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A Map of the PFI Process

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Introduction

To Local Authorities considering the Private Finance Initiative (PFI) for the first time, the PFI developmental and procurement process can appear daunting. This 'Map' has been produced by the 4ps to provide an overview of the process as a whole, and includes a short introduction to each of the stages in the development and procurement of a service or project through the PFI.

The principle purpose of this guidance note is to provide an outline of the PFI process for those who need a general understanding of the key stages, and to show how the stages fit together. Each stage referred to here involves considerable preparation, planning and management, and can be subject to legal requirements and regulations. Any procurement, whatever the scale, will be delivered more effectively and is likely to give a better result where there is adequate preparation, consultation, and resourcing, together with good project sponsorship and leadership.

Comprehensive guidance is now available in *4ps Procurement Packs* and procurement skills training is available from the 4ps to help Local Authorities understand and tackle the tasks involved at every stage.

What is the PFI?

A public private partnership is a broad term that encompasses a number of partnership options for service delivery. The PFI is one form of public private partnership, and is particularly relevant for capital-intensive services. The PFI transforms Local Authorities from being the owners and operators of assets, to the purchasers of services. In a PFI transaction, a private sector Service Provider is given responsibility for designing, building, financing and operating assets, from which a public service is delivered.

Using the PFI, Local Authorities and their communities can achieve long-term benefits from private sector expertise and investment in the delivery of public facilities and services. Local Authorities are also eligible to seek central government support (in the form of PFI Credits) towards the costs of the PFI project, provided that the project is able to satisfy Office of Deputy Prime Minister, departmental and the interdepartmental Project Review Group (PRG) criteria.

The overriding objective of the PFI is to create a structure in which value for money is optimised, through private sector innovation and management skills, through the synergies from linking design, build and operate, through re-engineering, through the efficient allocation of risk, and through the whole life and whole service approach to service delivery.

The procurement process is likely to take between 18 and 24 months from approval of the proposals (by members, and PRG if the Local Authority is seeking central government support towards the costs of the project) to contract signature. However, as more schemes have been completed, and more use if made of *4ps Procurement Packs*, these timescales continue to be reduced.

Case studies of completed and operational schemes are indicating that there can be significant financial and non-financial benefits of procuring schemes through the PFI, and that such schemes clearly repay the effort required. With the PFI, operational issues and whole service/whole life implications are considered from the outset as part of the investment decision, which should contribute to the long-term success of a project, and optimise best value over the long-term. Many of the functions that underpin the delivery of the service become the responsibility of a single Service Provider, who is contracted to deliver the service to agreed standards and subject to a performance-related payment mechanism.

Whilst this paper focuses on the PFI developmental and procurement process, much of the guidance is equally applicable to other types of public private partnership scheme, including strategic service partnerships, joint ventures, and to Local Authorities using a Local Improvement Finance Trust (LIFT) or procurement through a Building Schools for the Future (BSF) local education partnership.

Planning for success – Identifying the need for a Project

All PFI projects should be developed in the context of the Local Authority's corporate plans and policies, the strategies and priorities for the particular service, the comprehensive performance assessment and the best value framework. Ideally any major project will flow from the conclusions of a strategic service review or best value review.

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Getting started – the Outline Business Case

