

4ps

# Portsmouth City Council highways management PFI scheme



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**Acknowledgements**

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## Foreword

In what has been a monumental year for us with our close associations with Nelson and the sea, Portsmouth is also celebrating another big success – this time on land.

The City Council's pioneering £500 million Private Finance Initiative to put the management and maintenance of all 414 kilometres of its roads in the hands of a private company is transforming much of our infrastructure.

When we regained unitary status in 1997, our roads needed considerable investment to halt their decline. There was also a significant backlog in maintenance.

We have entered into the Contract with Ensign Highways Ltd, which in turn sub-contracted to Colas Ltd. The innovative 25-year Contract is structured around an initial five year 'core investment period' during which major rehabilitation works are being undertaken. For the next 20 years, Colas will maintain the roads.

Our PFI is not only revolutionising the way that roads are managed and maintained. It is also offering a one-stop shop for many other aspects of the street scene including road cleansing, pot-holes as well as bringing street lights up to modern standards and managing the highways with regards to licences and inspections.

Core investment works have been undertaken in every area of the city. In the first six months of the Contract, eight miles of roads were resurfaced, 13 miles of pavements renewed and 702 lamp columns replaced – greatly easing the fear of crime in some areas.

I could go on, but the bottom line is the very positive reaction that we've had from most residents to the speed, efficiency and quality of the investment works. They've noticed a big difference.

Portsmouth's vision has led to a greatly improved service for everyone who works, lives or visits the city, it is good value for money and it fits the government's Modernisation Agenda.

Finally, I'd like to say that we greatly appreciate all the support that 4Ps has given us from day one with this project. Their guidance and expertise was invaluable.

Gerald Vernon-Jackson,  
Leader of Portsmouth City Council  
October 2005

## Section 1

# Executive Summary

The first highways management and street scene project to be procured through the Private Finance Initiative (PFI) was signed on 30 July 2004. Portsmouth City Council awarded the 'groundbreaking' £500 million Contract to Ensign Highways, and from January 2005 Ensign Highways assumed responsibility for all aspects of highways management and maintenance throughout the City for the next 25 years. The project is one of the most complex and innovative local authority PFI projects to be developed to date.

The Contract includes upgrading, over a core investment period of five years, some 414 kilometres of highway network, including roads, bridges, street lighting and footways. Ensign Highways will also be responsible for the day-to-day fence-to-fence management and maintenance of the highways network.

This 4ps *Project Information Briefing* sets out the process followed by Portsmouth City Council in the development and procurement of this project, and includes a review of the mobilisation arrangements and the first 6 months of operations.

### Background to the development of the Project

Portsmouth City Council attained Unitary Authority status under Local Government Review in April 1997, taking over full responsibility for all highways functions from Hampshire County Council. In December 1997, the City Council was also selected by the Government as a Best Value Pilot Authority. Visualising the need for a new approach to the operation and maintenance of the Council's assets, the City Council chose to embark upon a Best Value 'Asset Management' Review.

As part of the Pilot Project, a comprehensive review of the highways operations led to the City Council re-profiling its highways business approach and establishing a highways maintenance service which embraced the concept of whole-life asset management. The new structure enabled the City Council to provide a more efficient, customer-focused approach to highways service delivery, albeit within recognised financial constraints.

With this in mind, the City Council sought to identify areas of additional funding, with the potential to deliver better value for money, and in order to halt the deterioration of its highways assets.

The general thrust of these policies reinforced the findings from the City Council's Best Value Review, and the way that it developed project objectives as a basis for assessing new service delivery options.

However, as with many highways authorities, there were clear indications that the annual budgets available to fund highways maintenance works were unlikely to keep pace with declining network condition. Stakeholder consultation consistently demonstrated public concern about footway and road condition, street lighting and public safety. These views were confirmed by the Best Value Review.

The City Council was also aware of emerging national policy initiatives for transport, namely the *Integrated Transport White Paper 1998 – A New Deal for Transport*; *Transport 2010 – The 10 Year Plan*; *Road Traffic Reduction Act 1997*; *Planning Policy Guidance*; *Environment*

*Act (1995); and Air Quality Regulations (1997). Transport 2010* included a number of targets for local authorities, including a target to eliminate the maintenance backlog on local roads and street lighting by 2011.

### **The PFI Project**

To develop a long-term strategy capable of addressing the issues highlighted in the Best Value Review, and to meet the emerging national targets set out in *Transport 2010*, the City Council undertook a more detailed review of the service delivery options available. This work demonstrated that network condition could be restored to an acceptable level, and value for money achieved, by adopting a whole-life costing approach to the maintenance and management of the highways network. The results of this work were documented in an Outline Business Case (OBC).

The options appraisal and business planning work identified that a project including highways, bridges, structures, street lighting, maintenance of traffic management equipment, highways-related tree and grounds maintenance, winter maintenance and street cleansing, to be procured through the Private Finance Initiative (PFI), offered the best value solution to the City Council. However, the preparation of the OBC also identified that significant additional funding was required over and above the existing Portsmouth City Council resources.

### **The Contract**

The total value of the contract over 25 years is approximately £500 million. The City Council will finance approximately £300 million, or 60% of these costs, through its Formula Spending Share (FSS) and its allocations through the Local Transport Plan. The Department for Transport (DfT) will finance approximately £200 million by special grant derived from a PFI credit of £121 million awarded to the scheme.

### **The Service Provider**

The Service Provider for the Portsmouth City Council highways management scheme is Ensign Highways, a special purpose vehicle (SPV) owned by Colas Ltd and its parent Colas SA, one of the world's leading road construction and maintenance groups, with operations in over 40 countries. Colas SA is a subsidiary of the Bouygues Group of companies.



The team that led the negotiations for Colas SA is now leading the operational delivery of the scheme.

## Benefits of the Street Scene approach

There are very few services that affect all of the population. However, everyone has regular contact with the street scene in some way; and numerous public surveys demonstrate that the state of the streets is high on the public's list of priorities for local authorities to address. The public wants streets to be safe, attractive, clean and accessible.

