

Birmingham City Council

Report to Cabinet

16 March 2021



Subject: Highway Maintenance and Management PFI Contract

Report of: Acting Director, Inclusive Growth and Interim Chief Finance Officer

Relevant Cabinet Members: Councillor Waseem Zaffar, Transport and Environment
Councillor Tristan Chatfield, Finance and Resources

Relevant O&S Chairs: Councillor Liz Clements, Sustainability and Transport
Councillor Sir Albert Bore, Resources

Report author: Kevin Hicks, Assistant Director, Highways and Infrastructure, Telephone No: 0121 303 7939
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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: 008304/2021		
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 (C): 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 Cabinet authorised the Council to enter into a settlement of a series of long-running disputes under the Highway Maintenance and Management Private Finance Initiative (PFI) contract. This settlement enabled a number of important steps to be taken to move forward with the improvement of highway maintenance and management services. This included the replacement of the subcontractor (Amey LG), starting the process of stabilising service delivery and recommencing capital investment in the Council's highway infrastructure asset.
- 1.2 Given the scale of the services provided under the contract, making such changes cannot be brought about immediately. Since the settlement the Council has:
 - 1.2.1 worked with Birmingham Highways Ltd (BHL) on their appointment of a replacement subcontractor for the Interim Period. Kier Highways has been in this role since April 2020 and is performing strongly; and
 - 1.2.2 been working with BHL to develop the long-term approach to providing these services towards a target date under the restructuring of June 2021.
- 1.3 This report provides recommendations to enable the next stage of this development to be implemented and to allow the Council to take decisions according to different potential future scenarios.

2 Recommendations

That Cabinet:

- 2.1 Delegates authority to the Acting Director, Inclusive Growth, in conjunction with the Interim Chief Finance Officer and in consultation with the Cabinet Members for Transport and Environment and Finance and Resources to:
 - 2.1.1 negotiate a commercial agreement to determine the future approach to the contract:
 - i. within the parameters of the acceptable terms (as described in the Exempt Appendix (C)); and
 - ii. which are consistent with the Council's objectives for the PFI Contract (set out in paragraph 3.4); and
 - 2.1.2 bring a further report to Cabinet for approval of the terms of the final agreement;
- 2.2 Notes that the Council's updated business case has been submitted to Government based on the commercial position set out in Exempt Appendix (C);
- 2.3 Approves that the Interim Services Contract between Birmingham Highways Ltd and Kier Highways Ltd is extended to 31 August 2023 and authorises the Assistant Director Highways and Infrastructure to take the contingency actions as described in Exempt Appendix (C);
- 2.4 Delegates authority to the Assistant Director, Highways and Infrastructure in consultation with the Assistant Director Development and Commercial (Deputy

S151 Officer) to finalise all necessary agreements with the West Midlands Local Government Pension Scheme (WMLGPS), BHL and Kier Highways Ltd in relation to the requirements for a pension bond and awarding Admitted Body Status (ABS);

- 2.5 Delegates authority to the City Solicitor to execute, seal and complete all necessary agreements and documentation to give effect to the above recommendations.

3 Background

Events leading to the 2019 settlement

- 3.1 The Council's Highway Maintenance and Management PFI contract commenced on 7 June 2010. After an initial period of investment, issues with delivering works and poor performance by the subcontractor (Amey LG) emerged. Although these were managed fairly but robustly by the Council, this led to an escalating series of high value commercial disputes from late 2014 onwards.
- 3.2 Pursuant to Cabinet's decision of 25 June 2019, the Council entered into a multi-party legal settlement relating to its Highway Maintenance and Management PFI Contract on 29 June 2019. This settlement addressed disputes between project parties and provided for a period of hiatus until 29 June 2021, to enable parties to develop a way forward with the contract. The Council has continued to receive its PFI grant from Government during this "Restructuring Period", subject to a requirement to present an updated business case for the restructured project.
- 3.3 A diagram showing the project structure and relationships between the various parties to the contract is shown as Appendix B. Since the 2019 settlement the Council has been working with the Special Project Vehicle (SPV, which is BHL) on the steps towards this restructuring, which have included:
 - 3.3.1 Kier Highways Ltd taking over as interim subcontractor to BHL on 1 April 2020, providing mostly operational services and inspections;
 - 3.3.2 Commencing delivery of £50m of capital investment in surfacing by June 2021; and
 - 3.3.3 Working towards restructuring the contract to provide a long-term way forward that is acceptable to both project lenders and the Council by June 2021.

