Department *of* Education

INFORMATION MEMORANDUM

on

The Private Finance Initiative in Schools

INVESTOR IN PEOPLE

September 2000

INTRODUCTION

1. The Private Finance Initiative (PFI) has developed significantly from its launch in 1992 and has become one of the Government's main instruments for delivering higher quality and more cost-effective public services involving capital investment. Since 1997 alone 140 PFI deals have been signed in the United Kingdom worth £4.7 billion. Of this some £850 million of capital investment has been planned for schools in England and Wales up to 2002 (with many deals already signed), while in Scotland deals for schools projects worth £274 million have already been signed and further deals worth £234 million are expected to be signed within the next 2 years. Indeed the use of PFI has now become established in a large number of countries throughout Europe, including the Republic of Ireland, as a key means of modernising public services infrastructure.

2. The Department of Education, with its responsibility for managing capital investment in the schools estate, has been actively engaged in recent years in evaluating the usefulness of PFI to meet the capital needs of schools, and this information memorandum is primarily aimed at providing schools authorities, along with other interested parties, with information on PFI in schools; what the Department has done in the context of PFI; and how it proposes to use PFI in future as a means of securing capital investment in the schools sector along with conventional public sector capital projects.

3. This document is intended to form the basis for consultation with schools authorities on the future use of PFI. This will be undertaken by the Department in planned meetings with schools authorities during October and November, and culminating in a one-day conference in early December, to which schools authorities will be invited to send delegates. It is intended that this consultation will provide an opportunity for all interested parties to discuss a broad range of issues arising from experience so far in the use of PFI in Northern Ireland and further afield, and to comment on the Department's proposed way forward prior to the Minister making decisions on the 2001 capital investment programme.

4. The sections below are structured as follows:-

    a. What is PFI?

    b. Progress to date

    c. The experience so far.

    d. What next?

    e. The Consultation process

WHAT IS PFI?

1. The principal aim of the PFI is to involve the private sector in the provision of public services, shifting the role of the public sector from owner and provider to enabler and purchaser and guardian of the interests of the end-users, the general public. It is driven, in part, by the view that the public sector should focus on its core functions, leaving the private sector to perform those functions which it can often do more cost-effectively and efficiently than the public sector.

2. The traditional procurement of public sector infrastructure and its related services, where the public sector is owner and operator with responsibility for design and construction, has given way to the private sector assuming responsibility for design, construction, operation, management, maintenance and finance, with the public sector as the customer, or ,with the public itself as direct user, paying for the provision of a service.

3. The focus on the provision of a service to the public sector, rather than the purchase of a capital asset, underpins the PFI. By giving the private sector the responsibility for providing, maintaining and operating an asset, the public sector's motivation is to define a standard of service to be delivered to it (or to the general public, as end-user) leaving the private sector to determine the way to deliver that service. In other words, the public sector will prescribe a set of outputs (the 'what') leaving the private sector to determine the technical solution (the 'how'). By way of example, if the task is the delivery of constant hot and cold running water in a building, the output specification will be framed in terms of the provision of water to a certain number of people and a definition of what constitutes 'hot' (for example, water within a prescribed temperature band). The private sector's responsibility is to determine the quantity of water required, the capacity of tanks and the system necessary to ensure that there is always hot water. In return the public sector user pays a fee to the private sector operator for the use of that hot water. If the hot water is not available to the user when needed or, is not of the contracted quality (cleanness and temperature) then the recurrent fee paid to the operator is reduced, according to an agreed scale of deductions.

4. In other words the private sector operator manages the risks of ensuring a reliable and quality supply of hot water. If performance standards are met, the operator's gains profit from the fee paid. If performance is substandard the operator's profit is reduced or even eradicated in extreme circumstances.

5. The operator would normally borrow capital from a bank to fund the development of the service and pay off that debt over a number of years. Where the operator company fell into difficulties (eg went bankrupt) the Bank would normally step-in

and replace the operator with an alternate company in order that it could secure its loan; thereby ensuring continued delivery of service to the public sector client.

6. This is only a very simplistic example of a PFI arrangement, but it serves to highlight a few key points as follows:-

   a. in PFI the public sector purchases a service, not an asset;

   b. a key element of a PFI deal is the transfer of risk to the private sector;

   c. the private sector operator can only be profitable if the contracted service is delivered to the agreed performance standard; and

   d. the involvement of funders such as banks acting as senior debt lenders in a PFI contract extending often over 25 years provides security of service delivery even where private operators run into difficulties.

