

Birmingham City Council

Report to Cabinet

5 September 2023



Subject: Highway Maintenance and Management PFI Contract
Report of: Craig Cooper, Strategic Director, City Operations
Relevant Cabinet Member: Cllr Liz Clements, Transport
Relevant O&S Chair: Cllr Lee Marsham, Sustainability and Transport
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Are specific wards affected?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No – All wards affected
If yes, name(s) of ward(s):		
Is this a key decision?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
If relevant, add Forward Plan Reference: 011139/2023		
Is the decision eligible for call-in?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Does the report contain confidential or exempt information?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Exempt Appendix (Appendix A)		
Exempt information paragraph 3. Information relating to the financial or business affairs of any particular person (including the Council)		

1 Executive Summary

- 1.1 In June 2019 the Council entered into a commercial settlement regarding its Highway Maintenance and Management PFI contract with Birmingham Highways Limited (BHL). That settlement included:
 - 1.1.1 Requirements and arrangements for replacing BHL's sub-contractor that delivers highway maintenance and management services on behalf of the Council;
 - 1.1.2 Restructuring of the contract to facilitate the replacement of the sub-contractor; and
 - 1.1.3 Ensuring that highway maintenance and management services were delivered while this was undertaken.
- 1.2 The 2019 settlement was entered into with full support of Department for Transport (DfT) subject to the Council submitting a revised business case for continuing to receive £50.311m per annum PFI grant funding.
- 1.3 Cabinet has received regular updates on progress since 2019 and has approved decisions to enable officers to develop the way forward within specified financial and operational parameters.
- 1.4 Cabinet is now asked to approve the Council's revised Full Business Case (FBC) for the continuing operation of the PFI including revisions to the contract with BHL, and the submission of the FBC to Government

2 Recommendations

That Cabinet:

- 2.1 Approves:
 - 2.1.1 The Full Business Case (FBC) attached at Appendix A1 (Full Business Case);
 - 2.1.2 Subject to receiving approval from Government:
 - i. The appointment of a preferred bidder by Birmingham Highways Limited (BHL) following the agreed procurement process; and
 - ii. That the Council enters into revisions to the PFI contract with BHL implementing the commercial arrangements set out in in Appendix A;
 - 2.1.3 The sources of assurance proposed in Appendix A and approves the resources to put these in place assumed in Appendix A5.

- 2.2 Delegates authority to:
- 2.2.1 The Strategic Director of City Operations and Director of Finance (s151 Officer) or their Delegates to finalise outstanding commercial matters within the parameters set out in Appendix A;
 - 2.2.2 The Strategic Director of City Operations and Director of Finance (s151 Officer) or their Delegates to enter into a joint agreement with BHL for the provision of an Independent Certifier to meet the revised terms of the PFI contract variation approved under 2.1.2ii above;
 - 2.2.3 The Assistant Director, Highways and Infrastructure to implement the necessary changes to the structure of the Highways and Infrastructure service to provide the assurance set out in Appendix A, given the proposed changes to the contract, within the identified and approved cash limits; and
 - 2.2.4 The City Solicitor (or their Delegate) to negotiate and complete all necessary documentation to give effect to the above recommendations.

3 Background

- 3.1 The PFI contract commenced on 6 June 2010 with a term of 25 years. Following poor performance and disputes with the previous Highway Maintenance and Management PFI sub-contractor Amey LG, a commercial settlement was agreed in June 2019. This settlement resulted in the replacement of Amey LG with Kier Transportation from April 2020 as an interim provider of highway services.
- 3.2 Since June 2019 the Council has worked with its PFI contractor (Birmingham Highways Limited - BHL) to develop a long-term approach to its highway maintenance and management services. This has included:
 - 3.2.1 Appointing an interim sub-contractor from April 2020 (Kier Transportation Limited) to deliver operational services to keep the highway safe and to stabilise delivery of those services;
 - 3.2.2 Delivering a £148m programme of capital investment, predominantly in roads and pavements but also in street lighting, traffic signals and structures, bridges and tunnels; and
 - 3.2.3 Restructuring the Highway Maintenance and Management PFI contract and procuring a long-term replacement sub-contractor to the terms of the restructured contract.
- 3.3 In line with Government requirements, throughout this process the Council has received external legal advice, including expert financial and commercial advice. This has been provided by DLA Piper, assisted by Arup.
- 3.4 The Council has continued to receive its £50.311m per annum PFI grant from Government during this period. Future grant is subject to Department for

Transport (DfT) approving a revised Full Business Case for the restructured project.

