



# Committee report

**OWING TO THE URGENCY OF THIS DECISION CALL-IN HAS BEEN DISAPPLIED**

Committee	<b>CABINET</b>
Date	<b>TUESDAY, 29 MAY, 2012</b>
Title	<b>HIGHWAYS PFI PREFERRED BIDDER AND FINAL BUSINESS CASE</b>
Report of/to	<b>PFI PROGRAMME DIRECTOR, JAY JAYASUNDARA</b>

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**EXECUTIVE SUMMARY**

1. This report asks the Cabinet to:
  - Endorse of the selection of the Preferred Bidder, who is likely to be appointed the Service Provider (SP) for the Highways PFI Project (the Project), following Financial Close and Contract Signature; and
  - Approve of the Final Business Case (FBC) to be submitted to the Department for Transport (DfT) and HM Treasury (HMT).
2. The report provides an update of progress since Cabinet's approval of the Outline Business Case (OBC) in August 2009. It also sets out the process from the Preferred Bidder appointment to reaching Financial Close, leading to formal signing of the Contract and the eventual Service Commencement.

**CONFIDENTIAL / EXEMPT ITEMS**

3. Certain aspects of the FBC which is to be submitted to the Department for Transport (DfT) and HM Treasury (HMT) on 30 May 2012 and its associated appendices are commercially confidential. Similarly, some items contained within the Outline Business Case (OBC), and Interim Final Business Case (IFBC) submitted to DfT/HMT previously, also contain commercially confidential information. In addition, this report is being submitted ahead of the Project Board and the Member Review Board meetings on 28 May 2012, for the approval of the Preferred Bidder selection. Once approved, the final copy of the full FBC will be hand delivered to Cabinet Members. This document will remain Commercial in Confidence; hence a version of the FBC with those items that are confidential and excluded from the published version is attached at Appendix 1 to this report (a copy of this redacted version will be available for the public to view on the Highways PFI section of the Council's website immediately after the Cabinet meeting). A Preferred Bidder Memorandum

will be released on 29 May 2012 to update the Cabinet Members of the recommendations from the Project Board and Member Review Board and will form Appendix 4 to this report.

## BACKGROUND

4. The Council approved the development of the Project in May 2005 and an Expression of Interest (Eoi) bid for Private Finance Initiative (PFI) funding was submitted to the Department for Transport (DfT) in September 2006. The Eoi was refreshed in February 2008 at the DfT's request. The DfT gave the Council approval to proceed with the Project on 25 March 2008. The OBC was prepared and submitted for approval in August 2009 with an application to the DfT for PFI grant of £399.5m in net present value (NPV) terms. Following discussions with the DfT, a number of items were removed from the Project scope in December 2009; these included the floating bridge, Rights of Way and car parking enforcement. The OBC was therefore refreshed in December 2009 and the DfT grant was reduced in line with the change in scope to £364.6m (NPV) and formally approved by the DfT and HMT in February 2010.
5. Following the general election in May 2010, the new Coalition Government announced a review of all capital projects approved since January 2010 and all previous approvals given were withdrawn. The Project was eventually re-approved as part of the Comprehensive Spending Review (CSR) announced in October 2010 but with a requirement to reduce the cost of the Project by up to 30%. The cost reduction requirement applied to all capital projects that were in the procurement phase. The Council and the DfT reached agreement on a revised allocation finally in March 2011, resulting in a 28% reduction of grant; the new agreed grant of £260m NPV (equivalent to £487m in cash terms) will be paid in accordance with the following profile:
  - £15.3m (2013/14)
  - £17.2m (2014/15)
  - £19.0m (2015/16)
  - £19.85m per annum (2016/17 up to 2038)

The above contribution is subject to the final agreed financial model at Financial Close. The grant will be revised to reflect any movements in the rate used to convert a flexible borrowing rate to a fixed borrowing (known as the "swap" rate) from that approved at OBC. This rate is obtained from the "swap markets" on the day of the Financial Close; the DfT will take the entire benefit from any swap rate reduction in the financial markets; however, should the swap rates increase beyond the OBC approval figures, then grant support will be limited to the grant profile set out above. This will result in the Council funding the gap resulting from any swap rate increases.

6. The DfT grant for the Highways PFI Project is a grant to the Council and not a loan and therefore does not have to be repaid. The PFI grant represents new and additional money to the Council. The Council currently receives an annual Highways Capital Maintenance grant from the DfT for the maintenance of the public highway network on the Island. This Capital Maintenance grant will be subsumed in the Highways PFI grant from April 2013. The following sets out the historical and future grant profiles:

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2017 to 2038
DfT Grant	£2.68m	£2.90m	£3.18m	£2.81m	£15.30m	£17.20m	£19.0m	£19.85m

The Highways PFI grant represents a significant increase (five to six fold increase) over the previous Highways Capital Maintenance grant. In addition, the Council will continue to receive the Integrated Transport (IT) grant annually, to address future safety schemes. Over the last five years, the IT grant has averaged over £1m per annum and this will be determined on a rolling three year cycle. The Council will continue to use the IT grant to improve the safety of the network throughout the 25 year Contract period.

7. The Council agreed in principle to make an annual contribution towards the Project, equivalent to the revenue cost of carrying out routine maintenance and operations. The Council currently carries out these duties as the Highway Authority and would still need to continue to deliver these services, either internally or through a service provider regardless of the Highways PFI Contract. However, the inclusion of the maintenance and operations along with the capital renewal of the highway network offers significant operational, contractual and cost efficiencies leading to a much more cost effective contract. The Highways PFI Contract therefore includes the capital renewal of the assets (largely funded by the DfT grant) and continued maintenance and operations of the network (funded by the Council) within a single contract. The Cabinet therefore agreed to a contribution of £10.45m per annum in August 2009, based on the revenue cost of carrying out routine maintenance and operations; this included a £0.5m allowance for growth in the budget from 2009 to 2013 when the service is due to commence. Following the reduction in scope of the Project in December 2009, the Council's contribution was reduced to £8.3m per annum. Based on the Preferred Bidder's bid, the Council's contribution is now expected to be between £6.6m and £7.0m per annum at 2013 prices, indexed linked annually by RPIx. The final contribution from the Council will be determined at Financial Close, when the rate for fixing long term "swap" rates will be determined (see paragraph 5 above).
8. The Scope of the Project is outlined in paragraphs 17 to 19 below and has broadly remained unchanged since December 2009, despite the reduction in grant funding. The Project Team, with the help of the bidders for this Project, have focused on improving value for money through innovation; the consequence of this has been to achieve the same scope within a reduced affordability envelope and to deliver services in an efficient and cost-effective manner.
9. The Preferred Bidder has now developed a Project which meets all of the Council's aspirations for this Project; namely:
  - provide a step-change in the condition of the Island's roads within seven years from the start of the Contract, and sustain that improvement over the remaining eighteen years of the Contract;
  - enhance the Island's street-scene to deliver a more pleasing public realm;
  - improve the lighting on the Island's streets and thereby reduce crime and fear of crime;

- reduce vehicle maintenance and fuel costs;
- contribute to enhancing and protecting the environment;
- improve highway services to customers;
- ensure the provision of a high standard, fit for purpose highway network to meet the needs and aspirations of residents, business and visitors for the movement of goods and people;
- promote sustainable transport options and initiatives by ensuring the availability and maintenance of the whole highway network, and appropriate traffic management;
- provide a comprehensive and seamless service for all parts of the highway, fence to fence, both in built up areas and the countryside, with appropriate standards and use of materials to reflect local distinctiveness and character;
- create a safe highway environment within the context of a well managed public realm/whole street scene, enhancing the ambience of the Island for residents and visitors;
- create a highway maintenance industry that acts as a stimulus for the economy;
- take a holistic approach to the Island's sensitive environment;
- reduce the Carbon and Water Footprint on the Island;
- drive innovation, integration and efficiencies in the Island's highways maintenance industry and supporting partners; and
- address the inherent geotechnical features and weakness that affect the highway network by implementing short or longer term remedial works.