7. Whilst the precise terms of each PFI contract will differ, they generally involve a deal under which the contractor will design, build and operate the necessary facilities, and will also provide and manage certain associated services such as caretaking and cleaning (and in the case of schools, perhaps school meals). In return, the contractor receives an annual payment, provided the agreed service standards are being maintained. This annual payment - the 'unitary charge' - covers the cost of these services and related 'risks' and also recompenses the contractor for his capital outlay in erecting the premises (which he in turn will probably have financed via a loan). Contracts will typically be for a 25-year period. One of the advantages of this arrangement from a budgetary point of view is that it is not necessary for the Department to pay the full capital cost up-front as would be the case with conventional procurement. Nevertheless, each deal is subject to rigorous value-for-money tests, measured against a Public Sector Comparator[1] (PSC), to ensure that the public purse is being protected. In essence the PSC is a financial model comprising all the risk adjusted costs of the public sector designing, constructing, funding and operating the facility required, such as a new school. In order for a private sector bidder to be awarded a PFI contract the 'price' of the bid must be better that the 'price' of the PSC.

[1] *Public Sector Comparator: Typically based on a set of hypothetical contracts to design, build and manage a public sector facility, based on recent experience of actual costs.*

PROGRESS TO DATE?

1. The present schools estate (nursery, primary and secondary) comprises just over 1,200 schools and is valued at approximately £2.5 billion. There is currently a backlog in major capital works valued at approximately £500 million. In addition, there is an estimated backlog in buildings' maintenance work of some £90 million. It is clear that with capital and maintenance expenditure at current levels, it would take very many years before this backlog could be eliminated. While it was clear that the major element of future capital programmes would continue to be financed by the conventional procurement approach, the Department decided in 1996 to explore to what extent PFI could be used to complement conventional procurement and thus increase the 'buying power' of the available resources.

Pathfinder Projects

2. In 1996 the Department launched a twin track approach, involving pathfinder projects and a market sounding study, to assess whether PFI could deliver value for money solutions to meet the extensive and growing capital investment needs of schools. Most of the 120 high priority schools capital projects are relatively small in capital value terms (average capital value less than £3 million with just over 50% with a value less than £1.5 million). It is generally accepted that projects of small size are less likely to attract interest from private sector investors, and can also require disproportionate effort and cost in achieving a PFI contract.

3. The Department promoted 6 pathfinder projects - 2 FE colleges[(2)] and 4 secondary schools. These were selected on the basis that they were high priorities in the Department's planning list and that they were of sufficient size (in capital terms) to attract interest from potential private sector investors. It was expected that, as well as testing the market's keenness to offer PFI solutions to these projects, these procurements would provide a valuable learning experience for the education service in evaluating the longer term prospect of PFI solutions in education. All of these projects were "orthodox" PFI procurements in that they sought a Design Build Finance and Operate (DBFO) arrangement, through a contract between a private sector operator and school authority for the provision of accommodation and related services for a school over a period of at least 25 years.

[(2)] *Under devolution the FE Colleges have now become the responsibility of the Department of Higher & Further Education, Training & Employment (DHFETE).*

4. The North West Institute of Further and Higher Education (NWIFHE), was assigned pathfinder status in March 1996. The four schools projects (Drumglass High, Wellington College, Balmoral High and St Genevieve's High) and the other FE project (Belfast Institute of Further and Higher Education) were selected in June 1996 to test the feasibility of PFI across a range of types of projects - new build, refurbishment, Maintained and Controlled - in order to maximise the opportunity for testing the advantages and disadvantages of PFI procurement.

5. Contracts for all of the projects, involving a total capital investment of some £50 million, have now been awarded or, in the case of Wellington College and Balmoral High School, are expected to be awarded imminently. Construction of the new Drumglass High School, the contract for which was awarded in June 1999, was completed this summer and became operational on 1 September 2000. The refurbishment projects in Wellington/Balmoral resulted in value for money bids from the private sector involving complete new build projects. Contracts have been awarded only after detailed negotiation with private sector bidders and on the firm basis that in each case the solutions offered represented value for money and met the education and service requirements of the various schools and college authorities.

6. All these contracts involve private operators being responsible for the design, building, financing and operation of the new facilities and bearing the associated risks in each case. In respect of "operations", this involves the private operator in delivering a range of services to contracted standards such as building and ground maintenance, caretaking, security, cleaning, utilities, and catering. In most cases the transfer of these functions from the schools authority to the private operator involves the transfer of public sector employees to the operator under TUPE provisions whereby their terms and conditions of employment are protected. This creates a very different dynamic in terms of service management in that the operator is now responsible for certain services and associated staff which previously were the responsibility of the school authority or the school itself. This has the potential to reduce the management load of school principals. Equally, the management of a PFI contract requires new approaches and in this regard the Department has taken a number of steps to ensure that suitable contract management structures, supported by appropriate training of relevant staff, has been put in place.