- 3.5 Following the 2019 Settlement Agreement, changes to the scope and terms of the PFI contract were always envisaged by the Council. The standards in the original contract were largely to invest to improve the condition of highway infrastructure to a good quality 'steady state' and then maintain that condition.
- 3.6 The Council has invested £148m in improving highway infrastructure (and particularly road condition) from 2020 to 2023. This has begun to address the legacy of issues from the previous sub-contractor. A PFI model provides a better level of investment to 2035 in comparison to a non-PFI alternative. As demonstrated in the FBC, the PFI approach is therefore considered the best approach for the Council.
- 3.7 Restructuring the contract will affect the underlying basis of the business case for the PFI funding, requiring Government consent. In its decision of 14 December 2021, Cabinet approved the parameters within which commercial agreement of revised terms could be reached. Cabinet delegated authority to the Strategic Directors of City Operations and Council Management (now Director of Finance – s151 Officer), in consultation with the Cabinet Members for Transport and Finance, to agree those terms.
- 3.8 BHL commenced procurement of its long-term replacement sub-contractor in February 2022 through a competitive dialogue process. The Council has been closely involved in the procurement process activities including dialogue and evaluation because the procurement is integral to the restructuring of the Council's contract with BHL. The Council's involvement has been to ensure that BHL is procuring a subcontract to deliver the services that the Council requires.
- 3.9 Two bidders participated in dialogue and final tenders were submitted in July 2023. Following evaluation of the bids a preferred bidder has been selected and is proposed for appointment by BHL.
- 3.10 The revised Full Business Case (FBC) has been prepared on the basis of the preferred bid and was submitted to DfT on 11 August 2023 in order to meet their submission deadlines, with an agreement that it would be subject to subsequent approval by Cabinet. The FBC has been prepared in line with government requirements for business cases (as set out in The Green Book) and has been developed through the Strategic Outline and Outline Business Case stages to meet government's requirements.
- 3.11 The next stages are:
- 3.11.1 If Cabinet approves the FBC, DfT is requested to provide a decision by 30 October 2023

3.11.2 If the FBC is approved, the Council proposes to enter into a revised contract with BHL (and BHL a sub-contract with the preferred bidder) no later than November 2023 with the revised services to commence on 1 February 2024.

3.11.3 The revised contracts will then run until 6 June 2035.

3.12 If the FBC is rejected by Government, the Council will implement its contingency arrangements to ensure continuity of statutory services. These arrangements are described in Appendix A (Exempt Information).

4 Options considered and Recommended Proposal

4.1 If the Council does not pursue a PFI delivery model the alternative is to deliver highway maintenance and management services through a combination of directly managed resources and contracted services. This option is not recommended as would not retain the Council's £50.311m per annum PFI grant and therefore would represent a substantial reduction in financial resources available for investment in highway assets.

4.2 The recommended option is that Cabinet approves the FBC and accepts the related commercial arrangements in Appendix A. Together, these represent:

4.2.1 The best commercial terms and service standards that could be negotiated with BHL and a competitively procured preferred bidder; and

4.2.2 The optimum means of remaining within the commercial parameters that Cabinet established in December 2021.

4.3 The proposed terms and service standards have been developed in line with previous Cabinet approvals, in negotiation with BHL and through the Competitive Dialogue procurement process. As BHL's procurement of the sub-contract is now complete, to seek to negotiate further will change the commercial basis, lead to delay and risk Government not approving the FBC.

4.4 If the Council decides not to approve the FBC to DfT and / or does not accept the related commercial details in Appendix A, this will mean:

4.4.1 The PFI contract cannot be restructured;

4.4.2 The Council's PFI grant will cease and the Council will be forced to terminate the PFI contract and implement the contingency arrangements described in Appendix A; and.

4.4.3 As in 4.1 this is not recommended as would represent a substantial reduction in financial resources available for investment in highway assets.