#### THE NEED FOR THE HIGHWAYS PFI PROJECT

10. The Island's highway network has suffered from years of less than required levels of investment and as a consequence the condition of roads and footways has reached a level where weight and width restrictions are now becoming a regular feature. When the Council approved the OBC in August 2009, 20% of the public highway network was subject to width and or weight restrictions and currently, national indicators show the Island is generally in the bottom quartile on asset condition. Highway related claims have increased due to the condition of the network, and footway related claims also show a general upward trend. Over 40% of street lighting columns are more than 20 years old and due to the general lack of long term investment in lighting stock, combined with the corrosive effect of the Island's salt-air, a significant proportion of the Island's street lighting and illuminated traffic signs asset is in a seriously degraded condition. Additionally, it is estimated that 50% of the existing lighting levels on the Island fall below current European and British lighting standard requirements.
11. The poor condition of the Island's highways, footways, street lighting and traffic signs, has a negative impact on residents, visitors, and the local economy. Journey times are increased, emergency repair works cause congestion, vehicles are more prone to damage, ride quality is impaired, inward investment is discouraged, and the street scene and general ambience affects perceptions of the Island as a holiday destination.
12. The Island-wide customer survey indicates that the state of the roads is now the biggest concern for the residents and visitors. The need to refurbish the Island's

highway network is therefore overwhelming and this can only be successfully achieved through the significant investment provided by the Project.

## STRATEGIC CONTEXT

13. The drivers for change for this Project stem from overarching national transport policies which are then interpreted at a local level. Local drivers for change are influenced by a range of plans and policies including the Isle of Wight Community Strategy, the Isle of Wight Economic Strategy, Island Plan Core Strategy, Local Transport Plan, AONB Management Plan and Shoreline Management Plan.
14. This Project is one of the Council's strategic priorities and forms part of the strategic reforms to increase the capability and capacity of the Island and improve its attractiveness for inward investment. The Island Transport Plan (ITP) adopted in June 2011 clearly recognises the importance of maintaining and improving the highway network, and the Project is recognised as the most effective way to bring about much needed improvements to our highway network.
15. The Project is seen as the significant catalyst not just for improving the condition of the highway network, but also for creating a road construction and maintenance industry on the Island using local natural and physical resources. These aims were translated into the Council's contract specification and are now fully embedded in the Preferred Bidder's proposed solution. It is expected that through the proposed investment from the Preferred Bidder on the Island, the Project is likely to bring significant economic benefits, both directly and indirectly through the supply chain.
16. The Preferred Bidder has developed a project that takes a holistic approach to the Island's sensitive environment, by the re-use of materials, careful choice of public realm materials in Conservation Areas and specially designated rural areas such as Areas of Outstanding Natural Beauty (AONB). A Strategic Environmental Assessment along with associated Habitat Regulations Assessments has been prepared to ensure that all environmental considerations are an integral part of the Project.

## SCOPE OF THE PROJECT

17. The Project has provided the Council with an unrivalled opportunity to take a holistic and co-ordinated approach to highway maintenance throughout the Island and provide a seamless service, and restore the street scene to a quality that matches the Island's heritage.
18. The Project therefore covers the Island's entire adopted public highway network encompassing all forms of highway maintenance and relevant enforcement, and is described as "fence-to-fence" scope. In this context, "fence to fence" is defined as all assets that are between the fences on either side of the road and all are included in the scope of this Project.
19. For the purposes of upgrading the highway assets, the Island has been divided into six districts (see Appendix 2 to this report). Assets in each of the districts would be upgraded to the required standards in 14 six-monthly steps over a seven year period; this period is known as the Core Investment Period (CIP). All six districts are required to be upgraded to the same level, ensuring that no one area is either ahead

or behind the rest of the Island. Once upgraded, all of the assets are required to be maintained to the upgraded standard for the remaining 18 years, known as the Life Cycle period (LC).

## CORE SERVICES

20. The services that are included within the scope of the Project as Core Services are detailed below and listed in Section 2 of the Final Business Case in Appendix 1 to this report and covered by the “Unitary Charge” payments. The required service standards for the principal elements of the Core Services form the basis of the technical “Output Specification”; the Terms and Conditions of the required performance are set out in the “Project Agreement” (or the Contract). The Highways PFI Service Provider (known hereafter as the Service Provider or SP) gets payment for the services he delivers through a payment regime set out in the “Payment Mechanism”. Hence the Output Specification, the Project Agreement and the Payment Mechanism are three contractual documents that govern how this Project will be delivered over the 25 year period.
21. The Project has promoted the concept of “Street Scene” as the corner stone for designing future improvements. The Street Scene provides a series of design pallets that are acceptable in different parts of the Island to match with the heritage, and environmental sensitivity of that location. The Street Scene will act as a design guide to consider the suitability of all proposals; this will include the appropriateness of the materials used for footways, kerbing, lighting, bus shelters, benches, planters and all other assets to ensure an aesthetic harmony.

## Carriageways

22. The Project scope includes refurbishment of 818 kilometres of publicly maintained adopted road network including the associated kerbs, channels, footways and drainage improvements. The road network, which requires considerable upgrade within the 7 year CIP programme has been reclassified into H1, H2, H3 and H4 roads based on the level of traffic; H1 and H4 being the highest and the least trafficked roads respectively. The refurbishment of the carriageways has therefore been targeted to provide deeper treatments for the highly trafficked roads to ensure the investment delivers better value for money. The acceptable condition for the roads is defined by an index known as the Wight Condition Indices and the payment to the SP is linked to achieving improvement in condition indices during the CIP and then maintaining it at or above that level post-CIP. The Preferred Bidder solution conforms to the Council’s requirement for upgrading the H1, H2, H3 and H4 roads, consistent with all of the other requirements set out in the Output Specification (e.g. environmental constraints, street scene, tar contamination, etc.).

## Footways & Cycleways

23. The urban and rural conurbations on the Island are linked by an extensive network of footways and cycleways. As part of the CIP works, the footways and cycleways will be upgraded to provide acceptable foundations and walking/riding surfaces. The rights of way are excluded from this Project. The acceptable surface condition for footways and cycleways is defined by a series of Indices and the SP is required to meet this requirement thereby minimising the current defects to reduce the risk of third party claims. The combination of footway renewal with the carriageway renewal

offers the opportunity to have a single upgrade programme. The Preferred Bidder solution conforms to the Council's requirement for upgrading the footways and cycleways, and, as with carriageways, is consistent with all of the other requirements set out in the Output Specification (e.g. environmental constraints, street scene, tar contamination, etc).