Market Sounding Study

7. The Department also conducted a unique Market Sounding Study in 1996 and 1997. This was aimed at gauging the views of the private sector on a wide range of schools capital projects, and in particular seeking views on how best, if at all, to bring schools projects to the market in a PFI context. The study surveyed over 300 private sector companies and gathered detailed information by way of a questionnaire from 70 companies expressing interest in PFI deals in education. The study also involved structured interviews with over 20 companies representing

construction, facilities management, property development and financial business sectors. The results of this market study reinforced the growing view, later confirmed by the Treasury Taskforce Bates Review in September 1997, that typical schools' capital projects would be more attractive commercial prospects in terms of PFI, and would be more likely to deliver good value for money deals, if a number of projects were packaged or bundled together for a single contract. This would have the two-fold benefit of presenting a larger capital investment more worthy of the cost of bidding to be expected by the private sector consortia, and a much increased facilities management operation capable of sustaining a realistic long-term business commitment by any consortia. Typically such bundles of projects were defined in capital terms of a minimum of £20 million, and preferably greater than £50 million, as being most desirable.

THE EXPERIENCE SO FAR

1. Over the last 4 years the Department has gained valuable experience and insights in the subject of Public Private Partnerships, or PFI, through its pathfinder programme, a market sounding study, and from subsequent financial modelling exercises undertaken in conjunction with, among others, the HM Treasury Taskforce. It has undoubtedly been a steep learning curve for all those involved in the pathfinder programme. The main strategic points which have emerged are summarised below. These fall under 3 categories, namely:

    a. lessons learned from the pathfinder projects,

    b. the experiences of other education authorities in Great Britain, and

    c. conclusions arising from the Department's market sounding study and subsequent financial modelling exercises aimed at exploring the comparative benefits of PFI bundling and conventional public sector procurement.

Lessons Learned from Pathfinders

Economic and Financial Issues

2. The Pathfinders generally demonstrated that is it is possible to broker viable deals on individual PFI projects. However, in these projects the value for money of bids, as measured against the Private Sector Comparator (PSC), were marginal - in the order of 1-2%. Indeed the close proximity between the PSC and the bids suggests that the limited disclosure of the PSC has been a significant factor in determining the bid price. This is a concern, given the difficulties associated with measurement of risk and the absence of detailed local databases on historic costs - though this is likely to become a less significant issue as both bidders and procuring authorities gain experience in costing deals of this sort. However, the potential VFM in larger deals such as would be inherent in a 'bundle', which on the evidence of projects in Great Britain offers a prospect of better VFM, not least because the bidders' costs would be a proportionately smaller relative to the contract price, has yet to be tested in Northern Ireland. Evidence from bundled projects signed in Great Britain suggest that VFM of at least 5% or more is attainable.

3. Whilst the complexity of negotiating a PFI deal requires a longer procurement period than a conventional contract, this has to be set against the period during which a project might have to wait in the priority 'queue' for resources for a conventional procurement. Moreover, PFI holds out the potential to release a larger volume of priority building work than would be possible under conventional contracts. For example, the combined capital value of the 6 pathfinder projects is of the order of £50m which, if all contracts were being let on a conventional basis within the present calendar year, would entail expenditure of £15-£25 million in each of the

years 2000/01 and 2002/03. In contrast, the combined 'unitary payments' - which will come into effect only when the buildings become available for use - will be of the order of £7 million per annum (which includes both operational costs as well as capital). This leaves substantial headroom in the capital budget to enable additional projects - whether conventional or PFI - to proceed sooner than would otherwise be possible. In addition, as has been evidenced at Drumglass High School, the first pathfinder contract awarded, a significantly faster rate of construction is achievable - in this case only 12 months. The downside of this financial phasing is that the capital budget will be required to meet the PFI costs for usually 25 years in each project.

Resourcing PFI Projects

4. In initiating a programme of 6 pathfinder projects the Department now realises that it seriously underestimated the resource needs of projects of this kind. The planning and procurement process is complex and, by virtue of being a negotiated procurement process, can be time consuming and lengthy. The pathfinder projects were resourced by officials (in DE, ELBs, CCMS and schools/colleges) contributing invariably on a part-time basis in addition to other duties, and externally recruited consultants. The latter resource has been used to a very much greater extent than initially envisaged, with significant cost consequences. Another consequence of this part-time mode of operation has been to lengthen the procurement process, as external consultants have had to seek instructions from public sector officials at numerous stages in the negotiations. For the future it is acknowledged that project teams involved in PFI procurement will have to include more in-house personnel dedicated to the project on a full time basis. The Department has already taken steps to allocate, train and develop staff for this purpose, and has increased the staffing of its PFI Unit.