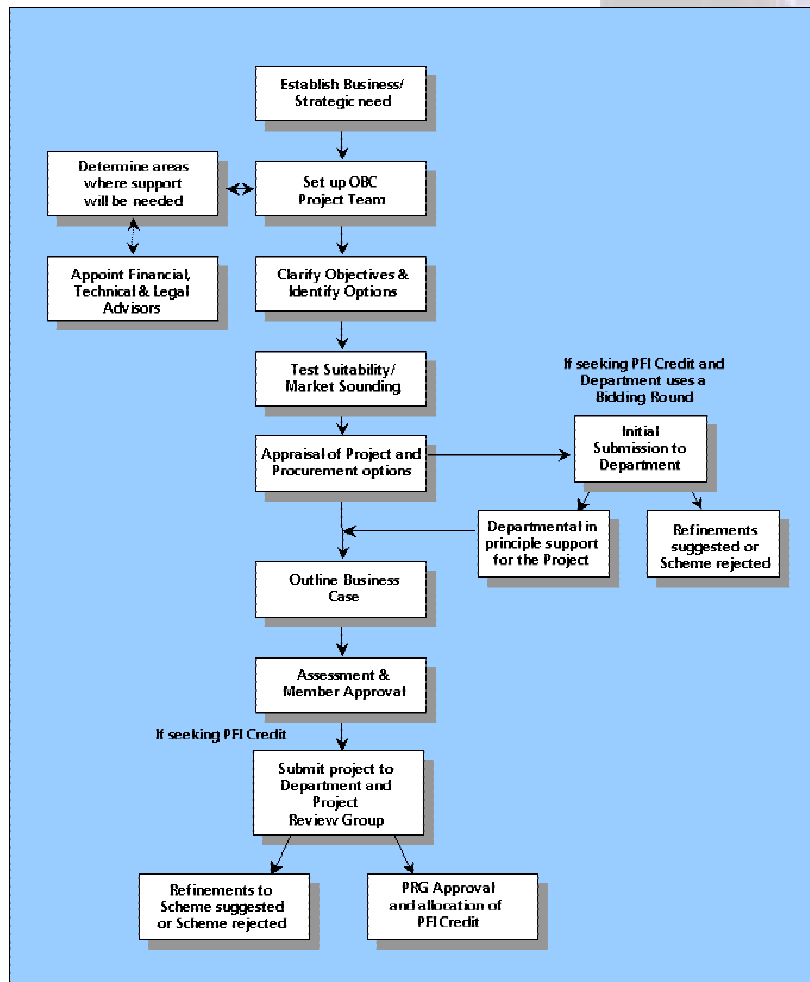
Once the need for service provision/improvement has been established at the strategic level, project and procurement options are considered, and investment appraisal exercises undertaken. Such appraisal exercises should build on, and develop further, the strategic appraisal work done as part of the best value review or strategic service review. Detailed options appraisal is encouraged in the guidance on the prudential framework.

The conclusions of the detailed options appraisal exercises should be documented in an **Outline Business Case (OBC)**, the purpose of which is to support and justify the choice of service delivery route and to provide the decision-makers with all the relevant information they need to give their approval to taking forward the project.

If the Local Authority is seeking central government financial support towards the costs of its PFI project, and the sponsoring government department has adopted a two-stage approval process, the Local Authority will need to prepare an Expression of Interest as part of the departmental bidding round. 4ps recommends that the principles for developing an OBC be followed in the development of the Expression of Interest, albeit at a less detailed level. If a Local Authority is successful from a departmental bidding round, the next stage is to prepare and submit an OBC to the relevant sponsoring department.

Key stages in preparing the Outline Business Case for a PFI Project are shown in figure 1.

Figure 1 – Preparing the Outline Business Case for a PFI Project



Each appraisal should start from a clear understanding of what the project is intended to achieve. Emphasis should be placed on outputs and how the outputs enable the objectives for the service to be achieved. A sound OBC will document a systematic approach to analysing the current service, setting out the evaluation criteria, examining the different project and procurement options, identifying the best value solution, and considering key implementation issues.

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The OBC sets out the impact and contribution of the project on existing arrangements and other stakeholders of the service. At this stage, the Local Authority must also identify the legal powers on which it intends to rely for entering into a contractual commitment for providing the service.

A project plan is drawn up to deliver the OBC within the timetable agreed as part of the best value or strategic service review. The plan outlines:

- The input required from Local Authority and other stakeholders
- The skills required for delivering the OBC
- The timetable for the process – Local Authorities typically allow a minimum of three months for the development and approval of an OBC
- The approval arrangements to develop the project and OBC.

A Project Owner with overall responsibility for ensuring the delivery of the OBC should be identified at an early stage. A Project Director and small project team should also be appointed to take day-to-day responsibility for the detailed work, and external financial and technical advisors will need to be appointed if the relevant skills and expertise are not available in-house. It is suggested that these appointments be made at the OBC stage with the intention that the team put in place is also responsible for the subsequent procurement of the project (assuming their performance developing the OBC is satisfactory).