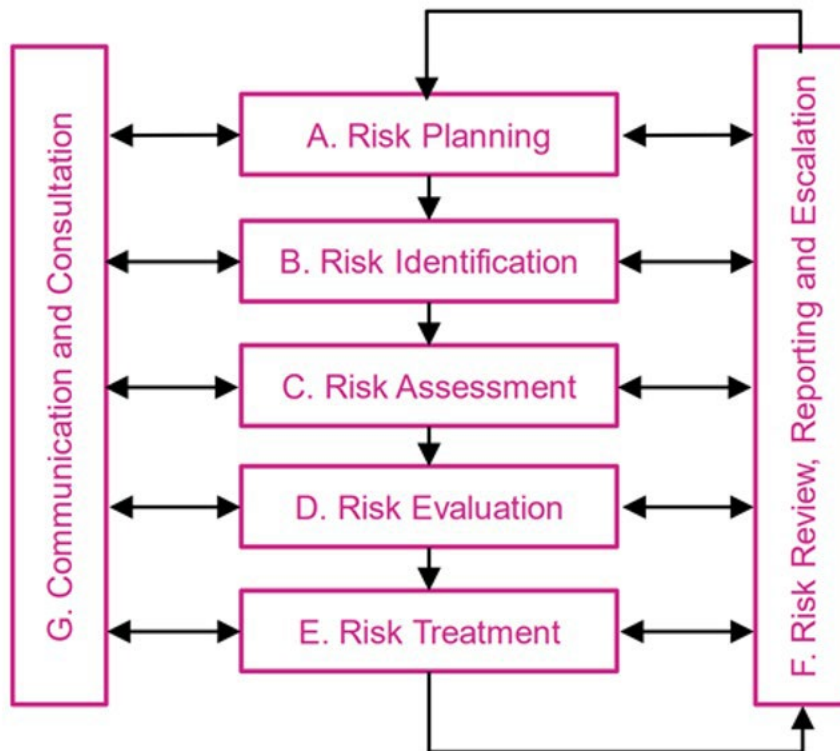
5 Consultation

- 5.1 Since 2021 the project has had a revised governance structure, strengthening internal consultation and engagement on the delivery of the PFI contract restructuring. This includes:
- 5.1.1 A Sponsoring Board, chaired by the Cabinet Member for Transport and including the Cabinet Member for Finance, Strategic Director of City Operations and Director of Finance together with the City Solicitor; and
 - 5.1.2 A Programme Board, chaired by the Assistant Director for Highways and Infrastructure as Senior Responsible Officer, and including senior officers from Highways, Finance and Legal Services.
- 5.2 The Programme Board recommends operational decisions regarding the development of the future services and the Sponsoring Board provides strategic decision-making and oversight. The Sponsoring Board recommends this decision to Cabinet.
- 5.3 In 2019 the then Cabinet Member for Transport and Environment formed an all-party member working group. This group was to act as a 'sounding board' and provide member feedback to the Cabinet Member on the acceptability of potential proposals. The feedback from the group enabled officers to develop appropriate commercial proposals in the procurement and validate priorities for service delivery.
- 5.4 The FBC proposals have been discussed with the Sustainability and Transport Overview and Scrutiny Committee on 2 August 2023. The committee provided its comments to the Sponsoring Board, and these have been considered in recommending the FBC to Cabinet.
- 5.5 DfT, as the Council's sponsoring Government department for the project, has been consulted directly throughout discussions and have supported the development of the business case. Officers have also worked with government officials at DfT, HM Treasury and HM Treasury's Infrastructure Procurement Authority in developing the business case proposals.

6 Risk Management

- 6.1 The risk management approach is detailed in the FBC attached in Appendix A.
- 6.2 The risk management process aims to identify and manage all foreseeable risks and opportunities in a manner which is proactive, effective and appropriate, in order to maximise the likelihood of the project achieving its objectives, while maintaining risk exposure at an acceptable level. The risk management process aims to engage all project participants appropriately, creating ownership and buy-in to the project and to risk management actions.

- 6.3 The risk management process enables project participants to focus attention on those areas of the project most at risk, by identifying the major risks and opportunities and strategies for managing them. The process covers all activities undertaken by the project team during the lifetime of the project.
- 6.4 Risk-based information is communicated to project stakeholders in a timely manner at an appropriate level of detail, to enable the project strategy to be modified in the light of current risk exposure.
- 6.5 The project has applied a structured, systematic and ongoing process, in accordance with the best practice, for identifying, assessing and managing risk at project level to reduce the likelihood that risks will occur, and where risk is unavoidable, to reduce or mitigate its impact.
- 6.6 The risk management process adopted for the project will be set out in the Project Risk Management Plan and is summarised in the diagram below. The Risk Management Plan is a live document and will be updated throughout the lifecycle of the project.