5. It is clear that public service project team members, with a few notable exceptions, lacked appropriate skills in project management as well as commercial contracts and negotiation. In many cases team membership was determined more by who could be made available at the time. The Department has taken steps to identify future training needs for relevant staff and plan for appropriate training of project teams prior to procurement commencing in any future project.

6. The recruitment of consultants was centrally co-ordinated by the Department's PFI Unit. Legal advisers were contracted to DE to provide advice for all 6 projects. This facilitated a consistent approach across all projects and has contributed significantly to the development of standardised procurement procedures and contract drafting. Financial, property and technical advisers were recruited on a project by project basis and contracted to the relevant school/college authority rather than the Department. Given the fact that procurement in all pathfinders has taken much greater time that originally envisaged this has resulted in higher than anticipated external consultancy costs. This needs to be addressed in future projects by much tighter control and shorter timescales.

7. Difficulties were also experienced with unplanned changes in project teams' personnel - both in-house and consultants. Such changes are difficult to avoid in any project, but for the future more robust contingency plans and hand-over arrangements need to be put in place to avoid any significant loss of project knowledge and to ensure continuity of quality inputs.

8. To summarise, it is clear that there is a need to plan much more carefully for the resourcing of future PFI projects. The core members of project teams need to be deployed on a full-time basis - it is not feasible to rely solely on the continued part-time input from DE, CCMS, ELB staff or individual school management teams. These teams also need to be multi-disciplinary involving a range of expertise - both in-house and external advisors. Where external consultants are needed they should be contracted on the basis of capped fees and where possible with performance incentives. In addition, the possible use of secondments from consultancy firms will be investigated. Project team members need to be trained in a range of skills including PFI procurement, project management and negotiation.

Managing PFI Projects

9. Given the complexity of the PFI procurement process sound project management is essential. The requisite skills are not readily available within the education service and undue reliance on external consultants to provide project management is not necessarily effective or in the best interests of the public sector. There is a need to strengthen project management generally in terms of project structures, procedures and reporting to streamline the procurement process, provide greater assurance of accountability, and provide effective management of resources in PFI projects.

10. The Department's PFI Unit will publish new guidance on project management by December 2000. It is essential that the management and negotiation of future projects is conducted within clearly established guidelines and timeframes in order to preclude the possibility of protracted negotiations by bidders (and their banks) which has been a feature of some of the Pathfinders.

Planning PFI Projects

11. The pathfinder project teams were, for obvious reasons, anxious to commence procurement without delay in order to secure a deal and a new school as quickly as possible. As a result there was inadequate pre-planning and the actual procurement process was lengthened as problems were dealt with in an incremental fashion throughout the project. However, a useful innovation was introduced at an early stage of each pathfinder such that each project was subject to a Legal Viability Report at the same time as preparation of the Outline Business Case. This ensured that a range of legal issues were resolved at the outset and avoided some later difficulties which other projects in GB suffered from eg vires, land deeds etc; but not all.

12. There is a need, for future projects, to establish clear guidelines on what preparatory work needs to be undertaken before procurement begins. This would include scoping of projects (ie nature of facilities required, service functions to be transferred to the private sector, etc), development of output specifications (with particular emphasis on determining ways of encouraging innovation by bidders), procurement documentation, models on payment and pricing mechanisms, standard contract terms and negotiation strategies. The Department will publish new guidance on all of this. Future PFI projects will also benefit significantly from the project documentation developed during the pathfinder projects, such as output specifications, user requirements, payment mechanisms, and standardised contracts. The existence of this documentation will greatly reduce the amount of time and effort required for their preparation in future projects. It will also significantly reduce the amount of negotiation required with private sector bidders and thereby shorten the procurement process. Approval by the Department to commence formal procurement in future PFI projects will need to be contingent on the Department being satisfied that the necessary preparatory work had been substantially completed.

Developing Public Sector Comparators

13. A great deal of work was carried out by the Department's Economic Advisory Unit in developing Public Sector Comparators for the pathfinder projects. This has been a highly complex area of work particularly in the area of risk assessment. These risk assessments are critical in determining whether or not a bidder's proposal can deliver value for money. This aspect of the development of PSCs requires further refinement to provide even more robust and reliable measures of risk to ensure that decisions taken on value for money are defensible and reliable.

