Because of the nature of the contract the Council did not get involved in the actual costs. (Jarvis Construction claimed they had lost money on the project but I doubt they were working to the same figures as Jarvis Projects bid!)

64. There was no construction and property specification - the Council considered that the way the building was constructed was the Provider's risk and responsibility as they were liable for future maintenance costs etc. The Output Specification comprised schedules of the required rooms with reference to relevant Building Bulletins and other DfEE documentation, together with room by room furniture and equipment schedules. Floor plans were agreed with the school during the negotiation phase and included within the contract. The Provider issued proposed room layouts to the school as part of the process of agreeing the exact furniture and equipment to be ordered, hence the school did get the opportunity to influence the details at this stage and ensure the spaces provided were workable.

65. There has been no project evaluation of the construction itself - which is just part of the whole project - but there is a commentary in the case study at Appendix A.

**P J KENT**
**PFI Project Leader**

19 April 2001

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## LEEDS CITY COUNCIL

10 April 2001

Please find attached written evidence relating to the "Inquiry into Public Private Partnerships" set out in your letter of 22 March 2001. The majority of the comments relate to PPP as exemplified through the Private Finance Initiative. A brief summary of the PFI Projects within the City Council, and the stage of each Project is provided below.

**COMPLETED PROJECTS**

Cardinal Heenan High School

Leeds City Council has one completed PFI Project. This was a Pathfinder project, involving a partnership between the Roman Catholic Diocese of Leeds, the City Council and the successful contractor, Jarvis, for the rebuilding of a Voluntary Aided Secondary School. The Project reached contract stage in June 1999 and the school was completed and handed over for the Autumn Term 2000. The Department for Education and Employment (DfEE) is the sponsoring Government Department.

**APPROVED PROJECTS CURRENTLY IN THE PROCUREMENT PROCESS**

Leeds 7 Schools PFI Project

This Project involves the rebuilding of two existing High Schools and four Primary Schools and the construction of a new Primary School. The Project is at Preferred Bidder Stage, with the John Mowlem Consortium as the Council's preferred partner. Negotiations with John Mowlam are at an advanced stage and it is planned that contract completion will take place by the end of April and construction to commence in late Spring and Summer this year. The DfEE is also sponsoring this Project.

Swarcliffe Social Housing PFI Project

This is a Pathfinder Project involving the refurbishment of approximately 1,800 low rise dwellings of mixed design and construction and the demolition of a further 800 high rise dwellings. This Project, which is sponsored by the Department of Transport and the Regions (DETR), is currently at the Invitation to Negotiate Stage (ITN). A shortlist of four bidders has been agreed and documents for the ITN stage are currently being prepared and are planned to be sent out to the four shortlisted bidders in May.

**APPROVED PROJECTS NOT YET IN THE PROCUREMENT PROCESS**

Leeds Super Tram

The lines will serve three key radial corridors to the north west, north east and south of the City. It is planned that each line will have a major park and ride site at its terminus. The network will serve 49 stations along a total route length of 28km.

Primary Schools PFI

The DfEE has given provisional allocation of PFI Credits for the rebuilding and refurbishment of 12 Primary Schools in various parts of the City. The Outline Business Case is due to be submitted in September this year.

Inner Ring Road Stage 7

PFI is the preferred option of DETR, and an Outline Business Case is also due to be submitted in September this year.

**MAJOR PROJECTS WHERE THE PFI ROUTE IS LIKELY TO BE PURSUED**

Waste Management

PFI Credits to a maximum of £25m are available for PFI Projects which meet the Government targets for recycling and diversion from Landfill. Leeds currently disposes of 350,000 tonnes of domestic waste per annum.

Regional Archives Centre for West Yorkshire

An outline application has been submitted to the Department of Culture, Media and Sport for their consideration.

Little London Social Housing Project

DETR is considering an application for the refurbishment of this inner city Housing estate.

Details of how the City Council manages PFI Projects is attached as Annexe 1 to this letter.

Annexe 2 to this letter deals with the questions asked in the section “General Context of PFI/PPP, whilst Annexe 3 covers the questions under “Specific Projects and Programmes”. The numbering in these final two Annexes follows the numbering set out in your Notes for Guidance. With regard to the questions in Request for Information (2), I have utilised the Leeds 7 Schools PFI Project as the model for this section. As I indicated above, we hope to come to Contract Completion at the end of April. Some of the questions relate to post contract situations which do not yet apply to this Project.

