BIRMINGHAM CITY COUNCIL

PUBLIC REPORT

Report to: Audit Committee

Report of: Mike Jones (Head of Contracts Management – Education & Infrastructure)

Date of Meeting: 15 March 2016

Subject: Schools PFI (Private Finance Initiative)

Wards Affected: All

1. Purpose of Report

1.1 To update Audit Committee on the issues facing the Council and its schools, where schools and academies remain in long term Private Finance Initiative (PFI) or Facilities Management contractual arrangements and where the Council remains the client for the contracts.

1.2. Further, to present the financial pressures brought about by long-term contracts, both in relation to schools that continue to be in Council control and in instances where the Council has "ceased to maintain" the building and is thereby no longer funded as a result.

2. Recommendations

2.1 To receive this report outlining the current financial pressures impacting the Council in connection with long-term schools PFI contracts.

2.2. To note the progress being made on addressing the Council's "affordability gap" over the period January 2015 to January 2016.

3. Executive Summary

3.1 The City Council has 4 PFI/FM (Facilities Management) packages servicing 35 schools (see Appendix 1) at an annual revenue cost of £35m. The PFI arrangements have supported £196.6m of investment in Birmingham Schools and the long-term contracts in place which extend up to 30 years are envisaged to cost the Council circa £959m in total over the respective contract terms. The contracts in place are referred to as:

- **PPP1** – Birmingham Schools Partnership Limited (Galliford Try) - contract was signed in February 2000 and there are 16 years remaining of the operate phase.

- **PPP2** – Transform Schools (Balfour Beatty) - contract was signed in March 2006 and there are 18 years remaining of the operate phase.

- **BSF Phase 1a** – Birmingham Lend Lease Partnership (BLLP) - contracts were signed in August 2009 and there are 20 years remaining of the respective operate phases.

- **BSF Phase 1b** – Birmingham Lend Lease Partnership (BLLP) - contracts were signed between 2009 and 2011 and there are between 10 and 23 years remaining of the respective operate phases.

3.2 More recently there has been a heavy focus on PFI deals placing increased financial pressure on the public sector. Whilst the focus has tended to circulate around NHS Trusts and in particular their inability to meet contractual payments, there is now an acceptance that continuing rising costs associated with PFI in a climate of public sector cuts are now extending these pressures to other public sector bodies.

3.3 The report summarises Birmingham's Schools PFI deals and considers the impact of:

- the current annual affordability gap and the continuing and increased financial pressures facing the Council where contractual payments are indexed linked year on year and where in excess of 16 years remain of the respective concession terms;

- the impact of a changing educational landscape where funding moves in a different direction but the Council retains client responsibilities;

- progressing a range of initiatives to reduce the financial burden on the Council.

3.4 With HM Treasury and Central Government expressing a clear desire to drive efficiencies from within PFI there is now a potential opportunity to carry out a much more fundamental review of contracts that examines the scope of services, margins, overheads and profits and lending rates. These areas and a range of other options were captured in HM Treasury guidance issued in early 2012. More recently (June 2013) HM Treasury published a voluntary code of conduct which sets out how public bodies and their private sector partners will work together to make savings from Public Private Partnerships (PPP) contracts, including PFI deals. The Council is signed up to this Code of Conduct.

3.5 The conclusion to this report outlines a range of activities that are currently being undertaken to review arrangements and potentially deliver savings for the Council.

4. Birmingham Schools Affordability

4.1 The costs associated with these contracts (known as the PFI Unitary Charge) are essentially funded from 3 separate sources:

Funding Source	**PFI**	**Non PFI**
Additional Rate Support Grant or PFI Special Grant	✓	
Schools Premises Related Budgets (Relevant Proportion)	✓	✓
Centrally held CYPF budgets (includes the "affordability gap")	✓	✓

4.2 The Unitary Charge relating to all 4 PFI contracts repays the original bank debt and meets the cost of all operational services to the respective buildings i.e. lifecycle, planned preventative maintenance, caretaking, cleaning and grounds maintenance etc. The amount payable to the company managing the contract (Special Purpose Vehicle or SPV) is indexed annually and is subject to bench-marking / market testing arrangements every 5 years throughout the contract term. Where schools are part of an FM contract (only Building Schools for the Future (BSF) non-PFI) the equivalent to the Unitary Charge is effectively the FM Service Charge. To date the Council has experienced increases in the Unitary Charge and FM Service Charge which have exceeded the available resources from Central Government and schools, this shortfall is recognised as the PFI "affordability gap" and currently stands at circa £6.5m per annum after the application of £3.5m from the Dedicated Schools Grant (DSG) allocation.