14. The degree to which details of constructed PSCs for pathfinders should be exposed to bidders was considered at an early stage of the pathfinder programme. Full exposure, it was argued, could ensure that bids fell within the range of the PSC and therefore avoid the situation where bidders "over-egged the pudding" and submitted unaffordable bids. Conversely it was argued that full exposure would tempt bidders to seek to negotiate up the costs included within the PSC, and there was some evidence in the case of one bidder for this very approach. It was concluded that only outline details of the PSC should be exposed including non-risk adjusted NPV figures as a guide to affordability. However, for the future, as further experience is gained in the construction of 'robust' PSCs, there may be scope for testing different approaches to procurement - namely, setting the PSC from the outset as the ceiling on costs, and inviting bids which would then be judged on the basis of quality of bid/best innovation or not issuing the PSC at all.

Lessons learned from Education PFI Projects in Great Britain

15. The Department has closely monitored developments in other PFI projects in the Education sector in Great Britain and the Republic of Ireland. In 1998 Falkirk County Council signed the first bundled schools contract in the UK. This project was for 5 secondary schools - 4 new build and 1 extension and refurbishment valued in total at £70 million. A significant feature of this project was that procurement was completed within 15 months. This was achieved by use of a full-time project team involving in-house staff and external consultants, and with substantial input from the HM Treasury Taskforce personnel. The Dudley Grid for Learning initiative is the largest and most ambitious Public Finance Initiative (PFI) project of its kind. It will deliver the National Grid for Learning to the 105 schools within Dudley Local Education Authority. Under the 10 year contract, which was initially rolled out in March 1999, teachers and pupils will benefit from an upgrade in computer equipment, Internet access and new learning software.

16. Colfox school in Bridport, Dorset was the first PFI project to be completed in the schools sector in the UK. It is a co-educational 11-18 secondary school for over 1,000 pupils. The contract was signed in November 1997 after a procurement process lasting almost 2 years. A feature of this project was final designs for the new school were not completed at the point were a contract was awarded. This compares with the pathfinders projects in Northern Ireland were all design issues were completed at the point of contract award and this goes some way to explaining the longer procurement cycles here. The new school was completed and commenced operations in September 1999.

17. Glasgow City Council is currently undertaking a Best Value Review of its Education provision for primary schools. The review is being carried out against a background of outstanding repairs of £1.3 billion for all primary schools in Scotland. Glasgow's share of this bill is estimated at over £100 million. A new build investment programme may need to be delivered in phases as other regeneration activity occurs within Glasgow. The Council completed the final stages of negotiations of the Secondary Schools PPP contract in June this year for the replacement or refurbishment of all of Glasgow's secondary schools following a procurement cycle lasting some 18 months. As with the Falkirk Schools project, this project involved a full-time project team and significant input from the Treasury Taskforce.

18. It is clear from the experiences of education authorities in GB that PFI bundled schools projects can deliver good VFM and can be procured within a reasonable timescale of between 15 and 20 months provided sufficient full-time project team resources, suitably trained and skilled, are deployed. It is also clear in these cases that direct input from the Treasury Taskforce was also important in ensuring successful outcomes to negotiations. The role of the Treasury Taskforce in promoting and supporting PFI projects in the UK has recently been superseded by a new body,

Partnerships UK, and the Department is investigating what role this body could play in supporting future PFI projects in education.

19. On 1 June 1999 the Irish Government announced a list of pilot Public Private Partnerships projects. These projects involve an estimated total capital expenditure of IR£600 million. A project sponsored by the Department of Education and Science in Dublin involving the bundling of 5 secondary schools, with an approximate capital value of IR£40 million, has been included in this pilot programme. The Department has liaised closely with its counterpart in Dublin and it is clear that in initiating this programme the DES has concluded, on the basis of experience in both Great Britain and Northern Ireland, that the PFI procurement process offers an important means by which it can supplement its conventional public sector capital investment programme in order to modernise the infrastructure of its public services, including schools, more quickly than might otherwise be achieved.

20 The PFI Unit in the Department has maintained close relations with all these projects in order that an exchange of information can be ensured and future PFI projects in Northern Ireland can benefit from their experience.

Lessons Learned from the Market Sounding Study and Financial Modelling

21. The Department has been developing a longer term strategy for the use of PFI in addressing the capital needs of the schools estate. This has been based on experience gained in our pathfinder projects and on the results of the Market Sounding Study undertaken in 1996.

22. Experience with the pathfinders has shown that negotiations on individual contracts can be complex and time-consuming. The market sounding study confirmed the private sector view that for future PFI projects in the schools sector it would be preferable to bundle capital projects together as single contracted packages, because individual schemes may not be large enough to be attractive or financially viable as separate contracts. In addition, private sector interests with a particular interest in delivering PFI solutions indicated strongly that the existence of a "viable deal flow" would both generate increased interest by potential investors generally and most importantly attract the companies with a long term commitment to PFI projects. Essentially a "viable deal flow" relates to a clear programme of PFI projects spread over a number of years emanating from a single sector. Such a programme encourages investors to risk bidding costs (which can be substantial) and from a commercial standpoint a commitment to such a deal flow by the public sector is more attractive to the private sector than piece-meal procurement of projects.