A study by the Audit Commission in 2004 suggested that these aspects of the street scene are often managed as narrowly defined, specialist elements, and that by providing services separately rather than providing a coordinated street scene service, the opportunity to respond coherently to the public's aspirations in this respect is being missed.

Portsmouth City Council has led the way, using the PFI, to a more integrated approach to highways and street management. This will not only allow the City Council to deliver urgently needed improvements to the highways network, but will also ensure that its street services are delivered in a genuine fence-to-fence way, bringing considerable benefits to residents and road users.

## Key Messages

The successful completion of this PFI scheme was brought about by a number of contributory factors, in particular:

- The demonstrable commitment of the Members to improve the street scene service in Portsmouth.
- The clear need for the project identified as part of a wider Best Value and strategic review, supported by consultation with local residents and other organisations.
- The quality of the project team, which was led by a Project Director with experience of other PFI schemes, and with participants who possessed the key skills to deliver the project.

A number of important lessons were learned from the development and implementation of this pathfinder scheme. Other local authorities intending to develop similar schemes for street scene and highways management will be able to benefit from Portsmouth's experience, which highlights the following factors:

- The amount and quality of the information held on the condition of the assets and infrastructure to be included in a highways management/street scene project is critical to the successful delivery of a project, and local authorities need to invest time and effort in collecting this information as part of the business planning process.
- The local authority needs a good understanding of the risks inherent in such a project, and must prepare a detailed quantification of all risks associated with the project as part of the OBC to facilitate bid evaluation and negotiation with Bidders.
- Technical, financial and legal advisors with experience of similar schemes must be members of the core project team.
- Do not underestimate the complexity of the project.

## **Mobilisation and the first 6 Months of Operations**

The project incorporated a six-month mobilisation period, to enable the Service Provider to put in place all the necessary facilities and arrangements for the provision of the services.

Following the mobilisation period, operations commenced on 31 January 2005. The view of both the City Council and Service Provider is that the first six months of operations have been very successful, and a strong partnership has developed.

There were many challenges during the mobilisation period which saw the development of a depot for Ensign and their main sub contractor, Colas. The depot included an 800sqm office which needed to be operational for service commencement.

During mobilisation considerable effort was expended in ensuring that the ICT systems were in place for contract commencement, together with the reporting procedures. Ensign also developed with the City Council the operational aspects of the payment mechanism.

On 30 January 2005, staff from the City Council and the previous maintenance contractor were working to an existing specification and standards. On 31 January 2005, service commencement; all works were to comply with the new PFI documentation, and from this date failure to comply with the service specification and performance standards has resulted in the award of monetary deductions and service points. The focus on the need for Contract compliance within the Ensign and Colas teams was imperative. Training and coaching of staff in the requirements of the PFI Contract was essential, the Contract is based on a series of performance targets with the key driver being service delivery.

During the first six months of operations Ensign/Colas have undertaken 40 road construction schemes. This compares with the three or four schemes previously undertaken annually. Ensign/Colas have erected 850 new lamp columns, compared to an average of 200 per year under the old contract. The residents of Portsmouth have seen considerable change within the City, which is being reflected in the reduced levels of complaints received by the City Council's Help Desk.

Six months into the contract Ensign/Colas are extremely pleased with the way that all staff and operatives have performed. The attitude to changes in personal terms and conditions and working demands have been excellent. Team morale and belief in the project are essential for the project to be a success.

However, both parties believe that further improvements can still be made, most noticeably as regards the move to a full "stewardship of the highways network" service.

## Section Two

# The Procurement Process

### Overview

The Contract for the first highways management PFI scheme in the UK was signed by Portsmouth City Council and its Service Provider (Ensign Highways Ltd) on 30 July 2004. The Service Provider immediately took over responsibility for managing third parties and statutory undertakers using the network and, following a six-month mobilisation period, commenced full service operations on 31 January 2005.

The City Council's decision to bid for PFI credits to help finance the project was taken in 1999 and the Outline Business Case was submitted to the DfT in November 1999.

DfT approval was granted in December 2000, and an advert was placed in the European Journal in April 2001.

The elapsed time of five years between the development of the proposal and the signing of the Contract is longer than should normally arise, but reflects the innovative nature and scope of the pathfinder project. The timescales not only demonstrate the complexity of the scheme, but also the need to review aspects of the project following receipt of ITN bids, and subsequent requirement to request additional funding from the DfT. These issues are explained in further detail later in this *Project Information Briefing*.

The key stages in the procurement process were:

- Outline Business Case and Project Approval
- Project Management Arrangements
- Preparing the Project Documentation
- Advertisement, Pre-Qualification and Short Listing
- Issue of the Invitation to Negotiate
- Receipt, Clarification and Evaluation of ITN Bids
- Best and Final Offer
- Selection of Preferred Bidder
- Final Negotiations, Approvals and Contract Signature

### The Outline Business Case (OBC)

As indicated earlier, the trigger for the decision to examine the way highways management services were provided in Portsmouth was a Best Value Review that was carried out early in 1999.

The Best Value Review identified that the City Council's highways network was in a poor condition with substantial lengths of the network in a 'failed' or 'critical' state. These roads had declined beyond normal maintenance, into a condition where major intervention was required to reconstruct the highway.

The City Council produced an OBC with input from technical advisors and from the 4ps project support team. The overriding purpose of developing an OBC was to test various options to halt the decline in road condition, and restore the network to an acceptable standard, identifying the various procurement options that might be available for delivery of the service in the future.

### **Options Appraisal and Scope of the Project**

In the first instance, the options appraisal considered assessing the 'scale' of the services that might be included in a project, and was initially focussed on the principal road network. However, the business planning work also identified considerable benefits from including the secondary and unclassified road network as part of the project scope. It was only after discussion of the draft OBC with the DfT that both parties recognised the magnitude of the benefits which could be realised if the DfT allowed a policy change which enabled the City Council to make eligible all necessary capital works for PFI credit on all parts of the highway network, not just those that had previously been funded through Local Transport Plan settlements.

The business planning work explored in detail various options for the 'scope' of the project and evaluated a series of potential options against financial and non-financial criteria. The combined results from the options appraisal work concluded that the 'all in' approach was likely to be the best project option in terms of creating clear lines of responsibility and best value.