4.3 At the inception of PFI it was generally recognised and accepted that the Council would need to invest in the region of £250 per head of pupil per annum during the life of the project, to supplement central government grant and school contributions. This requirement has now risen to the equivalent of £340 per head of pupil factoring in indexation. The Council wide contribution has however increased to a level of circa £560 per head of pupil per annum inclusive of the DSG allocation of £3.5m.

5. Dealing with the "Affordability Gap" in a changing educational climate

5.1 The changing status of schools / academy conversion process does not in any way offer up an opportunity to mitigate the Council's affordability gap on these contracts. Effectively at the point of conversion all property and financial arrangements must follow the "as is" and as such risks associated with the PFI contract remain with the Council, this is despite the Academy Order (issued by the Secretary of State) which instructs the Council to "cease to maintain". Given that only a small proportion of the Unitary Charge is met by the school/academy directly any additional gap will be for the Council to manage/pick up, unless there is an increase as a consequence of bench marking or market testing where protections exist in the School Agreement which supports the conversion. Inflationary pressures however must be borne by the Council where they relate to the Council's contribution. This fact alone has resulted in some authorities stalling the conversion of PFI schools to academy status.

5.2 With regards to those schools having converted in BSF FM Contracts there is an unusual situation whereby the academy maintains the benefit of an Asset Replacement Management Strategy through the Council's contractual arrangements even though they can access funding directly through the Education Funding Agency (EFA). As DfE policy guidance effectively ignores the former BSF arrangements the Council retains all risks without any protection should the academy for whatever reason "fall over".

5.3 As the Council's ability to divert funding is becoming increasingly difficult given that more and more schools are being funded directly by the EFA and top-slicing arrangements from the DSG has all but disappeared, the likelihood of additional budget pressures now and long into the future are unavoidable without intervention or mitigation of some kind.

6. Work undertaken and progress made since January 2015

6.1 In light of the above, officers from within Education and Infrastructure (EdSI) supported by a level of technical expertise in PFI and the retained estate, have for the last 12 months focussed on exploring a number of initiatives to drive out savings from these contracts.

6.2 The exercise commenced in January 2015 when the Council agreed to support a "pilot study" being undertaken by Local Partnerships. The study sought to explore the potential for savings from PFI contracts and had the buy-in of HM Treasury, DfE, EFA and the Local Government Association. Following the production of a report in April 2015 the Council has continued to work to implement any "lessons learned" and further provide a far more robust challenge to PFI Providers. Not least in influencing, overseeing, challenging and validating benchmarking exercises on 3 of the 4 Council contracts.

6.3 The more immediate opportunities coming out of the report's findings, the Council's internal review and the work progressed to date can be described as follows:

- the potential removal of Broadway Academy Lifecycle obligations from the Hard FM contract allowing the academy to manage its own arrangements, with a proportion of the school's contribution to the Council being passed back to the academy to support any short and medium term requirements associated with its estate;

- a potential reconfiguration of the Hard and Soft FM contracts for BSF Design and Build Schools with the premises related budgets being passed back to schools/academies to run operational arrangements either themselves or through a 3rd party;

- the carrying out of a comprehensive and thorough exercise in supporting a 5 year benchmarking exercise on the Council's PPP2 and BSF PFI and FM arrangements. Work has extended to undertaking an internal Council led benchmarking exercise with the express intent to ensure value for money from the contracts and effectively diligence the independent advisers findings;

- additional areas being considered are market testing of PPP1 services, re-scoping, re-financing, re-alignment of school/academy contributions with a view to restructuring and increasing the respective schools relevant proportions.

6.4 Whilst work continues in all of these areas early indications are that a reconfiguration/removal of the Broadway Lifecycle and Design and Build FM contracts could realise annual savings of circa £700,000 per annum, with the respective benchmarking exercises carrying a targeted saving of at least £500,000 per annum.

7. Conclusion

7.1 In all aspects the Council cannot at present extricate itself from its contractual obligations and the consequential affordability pressures whilst it remains the client to the PFI contract. Funders have made it clear that the credit status of academies as untried and untested entities prevents novation or assignment and therefore the Council will continue to sit behind a significant level of risk, as well as having a need for a robust Contract Management function.

7.2 Contract Management activities will become increasingly more difficult to manage given that the Council will be expected to consult and liaise with a much wider audience, all with individual needs, aspirations and demands. In light of this and coupled with the work associated with the PFI savings exercise there will need to be a review of the current resourcing to ensure that the Council engages the right interpersonal and management skills to manage both the commercial aspects of the contract as well as relationships on a peer-to-peer basis and at multiple levels in the organisation.

7.3 Those involved in managing the contracts must understand the business fully and know the contract documentation inside out ("intelligent customer" capability). This will be essential if those involved in all aspects of the function are to understand the implications of problems (or opportunities) over the life of the contracts.

Schools PFI

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