The OBC includes a summary of the results of the appraisal of project options, with the supporting information such as the financial models included as Appendices. Any organisation undertaking a long-term financial deal of a PFI nature will need well-developed, tested and robust financial modelling.

A thorough analysis of the anticipated costs of the project will include its affordability for the Local Authority and an assessment of whether it provides a potential Service Provider with a bankable solution. This also identifies any differences in approach to service provision, the basis of costs and increasingly through partnership arrangements responsibility for those costs. Highlighting these issues at this stage and reaching agreement on service provision and funding provides a strong platform for the ongoing procurement.

Soft market testing or deal testing interviews with a small number of potential Service Providers may be carried out to test the assumptions used in the appraisal exercises. PFI procurement is only practicable where there are Service Providers able to deliver the required service, and it is sensible to assess the market before commencing a PFI project to gauge the likely levels of interest and capacity. In doing this, care needs to be taken to ensure that there is no distortion of competition, or to give one potential Service Provider an unfair advantage over another in any subsequent tendering process.

From the appraisal of a number of possible project and procurement options, a preferred service delivery option will be identified. This preferred service delivery option is typically referred to as the **Reference Project** and is the benchmark solution against which bids are subsequently evaluated. The same project option, procured through a traditional procurement route, is known as the **Public Sector Comparator** (PSC) and provides a benchmark against which the value for money of the PFI option can be assessed at the OBC stage. The PSC will need to be developed in accordance with the HM Treasury *Value for Money Assessment Guidance*.

The OBC documents the Local Authority's intended approach to the procurement of the project and sets out the key issues to be addressed in the subsequent development, procurement and delivery of the project. First drafts of some aspects of the project documentation, such as the indicative Output Specification and payment mechanism, will be needed for the options appraisal exercises and development of the OBC. The OBC should also set out the Local Authority's approach as to how other key project documentation, such as the Information Pack, Pre-Qualification Questionnaire and Model Contract will be developed.

Commentary is included in the OBC on:

- Service requirements and performance standards, which are set out in detail in the Output Specification
- The payment mechanism, which determines the unitary charge payable to the Service Provider for the satisfactory provision of the service
- Preliminary proposals for monitoring the Contract
- The Authority's initial views on indexation and change.

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How the Local Authority will develop the key terms and conditions in the Contract for the project are also set out in the OBC. Guidance on the *Standardisation of PFI Contracts* is available to assist with the development of the PFI Contract, as are the service specific model contracts included in 4ps *Procurement Packs*.

If a Local Authority is seeking a PFI credit towards the on-going costs of the PFI project, the proposed PFI transaction will need to comply with the relevant ODPM, departmental and the interdepartmental Project Review Group criteria. Importantly, the proposed transaction will need to satisfy the off balance sheet test under Financial Reporting Standard 5 - Accounting for the Substance of Transactions (FRS5); unless the sponsoring department is prepared to contribute towards the costs of the scheme through an alternative approach.

The OBC also includes a **risk register** for the Reference Project that identifies, allocates and quantifies the risks associated with the project. Risks are encountered in delivering any project, and a comparison of the costs and benefits of the various project and procurement options will include the expected value of the risks associated with each option. The risk register for the Reference Project must reflect the contractual approach that the Local Authority expects to use for the project.

Effective project management and governance is critical to the successful delivery of PFI projects. How the Authority plans to govern and manage the procurement and the project is included in the OBC, together with a draft procurement timetable. It also sets out the approval process required for the OBC, details of the commitment of members to funding the project, and evidence of the support of key stakeholders.

The OBC provides a commentary on the Local Authority's intended approach to the staffing implications of the project and may address, for example, employment issues such as the Local Authority's views as to whether the TUPE regulations may apply to staff or contractors currently employed (if any).