The Council's objectives

- 3.4 The Council's objectives for the PFI contract are to:
 - 3.4.1 Ensure that highway maintenance and management services continue to be delivered to meet our statutory duties and provide a safe and serviceable network;
 - 3.4.2 Maximise the capacity and financial support for investment in the Council's highway infrastructure (in terms of funding, potential risks and uncertain investment returns being taken out of the project); and

- 3.4.3 Deliver these services in a value for money way that manages the Council's highway infrastructure asset as effectively as possible within the available resource.

Challenges post-settlement

- 3.5 The replacement of Amey LG was an essential component of the 2019 settlement. All parties entered into that settlement clearly understanding that (i) further work was required to better understand the condition of the network and (ii) any settlement affordable to Amey was unlikely to meet the full extent of its contractual obligations. This meant that the available resources were unlikely to deliver the same improvements in asset condition. It was nevertheless reasonably considered at that stage that changes to the contract requirements would enable the broad scope, standards, investment commitments and structure of the contract to be retained.
- 3.6 The contract pavement management model is central to understanding the condition of the largest asset group – carriageway and footway surfaces. This model calculates the condition of roads and pavements based on survey data and it was Amey's errors in this model that had been the source of the most significant disputes. Through the Autumn of 2019 and first quarter of 2020 the Council worked with BHL to correct the pavement management model. The outcome of this work was that the condition of the network is now better understood. However, it has also become clear that the original condition levels expected from the investment under the contract are now not achievable within the available resources.
- 3.7 It should be emphasised that this will not impact the Council's ability to discharge its statutory obligations and ensure that its highways remain safe and available. Due to a combination of the Council's strong management of the contract with Amey, under any potential scenario the resources available to the Council to undertake capital investment exceed those available to other local authorities. Despite the project not being able to deliver the original condition outcomes, provided that the project remains eligible to receive PFI grant then the Council will still have additional funding for its highway maintenance and management services in comparison to other authorities.
- 3.8 The Council has continued to work with BHL and to review the means by which the improvement on current condition can be optimised within the available resources, whilst still maintaining a PFI project. Potential future scenarios are subject to negotiation of a commercial agreement on the way forward and the next step is to negotiate this to achieve the optimum position for the Council.
- 3.9 The parameters within which an agreement can be acceptable to the Council are set out in Appendix C to this report. Recommendations for decisions to accept an agreement within those parameters will be brought back to Cabinet in due course as appropriate.

3.10 In parallel, the Council's updated business case has been submitted to Government to allow this to progress. Government is expected to confirm the position regarding the business case and the Council's PFI credits in May 2021. The business case evaluates the options available to the Council and recommends the optimum way forward for the Council.

Further requirements

3.11 The combination of delays due to COVID-19 and the additional time taken to both understand the condition of the network and potential approaches to investment mean that a revised set of long-term arrangements will not be completed by the end of June 2021. It is anticipated that this will be completed by the end of August 2023, although it should be noted that this is subject to a number of factors.

3.12 Further steps are therefore necessary, relating to continuing:

3.12.1 Provision of operational services to ensure that the highway network is safe and available;

3.12.2 Investment in highway infrastructure to ensure that deterioration and the cost impact on future works are minimised as far as practicable; and

3.12.3 Provision of specialist external advice relating to the restructuring of the contract and procurement.

3.13 In any future circumstance the Council requires continued provision of operational services to meet its statutory obligations to keep the highway safe and available until a long-term way forward is in place. The Interim Services Contract between BHL and Kier Highways contains contractual extension options and the Council's preference is that these are implemented. Details of the proposed approach are described in Exempt Appendix (C).

