



Urgency Committee

5 September 2006

Report of the Director of City Strategy

Highway Services – PFI Option

Summary

1. This report is an item for consideration by the Urgency Committee. The reason for bringing this report at this time is due to the limited timescales available for the investigation of a PFI option and the preparation of an expression of interest for submission to the DfT by 10 September 2006.
2. This report advises on progress with the preparation pathfinder of the highway maintenance private finance initiative (PFI) Expression of Interest (EOI). It provides information on the key benefits and drawbacks associated with this project and recommends that subject to a manageable affordability gap being achieved, officers are delegated authority to submit the EOI to DfT by 10 September 2006.

Background

3. The previous procurement process reached the stage of Members appointing a preferred provider. The procurement was delayed in February 2006 to enable other options to be considered.
4. City Strategy is investigating a number of strategic options for the delivery of highways services and also the delivery of projects identified in the Local Transport Plan and other construction related initiatives. The options provided for consideration by the Executive on 2 May 2006 were:
 - A: Complete the current procurement for both parts of the service.
 - B: Abandon the current procurement and submit an EOI to the Department for Transport (DfT) for pathfinder status in Highways Management PFI.
 - C: Abandon the current procurement and retender an extended scoped package.
 - D: Abandon the current procurement and retender on the basis of a package of services under a term contract with an in-house client in the event that options B and C are unsuccessful.

Members agreed that the options B and C could be considered in the first instance to determine their suitability as an alternative to the previous procurement.

5. At the meeting of the Executive on 11 July 2006 it was agreed that a management and reporting structure should be put together including a Project Board and Member Steering Group to manage the procurement process. It also made provision for a report to be brought to this committee immediately prior to submitting PFI Expression of Interest so that Members could be advised of the progress in developing the project and seek their approval for submission.
6. The highway maintenance PFI project being offered by DfT has a total of £600 million in PFI credits and they are seeking schemes that provide “path finder” status. Our investigation has revealed that 10 to 12 authorities may be interested in the submission of an EOI. However our advisers think that a submission by the Council will have a better than average expectation of success and this is potentially excellent opportunity to achieve a level of investment that will make a significant improvement on the standard of the highway infrastructure.
7. By mid June financial and technical advisers had been procured and appointed, Deloitte and Halcrow respectively. Both of these organisations have considerable experience with PFI schemes and one of the few organisations that also have experience with the very limited amount of work already done with highway maintenance PFI projects.
8. Between the appointment of our advisers and the present time the following has been achieved, even though the timescales have been limited.
 - Discussions with 4P's (an advisory body to local government) have taken place to seek their advice on the approach to the project.
 - Discussions with DfT about content and format of the project and the EOI.
 - Soft market testing with 3 potential contractors/providers so that they assess the level of interest in a project and take their comments into account when developing the EOI.
 - Workshops with staff and advisers to determine.
 - Scope and content of the bid
 - Options and qualitative analysis
 - Explored the project and compare objections
 - Consider the financial implications of the project
 - Advised staff of progress through briefing notes and team briefs.

- Preliminary meetings with unions to advise on progress and seek their initial comments.
- Formatting and analysis a considerable amount of information in relation to the size and condition of the asset, to enable preparation of the cost elements of the financial model.
- Analysis of the highway maintenance backlog in a fundamentally different way based on a whole life approach as opposed to a budget led approach.
- The preparation of a draft EOI.