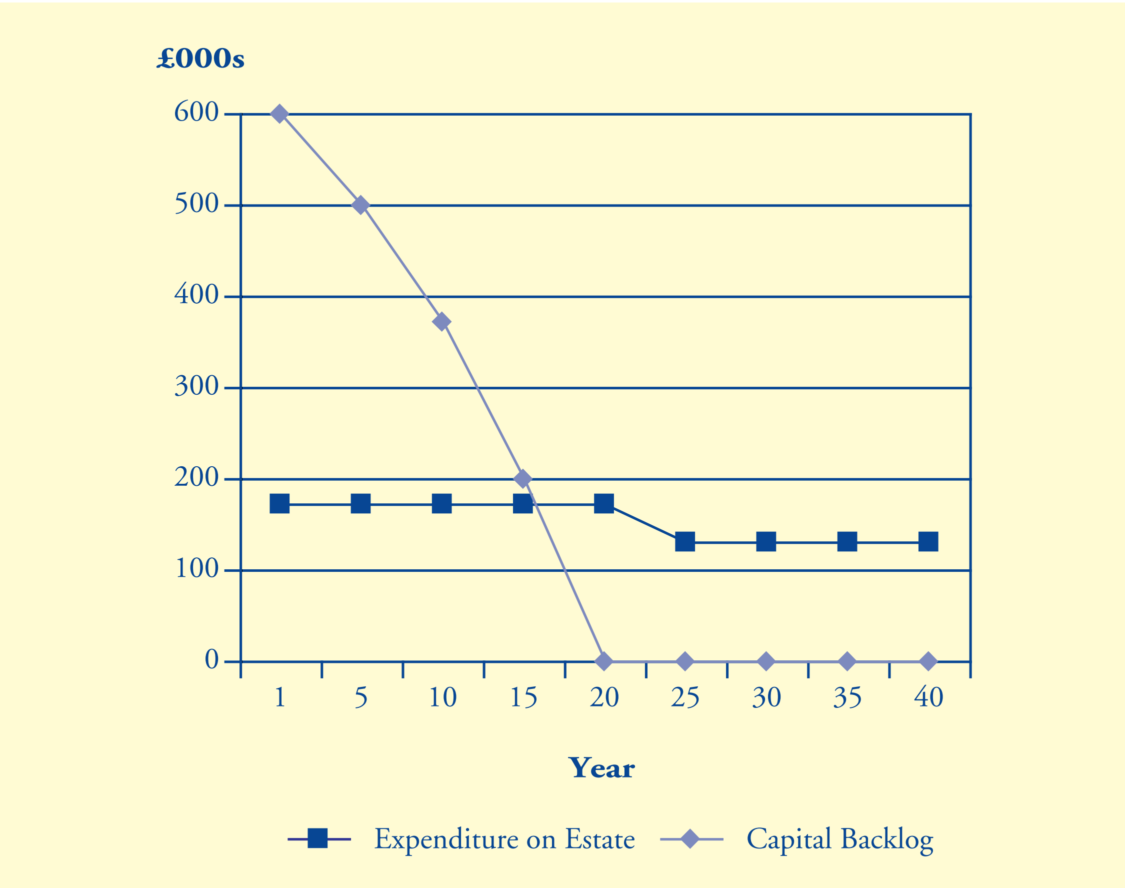
Bundling Approach

23. The Department has discussed the concept of bundling with private sector interests, HMT Taskforce, DfEE and DFP, to assess whether this approach could be worth pursuing, in terms of practicality and value for money. In addition, it is clear that the advantages and disadvantages of any such approach is difficult to evaluate in the abstract. Consequently, it was decided in 1998 to develop quantitative models that would provide a basis for analysis comparing conventional capital funding of schools projects with the use of PFI bundling which, would facilitate more informed decisions on the best way forward. The support and guidance on designing and conducting this modelling exercise was provided by the Treasury Taskforce.

24. In this exercise the working assumption was that annual capital investment in the schools estate would at least remain at the levels implied by the then existing public expenditure baseline (pre CSR-1998). (When constructing the models in June 1998 the assumption was that the Department's capital baseline of £63 million per annum and estimated estate operating costs of £110 million per annum would remain constant). The issue thus becomes one of deploying those resources to best effect. The model for conventional public sector procurement demonstrated that it would take at least 20 years to eliminate the current backlog in capital works (See Figure 1).