### Structures

24. The Island's 209 bridges and 621 retaining walls in the publicly maintained adopted road network are in scope. These include bridges that carry the road over rivers, streams, railway (both Network Rail and Isle of Wight Steam Railway) and Environment Agency assets. The condition of structures is assessed by a Bridge Condition Index and the inspection cycle is pre-determined by the DfT standards and built into the Output Specification. In addition, the bridges and retaining walls also need to conform to the required parapet safety standards set out by the DfT. A Technical Approval Procedure is prescribed by the DfT for the approval of structural work to bridges and retaining walls and the Council's Highways PFI Contract Management Team (known hereafter as the Contract Management Team) is proposed as the formal Technical Approval Authority (TAA). The Preferred Bidder solution conforms to the upgrade requirements set out in the Output Specification and the DfT Technical standards.

### Ferry Terminals and Yarmouth Bridge

25. The Council has taken a global approach to improving the safety and performance of the network. It has therefore considered the importance of managing traffic to and from these terminals. In particular, Yarmouth Bridge opening and closing is an additional constraint on the smooth flow of traffic in the Yarmouth area. The SP is required to control the opening and closing in accordance with pre-agreed opening times and unscheduled openings ordered by the Harbour Master. The actual opening and closing of the bridge will be managed from the Central Control Room in the SP's offices, where there will be full visibility of river, road and pedestrian traffic using a modern CCTV system that has increased visibility during fog or mist; this will provide far better coverage than a single person standing on the bridge to gain visual clearance of traffic. In addition, the Central Control Room will be able to coordinate the movement of any emergency vehicles that are about to cross the bridge providing safe passage for them. The system fully respects the navigable rights of the river traffic over the road traffic. The Harbour Master will have a link to the Central Control Room and in an emergency, will have the ability to override the bridge opening and closing. A number of other safety features will be improved including remote fault reporting of the bridge opening/closing mechanism, barriers on the bridge, audible announcements before opening and CCTV imaging for prosecution of trespassers. The Preferred Bidder has proposed a system that is in compliance with the Council requirements and will be participating in discussions with the Council and the interested parties before Financial Close is reached.

### Geotechnical Schemes

26. The Island has a unique geology and localised geotechnical complexities that have had some isolated impact on the roads. The Council took a proactive approach to dealing with these potential vulnerable sites and identified them as sites that need geotechnical solutions during the 25 years. The sites were categorised using

geological maps, coastal erosion maps and local knowledge of past movements, and eighteen potential sites were identified (labelled red sites) with potential for failure within the Contract period. A further eighteen sites were identified as having a possibility of failure during the Contract period but the probability is considered to be low (labelled amber sites).

27. The SP is required to design the CIP upgrade with appropriate geotechnical solutions for the 18 red sites and these designs need to be within the “fence to fence” limit and taking full account of the local, national and international environmental classifications. These sites include the well known Military Road, Undercliff Drive, Bouldnor Road, and Newport Road in Ventnor (Graben). These sites are strategically important parts of the Island’s road network and hence the SP is required to develop a short term, repeat solution for the duration of the Contract or a long term solution that lasts for the full duration of the Contract. There are incentives built into the Contract for the SP to promote a long term solution; however, at some sites it is neither practical nor feasible to develop such long term solutions within the confines of the highway boundary or where the geotechnical and/or geological issues extend beyond the highway boundary.
28. The Council developed a risk share approach whereby the failure liability is capped (a) before the remedial works are due and (b) when a short term solution is chosen by the Preferred Bidder; however, if a long term solution is promoted, the cap will expire when the solution is fully implemented and as an incentive, the Preferred Bidder would have gained some economic benefit, offset against his bid price. The principles for providing the economic benefit were published as part of the tender process and a detailed economic benefit model was provided to all bidders.
29. The solutions offered by the Preferred Bidder for the 18 red sites have been innovative and offer good value for money; these were judged against the Council’s own remedial solutions developed to scrutinise the feasibility, cost and practicality of carrying out the works without detriment to the environment.

### Street Lighting

30. The highway network has 11,934 street lights and 1686 illuminated signs or bollards; these will be renewed during the CIP to meet the current lighting standards. The Council has also transferred the energy consumption and pricing risk to the SP; this is the first time such a risk transfer has been achieved but this is consistent with the Council’s ambitions for the Island to become an Eco Island. The lighting upgrade has an accelerated target to ensure the savings from reducing energy consumption accrue from the earliest possible date. The Output Specification therefore requires the upgrade to be achieved before the end of year 3 of the CIP. The Preferred Bidder has proposed the installation of an LED lighting unit solution with a provision to “dim” and “trim” in accordance with the Council policy on dimming and trimming. The dimming and trimming will be managed through a Central Management System (CMS) located centrally in the SP’s depot. The CMS will form part of the Central Control Centre, integrating lighting, CCTV, traffic signals and Yarmouth Bridge operations within a single location.

## Drainage

31. The drainage of the highway network is crucial for the safety of the highway users and for the long term integrity of the highway foundation. The Preferred Bidder has identified the importance of effective drainage maintenance including replacements of gully gratings. There are 16 major and 124 minor drainage schemes included in the Preferred Bidder submission. These will address all known drainage shortfalls on the highway. The Output Specification requires the carriageways to be free from standing water within set timescales following precipitation and this will promote further additional drainage schemes during the life of the Project.

## Street Furniture, Signs, Street Nameplates and Road Markings

32. The Island's roads contain compulsory, directional, and tourist signs, roadside seating, bus shelters, street name plates and roadside planters. During the CIP, the SP will upgrade the signage to current standards and other assets will be kept available for use in a good state of repair as set out in the Output Specification. The Preferred Bidder has conformed to all the requirements in the Output Specification and provided a variety of different materials and types of street furniture to suit various Island environments which will be used to enhance the street scene, especially in urban Conservation Areas.

## Traffic Signals

33. The Island has 79 sites where traffic signals are used to control traffic flows (36 junctions & 43 pedestrian crossings). All sites will be monitored remotely with a fault management system for automatic identification of faults and will be linked to the Central Control Room.

## CCTV

34. The CCTV cameras that are already on the highway network are utilised for crime reduction and highway management, and their monitoring is included in the Project scope. Some of the CCTV cameras and monitoring equipment were replaced over the last three years and these will become due for replacement towards the end of the CIP. The SP will be implementing a 24 hour CCTV monitoring system and this will be managed in line with current legislation for monitoring and storing of CCTV recordings. The CCTV operations will be part of the overall Central Control Room but will have its own secure, controlled area. The Preferred Bidder's solution conforms with the Output Specification in all respects and proposes its use for effective management of traffic on the network.

## Grass Cutting and Street Cleansing

35. The Preferred Bidder has embraced the "fence to fence" approach to service provision, taking full advantage of the synergies that will be gained in managing highway services. The grass cutting, drain cleansing and street cleansing activities are programmed sequentially to provide an efficient service with minimum disruption to the travelling public. The street cleansing activity will be further synchronised with the domestic refuse collection cycle (which is outside the scope of this Project) to ensure the Island is clear of refuse at all times. The standards for grass cutting have been set to suit "high amenity", "low amenity" and rural areas to ensure the service is

targeted to meet requirements and delivers value for money. The street cleansing standards of the Output Specification have been aligned with the standards from the Environmental Protection Act (EPA). The Preferred Bidder has proposed all litter bins in the highway network have the provisions for waste to be segregated at source. All dog bins and litter bins will be renewed during the CIP. The Preferred Bidder solution contains a number of innovative ideas to improve the service and to work in partnership with other agencies and contractors.

### Highway Trees

36. The SP will be responsible for maintaining all trees that are within the “fence to fence” highway boundary. In addition, the SP will be responsible for issuing safety notices and monitoring where third party trees pose a safety threat to the travelling public. The Preferred Bidder’s submission is fully compliant with this requirement.