3.14 Similarly, the Council must continue to carry out capital investment works until a long-term approach is in place. Surfacing and street lighting works will continue under the 2019 settlement to the end of June 2021. Further capital investment works on surfacing, street lighting and structures will need to be designed, programmed, supervised and delivered.

3.15 The level of capital investment depends upon the future position as a result of both the commercial agreement referred to in paragraph 3.8 above and approval of the Council's business case. Investment being delivered as part of the 2019 settlement will continue. The actions to ensure that capital investment continues after the current programme will therefore be brought to Cabinet as part of a future decision. Similarly, there will also be requirements relating to contracts for project systems, including the Management Information System that will also be brought to Cabinet.

Pension Bond

3.16 A further issue related to the project also requires a decision from Cabinet at this stage. Upon commencing the Interim Services Contract, Kier Highways inherited

responsibility for former Council employees transferred under TUPE including their pension arrangements. Kier is required to obtain Admitted Body Status (ABS) to the WMLGPS. It is Council policy that applicants for ABS are supported by a bond of an appropriate value, recommended by WMLGPS (£4m).

- 3.17 Kier has sought to obtain such a bond and the Council would be required to meet this cost under the terms of the Interim Services Contract. However, due to the short-term nature of the Interim Services Contract and the challenges of the marketplace during the ongoing pandemic, Kier has been unable to secure the bond.
- 3.18 Since the Council (i) is the party requiring the bond and (ii) ultimately meets Kier's costs during the Interim Service Contract, an alternative solution is for the Council to 'self-assure'. This means:
- 3.18.1 The Council will temporarily remove the obligation from Kier to purchase a bond;
 - 3.18.2 The Council will ringfence the value for the required bond from project reserves for the duration of the Interim Service Contract;
 - 3.18.3 The position can be reviewed as part of the long-term contract arrangements with an updated market position; and
 - 3.18.4 Ultimately, the Council does not need to pay for this bond.
- 3.19 Therefore, it is proposed that in respect of pensions for staff employed by Kier Highways Ltd that are members of the WMLGPS, the Council will self-assure from ringfenced project reserves payment of employer's pension contributions and pension liabilities as an interim measure and support Kier's admission to the WMLGPS.

4 Options considered and Recommended Proposal

- 4.1 The recommended proposal is that the Council:
- 4.1.1 Negotiates a commercial agreement regarding the future approach to the contract;
 - 4.1.2 Notes the submission of an updated business case to Government;
 - 4.1.3 Ensures service continuity with Kier Highways Ltd for operational services, currently through BHL; and
 - 4.1.4 Takes steps with regard to pensions as described in 3.16 to 3.19 above.
- 4.2 Alternative options to these recommendations are as follows.

Commercial agreement

- 4.3 The options relating to a commercial agreement are described in the Exempt Appendix (C).

Business case

- 4.4 As stated in paragraph 3.2 above, the Council must submit an updated business case to Government to continue to receive its PFI grant. Without the Department for Transport's (DfT) support of the proposed restructuring, PFI funding could be withdrawn from the Project.

Ensuring service continuity for operational services

- 4.5 The alternative to extending the Interim Services Contract with Kier Highways Ltd through BHL would be for the Council to conduct a separate procurement for these services. The drawbacks to a new procurement are:
- 4.5.1 It is not currently known whether BHL or the Council will be primarily responsible for service delivery, and therefore who should run the procurement;
 - 4.5.2 A full procurement is estimated to take at least three months (possibly longer) and cannot be done in the time available to the Council;
 - 4.5.3 Rearrangement of interim services would be a distraction at this stage in the longer term restructuring; and
 - 4.5.4 Some degree of extension is required to ensure continuity of critical services.
- 4.6 Contingency plans in the event the current Interim Services Contract lapses without extension are described in the Exempt Appendix (C).