FIGURE 1

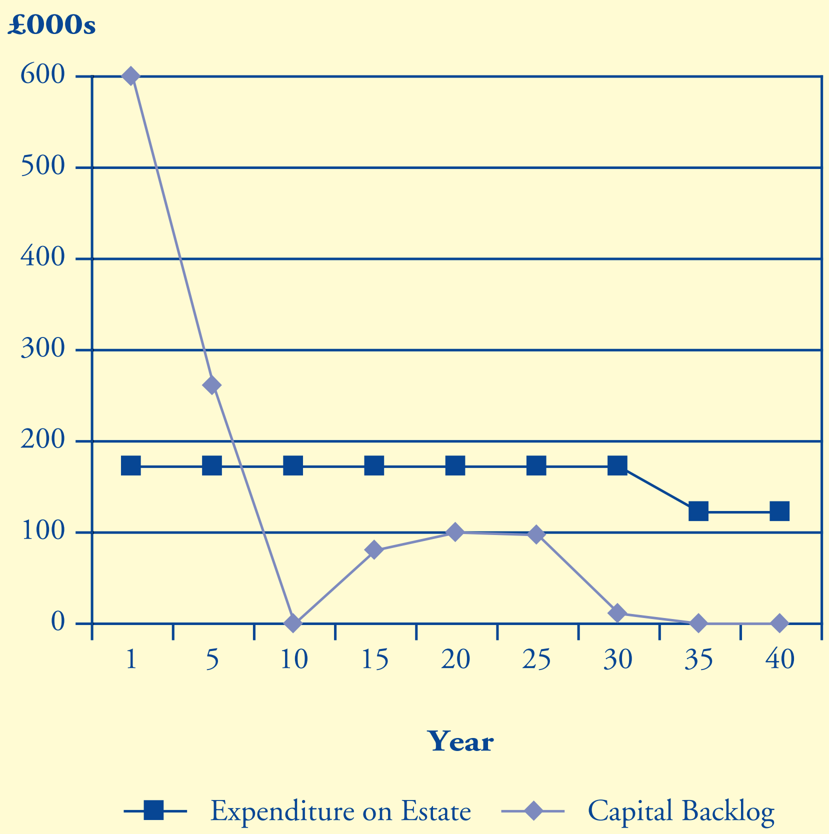
Conventional Public Sector Capital Investment Only



25. In contrast, the PFI bundling model demonstrated that the elimination of the capital backlog could be achieved by this approach within 10 years or less. However, the bundling model output also demonstrates a more complex outcome - see Figure 2. Assuming current levels of expenditure were maintained, and that savings realised in recurrent expenditure (eg maintenance and reduced surplus capacity) could be reinvested in the schools estate, the model points to an elimination of the backlog in 10 years. However, for a period following year 10 the capital backlog begins to rise again, although not to the same high level as at present, before declining again to zero in year 30 of the model. This outcome reflects mainly the fact that PFI bundles are funded by converting capital to recurrent expenditure, and thus when the existing capital baseline (assumed to be £63 million in the model) has been largely used up in procuring PFI bundles, the system "silts up" and no further PFI procurement is possible. It is only with the accumulation of continued savings in recurrent costs being reinvested as public sector capital in these years that the smaller backlog in years 10 to 30 eventually is eliminated. The 'silting up' effect could in practice be avoided or minimised if some additional resources were made available in the years in question, thus preventing the re-emergence of the backlog.

FIGURE 2

PFI Bundling and Conventional Public Capital Investment



26. The modelling exercise demonstrated that procurement of capital assets for the schools estate solely by means of conventional public sector capital funding, assuming that current levels of capital resources remain unchanged, would not produce sufficient improvement in the capital estate within an acceptable time frame of 10 years. The PFI option of bundling, alongside a conventional programme, offers the potential to realise such a strategic objective and within the scope of current resource levels.

WHAT NEXT?

1. The backlog in major capital works has been a feature of the schools estate for many years and has meant that the capital resources available to the Department, even with the significant increases in recent years, is invariably insufficient to deal decisively with the growing needs of schools. Many schools authorities have experienced very significant delays in addressing priority needs. The Department's recent experience in PFI pathfinder projects has confirmed that PFI does offer the potential for securing value for money services involving capital assets from the private sector and in a way that will maximise the impact of the available resources.

2. By using PFI to complement conventional capital investment it is clearly possible, in the view of the Department, to work towards eliminating the backlog of capital investment within a more reasonable timescale than might otherwise be achievable. Accordingly, the Department proposes to develop a programme of capital investment beginning in 2001 which incorporates both New Starts Programmes and Public Private Partnerships (PFI), where appropriate, with the aim of clearing the present backlog of works over a period of 10 years.