This view was corroborated by soft market testing of the options with three private sector Service Providers. This gave comfort about the deliverability of the project, and the results of the soft market testing were included in the OBC.

The appraisal of project options concluded that the scope of a highways management project in Portsmouth City Council should include:

- Highways rehabilitation and routine maintenance
- Highways management functions
- Winter maintenance
- Street lighting and traffic signs
- Traffic signal maintenance
- Grounds maintenance and trees
- Street cleansing
- Gully emptying and gully maintenance
- Bridges and structures
- Third party claims.

The main exclusions for various historical, political, legal or operational practical reasons were:

- Urban traffic control systems
- Refuse collection and waste disposal
- Certain retained highways functions
- Other highways functions that were considered more appropriately undertaken by other agencies, for example the abandoned vehicles service
- Coast protection.

The scope of the project reflected local circumstances and took into account all interface issues associated with the delivery of the project. This exercise involved determining the City Council's existing contractual obligations with third parties, neighbouring authorities, internal service level agreements, and political acceptability of the proposed risk transfer.

Where a service was excluded from the project scope, the contractual arrangements put in place were careful not to attempt to pass any responsibility to the Service Provider that would be beyond its immediate control. For example, street lighting service delivery is measured by photometric light output at points on a carriageway; where overhanging trees are reducing the effectiveness of the lighting scheme and tree maintenance continues to be a function of a third party, the PFI Service Provider would not be able to accept contractual responsibility for failure to comply with the specification. In recognition of this, the City Council incorporated tree maintenance within the scope of the PFI contract.

Also incorporated is the maintenance of 83 structures falling within the project boundary, including road and pedestrian bridges, retaining walls, subways, culverts, and other ancillary structures. Structural inspection and reporting indicated that these assets were generally in a satisfactory and sustainable condition. Under the Contract, the PFI Service Provider has taken full responsibility for the associated maintenance requirements of these structures. In order to limit the Service Provider's exposure and costing of high-value low-probability risk the Contract introduces a financial cap to cover incidences of major structural repair.

Where failure by the Service Provider to undertake the correct cyclic structural maintenance duties results in a need to undertake major structural repairs, the Service Provider is responsible for the increased costs of the breach.

In order to achieve value for money, the City Council has agreed that two of its bridges will not be subject to the major structural repair provisions:

- Copnor Road Bridge has reached the end of its design life and had attracted separate DfT funding to be progressed as a major scheme in its own right during 2005-06. On completion, the structure will be handed over to the Service Provider through the change mechanism.
- Tipner Lake Bridge, a major pre-stressed structure located on the M275, provides the main gateway into Portsmouth. Inspections indicated that this structure was in good condition, with a residual life in excess of 20 years. Despite these indications, the nature and strategic location of the structure necessitated the Service Provider allocating significant capital sums within the financial model to mitigate any level of potential risk. As a consequence the City Council determined they were the party best placed to accept the risk. The Service Provider still takes responsibility for cyclic maintenance duties.

As part of the business planning work, the City Council also examined various procurement and funding options. This work concluded that a PFI solution was likely to offer best value for money.

This conclusion was reached after a detailed assessment of the savings to be achieved through a whole-life costing approach to maintenance, synergies within the programme of works, and economies of scale from a street scene approach. In addition, the City Council recognised that if they were to meet the requirements of the Government's 10-year plan to halt decline and eliminate the maintenance backlog by the end of the plan period, they would need to use the private sector to resource the impact of the increased workload.

### **Affordability and Value for Money**

The PFI option demonstrated value for money in comparison with a conventional procurement. *Since the City Council completed its OBC for the highways management project, HM Treasury has introduced the concept of 'optimism bias,' and new guidance on the assessment of value for money. Local authorities developing highways management schemes in the future will need to take account of these new requirements.*

The City Council also carried out substantial work assessing the affordability of the proposed PFI project. Affordability was based upon the City Council's estimates of capital costs and life-cycle maintenance costs, taking account of risk. However, the life-cycle costs were ultimately demonstrated to have been under-estimated when bids were received. Two issues principally contributed to this shortfall: the under-estimation of planned maintenance activity over years 6 to 25 of the contract, and the impact of the DfT publication *Delivering Best Value in Highway Maintenance – Code of Practice for Maintenance Management* which was launched in April 2001 after the OBC had been approved.

The key issue was that, following a long history of under investment and a programme of generally reactive maintenance imposed by insufficiency of funding, the City Council had little experience of maintaining a network to the required standard. Estimates of capital works costs covering the Core Investment Period were generally accurate.



The key principle underpinning the OBC was that the City Council must contribute all funds derived from Revenue Support Grant and the Local Transport Plan, and seek PFI credits from the DfT for the difference between the required funding and the funding available from local resources. The City Council would have to address the issue of re-assigning Revenue Support Grant provided for highways maintenance but currently allocated to support other services as part of the Council's commitment to the project. *DfT are currently reviewing the methodology for determining and computing the support that is to be paid to local authority highways management PFI schemes and local authorities may wish to contact 4ps project support team for more information on this.*

### **Project Approval**

The City Council submitted the OBC to the DfT in November 1999.

The innovative nature of the project raised some fundamental issues, and the DfT undertook a very detailed assessment of the policy issues. The DfT also commissioned its technical consultants to examine the financial and technical assumptions before deciding to support and approve the project.

Any local authority PFI scheme seeking central government funding support is also assessed by the Project Review Group (PRG). These reviews focus principally on deliverability issues, and the Portsmouth highways management scheme was duly considered by independently appointed PRG reviewers.

Following the departmental and PRG reviews, the scheme was approved in December 2000 and was described by the DfT as “ a pioneering and innovative way of procuring better road maintenance” .

## **Project Management Arrangements**

The City Council nominated the City Engineer as Project Owner to take ownership of the project and oversee the procurement from a client perspective in view of the long-term service commitment that this represented. The Project Owner was a member of the City Council's corporate management team.