Expression of Interest

9. The draft EOI is in the final stages of preparation and will be available to send to DfT if a decision is made to submit. The content of the EOI is extensive, even though it is only a 10-page document, with supporting information allowed. The main content of the EOI is described in the following paragraphs.
10. The EOI sets the context of highway maintenance and traffic management assets in a regional and local significance. The importance of having well maintained assets that support social, environmental and economic factors is vital. Clearly the assets are part of and underpin the public transport systems of the City that provide accessibility for business, residents and visitors who use them. The EOI draws together the connections between the standard of the asset and the support which they give.
11. A description of the project is provided demonstrating how it flows from the overall objectives of the Council and how the project's design and implementation will deliver the benefits necessary to contribute towards achievement of these objectives. The description of the project will provide information about the scope of the services and the options considered.
12. The EOI will show how an options appraisal, in both qualitative and quantitative terms, allowed the preferred option to be identified. The way in which this preferred option fulfils the needs of the project will be clearly identified as well as being able to demonstrate value for money in accordance with Treasury Guidance.
13. A section in the EOI will give an early indication of the major risks that might affect the proposals and any mitigating actions or contingency to reduce these risks. The strategy for consulting stakeholders, including employees and trade unions, will be provided, including actions taken so far. Political and financial commitment to the project will be clearly demonstrated.
14. Project management capabilities and PFI experience within the Council will be demonstrated through the successful 'Schools PFI' and the work carried out to date on the waste management PFI project. The commitment to

provide adequate procurement funds to enable the project management team to obtain all the external professional assistance necessary will also be highlighted.

15. Due to the whole life costing approach, R & R schemes, for example, carried out under the PFI project would be designed to ensure maximum life expectancy, so that little or no further work is needed over the life of the PFI. The same approach would apply to structures and streetlights and this is significantly different to the current budget led approach.

Scope of the Project

16. There are six options being considered for the expression of interest. These are:-

- Option 1 – Do minimum
- Option 2 – Highway Maintenance, Management and Works
- Option 3 – Highway Maintenance, Management and Works and Traffic Management Infrastructure Works.
- Option 4 – Highway Maintenance, Management and Works and Street Cleansing Operations.
- Option 5 – Highway Maintenance, Management and Works and Traffic Management Infrastructure Works and Street Cleansing Operations.
- Option 6 – Highway Maintenance, Management and Works with limited life cycle works.

Following the qualitative evaluation of these six options, 2, 3 and 5 were selected as the ones for financial assessment and of those option 5 was selected as the preferred option.

- 17 In addition this option provides the best solution in terms of addressing the key objectives regionally, locally and for public transport. It also meets the specific objectives in relation to highway maintenance and to traffic management. The fit with street cleansing operations is problematic in so far as to extract it from the “street scene” services would leave it vulnerable to economics of scale. The budgets for highway maintenance and traffic management for 2006/07 are made up as follows:

CYC revenue	£5366k
CYC capital	£2325k
LTP capital	£1386k
 Total	 £9077k

This option gives the best value for money solution based upon the qualitative and quantitative scoring.

Quantitative and Qualitative Scoring

18. The proposed preferred option includes all those areas of service included in Annex 1. The table below contains a comparison between the extent of the service provided at present against those services anticipated under the PFI arrangement.

	Typical annual existing R&R treatment lengths (2006/07)	Typical annual PFI treatment lengths during the core investment period to rehabilitate the network.
A class carriageways	2.3 km	8.0 km
B + C class carriageways	1.7 km	10.2 km
Unclassified carriageways	3.9 km	21.2 km
Footway	13.6 km	40.0 km

In terms of street lighting, the annual programme allows 80 streetlights to be replaced. Under the PFI proposal, 90% of streetlights would be replaced over the life of the PFI at an average of 600 per year, but with the majority of this being in the core investment period.

19. In terms of financial investment the PFI arrangement is projected to deliver: -

	£ million
• Investment, mainly in surfaces, structures and streetlights over the 5 year CIP	121
• Life cycle costs in years 6 to 25	174
• Operation and maintenance costs in years 1 to 25	116
• Service and management costs in years 1 to 25	108
Total	519

20. Any future PFI arrangement will be with a specialist contractor/provider who will enter into a long term contract of 25 years. In the first 5 years there will be a significantly large investment into the asset and then a further 20 years in which the asset will be maintained to an agreed standard for handover back to the Council at the end of the period.
21. The contract will be a negotiated arrangement based upon the Council's requirements, objectives and output based specification. The quality of the work will be agreed with the contractor before the contract is signed as well as the method of payment. Contracts and payment methods are being standardised by the DfT, however this is a pathfinder project and they will be seeking innovative approach to the way that the contract is prepared.
22. A key theme for the Council's requirements is that sustainability should impact on all areas of the service and bidders for the contract will be required

to demonstrate how they intend to achieve this. In particular there will be a requirement for a sustainable approach both to the provision of energy and the equipment used in street lighting.