3. Not all capital projects are suitable for PFI, particularly small projects, except perhaps through bundling. In addition, some larger projects at an advanced stage of planning have incurred significant costs in professional fees which could be lost under a PFI approach. However, a significant number of projects, having completed economic appraisals, are not so far developed and thus could sensibly be dealt with using PFI in the immediate future. Against this background it is important to stress that both conventional procurement and PFI, together, will have a role for the foreseeable future in addressing more effectively the needs of the schools estate.

4. Notwithstanding the evidence in support of the PFI bundling approach as being the preferred way forward, it is clear, from an examination of current capital projects in the Department's planning lists, that it is not a simple task to develop a feasible bundle of projects because of the variety of schools authorities involved. Ideally the procurement through PFI of a bundle of projects should result in a single contract with a single schools authority. This will reduce the complexity of contracts and their subsequent management. One example of this would be a bundle of Controlled schools in a single Education and Library Board. However, there are precedents also for a bundle of projects to be procured involving a number of schools in different board areas using one board as the ”lead authority” in letting a single contract on behalf of a number of boards. In the case of Voluntary Maintained, Voluntary Grammar and Grant Maintained Integrated schools, however, the concept of bundling presents slightly greater difficulty, primarily because the relevant schools authorities in each case are essentially independent entities rather than administrative groupings under a single authority.

5. This is not to say that bundling in these sectors would not be feasible or that single projects of sufficient size (say £20 million or more) could not be progressed using PFI, as in the case of the pathfinder project at St Genevieve's High School in Belfast. For example, it may be possible to bundle Voluntary Maintained schools which are located within a single Catholic Church Diocese and where the senior Trustees for the schools concerned are also representatives of the Diocese - ie there is a common denominator, so to speak, that could provide the basis for a single contract. In the case of Voluntary Grammar and Grant Maintained Integrated schools such a "common denominator" is less evident, but it may be possible for such schools to enter into strategic partnerships with the object of securing, through joint PFI procurement, a single PFI contract for a bundle of schools. Clearly further evaluation and planning would need to be undertaken before bundles of this type could be developed for PFI procurement. The Department looks forward to discussing these issues with the relevant schools authorities in the coming months.

6. Reference has already been made to the need for a viable deal flow where PFI projects are developed and initiated over a period of years in order to engage potential investors from the outset and to sustain their interest over time. The concept of a deal flow should not be seen as purely for the benefit of the private sector. On the contrary it is as much for the benefit of the public sector since it is clear that, just as much as private sector investors will be competing with each other for contracts, there is competition among public sector procurers to attract the best private sector companies to bid for their projects in what is fast becoming an aggressive and growing PFI market. With this in mind the Department view is that any PFI projects to be launched in 2001 should go alongside a commitment to initiate similar PFI projects over the following 2 years. Subject to the outcome of the 2000 Spending Review, the total capital value of these PFI projects could be in the order of £30-£50 million per year. In other words a programme aimed at procuring a total of up to £150 million investment in schools. This would be in addition to conventional public sector capital investments over the same period.

THE CONSULTATION PROCESS

1. Immediately following issue of this information memorandum, the Department will arrange meetings with the relevant schools authorities (particularly those with high priority capital projects) to discuss the Department's proposals in detail. It is planned that these meetings will take place during October and November 2000. In addition, the Department expects to consult the Assembly Education Committee, as well as Trade Unions and private sector bodies such as banks etc. In launching a PFI programme of this nature, it is essential that both the public and private sectors have a clear understanding of the proposals to ensure their commitment to the programme.

2. In addition to these meetings, the Department would welcome any written submissions which authorities or others may wish to make on its proposals by **22 November 2000**. Any written submissions should be addressed to:

   Head of the PFI Unit
   Department of Education
   Rathgael House
   Bangor
   Co Down
   BT19 7PR

3. The Department will conclude the consultation process with a one-day conference in early December to which schools authorities will be invited. The conference programme will include presentations by speakers from the Department (drawing particularly on issues raised by schools authorities during consultation), schools authorities in Great Britain who have completed bundled PFI projects, and PFI specialists with particular expertise in the procurement of PFI projects and legal and contractual issues. The programme will provide an opportunity for general discussion on the strategic issues arising from the Department's proposals.

4. Once the consultation process has been completed, the Department would finalise the PFI capital investment programme with a view to an announcement by the Minister in early 2001 at the same time as the conventional programme is to be announced.

INFORMATION MEMORANDUM
on The Private Finance Initiative in Schools

This document can be obtained in Irish on request

Rathgael House
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