- 6.7 In revising a long-term arrangement such as this it is appropriate that Cabinet has assurance regarding the changes proposed. (Assurance Measures) lists areas of assurance where measures have been put in place to address previous issues and provide appropriate assurance.
- 6.8 The contract and assurance measures which are provided in Appendix B:

- 6.8.1 Are considered appropriate to mitigate risks in the future contract to within acceptable levels;
 - 6.8.2 Are affordable within the project's assumed affordability; and
 - 6.8.3 May be revised in the future, but to do so will require full consideration of the risk to the Council, including the commitments that it has made to government in its FBC.
- 6.9 A risk register is also contained in Appendix A.

7 Compliance Issues:

7.1 How are the recommended decisions consistent with the City Council's priorities, plans and strategies?

- 7.1.1 The Council has adopted the Corporate Plan 2022 to 2026 on 11 October 2022. This identifies five strategic outcomes for the city, as follows:
 - i. A Bold Prosperous Birmingham;
 - ii. A Bold Inclusive Birmingham;
 - iii. A Bold Safe Birmingham;
 - iv. A Bold Healthy Birmingham; and
 - v. A Bold Green Birmingham.
- 7.1.2 This decision directly affects the priorities that relate to the strategic outcomes as follows:
 - i. **A Bold Prosperous Birmingham, Priority 3: Attract inward investment in infrastructure:** This decision directly affects investment in and maintenance of the Council's 2,500km highway network and Council-owned infrastructure on it. Such investment will directly reduce the percentage of carriageways that should be considered for structural maintenance.
 - ii. **A Bold Safe Birmingham, Priority 9: Make the city safer:** The future investment in street lighting that this decision supports contributes to citizens feeling safer.
 - iii. **A Bold Healthy Birmingham, Priority:** Encourage and enable physical activity and healthy living: The future investment in maintenance of footways and cycleways supports Active Travel choices which contributes to the health and wellbeing of citizens.
 - iv. **A Bold Green Birmingham, Priority 19: Continue on the Route to Zero:** Investment in street lighting technologies and future

investment in street lighting enables the city to manage and reduce its highway infrastructure energy use.

- 7.1.3 Citizens' priorities also reflect that road and pavement repairs are the fourth highest priority in the city for citizens.

7.2 Legal Implications

- 7.2.1 The Council has a statutory duty to maintain highway infrastructure, primarily under the Highways Act 1980 and the New Roads and Street Works Act 1991.
- 7.2.2 Under Section 111 of the Local Government Act 1972 the Council has power to do anything that is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions.
- 7.2.3 Approval of the FBC by Government means that the Council will enter into a revised contract with BHL, similar to the original contract and based on standard PFI contract drafting (complying with SOPC4). This will include amendments and derogations made to reflect lessons learnt and market requirements (i.e. those based on "flow-up" of sub-contractor changes) and restructure.
- 7.2.4 The information contained within Appendix A (Exempt Information) is considered exempt under Schedule 12A of the Local Government Act 1972, as it relates to the financial / business affairs of parties to the Highway Maintenance and Management PFI contract, including the Council.
- 7.2.5 As the results of the procurement process have yet to be announced and are legally and commercially sensitive, information relating to the procurement has been included in Appendix A (Exempt Information). The FBC also contains legally and commercially sensitive information (including third parties' commercially sensitive information), which, if disclosed, would present a material risk to the Council, including information that relates to a live procurement that has not yet concluded. For example, the FBC includes:
- i. Details of the successful tenderer, which has not yet been announced;
 - ii. Extensive details of the bidders' proposals, including financial and commercial positions, which are commercially sensitive to those parties; and
 - iii. Information in relation to the 2019 settlement and discussions with central Government and BHL at that time and thereafter, details of which are confidential and which the council does not have permission to disclose.

7.2.6 Disclosure of this information would also adversely affect the Council's ability to negotiate the best value outcome in relation to the contract by disclosing its strategy to those with whom it is negotiating. It is therefore not in the public interest to make this information available publicly at this time.

7.3 Financial Implications

7.3.1 The Council's resources for this project are as follows:

- i. A PFI grant of £50.311m per annum until June 2035.
- ii. The Council's annual ring-fenced revenue budget for services in scope of £ 55.847m, indexed at 3.1% for the contract term.
- iii. Revenue reserves of £132m assumed at 1 February 2024.

