

APPENDIX 1

CABINET REPORT
JULY 2006

(excluding Appendices)

SHEFFIELD HIGHWAY MAINTENANCE PFI PROJECT

1. PURPOSE OF REPORT

1.1 The purpose of this report is:

- 1.1.1 to inform Members of an invitation by the Department for Transport (“DfT”) for local authorities to submit Expressions of Interest (“Eol”) for Central Government support in the form of Private Finance Initiative (“PFI”) credits for PFI Highway Maintenance (“HM”);
- 1.1.2 to seek Cabinet approval for the completion and submission of an Eol for a PFI HM scheme in Sheffield, along the lines set out in this Report, and, if successful and invited to do so, for the preparation of an Outline Business Case (“OBC”) in respect of this scheme;
- 1.1.3 to give delegated authority to the Executive Director, Development Environment and Leisure, in consultation with the Director of Corporate Resources and the Assistant Chief Executive, Legal & Governance to undertake all necessary steps to further the submission of an Eol and preparation of an OBC, including the appointment of external advisers;
- 1.1.4 to confirm the actions taken to date by the Executive Director, Development, Environment and Leisure and the Director of Corporate Resources, as set out in this Report and including the establishment of a Project Board and a Project Team and the appointment of external advisers, to expedite and further the preparation of an Eol in respect of a PFI HM scheme for Sheffield; and
- 1.1.5 to approve a development budget of £1m for the preparation and submission of an Eol and an OBC for a PFI HM scheme, to be met from corporate resources and managed by the Executive Director, Development, Environment and Leisure, in consultation with the Director of Corporate Resources.

2. BACKGROUND

- 2.1 Like many other local authorities, Sheffield has not been able to invest in highway maintenance at a level sufficient to maintain the condition of the highway infrastructure. This is evidenced by the Highway Best Value Performance Indicators (“BVPIs”), where, in comparisons with other Metropolitan Authorities, Sheffield’s BVPIs are generally in the lower quartiles.

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- To improve the situation, a substantial and sustained increase in investment in the highway infrastructure is required.
- 2.2 The conclusions of the 2000 Highways Best Value Review, Comprehensive Performance Assessments and stakeholder feedback related to highway issues all indicate the importance of addressing the condition of the highway infrastructure.
 - 2.3 Delivering an improved, efficient and well maintained highway infrastructure fits well with the policies of the Government's Ten Year Transport Plan and with the Council's vision "of a best performing Council providing best quality services" and " a successful Sheffield with good quality of life for all its residents". An efficient highway infrastructure will, by facilitating enhanced accessibility, assist with wider corporate strategies such as Neighbourhoods and Housing Market Renewals, Regeneration, Learning and Attainment and Social Inclusion.
 - 2.4 A strategy for achieving an efficient and well-maintained highway would be to halt the present decline by addressing the backlog and establishing a threshold condition, to pre-defined standards, which can be sustained thereafter by planned and re-active maintenance. Addressing the backlog would entail intensive works of a major nature over a period of between 5 and 10 years.
 - 2.5 Although a major priority for the Council, improving the highway infrastructure, because of the cost of the work involved, represents a significant resource issue, and, although the Council's financial position is now much improved, it is unlikely that the scale of improvement required could be made using the Council's resources alone.
3. INVITATION TO SUBMIT EXPRESSION OF INTEREST
 - 3.1 In February 2006, the DfT wrote to all Local Highway Authorities inviting them to submit Eols if they wished to pursue a PFI HM Schemes. The invitation followed a Ministerial announcement that £600m of PFI credits will be made available to a small number of authorities in England for Pathfinder HM Schemes.
 - 3.2 For the reasons set out in this Report, the possibility of securing additional funding via PFI credits is seen as the best way of achieving the Council's strategic objectives in relation to the highway infrastructure in Sheffield, and, given the Council's priority of seeking to achieve improvements to the highway infrastructure at the earliest possible opportunity, the invitation to submit an Eol to become a leading Pathfinder in PFI HM is regarded as one to be strongly welcomed.
 - 3.3 As Pathfinder schemes, the DfT will be looking for not only the merits of individual proposals but the scope to test different approaches, with a view, after the current round, of formulating a full programme which may be capable

