

20th November 2017

Agenda Item: 5

REPORT OF THE SERVICE DIRECTOR, PLACE AND COMMUNITIES

Nottinghamshire County Council PFI Schools Management Contracts

Purpose of the Report

1. To inform the Committee of the current status of the Council's Private Finance Initiative (PFI) Contracts for Schools and allow members to consider whether there are any actions they require in relation to the issues contained within the report.

Information and Advice

Schools PFI Contracts

2. The two PFI Schools Contracts in Nottinghamshire are to provide schools and leisure centres (on behalf of the relevant Borough and District Councils) in East Leake and Bassetlaw and were signed in 2002 and 2005 respectively. Both contracts have a 25 year concession. Details of the contract coverage and cost are included in Appendix 1.

Nottinghamshire Schools Special Purpose Vehicles (SPV's)

3. Most PFI contracts are operated by Special Purpose Vehicles (SPVs) which are companies specifically established to develop and operate the facilities comprising a number of specialist partners usually including construction contractors, facilities management (FM) providers (for accommodation projects), funders, and other specialist companies experienced in specific areas of work (such as waste) or in pulling together all of the partners to provide a seamless service to the local authority.
4. In respect of the Nottinghamshire PFI Schools Contracts the SPVs are "East Leake Schools Ltd" and "Transform Schools Ltd (Bassetlaw)".

Funding Arrangements

5. Her Majesty's Treasury (HMT) through sponsoring departments (the Department for Education (DfE) in this case) provide fixed (non-inflating) ring fenced grant payments, generically known as PFI credits, to the client organisations to offset some of the costs associated with this private sector finance based on the submission of a detailed business case to support the proposals.
6. Councils normally therefore establish a "PFI reserve" at the start of a project to build up a sum of money (before the facilities are operational and the unitary charge payments commence or ramp up) to offset the difference between the inflating costs and fixed PFI

grant payments through the life of the project, based on expected budgets, modelled costs and inflation assumptions assessed in an affordability model.

7. Unfortunately in some circumstances these assumptions can prove wrong, particularly in turbulent financial times as have affected the UK since 2007. A number of PFI projects are therefore currently proving to be unaffordable to the client organisations (particularly in the health sector).
8. The overall reserves held by the County Council to support the Nottinghamshire PFI Schools Contracts projects are around £3.5m, and are currently deemed sufficient to cover potential costs for the rest of the contract term.

Contract Metrics and Monitoring

9. PFI Contracts are usually output based, with significant freedom allowed to the contractors to meet the agreed specification within the confines of an agreed cost and quality envelope.
10. Various service elements such as hard and soft FM (building maintenance, catering, cleaning and grounds maintenance etc) or waste disposal arrangements are subject to regular benchmarking (cost/quality comparison) or market testing (tendering) by the contractor to ensure they continue to offer value for money.
11. Payments to the contractors are made monthly through a “Unitary Charge” which covers all of the service elements provided, offset by any deductions made for performance failures or lack of availability. That way the contractors are incentivised to ensure services are provided effectively and any defects or service failures are rectified promptly.
12. Contracts are often referred to as self-monitoring as the contractor provides the performance data to support the payments requested each month, although a degree of oversight from the client is always required to ensure continued contract compliance.
13. Deductions can be for items as simple as failure to repair a leaking or broken tap or fix a loose tile or clean a floor correctly, or not providing accurate billing or performance data or can be more significant such as failing to ensure a facility is open as required. Obviously the timescales for rectification, or any financial penalties applied reflect the impact of the failure on the service provided to the Council and hence the schools and or the public.
14. Added complexity in some projects comes from the multi layered client structure behind many of the public sector bodies commissioning the works and contracts where multi use facilities are provided (such as leisure centres and schools under one contract) and the subsequent complications resulting from the programme of academy conversions in schools.

Standardisation of PFI Contract terms

15. The Schools PFI contracts in Nottinghamshire follow the appropriate standardisation of PFI Contract (SoPC) contract terms which were relevant at the time the contracts were signed and therefore come with a range of built in commercial protections.