Pensions

- 4.7 The options relating to pensions are that the Council could continue to require Kier to hold a bond. However, since Kier has been unable to secure a bond then this will not resolve the position and will cause hardship for retirees who will be unable to access their pension benefits.

5 Consultation

- 5.1 External legal advice has been obtained from DLA Piper.
- 5.2 Since the 2019 settlement senior officers from the Council have worked with DfT, advisors to project lenders, BHL's administrator and the chairman of BHL as part of a steering group regarding the way forward with the project.
- 5.3 DfT has also been consulted directly throughout discussions as the Council's sponsoring Government department for the project. DfT has been supportive of the Council's approach and has worked with the Council to enable alternative solutions to project issues to be considered.

6 Risk Management

- 6.1 An analysis of risks is contained within Exempt Appendix (C) – section 4 and Appendix C6).

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 *Council Plan 2018 to 2022*. This identifies five outcomes for the city, the first of which is "*Birmingham is an entrepreneurial city to learn, work and invest in.*" Priority 4 under this outcome is that "*We will develop our transport infrastructure, keep the city moving through walking, cycling and improved public transport.*"
- 7.1.2 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; this is a measure for Outcome 1 / Priority 4 of the Council Plan.
- 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 The information contained within Exempt Appendix (C) 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.
- 7.2.4 Disclosure of the information within Exempt Appendix (C) would adversely affect the Council's ability to negotiate the best value outcome in relation to the contract and disputes 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.

7.3 Financial Implications

- 7.3.1 The submission of the Council's updated business case to Government (within Exempt Appendix (C)) complies as far as it is required to do so with the principles of 'The Green Book'. The Green Book supplementary guidance provides a framework for the appraisal of policies, programmes and projects, which is flexible and scalable so as to apply proportionately to given situations and this has been applied to the current circumstances of restructuring an existing long-term contract where funding is already allocated. Whilst the five case approach has been used as the framework to appraise the commercial options available to the Council to take forward

the existing contract, not every single heading and sub-heading as set out in supplementary guidance is required, often simply because of relevance to the project at this stage. Specific points to note:

- i. The strategic case, financial case and commercial case in particular are broadly aligned however, Organisation Overview for example is not detailed as this was covered within the original project Business Case and DfT are already aware;
- ii. The management case focuses more specifically on the contract management arrangements wrapping around the contract and what further governance arrangements would be required, rather than project management;
- iii. The economic case looks at the options and appraises a preferred option, but does not seek to reassess the Benefit Cost Ratio (BCR) from the original project BC but frames value as how surface investment / condition is maximised within the funding constraints and other cost requirements.

7.3.2 Due to the unusual and complex circumstances, the Council's advisors have engaged with DfT on behalf of and alongside the Council throughout the development of the revised Business Case in order to ensure visibility of requirements. To that end the Council and its advisors have endeavoured to make sure all of the requirements are well covered and the approach is deemed to be compliant in the context of an existing long-term contract, when considering the commercial options moving forward where funding is already allocated. Additional information on the commercial options is provided in Exempt Appendix (C).

7.3.3 The Council's resources are based upon the following:

- i. The Council currently receives a PFI grant from Government of £50.311m per annum in relation to this contract and funding mechanism. Continued provision of this grant is subject to Government determination following review of the updated business case.
- ii. As part of its original Full Business Case for the original project, the Council has agreed to ring fence and index its revenue budget prior to the contract for the provision of these services. In addition to the PFI grant, the Council's budget for 2021-22 (including indexation) is £50.62m.
- iii. The Council has reserves (arising from the Council's strong management of the contract and ring fenced for the purpose of this project) totalling £188m. These reserves may be committed to a project that represents the best value for money to the Council.
- iv. Any financial implications will be maintained within existing Highway Maintenance and Management PFI budgetary resources. The Council

is considering its options in relation to service delivery for the remaining life of the contract with the expectation that it will maximise outputs. The parameters for consideration are specified in Exempt Appendix (C).