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- of being rolled out nation-wide. Therefore, while the Government is looking for innovation, it is likely that successful bids will be ones with a high degree of likelihood of being replicable in practical terms across a range of similar authorities. There will understandably be significant competition between authorities for Pathfinder status, and, given the limited level of the Government's announced committed resources in relation to the national backlog of highway maintenance work, it is probably unlikely that more than one major metropolitan authority will be successful.
- 3.4 Unlike the other areas of PFI in which the Council has so far been involved, PFI for HM is still new and comparatively underdeveloped and untested. Pathfinder status would therefore give the Council the opportunity to contribute to and develop the formulation of appropriate contracting strategies, both as best tailored to the requirements of major metropolitan authorities and for Sheffield's requirements in particular.
 - 3.5 Although the EoI itself will be a short document of no more than ten pages, it will need to be supported by significant amounts of work, particularly to ascertain with a fair degree of accuracy the level of PFI Credits likely to be required to achieve the objectives of the scheme (as has already been done in the EoI for the PFI Public Lighting scheme – see paragraph 4.6 below). Other requirements to be addressed in the EoI are the appropriateness of PFI as a procurement strategy, the level of political support and the outcome of an option appraisal, together with demonstrations of need, Value for Money ("VfM"), affordability and ability of the Council to deliver the scheme.
 - 3.6 An EoI must be submitted no later than 10th September, 2006. In view of the amount of work required to submit a robust EoI within the specified timetable, Executive Management Team ("EMT") on 27th February, 2006 gave approval to establishment of the project as a corporate priority and authorised the initial necessary steps to be put in place to produce an EoI and assemble a project delivery team.
 - 3.7 In this regard, the Executive Director, DEL and Director of Corporate Resources have been designated joint Project Sponsors, to be supported by a Project Board and a Project Team, with Mike Latham, Head of Special Projects, DEL, as Project Director and Michael Platt, Head of Project Finance, as Commercial Director of the Project. Further details of the proposed delivery team are set out in Appendix 1 to this Report.
 - 3.8 If the Council is successful with its EoI, the DfT will then invite the Council to produce an OBC to demonstrate the feasibility, VfM and affordability of the Council's proposals, which can be further refined at that stage.
 - 3.9 Authority is therefore requested in this Report for officers (a) to proceed to develop and submit an EoI, and to carry out such preparatory work for an OBC as may be expedient prior to the outcome of the EoI; and (b) subject to the Council being successful with its EoI, to complete the preparation of an OBC. It is proposed that a further Report should be submitted to Cabinet,

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once the OBC has been prepared but prior to its submission, for Members to confirm the scope of the project, the timetable, procurement strategy and

future client arrangements for the contract as well as the proposals for the continuing delivery of those elements of the Council's HM and related services which it may be recommended should fall outside the scope of the PFI contract, together with such further delegations to officers as may be appropriate at that stage to enable the scheme to be further developed.

- 3.10 A final Report would be submitted to Cabinet prior to appointment of Preferred Bidder to confirm the appointment and any changes to the project since previous reports. Between Reports, it is proposed that the Project Sponsors and Directors should, as part of the operation of the Project Board, report to and consult with appropriate Cabinet Members on the progress of the Project on a regular basis.

4. SCOPE OF PROJECT

- 4.1 The invitation from DfT highlighted the potential to explore variations in scope for Highways Maintenance projects. The decision as to what should be included within and what should be excluded from the scope of a PFI HM contract, and what arrangements should be made for those services which are excluded from the contract, is of early and paramount importance in developing this project. It is therefore proposed that the initial scoping, for the purposes of submitting the EoI, should be made by the Project Board in line with the principles set out below. As indicated above, these decisions would be subject to confirmation by Members at the OBC stage, once full consultations have taken place with services, service users, potential contractors, external specialist advisers and the DfT.
- 4.2 Under a PFI contract, the contractor would be responsible for attaining, and rewarded for achieving, specified outcomes, with reductions or deductions from payment to the contractor being made for failure to reach specified goals (or failure to react to adverse occurrences) within specified time limits or to specified levels or quality of service. The most appropriate period for a PFI HM contract is yet to be determined, but there is likely to be an initial intensive period during which the backlog is addressed, with increasing rewards to the contractor as this is achieved, followed by a longer period during which the highways network is to be maintained by the contractor at the new higher standard. The level of payment to the contractor will therefore build up gradually as the backlog is addressed rather than reflecting the profile of actual expenditure of the contractor, who will only fully recover costs and risk premiums over the life of the contract.
- 4.3 To begin the process of determining the most appropriate scope for the PFI contract, a workshop was held in April 2006, attended by key Council officers and their external advisers, which concluded that Sheffield's vision for the project should be based upon a holistic and co-ordinated approach, creating user perceptions of a seamless service. It is suggested that the initial vision