### Winter Maintenance and Highway Emergencies

37. The SP is responsible for keeping the highway network available for the travelling public by undertaking Winter Maintenance services; eleven designated snow clearing routes and six winter gritting routes have been set as initial priority and they are the strategic routes where the Council has historically provided the first line winter maintenance services. Once these routes have been cleared, the SP is required to attend to the remaining routes based on the order of hierarchy. The SP is also responsible for attending to all highway emergencies on the network such as fallen trees, flooding and road traffic accidents. The Preferred Bidder’s submission complies in every respect to the Output Specification including the necessary level of resourcing to meet the required performance standards.

### Enforcement and Utilities

38. The SP will be delegated the required powers to enforce action against highway infringements such as obstructions, overhanging vegetation and control of illegal footway crossings. The SP is required to manage the road space by allocating appropriate windows for Utilities and other third parties to undertake necessary works. The Preferred Bidder has already commenced discussions with the Utility companies and intends to work with them in partnership to reduce the impact of utility works. The road space allocation will be controlled by the Council’s Availability Matrix, which sets out the “rental” payments required to close a carriageway.

### On and off-street Car parking

39. The physical assets required for managing car parking will be upgraded and maintained by the SP, whilst the responsibility for car parking enforcement including collection of parking fees will remain with the Council. The SP is required to upgrade the car parking meters, maintain them and resurface the off-street car parks to meet the Output Specification.

### Abandoned Vehicles and Graffiti Removal

40. The SP has the responsibility for removing any abandoned vehicles and removing graffiti within the highway boundary; the Council is able to request the SP to provide

these services outside the highway boundary on a call-off basis for additional payment as set out in the in the schedule of rates.

#### Highways Development Control

41. The SP has responsibility for managing and delivering Highways Development Control functions including adoption, street naming and numbering and undertaking highway searches. This service will be managed in a close working relationship with the Council's Regulatory Services.

#### Miscellaneous

42. The SP will have a direct interface with the public and will respond to public enquiries and complaints. He will also support the Council in responding to any Freedom of Information requests, producing required government statistics and dealing with any third party insurance claims.
43. The SP will also be required to produce a real time Management Information System (MIS) to report on his performance against the contractual requirements. He is required to work in partnership with the Council by assuming membership of a joint partnering group known as the "Highways PFI Board" to manage and improve performance of the contract and avoid conflict.
44. The SP is required to produce monthly performance reports against targets and provide a request to the Independent Certifier (IC) to certify performance against achievements and hence payments. Failure to meet any performance requirements will be automatically recorded and these will result in payment deductions against the monthly payments.

#### NON CORE SERVICES

45. Non-Core Services include a wide range of works and services that are not covered by the unitary charge payments; these are services that can be called-off as and when the demand for that service arises and the Council will need to find additional funding for such services, as it does currently with its in-house operation.

#### Design

46. The shape and size of the future Integrated Transport programme will be dependent on the level of Integrated Transport Grant that the Council is likely to get in the future. The SP is required to provide a prioritised list of schemes annually to improve the safety of the highway network and the Council will use this prioritised list to fund specific safety schemes each year. This service will be provided on a call-off basis and the funding and the delivery will be managed by the Contract Management Team, using the Integrated Transport grant. During the 7 year CIP, the SP will be used to implement any Integrated Transport upgrades, using pre-agreed rates that have been obtained under competition. The SP will be able to make sure that there is no conflict with the SP's programme for CIP upgrade and Integrated Transport schemes. Post-CIP, the Council will have the opportunity to market test the service externally to ensure the selected contractor offers best value for money.

47. The SP is required to provide the Council with assistance in civil and other emergencies, such as flooding. As these are not regular occurrences, it is better value for money to purchase these services as additional services under a call-off arrangement.
48. The Council will allow certain street advertising on the network, subject to restrictions in the Project Agreement. The revenue flow from such advertising is outside the Core Services and will be shared between the SP and the Council in accordance with the pre-agreed percentages.

#### FUTURE ARRANGEMENTS FOR SERVICES OUTSIDE OF SCOPE

49. The Council has the ability to use the call-off provision to procure minor additions or extensions to services beyond the highway network, provided funding for those areas is found by those promoting such services and such extensions do not detract from the primary purpose of the Project, its timescales, funding and its quality.

#### PROCUREMENT STRATEGY AND PROCESS

50. The Council's procurement of the Project is governed by the Public Contracts Regulations 2006, under the Public Procurement Directive (2004/18/EC) and defined as a "particularly complex contract", one where the solution cannot be objectively defined at the outset of the project. Hence, the Competitive Dialogue procedure was the appropriate process for this procurement. The Council placed its notice in the Official Journal of the European Union (OJEU) on 3 March 2010 to invite potential bidders to submit their interest in the form of Pre-Qualification Questionnaires (PQQs). The Project Team, supported by Cabinet Members, held a bidder's day conference on 25 March 2010 to promote the Project. Upon evaluation of the PQQs, three bidders, Wight Highways Partnership (WHP), Vinci Ringway and Amey Ventures were selected to proceed to the ISOS stage of the procurement process. The complete list of procurement phases is as follows:

- Invitation to Submit Outline Solution (ISOS);
- Invitation to Submit Detailed Solution (ISDS);
- Invitation to Submit Refined Solution (ISRS);
- Call for Final Tender (CFT);
- Preferred Bidder (PB) Selection;
- Financial Close (FC);
- Mobilisation;
- Service Commencement.

51. The ISOS stage competition was based on a single district (District 3 - one of six on the Island) and the three bidders were invited to provide solutions that met the Output Specification and Project Agreement. This stage was completed in October 2010 and all three bidders were asked to participate in the ISDS stage to provide a comprehensive solution to the entire Island's highway network. This stage was completed in July 2011 and again after careful evaluation of the bids, all three bidders were taken through to the ISRS stage. The ISRS stage bids were received in December 2011 and the evaluation was completed by the end of February 2012, when the council decided to take two of the bidders, Vinci Ringway and Wight Highway Partnership (WHP), through to the final Call for Final Tender (CFT) round.

The invitation for CFT was issued in March 2012 following the approval of an Interim Final Business Case (IFBC) by the DfT. The CFT tenders were received on 2<sup>nd</sup> and 30<sup>th</sup> April 2012 and following detailed evaluation, a Preferred Bidder has now been selected, which is the subject of this Report.

52. The evaluation of bids and de-selection of bidders has been subject to a well defined and thorough process that has been scrutinised by both the Project Board and the Member Review Board. As required by the Procurement Regulations, the Council published its evaluation criteria and scoring methodology at the commencement of the procurement process and the highest level of evaluation criteria was set as:

- Technical 40%
- Legal 20%
- Financial 15%
- Risk Adjusted Price 25%

53. All bidders have been given detailed feedback on the evaluation of the previous stages and this has helped all bidders to improve their submissions in the subsequent stages.

54. The Project Team is currently targeting to reach Financial Close by mid August, three months ahead of the published end of November 2012 date, both to capitalise on “confirmed” financial terms offered by the Preferred Bidder that remain valid up to August and as a consequence to allow an additional three months for mobilisation. The Service Commencement is still targeted for 1 April 2013.

### DELEGATED DECISIONS

55. At the August 2009 Cabinet meeting it was agreed that certain matters pertaining to the Project be delegated to the Highways PFI Project Board, the Project Sponsor (the Director of Economy & Environment) and the Programme Director in consultation, where applicable, with the relevant Cabinet Member. Those matters that were delegated were set out in paragraphs 75 to 79 of the report to Cabinet in August 2009 (please see Appendix 3 to this report).