- v. Legal and expert advisory costs to finalise and progress such matters form part of this decision and are to be contained within the existing Highway Maintenance and Management PFI resources.

7.3.4 The details in the Council's business case will be further updated to reflect any commercial agreement that is reached as a result of this decision. Such agreement will be brought back to Cabinet for confirmation that this is within the parameters contained within Exempt Appendix (C).

7.3.5 The self-assurance by the Council of employer's pension contributions will not impact the Council's General Fund position and will avoid the cost of payment for the bond from the PFI funding. A call upon either a bond or the ring-fenced PFI reserve would be required were Kier to cease pension contributions, not meet pension costs or expenses or go into liquidation in a pension deficit position. Refusing ABS as this would prevent retiring employees from accessing their pension benefits and as original outsourcing body the Council stands as ultimate guarantor.

7.4 Procurement Implications

7.4.1 Implications for procurement are set out in paragraph 6.3 of the Exempt Appendix (C).

7.5 Human Resources Implications

7.5.1 The decision in respect of pensions has implications for former Council employees transferred to Kier Highways Ltd under TUPE. These implications are described within the Exempt Appendix (C).

7.5.2 At this stage Cabinet should note that there will be different human resource implications relating to the potential future scenarios. These are also described within the Exempt Appendix (C).

7.6 Public Sector Equality Duty

7.6.1 A copy of the initial equality assessment screening (reference EQUA638) is shown in Appendix A.

8 Appendices

8.1 Appendix A: Equality Assessment

8.2 Appendix B: Project Structure

8.3 Appendix C: Exempt Appendix (C)

9 Background Documents

- 9.1 Report of the Director, Inclusive Growth to Cabinet, 25 June 2019: Highway Maintenance and Management PFI Contract.

Appendix A

Equality Assessment

Title of proposed EIA	Highways Maintenance and Management PFI contract
Reference No	EQUA638
EA is in support of	Amended Function
Review Frequency	Annually
Date of first review	15/03/2022
Directorate	Inclusive Growth
Division	Highways & Infrastructure
Service Area	PFI Contract Management
Responsible Officer(s)	<input type="checkbox"/> Jenny Bent
Quality Control Officer(s)	<input type="checkbox"/> Janet L Hinks
Accountable Officer(s)	<input type="checkbox"/> Ravinder Sahota
Purpose of proposal	The Highway Maintenance and Management PFI contract delivers investment, maintenance and management services for the council's highway infrastructure to June 2035. This is a decision regarding the commercial management of the contract.
Data sources	relevant reports/strategies; relevant research
Please include any other sources of data	
ASSESS THE IMPACT AGAINST THE PROTECTED CHARACTERISTICS	
Protected characteristic: Age	Not Applicable
Age details:	Not Applicable There is no adverse impact on any of the protected groups and therefore this will not be applicable.
Protected characteristic: Disability	Not Applicable
Disability details:	Not Applicable There is no adverse impact on any of the protected groups and therefore this will not be applicable.
Protected characteristic: Sex	Not Applicable
Gender details:	Not Applicable There is no adverse impact on any of the protected groups and therefore this will not be applicable.
Protected characteristics: Gender Reassignment	Not Applicable