The core project team assembled by the City Council at the outset of the process remained substantially intact throughout the procurement. The City Council had previously demonstrated its commitment to using the PFI, where appropriate, when it signed PFI contracts in the Education and Personal Social Services sectors respectively. For the procurement of the highways management PFI contract, the City Council was able to use officers who had gained valuable experience and expertise when developing and implementing the earlier projects.

The project team was led by a project director from the corporate finance unit, with in-depth experience of the two previous PFI schemes. A project manager with extensive experience of the issues associated with highways schemes was also appointed.

The project team was set up so that it could respond to emerging issues and make immediate decisions as required throughout the development and evolution of the project. The team members continued to undertake their normal duties. A 4ps project support executive was a member of the project team throughout the procurement process.

The City Council appointed technical and engineering, financial and legal advisors to work alongside the internal project team.

Although this project management arrangement worked extremely well, and achieved a successful outcome, it created intense pressure on the staff involved, and some conflicts arose with other corporate priorities. The City Council has subsequently developed a different approach to project management as part of an overall review of service delivery based on a dedicated project resource for major schemes.

## **Preparing the Project Documentation**

At the OBC stage, first drafts of the project documentation were prepared, including information about the City Council and its highways assets. Following approval of the OBC, the key project documentation, including the Information Pack; Pre-Qualification Questionnaire; Invitation to Submit Outline Proposals; an Output Specification, setting out the service requirements and performance standards; a Payment Mechanism, which determines the unitary charge payable to the Service Provider; and a model Contract was developed further.

### **Asset Data and Inventory**

In order for Bidders to accurately reflect the cost of the Contract within the price, it was essential that the City Council were able to demonstrate the condition of its highways assets. Bidders require sufficient historical information to enable them to undertake trend analysis of the data, and where gaps exist, the risk associated with any uncertainty will significantly increase the costs of the final Contract. The main areas of focus during the bidding process were road condition (structural integrity, surface condition, and skidding resistance), street lighting, routine maintenance defects, and third party claims records.

Although Portsmouth City Council had in place what it believed to be reasonable data on the condition of the assets, the level of detail requested by Bidders was extensive and significantly higher than had been anticipated by the City Council.

During the procurement process, and in direct response to requests from the Bidders, the City Council had to commission additional surveys to supplement and support their existing information database.

As with asset condition, the provision of accurate information relating to the inventory will influence the prices submitted by Bidders for delivering the services. Each bidding consortium undertook extensive site checks to determine the accuracy of the information placed in their domain by the City Council.

It is often the case that inventory information is held in several different departments within a local authority, and changes to the network are not always centrally recorded. Events of this nature were uncovered during the procurement process, and updates undertaken as necessary.

*Local authorities developing highways management projects should endeavour to address any anomalies prior to issuing the ITN documentation as errors will only serve to undermine private sector confidence and increase costs of both parties.*

### **Output Specification and Performance Standards**

In determining the ultimate shape and content of the Contract, it was necessary for the project team to establish the correct level of service delivery consistent with national and local policies, the appetite for risk transfer, market acceptability, and the general affordability and value for money case associated with output-based performance standards.

The City Council and its advisors invested a substantial amount of time and effort into developing the Output Specification, which clearly identified the outputs expected from the Service Provider, but avoided being prescriptive in the detail of their delivery.

The Output Specification is split in to nine performance standards as follows:

Performance Standard 1 (PS1)	Network Condition
Performance Standard 2 (PS2)	Availability of the Highway Network
Performance Standard 3 (PS3)	Winter Service Operations
Performance Standard 4 (PS4)	Landscaping and Ecology
Performance Standard 5 (PS5)	Emergency Response
Performance Standard 6 (PS6)	Safety Performance
Performance Standard 7 (PS7)	Contract Management & Customer Interface
Performance Standard 8 (PS8)	Best Value Assistance and Reporting
Performance Standard 9 (PS9)	Handback

PS 1 addresses the requirements for network rehabilitation. The overall aim of this performance standard is to incentivise the Service Provider to bring all infrastructure included in the project up to the defined standards by the end of the core investment period. The standard is sub-divided into three parts, where the outputs are varied to best reflect the needs of each road within a defined network hierarchy (primary, secondary and tertiary). The number of component parts used to calculate the Network Condition Index (NCI) value also varies to reflect the network hierarchy; inputs are drawn from the surface condition, skidding resistance, and structural strength of the pavement. Differing material properties within the existing road pavement construction are recognised as a variable within the performance measurement criteria and surveyed accordingly. A single footway & cycleway standard is used and applied irrespective of network hierarchy.

Network condition targets, for delivery on or before completion of the five-year core investment period, are defined and linked to the Payment Mechanism. A series of further periodic step targets within the standard are also linked to Service Provider payment. Failure to reach the necessary standard will result in reduced payment, although there is no incentivisation associated with exceeding the target. The City Council recognised there would be affordability issues relating to early delivery, and that the amount of disruption that users of the network would be exposed to as a consequence would reach unacceptable levels.

PS2-9 address the provision of service delivery and Service Provider performance. Guidance has been taken from the *Delivering Best Value in Highway Maintenance Code of Practice for Maintenance Management* and Highway Standards issued by the DfT, and the approach suggested by 4ps for other types of transport project.



### **Standards and the Code of Practice**

A key factor in the cost and ultimate affordability of the project was the pricing by the Bidders of the output-based performance standards. Whilst certain aspects of the project scope were reasonably well defined in terms of input-based contracts, the conversion to output-based specifications necessarily left elements of service delivery open to differing interpretation in approach to risk and cost. The project team were mindful of the City Councils statutory requirements, but equally careful that the defined standards did not constitute 'gold plating' the level of service, and therefore jeopardise the value for money case.

Whilst the DfT Code of Practice publication mentioned earlier did not significantly increase the service standards expected of local authorities in highways management, it did make more explicit the expectations in the delivery of these services, and the consequences on local authorities of not delivering those service requirements. Coupled with the issue of working to a defined specification, the overall impact did mean that the costs of providing the on-going service were under-estimated in the OBC.

The negotiation process was used to refine the City Council's original proposals in this respect to the point where all parties to the process, including the review bodies which were set up, were satisfied with the technical, legal and financial outcomes. The resulting performance standards set the benchmark for future application.