56. It was also agreed that the selection of the Preferred Bidder would be the subject of a further report to Cabinet and this report fulfils that obligation.

57. Once all matters have been clarified with the Preferred Bidder and the Final Business Case (the submission of which is subject to the approval as part of this report) has been approved by the DfT and HM Treasury, the Council will be ready to enter into a Contract with the Preferred Bidder. At this stage, all of the financial, legal and propriety matters will have been completed and the Project Sponsor should consult with the Cabinet Member for Highways, Transport, & Waste, the Chief Executive, the Statutory Monitoring Officer and the Director of Resources (the Statutory Section 151 officer) prior to exercising the delegated authority to authorise the execution of the Contract. It is recommended that the Cabinet considers a report at this stage to review the readiness to enter into this Contract.

58. In view of the time-critical decisions which have to be made towards reaching the Service Commencement date, it is recommended that Cabinet agrees to delegate

authority to make certain decisions to the Project Board, the Project Sponsor and the Programme Director, in consultation, where applicable, with the Cabinet Member for Highways, Transport, & Waste on the following matters:

- approval of the terms and conditions of the contract, including any derogations from standard PFI contractual terms;
- approval of any required delegation of the Council's functions as Highway Authority, Lighting Authority or Traffic Management Authority;
- the appointment of the Contract Manager as the Traffic Officer under the Traffic Management Act 2004
- the appointment of the Contract Manager / the Technical Contract Manager as the designated Technical Approval Authority;
- approval of any required appropriations of land into or out of the highway;
- approval of amendments to the Project timetable;
- execution of the main contract and all related agreements and other documents, including all necessary property leases/licences and pensions agreements and bonds and the signing of all necessary Certificates under the Local Government (Contracts) Act 1997 (subject to the process of consultation referred to in paragraph 57 above); and
- any other matters reasonably necessary for the finalisation of the Project documentation (for example dealing with parish councils, external agencies such as Network Rail, Environment Agency, utilities, BT, educational organisations and Island based industries.

#### THE FINAL BUSINESS CASE (FBC)

59. The Council is required to submit a series of business cases to the DfT and HMT for approval. These are detailed documents with a large number of technical, legal and financial annexures to provide a detailed and robust case for investment including the affordability of the Project. The OBC was approved by the DfT and HMT in February 2010 when the standard of the case was considered by HMT to be "exemplary". This was refreshed following the CSR announcement.
60. At the end of the ISRS stage, the Council submitted an IFBC which was approved by the DfT in March 2012. This included the approval of "derogations" by HM Treasury for those areas where the Council intends to deviate from the standard form of PFI contract. The FBC is the last stage in the approval process, where the Preferred Bidder submission is reflected in the case; the FBC confirms that the Council still remains committed to funding the Project, it is delivering all of the objectives initially set, the PFI method of delivery offers better value for money, the benefits to cost ratio is within the acceptable level and that the Project remains affordable.
61. The attached draft FBC meets all of these requirements and makes a compelling case for continuing with the investment in this Project and readiness to enter into a Contract with the Preferred Bidder. A Gateway Review (Gate 3) was carried out independently by Local Partnerships (a division of HM Treasury), who commended the Project on some exemplary good practises and gave a "Green" status, endorsing readiness to proceed to Financial Close, without any reservations.

## PROJECT MANAGEMENT, CONTRACT MANAGEMENT AND GOVERNANCE

62. The PFI Programme Director has had overall responsibility for delivery of this Project effectively managing all of the risks relating this Project; he has been well supported by the dedicated Project Team and the specialist advisors to deliver this complex procurement to a very high quality, within the allocated budget and on time. The Project Sponsor, the Project Board and the Member Review Board have provided a high degree of scrutiny and support to ensure that the Project remained fully resourced and on schedule.
63. The Project Team, who are currently involved in the Competitive Dialogue process, have built up the vital knowledge and expertise needed to manage the Contract. The PFI Programme Director has set up the Contract Management Team to operate in “shadow” from April 2012 and this team will now be involved in the Preferred Bidder discussions, Financial Close and Mobilisation. The PFI Programme Director, in consultation with the Project Sponsor will shortly be advertising for the Contract Manager position. It is expected that this appointment will take place during the summer and the post holder will take his/her position during Mobilisation; the Contract Manager will have up to six months to familiarise with the Contract and take over the management from the PFI Programme Director at the start of Service Commencement in April 2013.
64. The Contract Management Team will report to the Director of Economy and Environment. A number of functions currently under the Highways and Transportation Department will be transferred to the SP and some retained functions (e.g. Traffic Manager role) will be transferred to the Contract Management Team.
65. It is proposed that there will be a reduction in staff numbers as the Project moves into Contract Management. There will be a further opportunity to review the structure at the end of the seven year CIP.
66. During the mobilisation period, the Project Board and the Member Review Board will continue to meet and review the newly appointed Service Provider progress towards Service Commencement. The PFI Programme Director will establish a Highways PFI Board at the start of the mobilisation phase which will remain in place throughout the Contract. The Terms of Reference and the modus operandi of this Board are set out in the Contract.
67. Once the Service Commencement starts on 1 April 2013, the Project Board will continue in its scrutiny and support role but the Member Review Board will be brought to a close. The Project will then start to report to the Economy and Environment Scrutiny Panel on a quarterly basis and where appropriate, call the SP to appear and account for his performance.
68. The Contract Management Team will be co-located in the same office complex as the SP to facilitate effective communications and prevention of any misunderstandings or breakdown in the professional relationships. Traditionally, major breakdowns in communications have resulted in contracts defaulting and this arrangement is seen as providing an efficient, partnering arrangement. The Council will ensure the necessary protocols are in place to safeguard the privacy and confidentiality aspects of the Contract Management Team and it is expected these arrangements will be subject to a review by Internal Audit.

69. The SP is required to provide an Annual Report in the format of a Company Report it to its shareholders. This Report will be presented to the Cabinet jointly by the Contract Management Team and the SP.

### CONSULTATION AND STAKEHOLDER MANGEMENT STRATEGY

70. The Contract Management Team and Preferred Bidder will form a robust working partnership with clear governance and monitoring to ensure the project delivery focuses on delivering a high quality service to the programmed plan. This will be supported by the detailed and considered stakeholder management and public engagement that will endeavour to foster strong community links through education, professional forums, clear public information and open dialogue with town and parish councils.
71. A Stakeholder Management strategy for the Project was prepared in April 2009 and subsequently approved by the Project Board and the Member Review Board. This plan has been regularly revised to continuously engage with the various stakeholders using a number of communications. A stakeholder management tool was developed to hold a complete record of internal and external communications, public meetings and other stakeholder communications. These records have been maintained throughout the procurement phase and will continue to be maintained during the contract management phase.
72. The Council Leader, the Cabinet Member for Highways, Transport & Waste, the Project Sponsor, the Programme Director and the Project Team have maintained regular contact with all stakeholders:
- Both formal and informal contact has been maintained with the DfT on a regular basis.
  - The Cabinet Member, supported by the Team, made a presentation to the Member of Parliament to update on the project status.
  - Press releases and wider media interviews have been given to continuously report on progress.
  - A series of three public meetings were held on the Island during the summer 2011 to inform the scale, scope and progress.
  - A live "Facebook" question and answer session also was hosted in 2011.
  - The Project Team hosted a "Local Industry Day" to inform the construction and supporting industries on the Island of the scale and potential opportunities that could arise from this Project.
  - The Project Team went on a "schools road show" to explain to school children and parents the potential future opportunities that may arise in the longer term.
  - The Project Team provided a number of opportunities for school students to spend time in the PFI Office and shadow the development work during procurement.
  - The Programme Director provides regular updates to the Chamber of Commerce and has made a number of presentations to its members.
  - The staff that are affected by the TUPE transfer are regularly kept up to date by all staff meetings, presentations and a series of one to one meetings with two of the bidders which took place at the ISRS stage.