I hope this information is of assistance to you. The City Council would wish that these comments be treated confidentially.

# ANNEXE 1

**PFI PROJECT MANAGEMENT ARRANGEMENTS IN LEEDS CITY COUNCIL**

The City Council currently have two PFI Projects in varying stages of the procurement process, the Leeds 7 Schools Education Project and the Swarcliffe Social Housing Project. These have the following management arrangements within the City Council:

Executive Board

↓

PFI Project board

↓

PFI Project Team

The Executive Board is the decision making body for the City Council comprising eight Members of the City Council, which includes the Leader of the Council, and the two Leaders of the Opposition Parties.

The Executive Board has granted the PFI Project Board delegated authority to take all decisions to ensure the smooth progress of the Project up to contract signature, when an Executive Board approval is required. Each Board is chaired by A Deputy Chief Executive of the City Council, who also has delegated authority to take urgent decisions on behalf of the Board, subject to subsequent approval by the Board. In addition the Deputy Chief Executive has statutory duties relating to certifying that the Project, when it reaches Contract signature, is affordable by the City Council.

Permanent members of the Boards are:

- Deputy Chief Executive
- Director of the Client Department (Education or Housing)
- Director of Leeds Development Agency
- The City Council's Chief Legal Officer
- The City Council's Chief Financial Officer

The day-to-day work to deliver each Project is undertaken by a Project Team, which is led by a designated Project Leader, who reports directly to the Chair of the Project Board. The composition of the Team comprises a "core team" from the client department and from differing professional specialisms within the City Council (Legal, Financial, Technical). Where necessary other specialisms (for example Procurement, Insurance, Taxation etc) provide expert assistance when required to do so.

The Leeds 7 Schools PFI Project, the first mainstream PFI Project undertaken by the City Council, has effectively established a working model of a project team, with a Project Leader, Project Manager and Technical Officer seconded from Leeds Development Agency, with specialist financial management and legal advice, supported by an officer from Education and supplemented by senior teaching staff representing the two High Schools on a part-time basis. All of these individuals have, at peak times, worked full time on the Project, however additional tasks have been undertaken by the majority of the members of the team throughout the procurement and contract negotiation stages.

The City Council also found it necessary to appoint external Legal and Financial Advisers.

# ANNEXE 2

**REQUEST FOR INFORMATION - GENERAL CONTEXT OF PFI/PPP**

| | |
|---|---|
| **1** | The overriding benefit of PFI/PPP is to deliver a solution to a problem where the City Council has no alternative sources of Capital Investment. The secondary financial benefit of PFI is the annual revenue support from Central Government which is attached to the Notional Credit Approval (NCA).<br>The benefits to stakeholders is clear. Improved, up-to-date school accommodation from the Leeds 7 Schools Project will benefit nearly 5,000 children and young people and assist in improving Educational Standards. Approximately 1,800 householders and their families will benefit from improved dwellings and estate. The City Council would not be able to undertake these Projects through traditional means. |
| **2** | **The key factors for the successful application of PFI is to have the commitment of all parties to the Project. These parties include:**<br>▪ Members of the City Council<br>▪ School Governors/Head Teachers/Teachers/Parents<br>▪ Tenants and their representatives<br>▪ Officers of the Council<br>▪ The Private Sector Partner<br>Other key factors are the demonstration of Value for Money and Affordability of the Project to the Public Sector. |
| **3** | The main “down side” of PFI is the amount of time taken to conclude a contract. A period of two years from commencement of the procurement process through to contract close is not unusual. This can cause frustration amongst stakeholders.<br>As PFI has developed the market has developed with it and many of the main contractors are now well versed in PFI.<br>With regard to the availability of skills, this is likely to be an issue with small organisations – larger organisations can gradually develop skills. There is no shortage of external advisers. Guidance in England and Wales is available from the PPPP (4 P’s), which is funded through the Local Government Association. Partnerships UK, which was part of the Treasury Taskforce, will assist, although there may be a cost for this. |
| **4** | The relative prioritisation of PFI Projects has not been an issue in Leeds, but does create a problem relating to the management and delivery of projects when the same internal expertise is required simultaneously on more than one project. |
| **5** | This has not been an issue for the City Council. |
| **6** | **The alternative procurement options are:**<br>▪ Procurement through traditional, Capital Programmes if the financial resources are available.<br>▪ Voluntary Partnerships – although the Capital Finance Regulations still apply.<br>▪ Routine maintenance through annual revenue programmes.<br>▪ Do nothing (although this is not a procurement option it is still an option to be faced by Public Sector organisations). |
| **7** | The Council has no views on how PFI should be taken forward in Northern Ireland. |
| **8** | **Financing either comes from the Public or Private sectors.**<br>Public Sector funding can comprise annual revenue support through PFI Credits from Central Government through to application of proceeds from the disposal of surplus assets and revenue funding from the organisation.<br>Private sector funding usually comprises equity funding from the Contractor and direct financing from a financial institution. The Private Sector can identify opportunities for income generation not available to the Public Sector which can help to reduce the cost to the Public Sector. |
| **9** | The economic basis of PFI is that the Private Sector undertakes the financing of a Project and makes its return from the Annual Charge. The finished product is “off” the Public Sector Balance Sheet. |
| **10** | The value of PFI to the City Council is in the delivery of a solution not available by any other means at the City Council’s disposal.<br>Service improvement can be assessed through the development of the Output Specification. |