Change Management

16. Despite perceptions to the contrary well developed PFI contracts offer a significant degree of flexibility in the way services are provided, and can deliver adaptable services which can be changed to meet ongoing pressures and developing aspirations.
17. All of the Councils PFI projects incorporate change mechanisms which allow for minor variations which do not require approval from the sponsoring departments. These mechanisms are used constantly to review what facilities are provided in schools and have been utilised across the majority of the schools and leisure sites on a number of occasions to change layouts or add additional capacity.
18. It is important however that where these minor variations are made the capital and lifecycle impacts are identified, and revenue streams secured to ensure the changes do not have a significant cumulative impact on budgets. The need to ensure the contractor is placed in a no better/no worse financial position can also impact on the value for money of any changes.
19. In Nottinghamshire the academy roll out has left a complex legacy of contractual changes and recharging mechanisms to be managed since the PFI contracts cannot be novated to the individual schools or academy chains, and still have to be managed by the Council which is ultimately liable for making the contract payments.
20. Therefore back to back arrangements have been put in place to ensure the Council recovers the agreed share of monies due to the contractors from the independent bodies now using many of the sites. This is further complicated by the number of multi-use sites resulting from the leisure provision in the original arrangements.
21. As a result the day to day contract management, and particularly change management in the schools projects is a complex and time consuming task for the Council, schools, and the contractors alike.
22. More significant variations are also possible subject to agreement between all the project partners, but do require a more detailed assessment of the impacts. Such variations are often very complex and require a detailed knowledge of the contracts, the services being delivered and more importantly a significant degree of technical and commercial knowledge and awareness in order to ensure changes do not adversely affect the risk and price profile of the project.
23. Changes to a contract beyond the scope of the original procurement could also potentially open the Council up to the risk of a procurement challenge if the changes are significant enough for the variation to be deemed a new contract. Specialist technical, financial and legal advice is therefore usually sought for major variations, often from outside of the Council.
24. In addition DfE has to be consulted on any significant contractual changes, and may require the submission of a Variation Business Case (VBC) prior to agreeing to any amendments. This can also lead to reassessment of the PFI Credits payable in certain circumstances. It is unlikely that any reassessment would lead to anything other than a reduction in the level of grant payable.

Major PFI Schools Contract Changes

25. A variation to the Bassetlaw schools contract is currently proposed to remove the very complex energy recharge formula by which the contract SPV, Transform Schools, recover energy costs from the individual sites from the contract and replace it with a straightforward requirement for the schools and leisure services to meet their own energy costs. This will

enable sites to better manage their energy use, and also encourage more investment in energy efficiency technologies, as the sites themselves will gain the direct benefit.

26. Additionally an extension to the Worksop Post 16 Centre is currently proposed by the Outwood Academy Trust which operates the site. This significant expansion may require a Deed of Variation to be agreed, although this is still under discussion with Transform Schools.

Current Contract Performance

27. Both of the schools projects offer excellent levels of performance, with the school and leisure buildings designed and maintained to a high standard, and although attributable to a wide range of factors, a number of the schools using those buildings are now achieving significantly improving GCSE results year on year.

28. Regular School/Leisure Operational Management Meetings continue to be held, however due to improvements in performance over recent years, the number of issues raised during these meetings has dropped significantly since 2015.

29. Despite judicious application of the payment and performance mechanisms contract deductions on the project have generally been minimal, with all output targets met to date, indicating the diligence of both SPVs and the quality of the facilities and services provided.

Factors Affecting the Projects

30. Common issues affecting all of the PFI projects include the lack of suitably skilled and experienced staff able to manage the detailed operational and commercial issues behind the contracts and the complex interfaces between the partners involved. Resourcing to effectively manage the risk and cost of these (and other) major projects is a key issue for the County Council if it is to ensure that the contracts continue to offer value for money.

31. Economic fluctuations affect the level of inflation paid on contract rates, which can widen the affordability gap by increasing the difference between the fixed payments made by HMT and the monies paid to the contractors.