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- should be “ To restore the Street Scene to a quality which will meet the Council’s commitment to a Cleaner, Greener, Safer Sheffield”.
- 4.4 To achieve this, it is proposed that Sheffield’s bid should be City-wide and encompass all forms of highway maintenance and relevant enforcement, together with street cleaning, include all adopted roads, and extend to what is being termed a “fence to fence” approach, with the contractor being responsible, as far as practicable, for the full stewardship of the highway.
- 4.5 Within this overall approach, recommendations by the Project Board about what services and activities will be included or excluded, and how the excluded services will continue to be delivered, will be based on principles including: statutory and regulatory considerations; contractability of services; market availability and appetite for risk; minimising wherever possible unnecessary interfaces; total contract cost considerations; potential to achieve best value for money; and affordability factors.
- 4.6 Cabinet on 12th October 2005 authorised the preparation of an EoI in respect of a potential Public Lighting PFI scheme, in response to a separate Central Government call for bids for PFI Credits for Public Lighting PFI schemes. This EoI was submitted on 13th February 2006 and an announcement from the DfT on whether the Council has been successful in its bid for PFI Credits is expected imminently. However, there are many practical and financial reasons for including Public Lighting as part of the Highway Maintenance PFI scheme, in accordance with the principles outlined above, and it is also understood that it is a DfT expectation that Councils that are successful in both schemes would merge the two projects. In view of this, whilst work continues on the Public Lighting PFI OBC, public lighting will also be included in the Highway Maintenance PFI EoI and officers will enter into discussions with DfT as to how the two schemes might be successfully integrated. Members are asked to endorse this approach.
5. IMPACT OF SCOPE
- 5.1 As noted above, the PFI HM scheme cannot be considered in isolation from the related services which may, for various reasons, not be included within the PFI contract, but which share resources with or provide services to or receive services from Streetforce. Consultation will therefore take place with those services for which Streetforce currently provides a service, with those services which provide a service to Streetforce and with related services, to ensure that, where necessary, those services can continue to be delivered, whether directly by the Council or through alternative arrangements with the PFI and/or other contractors and that the necessary budgetary provisions are in place for those services. Again, and as noted above, recommendations in respect of these service delivery matters will be brought to Cabinet in the next Report on this Project.

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- 5.2 In addition, and again in line with the above principles, indicative Client and Contract Administration models need to be drawn up at an early stage to ensure deliverability of the project in its operational phase and to establish in-house costs for use within the financial modelling element of the EoI. The principles of PFI include self-monitoring by the Contractor, with the Client having access to the self-monitoring records and the right to carry out its own additional monitoring and/or to step-in where service delivery is not satisfactory. It is therefore expected that, while the core Client function will not need to be extensive, it will need to have good access to high quality financial, legal and technical advice, and appropriate governance arrangements will need to be made and implemented.
- 5.3 A significant number of staff are likely to be affected by these proposals, and the major consideration for staff so affected will be job security, terms and conditions. It is expected that the TUPE regulations will apply to staff transfers to either the PFI contractor or its sub-contractors, and early consideration is being given to staff transfer matters, including pensions arrangements etc. It will be important to have early, clear and regular communications with staff and their unions, including formal TUPE consultations. The Executive Director, Development, Environment and Leisure will lead on staff communications, assisted by the Directors of Development Services and of Street Force, with support from the Council's Human Resources team. Clearly, all recruitment and any reorganisation within potentially affected services, will now need to be made in the light of the potential letting of the PFI Contract, including the potential for a greatly increased level of operational activity once the contract is let and the major backlog work commences.

6. FINANCIAL IMPLICATIONS

- 6.1 A significant amount of further work needs to be carried out in order to determine the full financial implications associated with the Project. However, indicative figures have been prepared by reference to similar schemes in Portsmouth and Birmingham, which are the only schemes of this type to have been taken forward to date in the UK. Portsmouth's scheme is the only scheme which is operational whilst Birmingham is still in procurement with two bidders currently competing for the concession.
- 6.2 PFI Credits will only be available to support the capital element of the project, and continued and potentially much increased revenue support will be required from the Council's own resources.
- 6.3 Central Government have suggested that, in addition to applying for PFI Credits for the backlog work, Local Authorities may also wish to include in their applications sufficient PFI Credits to cover the capital expenditure which will be required for future highway maintenance once the backlog work has been completed, whilst forgoing the