7.3.2 The sources and uses of funds from 1 July 2023 to 6 June 2035 in nominal terms (i.e. including inflation) are as follows:

Source	Amount (£m)	Use	Amount (£m)
PFI grant	600	Residual interim contract costs	80
Revenue budget	777	Unitary Charge payments	1,281
Ring-fenced project reserves and interest on cash balances	156	Retained risk provision (footway and structures)	130
Cash in BHL	7	Inflation reserve	16
		Council retained costs	33
Total	1,540		1,540

7.3.3 The Council has a gross annual revenue expenditure budget for highways maintenance of £106.158m in 2023-24. The annual PFI Grant of £50.311m forms a funding source of the overall annual budget. Continued provision of this grant is subject Government determination of the FBC.

7.3.4 Under the terms of the PFI agreement, the Council is required to provide a minimum level of match funding to the PFI Grant (subject to annual indexation), and that any revenue reserves built up over time from underspends against this overall funding envelope are required to be ringfenced for the project. This requirement will remain under the revised PFI arrangements.

- 7.3.5 It is estimated that the ringfenced PFI revenue reserve at 1 February 2024 (the service commencement date for the proposed replacement subcontractor) will amount to approximately £132m. These reserves will, over the course of the revised contract, reduce to nil by the end of the contract period. Reserves have been used exclusively for the project, including the capital investment referred to in paragraph 3.2.2 above.
- 7.3.6 Under the proposals set out in this Cabinet Report and associated FBC, costs of service delivery will comprise:
- i. A revised Unitary Charge payment for services to BHL from February 2024 to June 2035 of £98m per annum, of which 90% is indexed according to the Building Construction information Service (BCIS) index. Indexation is applied twice annually (in April and October) throughout the life of the contract.
 - ii. A provision for retained resources and risks managed by the Council, as set out in Appendix A5 Retained Cost Assumptions and included within the overall cost envelope above.
- 7.3.7 Subject to the commercial terms set out in Appendix A, the proposed contract is affordable with the financial provisions made. Appendix A contains further detail on those provisions.

7.4 Procurement Implications

- 7.4.1 There are no direct procurement implications for the Council as a result of the recommendations.
- 7.4.2 However, to deliver the FBC it will require the appointment of a preferred bidder by BHL as outlined in Appendix A, which is the result of a formal competitive tender carried out in line with the Public Contract Regulations 2015.
- 7.4.3 In addition, subject to approval of the Full Business Case the Council will be required to enter into revised commercial terms to the PFI contract which have been negotiated with BHL as set out in Appendix A.
- 7.4.4 Subject to approval of the recommendations by Cabinet and the FBC by DfT the Council will enter into a joint agreement with BHL for the provision of an Independent Certifier to meet the revised terms of the PFI contract variation.

7.5 Human Resources Implications

- 7.5.1 There are no direct human resource implications related to the progress of the long-term replacement subcontractor procurement.

- 7.5.2 Depending on the preferred bidder appointed, the Transfer of Undertaking Protection of Employment (TUPE) Regulations may apply to the existing workforce at Kier Transportation Limited.

7.6 Public Sector Equality Duty

- 7.6.1 An Equality Impact Assessment (EQUA1052) has been undertaken and is shown in Appendix C. There are no issues arising as a result of this assessment.

8 Appendices

- 8.1 Appendix A: Exempt Information
- 8.2 Appendix B: Assurance Measures
- 8.3 Appendix C: Equality Impact Assessment
- 8.4 Appendix D: Environment and Sustainability Assessment

9 Background Documents

- 9.1 Report of the Director, Inclusive Growth and Chief Finance Officer to Cabinet, 25 June 2019 (“Highway Maintenance and Management PFI Contract”).
- 9.2 Report of the Acting Director, Inclusive Growth and Interim Chief Finance Officer to Cabinet, 16 March 2021 (“Highway Maintenance and Management PFI Contract”).
- 9.3 Report of the Acting Director, Inclusive Growth and Interim Director of Council Management to Cabinet, 8 June 2021 (“Highway Maintenance and Management PFI Contract”).
- 9.4 Report of the Managing Director, City Operations to Cabinet, 14 December 2021 (“Highway Maintenance and Management PFI Contract”).
- 9.5 Report of the Strategic Director, City Operations to Cabinet, 8 November 2022 (“Highway Maintenance and Management PFI Contract”).
- 9.6 Decision taken by an officer under delegated authority, 27 January 2023 (“Highway Maintenance and Management PFI Contract – Commercial Matters”).