# ANNEXE 3

## REQUEST FOR INFORMATION - SPECIFIC PROJECTS AND PROGRAMMES

## ANSWERS RELATE TO THE LEEDS 7 SCHOOLS PFI PROJECT WHICH IS NEAR TO CONTRACT CLOSE

**BID PROCESS**

| | |
|---|---|
| 1 | The output objectives were very clear. In 1997, the City Council identified six schools that were experiencing serious problems due to poor building conditions and which were providing inadequate accommodation unsuitable for modern day teaching. Due to demographic reasons, a new Primary School is required in the south of the City. |
| 2 | The Bid documents contained detailed Output Specifications. Contract completion is expected shortly. Construction and operation have not yet commenced. |
| 3 | In total there were 17 Expressions of Interest at Pre-Qualification Questionnaire stage. PFI is a very expensive process for the Private Sector, particularly for unsuccessful bidders. |
| 4 | **Design and Construction:**<br>▪ Compliance with Planning Conditions<br>▪ Design<br>▪ Construction costs<br>▪ Construction time and commissioning<br>▪ Ground conditions<br>▪ Decanting<br>**Operations and Usage:**<br>▪ Availability of the schools<br>▪ Performance<br>▪ Operational costs<br>▪ Services<br>▪ Lifecycle costs<br>**Financial:**<br>▪ Interest rate |
| 5 | **The Procurement process covered:**<br>▪ 17 Expressions of Interest were subjected to a "Longlisting" process to produce eight consortia for interview.<br>▪ The eight consortia were invited to make a presentation of their proposals and were interviewed.<br>▪ Four consortia were formally selected to submit bids at the Invitation to Negotiate Stage.<br>▪ Following evaluation of submitted bids, two bidders were selected for the Best and Final Offer Stage (BAFO).<br>▪ Following detailed negotiations, the Preferred Bidder was selected<br>**The Evaluation process covered:**<br>▪ Legal issues – the degree to which the Project Agreement was marked up.<br>▪ Financial – Investment proposals, Affordability, Certainty of funding proposals etc.<br>▪ Design.<br>▪ Facilities Management.<br>▪ Other issues, including Health and Safety etc.<br>Weightings were attached to each evaluation criteria. |
| 6 | **The key features of the Full Business included:**<br>▪ A summary of the Outline Business Case<br>▪ A PFI Competitive Process<br>▪ The Preferred Bidder and the Preferred Solution<br>▪ Project Management Arrangements<br>▪ Details of the Public Sector Comparator<br>▪ Economic Appraisal and Value for Money Analysis<br>▪ Risk Analysis<br>▪ Financial Appraisal – Affordability<br>▪ Accounting Treatment<br>▪ Project Agreement |