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- possibility of applying for additional funds for this purpose at a later date via the traditional Local Transport Plan (“LTP”) route. Given the increased certainty that this approach would bring, it is felt that this opportunity should be seriously considered.
- 6.4 Based on the initial comparison with the Portsmouth and Birmingham schemes, it is estimated that Sheffield may require upwards of £300m in PFI Credits to address the maintenance backlog, although it must be emphasised that this is a very preliminary estimate and a more accurate figure will only emerge from the work currently being undertaken for the EoI, including more detailed surveying and costing of the backlog work.
- 6.5 As with all PFI schemes, the City Council will be required to make available revenue provision on an ongoing basis to supplement the PFI credits. Although the scale of the City Council’s investments cannot be precisely determined at this stage, and it is in any event only settled through the PFI negotiation process, Members are advised that an additional sum of £4–7 million should be earmarked for this purpose, representing in effect increased future investment in highways over and above current levels.
- 6.6 Clearly, this is a very significant increase in the resources allocated to this service, but the Director of Corporate Resources advises that, should Members wish to prioritise this project and carry it out in the manner outlined in this Report, then, following the improvements to the Council’s financial position and taking account of the Council’s reduced commitments in other fields following the recent restructuring of the Major Sports Facilities debt, then resources of this order could be planned to be committed from 2009/10 onwards, subject to other Member priorities. This timing is in line with the likely first operational date of the contract.
- 6.7 The amount that Sheffield would be required to contribute in revenue terms to the project would increase over time to take account of inflation and changes to the highway network that may result in increased maintenance costs. In addition, the City Council would forgo the “surplus” currently generated by Street Force and other Council services would lose the income they currently receive from Street Force. These factors will be taken into account in assessing the VfM and affordability of the project.
- 6.8 Work is continuing to develop more robust estimates of the financial implications of the project to support the Council’s EoI. These estimates could differ significantly from the indicative figures provided above depending, among other things, on:
- 6.8.1 The actual scope of the project;

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- 6.8.2 The cost of addressing the backlog of Highways Maintenance in Sheffield relative to Portsmouth and Birmingham (initial indications are that there is likely to be a greater proportion of backlog work required in Sheffield);
- 6.8.3 The length of the initial investment period needed to address the backlog (which is likely to be affected by the practicalities of carrying out the work while minimising unnecessary disruption to the highway network);
- 6.8.4 The likely value of any project specific or abnormal costs arising from addressing the backlog and ongoing maintenance (arising, for instance, from the number of and condition of Major Structures, such as bridges, retaining walls and culverts);
- 6.8.5 Any implications arising from the maintenance and operation Supertram; and
- 6.8.6 The level of funding requested and ultimately committed by the DfT.
- 6.9 A specific analysis of the financial costs and benefits of the proposed scheme will be undertaken to inform the EoI and subsequent OBC. This will include a detailed option analysis, comparing, both in financial and in non-financial terms, the benefits of a PFI scheme as against other alternatives, such as continuing with the current level of expenditure or utilising other forms of funding the backlog. Current indications are that a PFI scheme is the most likely to achieve the best value for money approach to a radical and speedy improvement to the condition of the Street Scene, but subject to the availability of adequate resources to fund this approach.
- 7. DEVELOPMENT AND PROCUREMENT PROCESS AND BUDGET
 - 7.1 It is estimated that the initial project development costs will be around £1m (see Appendix 2), split between the cost of preparing and submitting an EoI - £0.6m - and the cost of preparing the OBC – a further £0.4m. This initial Project Development Budget will be expended primarily on the appointment of external technical, financial and legal advisers, who have been or are currently being appointed, and on the cost of Council staff working on the project or back-filling for staff working on the project.
 - 7.2 It is proposed that the costs associated with preparing the EoI and OBC should be met from corporate resources, unless and until the project is successful in obtaining PFI Credits and a contract awarded, at which stage these and other project development and procurement costs would be recovered, over the life of the project, from the necessary client budgets to be established at that time.
 - 7.3 Should the Council not succeed in securing DfT financial support for the project then these costs will have to be met from the Council's own resources.

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The risk of not being able to recover development costs from the project is clearly at its greatest during the EoI stage, when the Council's proposals are in competition with those of other Local Authorities. The risk beyond that stage is much lower. Officers believe, however, that the level of costs outlined above, is both reasonable and necessary to enable the Council to submit a robust EoI and, if successful, to prepare a robust OBC, and therefore recommend, in view of the significant benefits that would accrue from the

delivery of a successful Highways Maintenance PFI Project, that the proposed Project Development Budget be approved.