23. Quality and management of the service during the contract period will be monitored by a client side which will act in partnership with the provider. However the client size will be sufficient to ensure that standards are being achieved and quality maintained.
24. No other form of funding, other than PFI, can deliver this level of investment and improvement in the condition of the highway network. In the absence of a PFI scheme, there will be a gradual deterioration in the condition of the infrastructure until some other form of capital investment is obtained. The submission of an EOI is a unique opportunity for the City's benefit from a major capital investment which will maintain the highway to a much higher standard than could be achieved by any other means.

Key Financial Information

25. We are advised that the cost of procurement could be as high as £2.5 million over a 3½ year procurement period. This cost can be incorporated into the scheme but there is the risk if the PFI scheme does not reach financial closure then the Council will have to fund this cost. The £2.5m would be in a payment to the Council on contract signature.
26. There is a limited number of PFI credits available and a high level of competition from other local authorities is expected. The advice we are receiving is that the bid needs to be as financially attractive as possible. The two main ways of achieving this are through an additional financial commitment by the Council, over an above existing budgets, and by attempting to keep the PFI credit requirement below the £300 million level if possible.
27. A number of iterations of the financial model have already taken place to refine it, both in terms of cost input and affordability modelling. Further work is ongoing but our advisers believe that the criteria set out for making the bid attractive to DfT can be met. The up to date position on this will be provided at the meeting.
28. A simplified way of understanding how the Annual unitary charge is met is shown in the table below. The Annual Unitary charge is the payment made to the contractor/provider each year by monthly instalments.

Annual Unitary Charge = Correct budgets of £9.077m
 + The revenue value of the PFI credits
 + Any affordability Gap which may develop

29. The current budgets for highway maintenance are under pressure and these are expected to reduce by say £1.5 million prior to the start of the PFI project

in April 2010. This is due to a downturn in the availability of CYC capital (£1 million) and the termination of Prudential borrowing (£0.5 million). This anticipated reduction in the current budget would have to be found by other means to provide budgets at 2006/07 levels from April 2010, as well as any requirement to fund an affordability gap.

Risks

30. The key risks have been identified as follows:-

Financial

- funding any affordability gap which may develop as the project progresses.
- maintaining current budgets at 2006/07 levels (plus inflation)
- the assumptions used in the model may change in relation to the cost of finance or the net present value
- the cost of procurement may change as the project develops.
- the potential cost associated with changes over the life of the contract that may be due to changes in inflation or employers requirements.

Reputational

- DfT require extensive commitment to a scheme if an EOI is submitted.
- Trade unions – meetings have been held with unions at which they have expressed considerable concern and opposition to this PFI proposal.
- Staff would be subject to change and possible transfer to the new provider resulting in poor staff morale.
- Media may have concerns about the PFI arrangements and the implications.

Time

- If the EOI is not successful then 4 months will have elapsed between September 2006 and January 2007, when the decision is published, resulting in delays to any alternative procurement option.

Proposal

31. The investigation of the PFI alternative for procurement of highway maintenance has been carried out within very short timescales. Progress has been good and an EOI can be submitted by 10 September 2006 if Members agree to do so. The submission would not necessarily commit the Council to proceeding to the next stage if circumstances changed and the project became unviable.

Corporate Objectives

- 32 The highway service procurement will be a key delivery agent for many of the corporate aims over a 25 year period. The EOI document emphasises the links between this PFI project and the Council's corporate objectives.

Corporate Aim 1: (Environment) Take Pride in the City, by improving quality and sustainability, creating a clean and safe environment.

Specific Objectives:

- 1.1 Increase resident satisfaction and pride with their local neighbourhoods.
- 1.2 Protect and enhance the built and green environment that makes York unique.
- 1.3 Make getting around York easier, more reliable and less damaging to the environment.

Corporate Aim 3: (Economy) Strengthen and diversify York's economy and improve employment opportunities for residents.

Not directly relevant to any of the specific objectives, but good quality highway infrastructure is vital to the local economy.