Gender reassignment details:	Not Applicable There is no adverse impact on any of the protected groups and therefore this will not be applicable.
Protected characteristics: Marriage and Civil Partnership	Not Applicable
Marriage and civil partnership details:	Not Applicable There is no adverse impact on any of the protected groups and therefore this will not be applicable.
Protected characteristics: Pregnancy and Maternity	Not Applicable
Pregnancy and maternity details:	Not Applicable There is no adverse impact on any of the protected groups and therefore this will not be applicable.
Protected characteristics: Race	Not Applicable
Race details:	Not Applicable There is no adverse impact on any of the protected groups and therefore this will not be applicable.
Protected characteristics: Religion or Beliefs	Not Applicable
Religion or beliefs details:	Not Applicable There is no adverse impact on any of the protected groups and therefore this will not be applicable.
Protected characteristics: Sexual Orientation	Not Applicable
Sexual orientation details:	Not Applicable There is no adverse impact on any of the protected groups and therefore this will not be applicable.
Socio-economic impacts	Not Applicable
Please indicate any actions arising from completing this screening exercise.	Not Applicable
Please indicate whether a full impact assessment is recommended	NO
What data has been collected to facilitate the assessment of this policy/proposal?	This is a proposed change to the arrangements under which highway maintenance and management services will be delivered. The means by which those services are delivered in

so far as they might impact upon protected characteristics is unchanged.

Consultation analysis

Adverse impact on any people with protected characteristics.

Not applicable

Could the policy/proposal be modified to reduce or eliminate any adverse impact? Not applicable

How will the effect(s) of this policy/proposal on equality be monitored?

Not applicable

What data is required in the future?

Not applicable

Are there any adverse impacts on any particular group(s)

No

If yes, please explain your reasons for going ahead.

Not applicable

Initial equality impact assessment of your proposal

This is a proposed change to the arrangements under which highway maintenance and management services will be delivered. The means by which those services are delivered in so far as they might impact upon protected characteristics is unchanged.

Consulted People or Groups

Consultation has taken place with Cabinet Members and elected members, senior officers and Department for Transport.

Informed People or Groups

Summary and evidence of findings from your EIA

The Highway Maintenance and Management PFI contract delivers investment, maintenance and management services for the council's highway infrastructure to discharge the council's statutory duties to maintain and manage the public highway and ensure that it remains available. This decision affects the way in which these services are contracted for and does not change how they are delivered in respect of the

potential impact on anyone with a protected characteristic.

QUALITY CONTORL SECTION

Submit to the Quality Control Officer for reviewing?

No

Quality Control Officer comments

Proceed to Accountable Officer 09 02 2021

Decision by Quality Control Officer

Proceed for final approval

Submit draft to Accountable Officer?