### **Risk Allocation**

The correct allocation of risks between the City Council and the Service Provider is central to the success and affordability of any PFI contract. In the highways management project, the willingness and variability within each bidding consortium to accept risk transfer was a significant factor in being able to demonstrate the value for money case of the bid, and ultimately award the pathfinder Contract. The City Council reached a negotiated position with regard to defining contractual liability for major structure and drainage repair.

### **Payment Mechanism**

The Payment Mechanism is based upon network availability and performance with an element linked to HGV usage. The high-level principle is that the Service Provider will take fence-to-fence responsibility for the complete highways network, and that failure to deliver on any one aspect should not be separable. A daily deduction will result in relation to any 'Deemed Road Section Closure' where the project network does not meet the service requirements. However, the amount of payment deduction incurred by the Service Provider does take into account the location of the failure in respect of the road network hierarchy.

The Payment Mechanism also contains strands specifically addressing street lighting and Best Value performance. The incorporation of a capped usage payment enables the Contract to cost adjust for any increase or decrease in the Service Provider's planned maintenance workload derived from HGV road damage.

Some limited opportunities exist for income to be derived from advertising, sponsorship, fees and charges. The City Council sought to define acceptable sources of income and share a proportion of this income in excess of certain pre-determined thresholds.

### **Energy**

The City Council procure energy as part of a wider local authorities' consortium in order to obtain a lower unit rate. The City Council retains responsibility under the Contract for purchasing electricity, but passes consumption risk to the Service Provider. As part of the bid submission, Service Providers were asked to submit a consumption range profile. To incentivise the Service Provider to minimise energy consumption, following completion of the core investment period the City Council will pay an amount to the Service Provider at the agreed unit rate for any consumption shortfall in the profile. Where there is excess consumption, the Service Provider will pay the City Council at the agreed unit rate. The overall concept is one of sharing energy risk.

## **Advertisement, Pre-Qualification and Short Listing**

Once the project documentation was drafted, an advert was placed in the Official Journal of the European Union in April 2001. The advert attracted a response from about 30 interested parties associated with highways management, major road construction and project finance. An Information Pack, Pre-Qualification Questionnaire and Invitation to Submit Outline Proposals were issued to all those organisations expressing an interest in the project.

An Open Day for interested parties was held in June 2001. The Open Day generated a very good attendance and involved presentations from members and officers, supported by a video presentation. The Open Day also provided an opportunity for Bidders to ask questions about the proposed project.

The City Council pre-qualified seven bidding consortia. The Outline Proposals for these consortia were then reviewed, and following a series of clarification interviews, the City Council selected four companies/consortia to bid against the Invitation to Negotiate (ITN).

## **Issue of the Invitation to Negotiate (ITN)**

The ITN documentation was issued to the four short-listed consortia in October 2001.

The ITN was a key document in setting out the Councils' objectives and requirements for the future stewardship of the network.

It was important at this early stage to establish the relationship that the City Council expected to develop in terms of risk allocation and responsibility for the network.

## **Data Room**

The City Council chose to convey data and information to bidding consortia in two formats. A project collaborative web was used to distribute electronically held data, and a physical data room established to allow access to paper documentation. The creation and on-going management of the data is central to the PFI process, and fundamental to the affordability of the project. The demand for data about the network and the project facilities exceeded what was originally anticipated. With the exception of the TUPE information, no other data was warranted by the City Council.

## **Question & Answer Process**

The City Council operated an electronic question and answer process in order to respond to issues raised by the various bidding consortia. Each Bidder was given the option to submit any enquiry in an open or confidential manner. To the credit of all Bidders, the vast majority of questions were submitted in open format benefiting the process as a whole. Throughout the ITN and Best and Final Offer (BaFO) processes the City Council received upwards of 360 individual questions requiring response, reflecting the innovative and complex nature of this pathfinder project.

## **Method Statements**

Bidders were asked to provide Method Statements on how they would deliver the service, and from the outset, the City Council deemed all Method Statements would be contractual. It was a disappointing aspect of the bidding process that, despite requests and offers of support, the quality of Method Statements generally fell below the required standard. The situation was only resolved late in the process, when time devoted to finalising statements would have been better spent on other tasks. *The City Council and 4ps advocate that future projects would benefit from agreeing the content of the Method Statements as part of BaFO submission, leaving only fine tuning to the Preferred Bidder stage.*

## **Receipt, Clarification and Evaluation of ITN Bids**

The City Council allowed Bidders approximately four months to review the data and prepare their bids. Standard bids from each of the four consortia, together with a number of variant bids, were received in February 2002.

The project team had established a detailed evaluation model to assess the quality and price of the bid submissions. Given that the procurement strategy determined that four consortia should receive the documentation, the work associated with achieving consistent and transparent analysis against this volume of material was arduous, but nevertheless painstakingly undertaken. Initially the evaluation was completed by separate disciplines, but it quickly became clear through internal meetings that this approach did not enable the team to appreciate the subtleties of each bid, particularly in the area of risk transfer.

Although all the bids proved to be technically sound in approach, each represented a significant problem in terms of project affordability. There were also significant variances in the Bidders' approach and 'appetite for risk'.

Clarification meetings were held with each of the Bidders to gain a better understanding of their project pricing and approach to risk. At the same time the City Council alerted the DfT to the emerging affordability problem.

## **Review of Project Scope and Objectives**

Although the City Council was disappointed with the project affordability issues, all the technical information contained within each bid was supportive of the overall proposal. The technical solutions put forward by Bidders offered practical ways to restore the network to the defined standard, and to maintain it afterwards in a cost-effective manner.

Clearly this was a critical moment in the development of the scheme, and an appropriate point at which to re-assess the scope of the project and the service requirements to ensure that City Council's objectives would continue to be met.

The City Council formally approached the DfT in April 2002 to discuss in detail the issues associated with the increased funding requirements. Initially the Minister was not minded to increase the PFI credit, but was persuaded that a revised approach to the procurement could still achieve an affordable value for money outcome. This approach entailed making a number of amendments to the documentation, whilst remaining within the overall scale and scope of the project as set out in the OBC and OJEU Notice.