- The Programme Director meets the Trade Union representatives at regular intervals to update them on progress.
- Dedicated Highways PFI Project pages on the Council's website ([www.iwight.com](http://www.iwight.com)) have been set up to update the public of regular progress including reporting on how the procurement budget is being utilised.
- The Project Team, supported by the respective ward members, have attended a number of town and parish council meetings to outline the scope and wider benefits of this Project.
- The Project Team hosted a "Utility Conference" between the bidders and the Utilities to facilitate a jointly agreed programme of works.
- A Preferred Bidder road show is being planned post-Financial Close to introduce the future SP to town and parish councils in the Autumn.

### SCRUTINY PANEL

73. The Project has been reviewed regularly by the Council's Economy and Environment Scrutiny Panel. This arrangement will be formalised when the Service commences in April 2013; the Scrutiny Panel will receive a quarterly report after this date and when necessary, the SP will also be asked to attend.

### FINANCIAL / BUDGET IMPLICATIONS

74. At the OBC stage, the Council committed to a contribution of £10.45m per annum at 2009/10 prices. When the OBC was revised following the changes to scope in December 2009, the Council revised its contribution to £8.3m at 2009/10 prices in line with the DfT grant of £364.4m NPV. The £8.3m was the Council's budget for maintaining and operating the items that were included in the Project scope. When the Project was re-approved by the DfT and HMT in October 2010, the grant was revised down to £260m NPV. The October 2010 CSR had a much wider impact on the Council's finances and these were taken on board by the Project Team to seek similar savings in the council's contribution. It is expected that the Council will now be contributing between £6.6m and £7.0m in 2013/14 prices; however, the final contribution from the Council will be determined at Financial Close when final "swap" rates for fixing the SP's lender terms are agreed and locked down in the Contract. It is likely that the Council's contribution will be in the region of £6.6m to £7.0m per annum in 2013/14 prices.
75. The Council's contribution, combined with the DfT grant will be paid as a Unitary Charge (UC) to the SP. The UC will start at 70% of the full UC in year one and gradually step up in a series of 14 steps to the full 100% of the UC at the end of the CIP in year 7. The Council will also be making additional capital contributions in line with HM Treasury (HMT) guidelines; the necessary clearance for making such payments have been approved as derogations by Infrastructure UK (IUK), the division in HMT responsible for agreeing project specific approvals. The capital contributions are made against achieving specific project milestones and have the effect of lowering the SP's borrowing requirements, and hence further increasing the value for money of the Project.
76. The Council contribution will be fixed for the duration of this Project, except for indexation by RPIx to take account of annual inflation, provided the scope remains unaltered and the Project Network remains the same for the 25 years. Annual

inflation has a much wider impact on the Council's budgets and does not affect just this Project. However, as part of prudent planning for a fixed 25 year contract, the Project Team has carried out various inflation scenarios and discussed the impact with the Director of Resources (the Section 151 Officer). As part of the Preferred Bidder Memorandum to be issued on 29 May 2012, the next three year budgets and longer term impact of inflation will be further explained. The impact of inflation remains a risk that will need to be managed, year on year and this is quantified under the risk section.

77. The Project Network (the extent of the carriageways, footways, footpaths and cycleways) is fixed at the start of the contract and both the Council and the Preferred Bidder have identified all of the assets that are due to be transferred to the SP for upgrading and maintenance. The Preferred Bidder's bid is therefore based on the quantified assets and condition as determined in October 2011, when a "pre-commencement survey" was released by the council. The SP would take account of any deterioration to the network from that point and the Council will take responsibility for any changes it makes including the standard of any planned capital and routine maintenance. During the life of the Project, if there are any changes to the network, the UC will be adjusted to take account of such changes. If new carriageway lengths are added to the network, the Council will need to contribute additional funds to increase the length of the network maintained by the SP. The costs for adding and subtracting network and assets within it are already included in the Preferred Bidder's bid and the Project Team is satisfied that this represents appropriate costs that would be incurred by the SP.
78. The overall impact of the Council entering into this Highways PFI Contract is that the Council's revenue budget for routine maintenance and operations will reduce from the current £8.3m per annum to a range between £6.6m and £7.0m, to be determined at Financial Close. This is likely to result in a cumulative (unindexed) saving to the Council of between £32m and £42m over the 25 years, releasing these funds for the Council to commit in other service areas.
79. The Council also committed an initial budget of £0.7m towards the setting up of a Contract Management Team from April 2013. This budget will continue to be reviewed as the longer term procurement and contract management function develops over time. The Contract Management Team has already been set up in shadow and the estimated costs are in line with the initial budget that has been set.
80. The Project was allocated a procurement budget of £7.6m in March 2009 and included expenditure that was incurred in 2008/09 even before the budget was set. The procurement budget has been well managed over the last three years, and as result a saving of approximately £0.6m is being forecast at the end of March 2013, subject to there being no delays to the Financial Close or Service Commencement that are outside the control of the Project Team.

#### WIDER BENEFITS

81. The upgrade and ongoing maintenance of the Island's highways, footways, street lighting and street furniture will have many benefits. Innovative surfacing materials proposed for the Island's roads will help to reduce noise levels, and improve air quality and journey ambience. Highways and footways related claims are likely to be reduced, highway drainage improved, and the street scene enhanced, helping to

promote the image of the Island to visitors and inward investors. Inevitably there will be some disruption as works take place during the CIP but all works are being carefully managed to ensure disruption is kept to a minimum, especially around key Isle of Wight events which are vital to the Island's economy. All existing traffic signals including the SCOOT system will be replaced during the CIP resulting in improved traffic flows. Once the CIP is complete the accessibility to the Project Network will be significantly improved, resulting in ease of movement of people and goods to and from the Island. The CIP investment will also lead to the removal of a number of the existing weight and width restrictions and a more effective CCTV monitoring operation will further improve accessibility, safety and journey times for residents, visitors, and businesses. Improved street lighting will also help to improve safety on the Island's roads and reduce the fear of crime amongst the local community. The LED lighting solution, which can be adjusted remotely by the Service Provider through the Central Management System (CMS), will also reduce the level of energy consumed leading to cost and environmental efficiencies.

82. As well as improved infrastructure, the local economy will benefit from the creation of a reinvigorated and integrated construction industry on the Island. The SP will develop a diverse workforce which will include apprentices, graduates and those from traditionally hard to reach groups and is likely to have a positive impact on the Island's employment opportunities. Given the long term nature of the Contract the future success of the Project will rely on the Island to provide a continuous feed of skilled and unskilled employees as well as apprentices over its lifetime. The Project Team has regularly briefed the Island's 14-19 Partnership Consortium on the future needs of the Project and the Preferred Bidder has expressed an interest in working with the group to progress potential training programmes. In addition to new job opportunities with the SP, local suppliers will be in a position to benefit from the Project and the multiplier effect is likely to be significant.
83. The PFI Project is one of the Council's key priorities as set out in the Corporate Plan. However, the benefits of the Project are far-reaching and align with other key priorities including *Regeneration of the Economy*, and *delivery of budget savings through changed service provision*.