On to procurement - confirming the Project Director and Project Board

Once the OBC for a PFI project has been approved, the formal procurement process can start. The first step is to refine the project management arrangements developed for the OBC, reflecting the individual needs and decision-making structures of the Local Authority, and the size and complexity of the scheme. The key issues for all, however, are likely to be:

- The appointment of a **Project Owner** (sometimes referred to as the Project Sponsor), ideally the Director or Assistant Director with overall responsibility for the service area in which the project is proposed, or for particularly complex and/or high risk projects the Chief Executive. The Project Owner, as the designation suggests, is the person ultimately responsible for the successful delivery of the project, and will typically chair the Project Board.
- The appointment of a **Project Director** in the Local Authority who is given delegated authority 'to do the deal'. Ideally this is an internal appointment, although it is acknowledged that this will not be feasible in all circumstances. The Project Director will be responsible for the day-to-day operational management of the project, and Local Authorities should assume that this is a full-time role for the majority of PFI procurements. Particularly for the high risk and complex projects, a Project Manager will be appointed to support the Project Director.
- The appointment of a **Project Team**: a team that has the relevant skills and experience to deliver the project, supporting the Project Director, and carrying out the detailed day-to-day work involved in project development, procurement and negotiation. Ideally this Team will comprise eight to ten individuals to keep the process manageable. Roles and responsibilities are defined at the outset. Appointment of **external advisors** to the Project Team will be needed in those areas not covered by in-house expertise.

The Local Authority will also need to determine the governance arrangements for the approval of key stages and decisions in the procurement process by chief officers and members. It is good practice to put in place a **Project Board** (sometimes referred to as the Strategic Project Board) for this purpose, which should ideally be chaired by the Project Owner.

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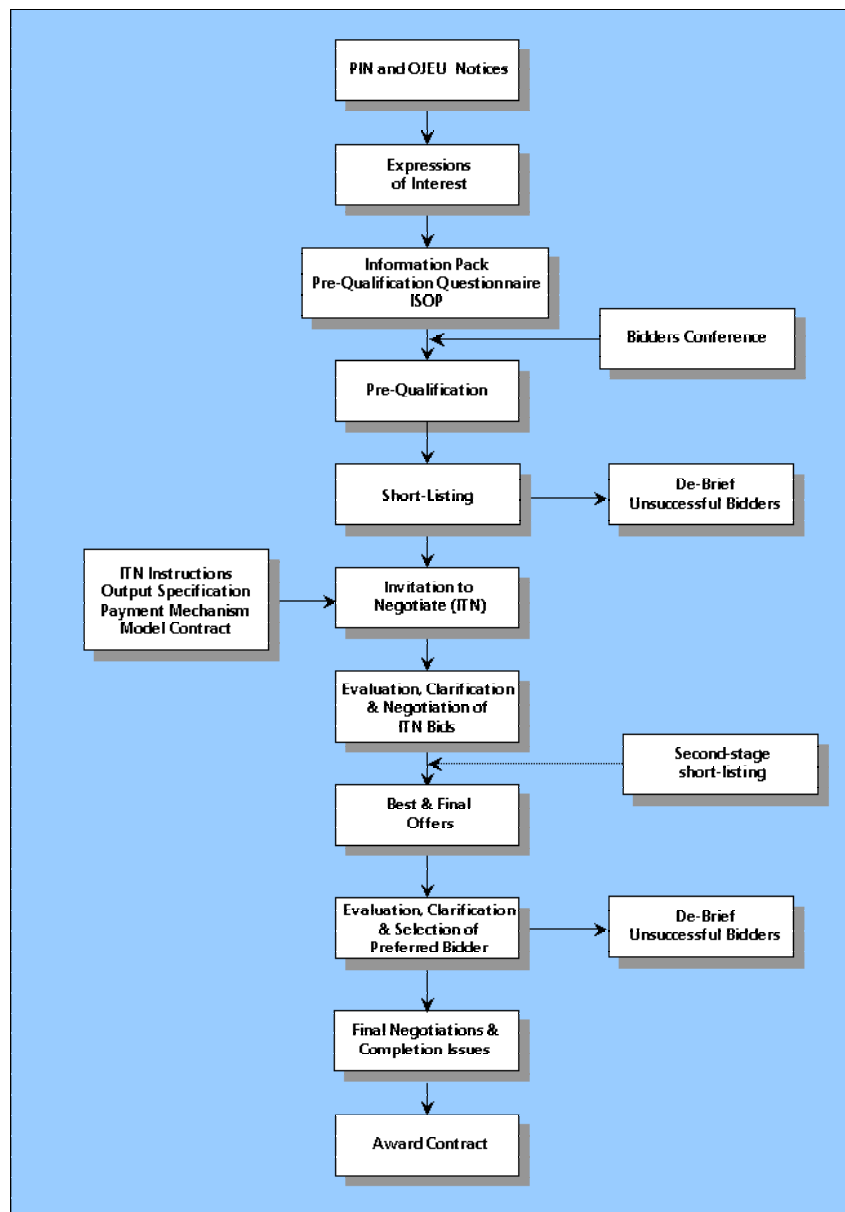
For the more complex projects, or those involving a range of stakeholders, such as school governors, or those projects involving more than one Local Authority, or those with agency arrangements, a Stakeholder Board should also be put in place. The Stakeholder Board is likely to be used as a means of seeking ratification from all stakeholders of decisions taken by the Project Board, to generally provide support for the project in the wider strategic context and to sign off key stages of the project.