| | |
|---|---|
| **7** | **The Public Sector Comparator was prepared taking account of guidance contained within the Treasury Taskforce:**<br>▪ Policy Statement No 2 'Public Sector Comparators and Value For Money'<br>▪ Technical Note No 5 'How to Construct a Public Sector Comparator'<br>The PSC was prepared to represent the solution the City Council would adopt to procure the Project through conventional means and within the timescale of the PPP including a quantification of risk.<br>The PSC represents the underlying cost to the Public Sector of directly supplying the services required to meet the Output Specification, produced as part of the PFI procurement exercise.<br>**The PSC covers:**<br>▪ Capital costs<br>▪ Lifecycle costs<br>▪ Operational costs<br>▪ Assessment of Risk Adjustment<br>▪ Discounted at 6%, excluding inflation |
| **8** | The Project Management arrangements within the City Council are set out in Annexe A. The City Council appointed Eversheds as its Legal Advisers and Deloittee & Touche as its Financial Advisers. |
| **9** | **The key contractual issues covered:**<br>▪ Development and Service obligations<br>▪ Benchmarking<br>▪ Insurance<br>▪ Assignment<br>▪ Adverse Law<br>▪ Compensation on Termination<br>**The key commercial terms covered:**<br>▪ Headline Unitary Charge<br>▪ Indexation<br>▪ Proportion of the Unitary Charge at risk for poor performance |
| **10** | The Procurement process commenced early in 1999, with the PQQ, ITN and BAFO stages being completed according to the timetable to June 2000. The negotiations with the Preferred Bidder had been timetabled to be completed by the end of October 2000. Negotiations have proved to have been very protracted and complex and final contract close to not expected before the end of April 2001. |
| **11** | The resources required to deliver the Leeds 7 Schools PFI Project included:<br>The full-time employment of a Project Team (see Annexe A).<br>The procurement of Financial and Legal Advisers and other Project costs amounted to £0.5m. |

# COMPLETED DEALS

## PERFORMANCE MANAGEMENT

| | |
|---|---|
| **12** | The Bid documents contained a detailed Output Specification which were developed and agreed with the Education client and the Schools. The Project related to the Buildings and their operation and did not extend to Curricular or Educational issues. Service targets were covered in the Payment Mechanism and failure to meet these standards will result in deductions from the Unitary Charge. |
| **13** | The costs and assumptions for the 7 Schools PFI Project were first compiled in 1997 and formed the basis of the Outline Business Case which was approved at the end of 1998. During the Procurement process it was necessary to review the original costs and assumptions set out in the Outline Business Case. |
| **14** | Demand forecasts for this Project relate to the relationship between pupil capacities and take up in the schools and, with the exception of catering, have not played a significant part of the Project. |
| **15** | The performance measurement systems are set out in the Project Agreement, where the Contractor is required to maintain a 'Help Desk' and to have procedures for rectification where shortfalls in service occur. The Payment Mechanism (a schedule to the Project Agreement) stipulates the deductions to be made for poor performance.<br>Unavailability through the fault of the Contractor will lead to 100% deduction of the Unitary Charge.<br>Persistent poor performance could lead to termination of the Contract. |

## FINANCIAL

| | |
|---|---|
| **16** | As indicated in 13, above, the costs and assumptions for the 7 Schools PFI Project were first compiled in 1997 and were accurate at that point in time. During the various stages of the Procurement process it became necessary to review the original capital cost assumptions set out in the Outline Business Case (OBC). The OBC was prepared long before the Output Specification and adjustments had to be made to the PSC to 'mirror' the requirements of the bidders and the Preferred Bidder. |
| **17** | The difference between the PSC and the final NPV of Unitary Charges provides the basis to determine whether the Public Sector obtains Value for Money and therefore merits a great deal of attention. The Full Business Case contains a separate section devoted to the compilation of the PSC. |
| **18** | Although the Contractor has revealed rates of return to Equity investors these have not played any significant part of the negotiations. The requirement is for the Contractor to deliver the Project to the standards set out in the Output Specification at an Affordable price to the City Council.<br>With regard to the rates of return made to the Banks, the Council is more concerned that the Contractor pays the competitive SWAP rate for the Senior Debt. |

## CONTRACTUAL

| | |
|---|---|
| **19** | The Project has not yet reached Contract Close. |
| **20** | A Risk Allocation Matrix issued with the ITN Documents is attached. Considerable detailed negotiations have and continue to be made with Contractor and expect to continue to Contract Close. |