Measures were taken to identify the complex nature of the network, provide additional data to the Bidders, align the service specification more closely with the *Code of Practice for Highways Maintenance*, and reduce the potential for 'pound swapping' in the payment regime. This approach reflected comments from advisors, the Bidders themselves, and the DfT, but maintained the core principle of allocating risk to the party in the best position to control that risk.

On this basis it was decided to proceed to Best and Final Offer stage in the expectation that affordable bids would be submitted.

### **Selection of Second Stage Short-List**

Despite the affordability issues, the City Council continued to evaluate the bids received on the previously defined evaluation criteria and was therefore able to invite two Bidders to go forward to the BaFO stage at short notice.

The situation was explained to the two successful Bidders, and a full debrief was given to each of the unsuccessful Bidders in July 2002. The City Council determined that adequate time should be devoted to the preparation and diligent delivery of the de-briefing by all members of the core project team. Key issues had emerged throughout the clarification and evaluation process, and the team were keen to disseminate the learning gained in recognition of the investment made by each consortium. In adopting this approach the City Council, whilst observing issues of confidentiality and commercial sensitivity, was able to benefit from the process, incorporating some of the feedback it received in relation to its project management and negotiation methods in later stages of the procurement.

The short-listed Bidders agreed to await the outcome of a procurement review and were prepared to engage the City Council in some preliminary dialogue to develop the BaFO documentation.

At this stage Bidders were also advised of the affordability threshold. This information had not previously been disclosed.

### **Best and Final Offer**

In November 2002, the two remaining Bidders were asked to submit their Best and Final Offer on the basis of a standard bid, a prescribed variant bid, and such other discretionary variants that the Bidders considered would offer better value for money, or a more cost-effective risk profile.

Bids were received back from both Bidders in January 2003, and confirmed that costs still could not be contained within the original affordability envelope.

Once again the DfT were alerted to the predicament on affordability, and the Department decided to commission independent technical advice to review the OBC, the calculation of the PFI credits, and the material supplied to the Bidders at BaFO stage.

The City Council co-operated fully with the review and accepted the technical advisors' conclusion that in some areas the Output Specification defined a level of service to a higher standard than those recommended by the Code of Practice. However, the advisors also highlighted the fact that for Portsmouth City Council to be able to comply with the requirements of the Code of Practice " will require additional funding above the level of current expenditure" allocated to the project by the DfT.

The City Council continued to evaluate the bids throughout this period, including the detailed assessment of risk issues. Despite the uncertainty of affordability, the City Council was able to select the bid that represented the most economically advantageous tender, based on quality, price, and risk transfer.

This decision was endorsed, anonymously for reasons of confidentiality and commercial sensitivity, by the Councils' Executive (Cabinet) in November 2003 in anticipation of a positive funding decision by the DfT.



During this period the City Council continued to provide the DfT with information to support the case for additional funding support. This involved new work on the value for money case against the public sector comparator, an analysis of the underlying cost increases, and revised PFI credit calculations based on up-to-date interest rates and cash flows. The City Council also provided a revised Benefit Cost Ratio statement and some sensitivities based on interest rate changes.

In late January 2004, the DfT informed the City Council that it would be awarded increased PFI credits on condition that the Contract could be signed by 30 July 2004.

### **Selection of Preferred Bidder**

A Preferred Bidder (and Reserve Bidder) was announced in February 2004, and the Council's legal advisors drew up a detailed letter of appointment. The letter set out all the outstanding issues remaining to be resolved, and the Council's declared position on each issue for the avoidance of doubt.

The Preferred Bidder signed this letter subject to certain caveats, and the letter broadly became the agenda for discussion and final negotiation.

The Preferred Bidder letter proved to be a labour-intensive exercise but was an important component in ensuring that all parties fully understood and signed up to the issues remaining to be resolved, and were clear about the City Council's position. Spending time on the Preferred Bidder letter also ensured that there were no opportunities for 'price creep' during the final negotiations.

### **Final Negotiations, Approvals and Contract Signature**

Core negotiating teams were set up by each party to lead the final negotiations. Specialist sub-groups were also set up to deal with specific issues such as insurance, IT, personnel issues, taxation and accounting treatment.

The Final Business Case (FBC) was submitted to the DfT in July 2004 and followed the template provided by the 4ps. The FBC was initially submitted in draft and updated on the advice received.

DfT signed off the FBC, and issued a Promissory Note and Approval letter immediately before contract signature.

This process also involved Partnerships UK checking compliance with the Treasury *Standardisation of PFI Contracts* documentation.

The District Auditor was kept fully informed throughout the procurement, and the required audit opinion on the off Balance Sheet treatment was received in the week leading up to contract signature.

Final City Council approval to the terms and conditions, and financial implications of the scheme was given on 27 July, although elected Members had been kept fully briefed on the details of the scheme during the negotiation process.

In parallel with the approvals required by the City Council, the Service Provider had a programme of Board meetings and lender Credit Committees to give all their necessary consents.

There is no doubt that the existence of a deadline provided a clear incentive to all the parties to achieve commercial close within the DfT timetable.

Contract signature was achieved on the evening of 30 July 2004.

The Contract will run for a period of just over 25 years, up until 31 March 2030.

### **Transfer of Staff**

Nineteen City Council staff were transferred to the Service Provider under TUPE. The Service Provider achieved Admitted Body Status under the Local Government Superannuation Scheme and the staff and Trade Unions were kept fully informed of progress through regular meetings and question-and-answer sessions.

### **Mobilisation**

The length of the Service Provider's required mobilisation period was the subject of much debate throughout the procurement process. The issues surrounding the resolution of the project's affordability, and the delay this caused to the project's planned commencement date inevitably meant that the City Council had to take steps to ensure that their existing levels of service would be met until such time as the successful Bidder was in a position to accept full responsibility for the delivery of service.

The City Council negotiated extensions to a number of existing contracts to ensure that continuity of service would be provided to its customers. The revised flexible contracts contained suitable notice provision for termination in order to reflect the new Service Provider's progress against the mobilisation milestones.