There is an enormous amount of work involved in any PFI procurement; irrespective of the size of the scheme, the complexities remain the same. Designated in-house officers are essential. Skilled, experienced and competent project managers and negotiators will enable the deal to be progressed within the planned timeframe and avoid the Local Authority getting drawn in to unnecessary detail. Local Authorities should consider the opportunities for developing and building in-house expertise and capacity, particularly as public private partnerships start to play a greater role in the provision of public services.

Once assembled, one of the initial tasks of the Project Team is to refine the **procurement timetable** for the project, signing up all members of the Project Team, Project Board and other stakeholders to the delivery of the project to the agreed timetable.

Key stages in the PFI procurement process are shown in figure 2.

Figure 2 – The Procurement Process



A Map of the PFI Process

Going Public – Pre-Qualification and Short-Listing

Once the project management arrangements are in place, the procurement process starts with the publication of a Contract notice in the Official Journal of the European Union (**OJEU Contract Notice**). A Local Authority must determine from the Regulations and guidance available the appropriate procurement route, and if it is necessary for their particular project to issue a Prior Information Notice (**PIN**) for the project. A PIN informs the marketplace that such a project is being developed and is likely to be formally advertised in an OJEU Contract Notice in due course. The form of OJEU Notice depends on which Regulations apply and which contract award procedure is to be used.

For PFI schemes, public bodies and Local Authorities have traditionally used the exceptional circumstances set out in the works and services directives to justify the use of the negotiated procedure but this assessment must be made on a project specific basis, and on the basis of legal advice. The standard templates for the PIN and OJEU Contract Notice must be used. Local Authorities should be aware that there are to be changes to the EU procurement law arising from the new 'classical directive' which has now been adopted by EU member states and which is expected to come in to force in the UK in 2006.

Either during, or on completion of, the statutory OJEU period, the Local Authority now issues an **Information Pack** and a Pre-qualification Questionnaire to everyone who responds to the OJEU Notice. The Information Pack provides details about the Local Authority, the proposed project, the Local Authority's expectations on design and quality, the procurement and project management arrangements and a timetable for the key stages in the procurement process, in particular the pre-qualification and short-listing stages. Since the Information Pack is an important element of the Local Authority's efforts to 'sell' the project and thereby attract the best quality Bidders, it will be presented as attractively as possible, and in a user-friendly style.

It can be helpful to arrange a **Bidders Conference** on completion of the statutory OJEU period to allow the Local Authority to provide more comprehensive information to potential Bidders about the scheme and for the Bidders to seek answers to issues on which they are unclear. The overriding purpose of the Conference is to promote the project and demonstrate that the Local Authority has the skills and expertise in place to deliver the project. If a Bidders Conference is to be held, details will be included in the OJEU Notice and Information Pack, and the Local Authority must ensure fairness in any discussions with potential Bidders.

The purpose of the **Pre-Qualification Questionnaire** (PQQ) issued with the Information Pack is to obtain information that will establish whether the potential bidders or consortia have the technical capacity and ability, and have the economic and financial standing, to deliver the project. It also enables the Local Authority to determine whether there are any grounds pursuant to which a Bidder may be rejected. The extent of the information that can be requested in a PQQ is limited by the Procurement Regulations.