32. Although contractual disputes do not occur often, when they do they are often complex to resolve, and where they involve national government or local authority partners may have a significant political dimension. This is particularly true where shared use sites are utilised.

33. Effective management of school places is also another complex area where the County Council's role as local education authority is impacted by the academy programme, and where PFI schools which are now outside of the Council control and with largely fixed costs need to be utilised effectively if they are to provide a valuable community resource. It is essential that the PFI schools continue to be considered within the wider school place planning by the Council.

34. Going forward, ensuring continued robust contract management and appropriate financial planning is in place to ensure the various arrangements remain affordable will be essential to their continued sustainability. Additionally facilitating a more direct relationship between the contractor and the schools, with effective use of communication channels to ensure issues are logged and actioned by the contractor without any input from the County Council, will ensure the services operate efficiently.

Contract Management Arrangements

35. The Schools PFI project is valued at around £22.6m per annum, and is currently managed by the Group Manager, Place Commissioning within the Place and Communities Division of the Place Department.
36. The schools PFIs have traditionally been managed by 2 FTE staff, previously located within the property structure, although only one post is presently filled, and now sits within the place commissioning group following the recent Place Department restructure. The group is operated by a small set of specialist staff with strong project management and commercial skills, acting as the retained intelligent client function.
37. A review of the contracts is shortly to be undertaken, and any recommendations from that review will be reported back to this Committee for consideration in due course.

Other Options Considered

38. None at this stage although in considering this report Members will identify whether there are any actions they require in relation to the issues contained.

Reason/s for Recommendation/s

39. Members of the Committee will no doubt appreciate the high value and complex nature of the PFI Schools Management Contracts.
40. In considering this report they will identify whether there are any actions they require in relation to the issues contained, however it is considered that Members can at this point be satisfied that, with appropriate staff and financial resource allocation, the PFI Schools Contracts will continue to deliver affordable and high quality school places for the County Council until the end of the relevant contract term.

Statutory and Policy Implications

41. This report has been compiled after consideration of implications in respect of crime and disorder, data protection and information governance, finance, human resources, human rights, the NHS Constitution (public health services), the public sector equality duty, safeguarding of children and adults at risk, service users, smarter working, sustainability and the environment and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

Financial Implications

42. The PFI Schools Management contracts represent a significant financial commitment for the County Council and continue to offer a value for money mechanism for delivering the relevant services. The PFI Financial model is updated annually to accommodate changes, current forecasts are that the predicted costs will be contained within the PFI Reserve and annual revenue budget.

Legal Implications

43. PFI contracts are complex contractual arrangements for the delivery and long term management of high value projects and as such are subject to significant scrutiny and

oversight by the County Council, HMT, and sponsoring Government departments. Contracts have to be managed, and where appropriate varied, within tight guidelines and best practice standards, and therefore both schools contracts have been suitably supported by both internal and external legal advice.

Implications for Service Users

- 44. Ensuring sufficient school places to meet the identified need remains an obligation of the County Council, and the East Leake and Bassetlaw PFI Schools projects help the authority meet these requirements either directly or through a cost effective delivery partnership with a range of facility providers and academy trusts.
- 45. The school facilities provided offer the students the best possible opportunities to learn in high quality, safe and sustainable environments.
- 46. The contracts continue to provide a value for money solution to meet the requirements of the residents of Nottinghamshire.

Implications for Sustainability and the Environment

- 47. The PFI School's Contract has delivered significant investment into the schools in order to help decrease waste, improve utilities performance and increase the use of renewable energies.

Recommendation

- 1. That members consider whether there are any actions they require in relation to the issues contained within the report.

Mick Allen
Group Manager, Place Commissioning

For any enquiries about this report please contact:
Mick Allen, Group Manager, Place Commissioning

Constitutional Comments (KK 06/11/17)

The proposal in this report is within the remit of the Finance and Major Contracts Management Committee. If Committee resolves that any actions are required it must be satisfied that such actions are within the Committee's terms of reference.

Financial Comments (SES 01/11/17)

The financial implications are set out in the report.

Background Papers and Published Documents

None

Electoral Divisions

All.