## LEGAL IMPLICATIONS

84. The Council, as Highway and Street Lighting Authority for the Island, has numerous powers and duties under the Highways Act 1980 to carry out maintenance, improvement and repair work. None of the arrangements with the Service Provider outlined and proposed in this report would relieve the Council of those powers and duties.
85. The Council's functions and responsibilities as Traffic Management Authority under the Traffic Management Act 2004, including the operation of permit and lane rental schemes and the linked functions and responsibilities under the New Roads and Street Works Act 1991 of co-ordination of works in the highway, will remain with the Council, with appropriate delegation to the Service Provider to undertake duties defined within the Project scope.
86. Contractual documentation and protocols will be finalised and agreed with the Service Provider in relation to all interface issues between the functions to be carried

out by the Service Provider and those to be retained by the Council (for example refuse collection) so as to give clarity to the risk allocation.

87. Any claims against the Council as Highway or Street Lighting Authority, even if they relate to matters within the proposed contract, will still remain the ultimate responsibility of the Council. The Service Provider will, however, provide an indemnity to the Council against such claims in so far as they relate to the services to be delivered under the contract.
88. In addition to the main contract, a number of other contractual arrangements will be put into place, including direct agreements with lenders and sub-contractors, pension agreements, property transfer agreements.
89. The Council intends the contract and the funders' direct agreement to be certified contracts for the purposes of section 2 of the Local Government (Contracts) Act 1997. This will afford the service provider and its funders sufficient protection against the remote possibility of a challenge being brought in respect of the Council's power to enter into the project agreement/contract.

#### EQUALITY AND DIVERSITY

90. An Equality Impact Assessment (EIA) highlights the universal benefits of the Project to all users of the highway network and to the street scene by improving safety, reducing crime and the fear of crime, making neighbourhoods more accessible to all and improving the use of public transport. In particular, the Project will, through the improvement of footway surfaces, be of great benefit to those with mobility problems, wheelchair users and people with young children using prams and pushchairs.
91. Public bodies must have due regard and need to consciously think about the three aims of the Equality Duty as part of the process of decision-making process. This means that they must try to eliminate unlawful discrimination, advance equality of opportunity and foster good relations between those with and those without protected characteristics. The Council is therefore required to consider the impact of their services, policies/strategies and decisions with regard to the nine protected characteristics cited in the Equality Act 2010.
92. The PFI contract procurement followed these procedures and assessed these against the Council's diversity policies. The equality impact assessment looks at how a service promotes equality and diversity to ensure legal compliance and that the services we provide, and the decisions that we make, meet the needs of our local community.
93. As part of the PFI contract procurement, particular attention has been made to ensuring community involvement. Road shows creating awareness of the PFI Project amongst the community were held at various locations across the Island including at education establishments. The PFI contract procurement has encouraged training opportunities for residents and has focused on ensuring that benefits can be attained by this contract for the whole community.
94. The EIA will be refreshed to take account of the contract terms and scope of services that have been agreed with the Preferred Bidder, and will continue to be reviewed towards Service Commencement.

## HUMAN RESOURCES IMPLICATIONS

95. It is estimated that 66 of the Council's employees will transfer to the SP, in accordance with the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). This predominately consists of staff within the Highways and Transportation Department, but also includes staff from other teams where at least 50% of their job role has been assessed to be in the scope of services subject to the Highways PFI contract.
96. In accordance with TUPE, the Council has been formally consulting with employees and their Trade Union representatives over the proposed transfer, and this consultation process will continue up to the date of transfer. All consultations will continue to be carried out in accordance with the Council's Code of Practice for staff transfers agreed with the Trades Unions and will cover pension issues as well as employment terms and conditions. The Preferred Bidder has elected to apply for membership of the Isle of Wight Council Pension Fund. The SP's membership of the fund is specific to those staff transferring from the Council to the SP and will remain a closed scheme (i.e. no other SP employees or new staff will be admitted to this schemes).

## SECTION 17 CRIME AND DISORDER ACT 1998

97. Under Section 17 Crime and Disorder Act 1998 the Council must exercise its various functions with due regard to the likely effect on, and the need to do all that it reasonably can to prevent crime and disorder in its area (including anti-social and other behaviour adversely affecting the local environment)..
98. A well-maintained street scene including the upgrading of street lighting will help to make everyone feel safer but particularly the elderly and the vulnerable. It will also give residents a clear signal that the area in which they live is important and well cared for, giving a message of reassurance and dispelling feelings of social exclusion.

## PROPERTY IMPLICATIONS

99. The Council has no Direct Labour Organisation (DLO) and hence has no depot that is large enough to deliver this major Project. However, the Council has a number of small depots that have been made available to the SP. The transfer of these depots to the SP will be finalised before Financial Close and the necessary leases will be transferred for a peppercorn rent for the duration of the Contract. The depot leases will be terminated at the end of the Contract and returned to the Council.
100. The SP is also required to procure a main depot that is of adequate size to deliver this major Project. The depot will also accommodate the SP offices and the Central Control Room. The operational part of this depot will revert back to the Council at the end of the Contract.
101. The Project Team, which shares resources with the Waste Project, will co-locate with the SP at Service Commencement. The cost of the Project Team accommodation is therefore already included in the Preferred Bidder's price and no further payments are required to be made to the SP; hence, there will be further savings being

generated from the Contract Management Team's accommodation costs from April 2013.

102. The Highways and Transportation staff currently located at Enterprise House will move to the SP's offices in April 2013. This will release a significant proportion of Enterprise House with the potential to completely vacate this building soon after that. Once Enterprise House is released from the Council's portfolio, significant savings will be accrued in the longer term.

## OPTIONS

103. The Project considered eight different scheme options and these are described in Section 3 of the FBC. These options have been evaluated using the Island's policy framework. The Preferred Bidder's submission fully satisfies the chosen option and further considers a variety of treatment and maintenance options. These have been the subject of a number of Competitive Dialogue sessions and the final solutions proposed by the Preferred Bidder provide the best value for money submission.
104. The Preferred Bidder submission has been assessed in line with the DfT's Economic Assessment guidance and found to offer 6.7 times more benefit than the original investment. This is a lot higher than the 2 to 2.5 benefit to cost ratio expected for a good investment case.
105. The Project Team has also assessed the value for money offered by the Preferred Bidder solution, in accordance with HM Treasury guidelines, and found the bid is 12.5% more advantageous in comparison to the Council delivering this Project using a non-PFI, traditional procurement route.