## SOCIAL

| | |
|---|---|
| **21** | TUPE and staff transfer issues affect approximately 70 staff and are a high priority for the City Council.<br>Employee representatives have been kept fully informed throughout the Project.<br>The Contractor has maintained a positive approach to TUPE issues and, in with the support of the City Council, has obtained Admitted Body Status to the West Yorkshire Superannuation Fund.<br>The Contractor also has its own Pension Scheme. |

## PROPERTY

| | |
|---|---|
| **22** | There are land and buildings surplus to requirements in four of the Primary Schools. It is the Council's intention to market these to produce capital receipts.<br>These receipts have been factored into the Unitary Charge and NPV of the contract. This has been the case since the OBC.<br>In addition to this the Council is making a contribution from its Insurance Reserve to incentivise the Contractor to install Fire Prevention Sprinklers. |

## CONSTRUCTION

| | |
|---|---|
| **23** | The construction costs in the PSC total £37.5m compared to the Contractors construction costs of £36.3m. |
| **24** | The Project has not commenced the construction phase. |
| **25** | The Project includes provision for an Independent Certifier after the construction phase.<br>The Project is not expected to reach this phase until 2002 for the first school through to 2004 for the last school to be handed over. |

# LAWNSWOOD

| **Preferred Allocation of risks Within The Project** (NB for ease of reference only. For a fuller representation of suggested allocation of risk within the Project. Bidders must refer to the appropriate provisions of the Agreement.) | **Contractor %** | **Council %** | **Agreement** | **Dis-agreement** | **Cost £** | **Comments** |
|---|---|---|---|---|---|---|
| **Risk Category** **Design** | | | | | | |
| Final design leads to greater than expected construction cost. | 100 | | | | | |
| Redesign needed due to non-accordance with design beef. | 100 | | | | | |
| Authority requested alteration to design specification | | | 100 | | | NB Phasing and finalisation of design to be suggested by Bidders. |
| **Construction** | | | | | | |
| Archaeological remains, etc causing delay. | 100 | | | | | |
| Archaeological remains, etc causing increased costs. | 100 | | | | | |
| User requirements changing due to technological advances or teaching methods change. | | 100 | | | | |
| Geological unsuitability, unforeseen ground conditions producing delays and costs. | 100 | | | | | |
| Uncertainty of future labour costs, salary increases, etc. | 100 | | | | | |
| Uncertainty of future costs of materials | 100 | | | | | |
| Delays and possible extra costs due to non-availability of particular materials. | 100 | | | | | |
| Delays incurred due to non-availability of labour due to strike or other industrial action. | 100 | | | | | NB Dealt with in Agreement as Relief Event. |
| Additional costs and delays as a result of adverse weather conditions. | 100 | | | | | NB Dealt with in Agreement as Relief Event. |
| Cost overrun due to unplanned workload or unanticipated fiscal environment, unexpected costs in relation to design, construction, commissioning, equipment supply. | 100 | | | | | |
| **Planning, Environmental, Safety etc** | | | | | | |
| Late design or build alternations result from need to comply with new regulations regarding design, construction, equipment supply etc. | 100 | | | | | eg if as result of Discrimination or Specific Change in Law. |