- 7.4 It is understood that Central Government is considering providing specific funds for the preparatory costs of Pathfinder PFI HM bids, but no allowance has yet been made for this.
- 7.5 It is currently estimated that the procurement process, which will follow the newly introduced Competitive Dialogue process, will take between three and four years from project initiation to contract commencement. Based on the assumption that the Council is successful in its EoI and OBC submissions and that go-ahead to begin the procurement process is obtained from Central Government by January 2007, this would mean that the PFI contract could be let sometime during the financial year 2009/10.
- 7.6 Full costs to complete the procurement process are currently estimated at around £4m to £5m (including the £1m initial costs referred to above). Again firmer details of this estimate will be presented in the next Report to Cabinet.

8. LEGAL IMPLICATIONS

- 8.1 There are no specific legal implications arising from this report although clearly any decisions on the size and scope of the contract will need to take into account the statutory obligations which are imposed on the Council as highway and street works authority (and which will remain with the Council) and any restrictions that may exist on its power to delegate these responsibilities, as well as the general regulatory responsibilities of the Council.

9. EQUAL OPPORTUNITY AND ENVIRONMENTAL IMPLICATIONS

- 9.1 There are no equal opportunity and environmental implications relating to this report although should the project proceed to delivery then there will be significant benefits in these areas. An Equality Impact Assessment will be carried out if approval is given to proceed with this project.

10. PROPERTY IMPLICATIONS

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- 10.1 There are no property implications relating to this report although should the project proceed to delivery then there will be property implications relating to depots, offices etc.
11. CONCLUSION
 - 11.1 The opportunity to apply for PFI Credits to solve the backlog of highway maintenance work in Sheffield is to be strongly welcomed as providing a clear way forward to fulfil, not only in the short but also in the longer term, the existing problems of a declining standard of highway network.
 - 11.2 Sheffield is well placed from its previous experience of PFI and other major contracts with private sector partners to fulfil the role of a lead pathfinder on PFI HM schemes.
 - 11.3 The key to success will be a dedicated Project Delivery Team (incorporating service and corporate officers of the Council supported by leading specialist external advisers) with clear objectives, a clear contracting strategy, and strong governance arrangements.
 - 11.4 A good start has been made in these areas and subject to Member approval, it is expected that Sheffield should be able to put forward and deliver a strong and successful PFI HM scheme for the City with multiple benefits for the citizens of Sheffield and for regeneration and investment in the City.
12. RECOMMENDATIONS
 - 12.1 Cabinet is recommended to:
 - 12.1.1 welcome the invitation by the Department for Transport (“DfT”) for the Council to submit an Expressions of Interest (“Eol”) for Central Government support in the form of Private Finance Initiative (“PFI”) credits for a PFI Highway Maintenance (“HM”) Project;
 - 12.1.2 confirm the actions taken to date by the Executive Director, Development, Environment and Leisure and the Director of Corporate Resources, as set out in this Report and including the appointment of external advisers, to expedite and further the preparation of an Eol in respect of a PFI HM scheme for Sheffield;
 - 12.1.3 approve (a) the completion and submission of an Eol for a PFI HM scheme in Sheffield, along the lines set out in this Report, subject to consultation by the Executive Director, Development, Environment and Leisure and the Director of Corporate Resources with the Cabinet Members with responsibilities for Streetscene and Green Spaces and for Finance and Performance on the content of the Eol, and (b) if successful with the Eol and invited to do so, the preparation of an Outline Business Case (“OBC”) in respect of this scheme;

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- 12.1.4 delegate authority to the Executive Director, Development, Environment and Leisure, in consultation with the Director of Corporate Resources and the Assistant Chief Executive, Legal & Governance to undertake all necessary steps to further the submission of the Eol and preparation of the OBC, including the appointment of external advisers;
- 12.1.5 note the potential financial implications of entering into a PFI HM scheme as set out in this Report;
- 12.1.6 approve a development budget of £1m for the preparation and submission of an Eol and preparation of an OBC for a PFI HM scheme, to be met from corporate resources and managed by the Executive Director, Development Environment and Leisure, in consultation with the Director of Corporate Resources; and
- 12.1.7 request the Executive Director, Development, Environment and Leisure and the Director of Corporate Resources to report back to Cabinet on the outcome of the Eol, the development of the Project and the proposed content of the OBC prior to its submission.

John Mothersole,
Executive Director, Development
Environment and Leisure

Laraine Manley,
Director of Corporate Resources

3rd July, 2006