Yes

Decision by Accountable Officer

Approve

Date approved / rejected by the Accountable Officer

09/02/2021

Reasons for approval or rejection

Please print and save a PDF copy for your records

Yes

Julie Bach

Person or Group

Content Type: Item

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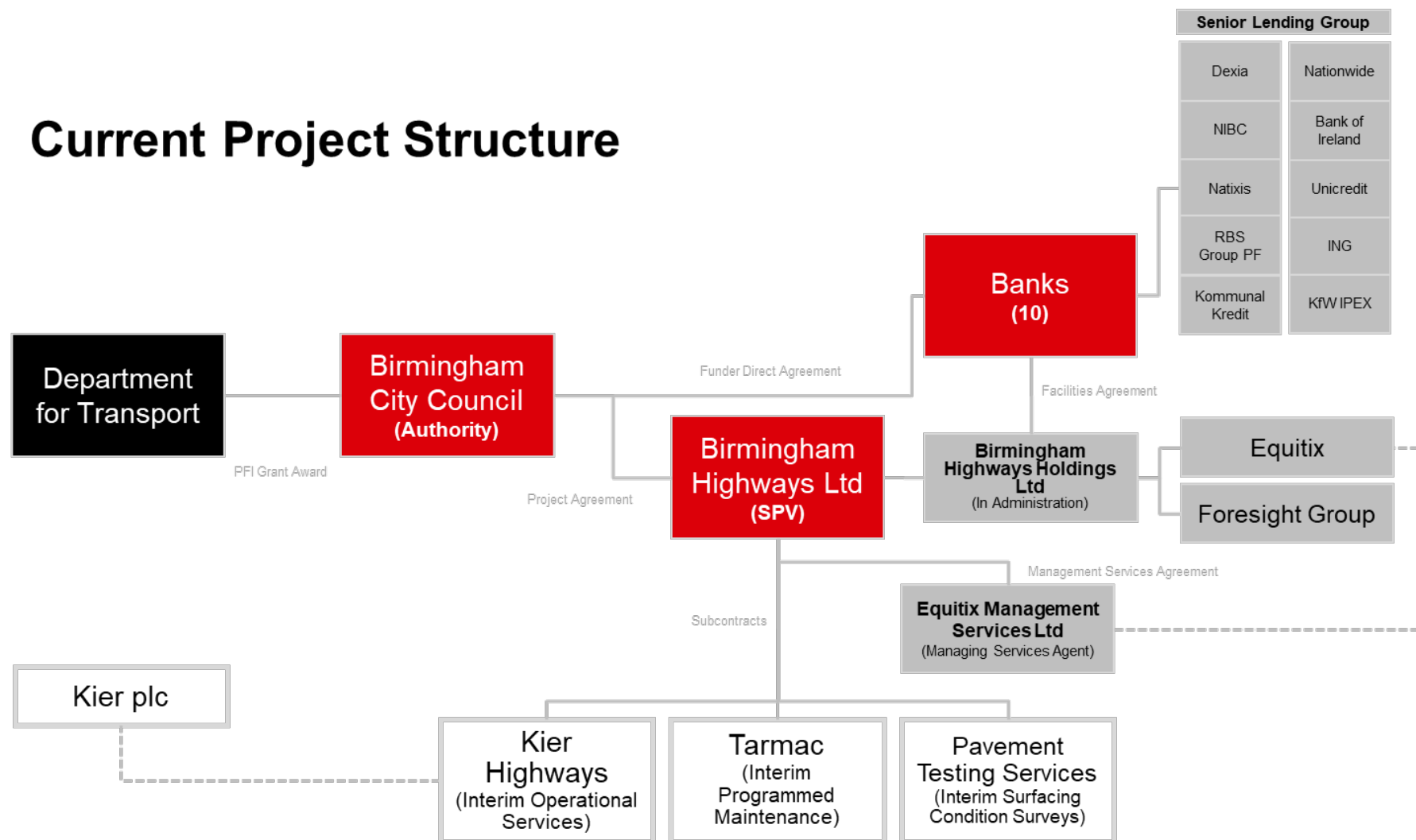
Last modified at 09/02/2021 03:07 PM by Workflow on behalf of ☐ Ravinder Sahota

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Appendix B

Project Structure

Current Project Structure



Clarification of Project Structure

The Council's contract (the Project Agreement) is with **Birmingham Highways Ltd (BHL)**. The Council gets funding for its contract from Government via a PFI Grant, for which **Department for Transport** is the sponsoring government department.

BHL is a Special Purpose Vehicle (SPV) owned by **Birmingham Highways Holdings Ltd (BHHL)**. BHHL is owned by its shareholders, **Equitix** and **Foresight Group**.

BHHL has borrowed from a lending group of banks (**Senior Lenders** or **Creditors**), under a lending Facilities Agreement. The Council has a direct relationship with the Senior Lenders under the Funder Direct Agreement.

BHL delivers services under its contract with the Council through subcontracts. Their principal subcontracts are with:

- **Kier Highways Ltd** (owned by **Kier plc**) for operational services;
- **Tarmac** for interim surfacing schemes; and
- **Pavement Testing Services (PTS)** for condition surveys.

BHL employs **Equitix Management Services Ltd (EMS)** to manage these subcontracts on its behalf. EMS is owned by Equitix.

Until 1 April 2020 BHL's subcontractor was Amey Local Government, owned by Amey plc. The 2019 settlement agreed Amey's exit from the project; BHL was formerly called Amey Birmingham Highways Ltd (ABHL). Amey is not shown in the structure because it is no longer in the project.

Appendix C

Exempt Appendix (C)