Both parties agreed that it would be counterproductive to set an unrealistic mobilisation period, given the complexity of transfer arrangements and the consequences of failure to deliver on any single aspect of the service upon commencement. Through discussion and negotiation, a six-month mobilisation period was agreed at signature.

### **Planning Issues**

Portsmouth is predominantly urban and has some of the densest housing outside London, characterised by extensive areas of terraced housing with comparatively little locally available open space. There is limited scope for development, with the city bounded by the Solent and two inter-tidal harbours to the south, west and east.

The City Council took the decision early in the procurement process not to directly provide or influence any of the bidding consortia in respect of their choice of depot site, leaving the commercial decision entirely to the private sector.

Ultimately, with land at such a premium within the City Boundary, the new Service Provider chose to re-develop the existing Service Provider's depot site which is owned by the City Council. The process of applying and obtaining planning permission for the modified use of the site was a factor in determining the minimum period required for Service Provider mobilisation.

Local authorities planning similar PFI schemes should consider the merits, costs, and programme implications associated with determining who is best placed to accept the individual risks associated with identification, planning, and development of a suitable depot resource.

### **Existing contracts**

Although the City Council took steps to effectively manage the process of terminating existing contracts directly affected by the project scope, it had recently entered into a long-term contract to provide tree maintenance on a city-wide cross-departmental basis with a private sector Service Provider.

The City Council was able to pass the management responsibility for the highways element of the contract to the new Service Provider in order to maintain the transfer of fence-to-fence responsibility. However, the solution is not ideal, and ultimate failure on behalf of the third party under the Contract will be treated as a Relief Event.

## Section Three

# The Highways Management Contract

### Overview

The overriding aspiration for the Portsmouth Highways Management PFI project was to create an opportunity to achieve a fence-to-fence arrangement for network management and street scene services, and to deliver a step change in service delivery, all within a single 25-year contract.

The Contract for the project was originally based on the 4ps' DBFO roads contract as used by Essex County Council and Newport CBC. It also reflected some of the guidance in *Standardisation of PFI Contracts (SoPC3)*, issued by the Treasury, as well as the 4ps supplement to that guidance specifically for local government PFI schemes. Other elements were incorporated from the 4ps' model street lighting contract.

The contractual structure is basically as follows:

- There is a mobilisation period to allow Ensign Highways to prepare for service commencement. At the end of this period a commencement certificate is issued (on satisfaction of certain pre-conditions) and the period for core investment will begin.
- The commencement certificate triggers the senior debt facility which allows Ensign to fund the five-year period of 'core investment works'. Whilst these works are being undertaken, the remainder of the services included in the project are to be provided. This means that core investment works and services occur concurrently over the highway network. This gives an instant revenue stream, as service payments commence immediately, and as the new infrastructure meets the specified standards, the level of deduction from the unitary charge is reduced. The specified standards are expressed through a Network Condition Index (NCI) and operation, maintenance and hand-back output performance criteria.
- The unitary charge is based principally upon availability and performance, but also includes an element related to usage by heavy goods vehicles.

### Purpose

At a strategic level, the Contract delivers a long-term strategy capable of halting the decline in highways asset value and restoring the condition of the network to a point where sustainable maintenance is achieved utilising the principles of whole-life costing.

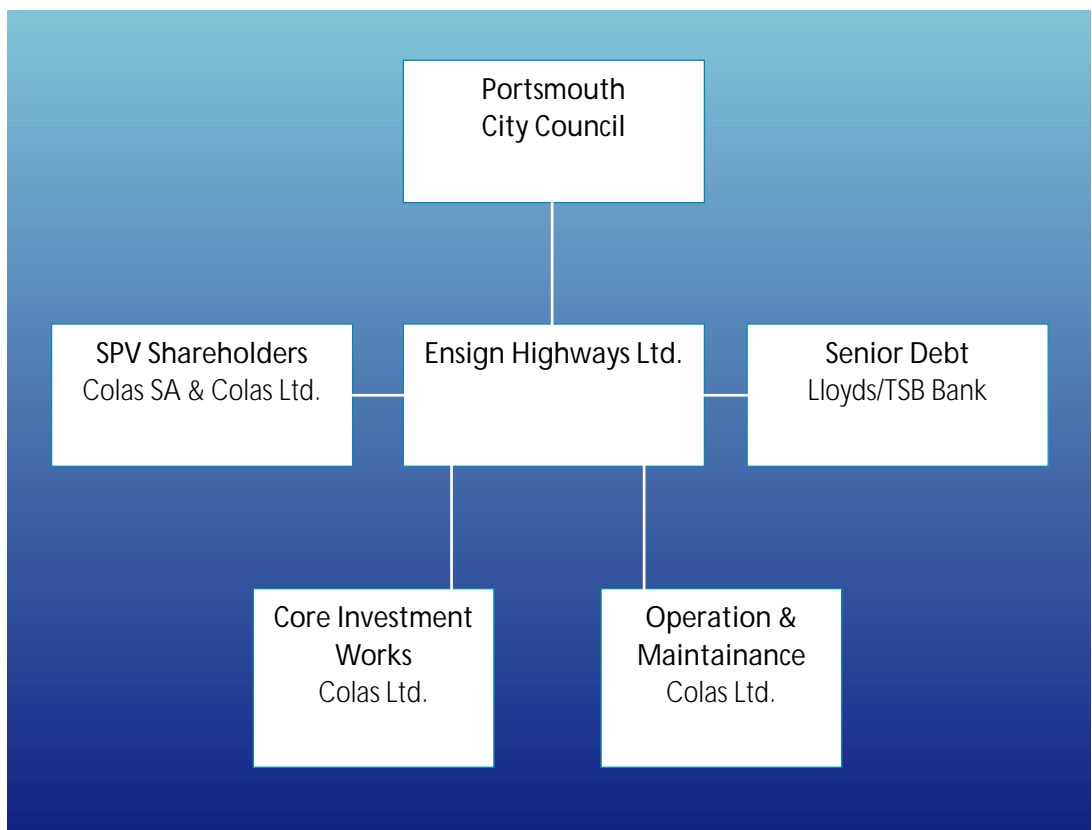


Specifically the objectives of the project can be summarised as:

- Bring all highways infrastructure within the project scope up to appropriate and defined standards by the end of a five-year core investment period, and thereafter maintain this standard in accordance with the principles of whole-life costing.
- Optimise lane availability for the end user.
- Provide a highways management service to defined output performance standards capable of satisfying the service levels demanded by users of the network.
- Achieve safe passage.
- Reduce the number and value of highways related third party claims.