| | | | | | | |
|---|---|---|---|---|---|---|
| Failure to obtain detailed planning permission or failure to obtain approval of all reserved matters. | 100 | | | | | |
| Compliance with obligations contained in Planning Agreements if required. | 100 | | | | | |
| Compliance with conditions attached to planning permission. | 100 | | | | | |
| Failure to comply with CDM regulations. | 100 | | | | | |
| Environmental (pollution, waste, noise) delays and costs arising as a result of the new site development. | 100 | | | | | |
| Delays and costs arising from lapsed site security during site redevelopment. | 100 | | | | | |
| **Operational and Maintenance** | | | | | | |
| The authority requires a different service output specification involving a true cost to the Bidder during construction. | | 100 | | | | |
| Inadequate monitoring of performance requiring increased deductions. | 100 | | | | | |
| right Cost overrun due to unplanned workload or unanticipated fiscal environment. | 100 | | | | | |
| Base estimate being inadequate leading to unexpected cost overruns. | 100 | | | | | |
| Poor maintenance leading to danger for staff, visitors and students. | 100 | | | | | |
| Repairs required as a result of vandalism and the ensuing disruption to service provision. | 100 | | | | | |
| Repairs required as a result of damage during School Day (or any additional periods required, ie for school lettings) caused by Authority staff, visitors or students. | | 100 | | | | |
| Unit cost of utilities increases. | 100 | | | | | |
| Disruption to utility supplies. | 100 | | | | | NB Dealt with in Agreement as Relief Event. |
| Energy efficiency of design and construction of buildings. | | | | | | |
| **Equipment/Maintenance** | | | | | | |
| Authority requested changes in equipment supply specification (at true cost to the Bidder). | | 100 | | | | |
| Equipment does not meet specification. | 100 | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Advance in technology causing the need to replace and upgrade equipment as it becomes obsolete. | 100 | | | | | |
| Equipment failure causing delays. | 100 | | | | | |
| Disruption of availability caused by maintenance. | 100 | | | | | |
| **Financing** | | | | | | |
| Delays in financial close due to substantial market change or change in economic condition. | 100 | | | | | |
| Delay or failure to achieve financial close when anticipated to: failure or delay in performing Authority's obligations in relation to the project agreements; lack of clearance from sponsoring government agency. | 50 | 50 | | | | |
| Variations in interest rates affecting the financial performance of the project. | 100 | | | | | |
| Effects on inflation on the financial performance of the Project (subject to agreement). | 100 | | | | | |
| Inability of Authority to reclaim VAT on purchases for non-business or exempt activities. | | 100 | | | | |
| **Insurance** | | | | | | |
| Insurable Risks | 100 | | | | | Contractor will be expected to assume primary liability in respect of insurable risks. (Subject to existing Authority Insurances.) |
| Insurable Risks | 100 | | | | | |
| Uninsurable Risks | 100 | | | | | |
| **Miscellaneous** | | | | | | |
| Change in VAT rate | | 100 | | | | |
| Change in Bidders ability to recover its input VAT | 100 | | | | | |
| Change in VAT status of service provided under contract. | 100 | | | | | |
| General change in tax legislation other than VAT. | 100 | | | | | |
| War, nuclear explosion or other identified Force Majeure Events | 50 | 50 | | | | |
| Voluntary termination by Authority. | | 100 | | | | |
| Early termination by Authority for poor performance by Contractor. | 100 | | | | | |

## COMMITTEE FOR FINANCE AND PERSONNEL
## INQUIRY INTO THE USE OF PUBLIC PRIVATE PARTNERSHIPS

## WRITTEN SUBMISSION BY:
## LONDON BOROUGH OF CAMDEN

11 April 2001

Thank you for your letter of 22 March 2001. The London Borough of Camden is actively pursuing a number of PPP/PFI projects at present, but none of these have yet advanced to the stage of finalisation of contracts. The projects currently in preparation include:

- The Chalcots housing scheme, a PFI project involving the comprehensive refurbishment of five tow blocks (708 dwellings) and their subsequent maintenance over a thirty year period. The total value (NPV) is estimated at £67 million. This contract is expected to start in September 2002.
- A second PFI housing scheme, the Maiden Lane refurbishment project, which is in the early stages of preparation, having received initial approval from DETR.
- The redevelopment by means of PFI of the Haverstock secondary school (approx value of capital works - £15 million). The outline business case is currently being prepared for this scheme.
- The implementation of Camden's e-government vision by means of a PPP. The intention is to make all public services available on-line by 2005 via a broadband network. It is yet to be determined whether this initiative will proceed as a PFI bid.

I have used our experience to date to respond to your questions about the general context of PFI/PPP (Annex 1 attached) and have then gone on to answer the "Bid Process" section of your Request for Information (2) in the context of the Chalcots housing scheme (Annex 2).

I trust that these responses will prove helpful. Please contact Roger Davis, Financial Advisor, on 020-7974-2213 (e-mail: roger.davis@camdem.gov.uk) if you require any further information.

**JOHN MABEY**
**Controller of Financial Services**

# ANNEX 1

## GENERAL CONTEXT OF PFI/PP

### 1. Benefits of PFI/PPP

- The ability to access private sector funding that could not otherwise be made available.
- The ability to seek out and choose between a wide variety of solutions to particular technical and management issues.
- The ability to specify output standards which can be applied consistently over a long period, together with the prospect of working together to raise standards further during the contract period.

### 2. Key factors for successful application

- Confidence as to the ongoing need for the facility in the form envisaged.
- Careful thought as to the apportionment of risk between the parties.
- Confidence that the private sector partner(s) have the technical, financial and managerial resources available for successful implementation.
- Confidence that the public sector partner will respect the spirit of the agreement by not interfering unduly in how the project is delivered.