The Local Authority and its advisors identify the tests and criteria that will be used to assess the general, technical and financial strength of the Bidders. The key stages involved in a typical pre-qualification evaluation are:

- A preliminary evaluation to remove any applicants that would clearly fail on any key criterion
- Evaluation of technical capacity and ability to deliver the project
- Evaluation of the Bidders' solvency and financial strength, and fund-raising capability.

From the PQQ evaluation, a list of pre-qualified Bidders is selected. A report setting out the results and conclusions of the evaluation is produced to provide a clear audit trail for the process, and of the reasoning behind the final assessment. Bidders that do not satisfy the pre-qualification criteria are informed as soon as possible, and offered feedback on their submission.

Short-listing Bidders and defining proposals

Evaluation and further 'de-selection' of the 'pre-qualified' Bidders to a **short-list** of (usually) three or four is determined on the grounds of ability and commitment to offer a viable bid for the project. Various options are open to Local Authorities for this part of the procurement process, and the choice depends on the project and local circumstances. A prime concern is the need to maintain a level playing field and avoid any suggestion of unfair discrimination. Legal advice should be sought to ensure that this is achieved.

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Although some sectors have used the pre-qualification information and interviews in order to select the short-list, a more typical and useful approach is to request further information from the pre-qualified bidders to enable the Local Authority to make such an assessment. This information might be sought subsequent to the pre-qualification stage, or at the same time as the PQQ is issued, but the additional ISOP submission (as described below) is only opened if the pre-qualification criteria are satisfied.

If further information is to be sought, the typical approach is to issue an **Invitation to Submit Outline Proposals** (ISOP). The ISOP requests in some detail the approach the pre-qualified Bidders propose to take to the project, their willingness or appetite for taking on the risks associated with the project, and how they propose to structure and organise delivery of the project. An evaluation framework is developed for Bidders' responses, and this may include interviews if appropriate.

A report is produced summarising the conclusions of the short-listing process and, again, providing a clear audit trail of the process adopted and the short-list selected. Unsuccessful candidates are informed as soon as possible, and offered feedback on their submission.

Only short-listed Bidders are taken through to the next stages of the procurement process, which involves the issue of the 'Invitation to Negotiate', which will include the finalised Output Specification, payment mechanism and Model Contract.

The Invitation to Negotiate

The **Invitation to Negotiate** is sent to the short-listed Bidders. It incorporates any issues identified as part of the pre-qualification and short-listing process. In most cases the ITN is a development of the Information Pack, providing more detail in terms of the instructions and guidance to Bidders on the process to be followed, the timetable, the Local Authority's requirements for bids, and the criteria to be used for evaluation. It is accompanied by details of the services required, as set out in the Output Specification. It also includes the proposed contractual terms governing the arrangement (the Model Contract), including any preferred contract length and payment mechanism, and the extent to which bidders are able to submit variant bids. It is important that the ITN is fully developed before it is issued to ensure that Bidders are able to submit the necessary information sought by the Local Authority.

The **Output Specification** is arguably the most important document in the procurement of a project through PFI, as it is the basis on which the Local Authority and its stakeholders state in output terms what they need to achieve from the services, and any associated facilities to be provided. The Output Specification aims to detail *what* needs to be achieved not *how* it is to be achieved. Its emphasis is on affordable service outcomes and outputs, the explicit allocation of risks, and the integration of design and build/installation with the operation of the services. A well-produced Output Specification allows for the introduction and development of new ideas about the design, build/installation and operation of the service. It states clearly and comprehensively what is required and the standards to be achieved.

As part of the preparation of the ITN, Local Authorities will need to determine the information that will be required from Bidders as part of their bid submission, and what will be used for both evaluation and contractual purposes. Requesting Bidders to provide Method Statements on how they will deliver the service is one way of doing this, with the Method Statements being included as a schedule to the PFI Contract.

The **payment mechanism**, through which the Service Provider will receive a payment for the services provided (the unitary charge), is tailored and structured to reflect the particular needs of the Local Authority and the nature of the deal. It is vitally important for those involved to see the 'fit' between the service requirements set out in the Output Specification, the payment mechanism, and the Contract monitoring regime, and for them to understand the different roles that the Local Authority and individual stakeholders will play in them.