Corporate Aim 4: (Safer City) Create a safe City through transparent partnership working with other agencies and the local community.

Specific objective:

- 4.7 Make York's roads safer for all types of user.

Corporate Aim 8: (Corporate Health) Transform City of York Council into an excellent customer-focused "can-do" authority.

Specific Objective:

- 8.9 Manage the Council's property, IT and other assets on behalf of York residents.

Human Resources (HR) Implications

- 33 The communication strategy, agreed by the Project Board, is being implemented with staff and unions being informed about the scale of this PFI project and its potential implications. The next milestone in this process is the submission, or otherwise, of the EOI and this will be communicated as soon as possible, in a coordinated manner to all staff potentially affected.
- 34 At a meeting with union representatives, where the possibility of a PFI project was raised, there was opposition to the principle of PFI and it is anticipated that this level of concern from unions and staff will be an ongoing issue. The numbers of staff potentially transferred by this proposal are about 60 and

include external staff from Amey (Street Lighting). All those staff would be protected under the TUPE regulations.

Equalities Implications

35. There are no equalities implications.

Legal Implications

36. There are no direct legal implications arising from this report. Legal advisers will be required if the PFI procurement route is pursued and this is also the case, but to a lesser extent, if an alternative procurement route is chosen.

Crime and Disorder Implications

37. There are no crime and disorder implications.

Information Technology (IT) Implications

38. There are no information technology implications.

Property

39. There are no property implications.

Other

40. There are no other implications.

Risk Management

41. The agreement by Members to the setting up of reporting procedures to enable the procurement of a complex and inter-related grouping of services to go ahead in a structured manner will provide considerable assistance in managing risk.
42. In compliance with the Councils risk management strategy the main risks that have been identified in this report are those which could lead to the inability to meet business objectives (Strategic) and to deliver services (operational), leading to financial loss (Financial), non-compliance with legislation (Legal and Regulatory), damage to the Council's image and reputation and failure to meet stakeholders expectations (Governance).
43. Measured in terms of impact and likelihood, the risk score for all risks has been assessed at less than 16. This means that at this point the risks need only to be monitored.

Recommendations

- 44 Members note that the outcome of the extensive investigation into a PFI option to provide highway maintenance services in the future.

Reason: To comply with the approval given in the Executive Report of the 2 May 2006.

- 45 To approve the submission of a PFI Expression of Interest for Pathfinder Project the DfT for highway maintenance management and works with Traffic Management Infrastructure works subject to acceptable financial proposals being provided at the meeting.

Reason: To take advantage of the opportunity to obtain additional funding and a service provider for highway maintenance and traffic management service.

Contact Details

Author:
Damon Copperthwaite
Acting Assistant Director City Strategy

Tel No. 01904 551448

Paul Thackray
 Head of Highway Infrastructure
 City Strategy
 Tel No. 01904 551537

Chief Officer Responsible for the report:
Bill Woolley
Director of City Strategy

Report Approved Date 1 September 2006

Damon Copperthwaite
Acting Assistant Director City Strategy

Report Approved Date 1 September 2006

Specialist Implications Officer(s) List information for all

Implication - Financial
 Name: Simon Wiles
 Title: Director of Resources
 Tel No. 01904 551100

Wards Affected: No wards specifically affected

All

For further information please contact the author of the report

Background Papers:

Highway Services – report to the Executive on 2 May 2006
 Highway Services – report to the Executive on 11 July 2006

L:\DOCUMENT\WORDDOC\COMM\highway services progress report - steering board 05 September 06.doc

URGENCY COMMITTEE - 5 SEPTEMBER 2006

EXPRESSION OF INTEREST

HEADLINE FIGURES FROM FINANCIAL MODEL

- Unitary Charge = £20.5m first year → £33.6m in 1st five years

- PFI credits = £305m
£597m of cash = £23.9m/year

- Contract Value = £1b

- Sinking Fund Surplus over 6 years (first year) = £10m + £3.4m = £13.4m

↑ ↑

budgets credits

- Budget = Works £9.1m
Insurance £0.4m
Advertise £0.1m
Additional £0.45m
Contribution

£10.05 / year