### 3. Wider issues, etc

- Our experience with housing PFI has been that there is a strong market base of suppliers with no difficulty in obtaining a good quality response.
- From discussion with IT suppliers, it appears that some of the bigger players are unwilling to embrace PPP in general and PFI in particular. However there still appears to be sufficient interest from enthusiastic firms to make the partnership approach worthwhile.

### 4. Prioritisation

- From the perspective of an individual public authority, this does not really arise. The schemes that may be suitable for PPP/PFI are easily identified within overall service investment needs – access to conventional means of financing has fallen well short of assessed needs.

### 5. Social factors

- PPP/PFI is seen to have a role in altering perceptions of public service by providing higher quality and greater reliability. This should be particularly helpful to those sections of the community that rely more heavily on public sector provision.
- Experience with Camden's secondary school scheme has shown some concern both amongst staff and the public about the ability of PFI to deliver service improvements at a reasonable cost. This has not been evident with the Chalcots housing scheme, where there seems to be greater acceptance that without PFI the necessary investment is unlikely to be achieved.

### 6. Alternative procurement options

- There are no alternative options currently available that would obviate the need for PPP/PFI.

### 7. How to take forward PPP/PFI

- No comments.

### 8. Alternative forms of financing

- For housing projects, voluntary transfer to a housing association would provide an alternative means of raising finance for refurbishment. However this would raise many other political and management issues and would arguably not provide the same degree of accountability as can be obtained through PFI.

**9. Economic basis of PPP/PFI**

- Greater accountability of the service provider over the whole life of the project should lead to better use of resources as a whole, taking into account both initial and ongoing costs.

**10. Assessment of value**

- The value of capital investment can be assessed by constructing a public sector comparator, but there is the danger that this can become a mechanical exercise.
- Levels of service improvement can in some cases be assessed by comparing against Best Value Performance Indicators and other management statistics for equivalent non-PPP/PFI operations, eg housing repair response times.
- Service improvements could also be assessed directly, eg through tenant satisfaction surveys, but there are obvious difficulties in putting a financial value to a higher satisfaction rating.

# ANNEX 2

## SPECIFIC PROJECTS AND PROGRAMMES - BID PROCESS

## CHALCOTS HOUSING PFI SCHEME

1. **Output objectives**
   - Objectives were clear, ie to address current disrepair and refurbishment issues, and then to provide consistent security and maintenance over the thirty year period.

2. **Output specification**
   - So far, the Council's requirements appear to be acceptable to bidders.

3. **Initial enquiries**
   - Initial inquiries were not undertaken for the Chalcots scheme, but this approach has been adopted in relation to the Council's e-government initiative with positive results.

4. **Risk transfer**
   - The Chalcots scheme places delivery of the refurbishment aspects in the hands of the service provider together with future maintenance and on site security. The Council retains letting responsibilities, rent setting and collection.
   - The Council will be transferring all relevant risks to the service provider, retaining only the demand risk and the risks arising from legislative changes, extent of right to buy sales, etc.

5. **Evaluation criteria**
   - No comments.

6. **Key features of business case**
   - The OBC demonstrated that the PFI scheme should be able to deliver a high quality solution to the current problems at lower cost than alternative options such as demolish and rebuild.

7. **Nature of public sector comparator**
   - The DETR financial model was used comparing the proposed PFI scheme against traditional procurement and also against the option of transfer to a registered social landlord.

8. **Recruitment of skills and experience**
   - The Council appointed Capita to undertake an initial condition survey of the Chalcots properties. PriceWaterhouseCoopers helped to prepare the OBC and are providing advice and support through the bidding process, including preparation of the payment mechanism. Eversheds are providing support on legal aspects.

9. **Key contractual issues**
   - The major issue so far relates to the rights of leaseholders of sold flats in relation to service charges. This was identified at an early stage.

10. **Procurement timetable/tendering requirements**
    - The procurement timetable has slipped by approximately eleven months since the initial timetable was drawn up.

11. **Sources of funding**
    - The Council has been awarded a PFI credit of £30.6 million by the DETR, which be reflected in higher payments of housing subsidy. The balance of costs will be recovered through HRA rents, many of which are rebated through Housing Benefit.

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