The payment mechanism provides a framework of realistic, challenging but achievable performance standards for the Service Provider to meet in order to secure the full unitary charge agreed in the Contract. It also provides incentives (by putting the unitary charge at risk and setting escalating penalties) for the Service Provider to meet agreed standards and to rectify problems. Performance monitoring systems are included, which are as simple and manageable as possible and which also take into account the difficulty of achieving absolute certainty in monitoring some services. The payment mechanism also provides an incentive to innovate and secure efficiency gains, and deliver best value throughout the period of the Contract.

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The ITN should include a draft of the PFI Contract - the **Model Contract**. This sets out the terms on which the Local Authority expects Bidders to submit a Standard Bid. The HM Treasury *Standardisation of PFI Contracts*, and the service specific model contracts included in *4ps Procurement Packs* (where relevant) should be used to develop the Model Contract. Local Authorities typically allow a limited number of Variant Bids to be submitted that enable Bidders to put forward proposals that depart from the terms in the Model Contract but are considered to offer to better value for money.

Following receipt and evaluation of the ITN Bids, the Local Authority may decide to de-select a number of Bidders and seek a **Best and Final Offer** (BaFO) from the new short-listed Bidders. Typically a BaFO is sought from no more than two Bidders. Alternatively, the ITN Bid evaluation may enable a Preferred Bidder to be selected without a BaFO stage.

Final stages - closing the deal

The selection of a **Preferred Bidder** from the final bids signals the end of the competitive process and is the final stage before financial close. Timing is important here: the ideal time to nominate a Preferred Bidder is when the key issues remaining for resolution revolve around the details and not the fundamentals of the payment mechanism and/or the due diligence/credit committee process of the funding institutions. Selection too soon will remove the competition, the paramount driver of value for money. Prolonging the selection unnecessarily will just increase costs for Local Authority and bidders.

A Reserve Bidder should, wherever possible, be appointed who is able to replace the Preferred Bidder should negotiations fail to reach financial close.

Once the terms of the PFI Contract are reasonably certain, a **Final Business Case** (FBC) is prepared setting out the finalised arrangements agreed on the project for approval by members, and the sponsoring department in those instances where the Local Authority is seeking a PFI credit towards the costs of the project.

The signing of the PFI Contract is known as commercial close. Financial close is when the financier's commitment takes effect and the interest rate and unitary charge are fixed. Ideally commercial and financial close should be co-terminus, although this may not be possible in all instances.

The final stage in the procurement process is however only the beginning of the long-term partnership for delivery of the new services.


Getting help

The 4ps is a Local Government central body and is the local government procurement agency for all major projects and public private partnership schemes. 4ps assists Local Authorities to develop and procure projects through public private partnerships and the PFI, and is able to offer advice to Local Authorities, and their potential partners, on a range of developmental, procurement and delivery issues associated with all forms of public private partnership and other major projects. The 4ps should be the first point of call for Local Authorities, and contacts for the 4ps project support team are:

- Schools and Leisure – Martin Lipson (martin.lipson@4ps.gov.uk) and James Stuart-Mills (james.stuart-mills@4ps.gov.uk)
- Transport – David Locke (david.locke@4ps.gov.uk) and Andrew Hugill (andrew.hugill@4ps.gov.uk)
- Housing – Steve Trueman (steve.trueman@4ps.gov.uk)
- Social Services, Waste Management and Fire Services – Alan Burnett (alan.burnett@4ps.gov.uk) and Samantha Gain (Samantha.gain@4ps.gov.uk)
- Transactional Services and Back-Office Projects – Paul Kelly (paul.Kelly@4ps.gov.uk)
- Joint Service Centres – Rob Hann (rob.hann@4ps.gov.uk) and Norman Ballantyne (Norman.ballantyne@4ps.gov.uk)

Details of 4ps Procurement Packs and other 4ps guidance can be found on 4ps website (www.4ps.gov.uk).

4ps (Public Private Partnerships Programme), the local government procurement expert, was established in 1996 by the English and Welsh local authority associations (predecessors to the LGA). 4ps offers comprehensive procurement support to local authorities including hands-on project support, Gateway Reviews, skills development and 'know-how' procurement guidance in the form of procurement packs, case studies and extranets.



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