### Contractual Arrangement

An overview of the contractual arrangements is shown below in figure 1.



Statutory guidance is available for many aspects of the Contract, but in softer areas such as contract management and customer interface, the requirements and service levels will depend upon the City Council's experience and perception of customer needs together with an assessment of the affordability of any new standards.

### Performance Standards

Schedule 4 of the Contract sets out the City Council's service requirements in the form of the outputs and performance standards detailed earlier in this *Project Information Briefing*.

## SoPC3

At the end of April 2004, HM Treasury issued version 3 of *Standardisation of PFI Contracts* (SoPC3). Adopting a stricter attitude to standardisation, the Treasury required that SoPC3 be used by procuring authorities for all projects that had not reached financial close by mid-May 2004. By this point the negotiation with the Preferred Bidder of the Contract for Portsmouth's PFI was already close to completion (it closed three months later). Nevertheless, in order to comply with the requirements of standardisation, the main areas where the Contract departed from SoPC3 had to be discussed with the DfT and PUK in order that such departures could be identified as suitable derogations from SoPC3.

The key derogations included:

- The approach to change and to compensation events replicated the precedents established in other PFI road projects, which differ structurally, although not in substance, from SoPC3 (see below).
- Allowing the Service Provider relief from payment deductions; a modified definition of Relief Events reflected its application in a highways asset management context, and the consequences of a Relief Event were also modified so that all non service-related events outside the control of the Service Provider were accommodated in the payment level (provided that the Service Provider was working towards remedying the effect of the Relief Event).
- Force Majeure – given the history of protestor action on roads PFI schemes, it was considered inappropriate for this to be a Force Majeure event. In addition, the issue of the potential impact of catastrophic events was treated on a value-for-money level, bearing in mind that the notional value of the network as a whole was very large.
- The provisions on surveys of the assets in SoPC3 were not relevant given that the assets, as a matter of law, remain in the sole ownership of the City Council at all times. There are no limitations on access for the City Council. There are, however, ongoing monitoring and survey requirements on the Service Provider. A significant part of the payment stream relates to the asset condition.

*To facilitate the development of future highways management and street scene PFI and PPP projects, 4ps has appointed advisors to assist with the development of a Highways Management Procurement Pack, including a sector specific model contract for highways management schemes.*

## Change

The City Council Contract incorporates the approach to change established in DBFO roads contracts. The Council anticipate a significant amount of change to the service and the standard of the service throughout the life of the Contract. The duty on a highways authority, which is passed through to the Service Provider, changes in response to evolving highways standards, third-party interventions, accruals to the asset base and de-accruals from the asset base. Accordingly the approach to change needs to reflect this requirement for flexibility. Rather than dealing with the consequences of change on a change-by-change basis (as suggested in SoPC3), the provisions have all been drawn together in a single schedule which provides a comprehensive mechanism for dealing with change.

The Service Provider is required to take a significant responsibility for continuing to upgrade the network to meet evolving standards and to carry out a continuing programme of capital maintenance. The Service Provider will take the risk up to an annual and three-year rolling cap figure.

### **Indexation**

All long term contracts need to reflect the impact of price inflation. The retail price index (RPI) is often used as a general proxy for price increases. However, for the Portsmouth highways management scheme, indexation is based upon a hybrid of RPI and the Civil Engineering Formula Series data to reflect the particular cost pressures in this type of scheme.

*Local authorities must be mindful that the basis of indexation will influence the determination of the accounting treatment for the scheme under Financial Reporting Standard 5.*



### **Insurance and Third-Party Claims**

It was regarded as a fundamental principle that management of the highways network and street scene must include responsibility for all third-party accidents and claims, as well as property and other liability covers.

Full claims experience was made available to the Service Provider to procure the required portfolio of insurance covers from the commercial insurance market.

### **Early Termination**

The Contract contains necessary detailed provisions for termination. The main circumstances in which the Contract might terminate early are where:

- The City Council terminates the Contract because the Service Provider has committed serious breaches of its obligations under the Contract.
- The Service Provider terminates the Contract because the City Council does not provide adequate access to the network for the Service Provider to perform the Service, or fails to make the payments due for the Service.
- Events outside either party's control makes the performance of the service impossible (such as an event of Force Majeure) or impracticably expensive (perhaps by a significant Change in Law).

In each case, the Contract contains provisions dealing with whether any compensation is payable to the Service Provider for the Contract coming to an end. The Contract retains the normal practice for PFI road schemes that no compensation will be payable to the Service Provider for any work already undertaken by way of rehabilitation works on the network if the termination is the Service Provider's fault.

## **Rail Agreements**

The City Council has entered into 21 Rail Agreements, with the earliest recorded agreement dating back to 1851. The Service Provider must comply with all obligations on the City Council under the agreements in so far as it is required in order to comply with the service requirements set out in the Contract.

This proved to be a major due diligence issue.

## **Client Function**

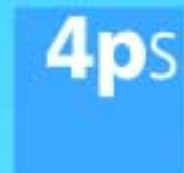
A highways client services manager and a small group of staff have been retained by the City Council to undertake residual highway functions and to monitor the Contract in parallel with the Service Providers self-auditing regime.

## **Liaison Procedures and Dispute Resolution**

The Contract contains various obligations in respect of liaison by the Service Provider with the City Council and a wide range of third parties.

In particular there is a requirement to establish a Network Board comprising an equal number of representatives of the Service Provider and the City Council. The Network Board is intended to operate by consensus and to facilitate the partnering ethic.

There is also provision for disputes to be resolved between the Chairman of the SPV and a representative of the City Council. If the issue still cannot be resolved, it can be referred to a neutral expert.



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