## RISK MANAGEMENT

106. A risk management methodology was agreed for the Project based on the Council's Risk Management Policy; this methodology is detailed in Section 6 of the FBC. A number of risk workshops were held throughout the procurement phase of the Project which identified and assessed all the key risks for which risk mitigation plans needed to be in place. The Risk Register is reviewed regularly at Project Team, Project Board and MRB meetings. The full Risk Register is included in Section 6 of the FBC.
107. The Project developed a Shadow Bid model, which provided an understanding of how the bidders would price the Project. This provided the Project Team with necessary insight and helped to negotiate a fair contract with the Preferred Bidder with appropriate levels of risk transfer.
108. The Project Team have identified a number of longer term risks that would need to be managed during the life of the Contract.
  - (a) Inflation Risk: the financial modelling for this Project is based on the HM Treasury requirement for inflation to be modelled at 2.5% per annum, as an average rate of inflation for the period of the Contract. The impact of inflation rising above this base line position by 1% would be an additional contribution of approximately £168,000 in year eight, at the end of the CIP. However, the Council will need to find this additional resource, regardless of this Project, as

inflation is a global risk and not a Project based risk. In mitigation against this risk, the Council would have saved as a minimum £32m over the course of the Contract (see paragraph 78) from the reduced contribution from the Council, in comparison to the current resource budget for highway maintenance and operations. The savings derived from this procurement is adequate to offset an inflation rise of 1% for the entire contract period. The more prudent approach to managing future inflation risk for the Council is to ensure that inflation costs are provided for in the in-year budgets and not allowed to have a cumulative impact towards the end of the Project.

- (b) Additions to the Contract: The Highways PFI Contract is a fixed price contract, subject only to inflation indexation, provided the Project scope and quantum remain the same throughout the contract period. However, it is likely, that any future increase in the network resulting from adoptions of private developer schemes will increase the SP's maintenance liability. The cost of adding a typical 1 km length of carriageway to the network is approximately £17,000 to £20,000 per annum, depending on the type and density of various assets (e.g. lighting, drainage gullies, bus stops, benches, street cleansing, footways etc). The Council needs to make adequate provision for this cost, either through developer contributions or from its own resources, before future adoptions are accepted to form part of the network. The Project Team have tried to mitigate this risk by including all known potential schemes that are likely to be adopted up to 2015; hence, the costs of accruing these developer schemes are already included in the Preferred Bidder costs.
- (c) Changes to the Scope of the Contract: The Contract has provisions that would allow the Council to vary the scope of the Project in the future. However, this will carry significant risk to the Council; any reduction to the Scope will result in loss of income to the SP, who has already borrowed monies to provide the services defined in the Contract. The Council is therefore unlikely to realise the full benefit of cost reduction resulting from such changes to scope.
- (d) Material Damage to the Project Network: The Council currently does not insure the Project network against material damage; most of the damage that has happened historically is due to third party incidents and these are recovered from third party insurance. However, if a major incident occurs either now or during this Contract that is not caused by a third party, then the Council would need to either fund the cost of rectification, seek an additional one-off special grant from the DfT or de-accrue (remove and stop-off) that section from the network. Typical events would be damage to the highway network from coastal erosion or major geotechnical or geological events outside the highway that affect the integrity of the highway. Under this Contract, the status quo is maintained, except for a small benefit to the Council, where the SP will contribute £25,000 towards the rectification cost, for each and every incident.
- (e) Latent Defect: The Council has carried out a series of surveys to produce a comprehensive asset inventory and current condition record. The Preferred Bidder has carried out his own due-diligence to validate the quantum and quality. However, for bridges and retaining walls, any built-in defects or any unknown phenomena (i.e. potential internal chemical reaction, not known in the construction industry so far) could potentially result in a defect in the

future. This is known as “latent” defect and all defects that are visible or expected because of industry knowledge are defined as “patent” defects. At present any defect resulting in the condition of the structure, whether it is patent or latent, is a Council liability. However, under this Contract, the SP will be liable for the first £1.25m of damage (cumulative cap for the entire duration) and the Council will need to find any additional costs resulting from any latent defect.

- (f) Future Changes to Highway Standards and / or legislation: Any future changes in legislation and highway standards will have an impact on this Contract. The Council will have some ability to manage this risk by only implementing those changes that are mandated. Where the changes are discretionary or subject to a risk assessment, alternative risk management approaches could be implemented without incurring any additional costs (e.g. by reducing speed). The Preferred Bidder’s bid includes acceptance of limited risk towards future changes in legislation. The Preferred Bidder has also accepted a risk cap of £0.5m for any impact resulting from Highway Standard changes during the entire Contract period.
- (g) Uncertainty in the Financial Markets: The uncertainty surrounding the European debt crisis has significantly affected the number of funders available for long term lending for the bidders. The continued reduction of funders willing to lend on infrastructure projects has steadily reduced in the last six months. If the current Euro crisis continues, then it is likely there could be some deterioration of the lending terms. As mitigation against this rising uncertainty, the Project Team has negotiated with the Preferred Bidder and obtained “Confirmed Terms” that are held for a three month period. The Terms offered are better than the anticipated rates at the OBC stage and hence, the European uncertainty has had little or no impact so far on this Project. However, if the Council fails to reach Financial Close within the next three month, there could be changes to the funding terms, which could potentially increase the Council’s contribution.
- (h) Failure to reach Financial Close within three months: The Council has a three month window within which to clarify all outstanding issues with the Preferred Bidder. In addition, the Final Business Case that will be submitted to the DfT and HMT immediately after this Cabinet Meeting must be approved before Financial Close can be achieved. The FBC has to be approved by the DfT’s internal Investment Committee, before the Secretary of State for Transport can seek approval from HM Treasury. Given that the Olympics is approaching and that the Parliament will be in recess in July, there is a risk that the FBC approval could extend outside the three month window. This would result in the Preferred Bidder needing to refresh the terms of lending (see g above).
- (i) Contract Management Risk: A Contract Management Team has been developed from the Project’s Procurement Team to ensure the knowledge of the Contract is retained for the contract management phase. However, the Team has no major PFI contract management expertise and the level of resourcing is low compared to the Birmingham Highways PFI and the Sheffield Highways PFI (this project is expected to commence service in the summer). The Council will never be able to quantify this risk as missed opportunities will always remain as “unknowns”. The Council intends to recruit

a “Contract Manager” with PFI Contract Management experience in the autumn of 2012.

## **RECOMMENDATION**

109. That Cabinet note the significant progress made in the development of this Project since August 2009, delivering excellent value for money. In recognising this progress the Cabinet is asked to:

- Approve the Final Business Case for submission to the Department for Transport and HM Treasury;
- Endorse the PFI Programme Director’s decision, supported by the Project Sponsor, the Project Board and the Member Review Board on the selection of a Preferred Bidder; and
- Approve the delegations set out in paragraph 58 of this report and note that a further report will be received by Cabinet prior to the formal signing of the Contract.

## **CALL-IN**

110. Call-in for these decisions will be disappplied, as highlighted at the beginning of this report. This is due to the urgency of obtaining the approval from DfT/HMT of the Final Business Case whilst the Preferred Bidder’s lending terms remain current. Any delay in the approval of the FBC could result in the need to refresh the lending terms offered by the Preferred Bidder which could result in increasing the cost of the Project. This approach has been endorsed by the Chair of the Overview and Scrutiny Panel, Cllr Vanessa Churchman who commented: “Given the tight timescales involved and the discussions I have had with the other members of the Overview and Scrutiny Committee I support the disapplication of call-in for this decision, provided that all members are sent a copy of the report and are (if they wish) able to attend the Cabinet meeting.”

## **APPENDICES ATTACHED**

[Appendix 1](#) – Final Business Case (redacted) – (To Follow)

[Appendix 2](#) – Six Districts of the Isle of Wight Map

[Appendix 3](#) – August 2009 Cabinet Report

[Appendix 4](#) – Preferred Bidder Memorandum (to be distributed at Cabinet meeting)

[Appendix 5](#) – Glossary of Terms

## **BACKGROUND PAPERS**

Equality Impact Assessment (Draft)

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Waste*

CLLR DAVID PUGH

*Isle of Wight Council Leader  
and Cabinet Member for Resources*