



Leicester
City Council

**WARDS AFFECTED
ALL**

**FORWARD TIMETABLE OF CONSULTATION AND MEETINGS:
Cabinet**

30 JULY 2007

FINAL BUSINESS CASE - Building Schools for the Future (Phase 1)

Report of the BSF Project Director

1. Purpose of Report

- 1.1 This report sets out the current position in respect of the Building Schools for the Future programme in Leicester and in particular describes the purpose and contents of the Final Business Case (FBC) for the BSF Programme. The report seeks Cabinet approval for submission of the FBC for phase 1 of the programme.
- 1.2 The report also describes the approach taken to risk analysis in respect of the programme and seeks authority to enter into an Early Works Agreement (EWA) as a way of mitigating the risks related to a delayed financial close (FC). Those technical issues that need to be addressed prior to entering into an EWA are currently being resolved and those that need to be considered prior to FC are defined in a programme of works that have been agreed with the Miller Consortium. These latter issues will be considered in the report to Cabinet on 3rd September.

2. Summary

- 2.1.1 The Authority has previously received approval from DfES (Now DCSF) and HM Treasury's Project Review Group (PRG) to proceed with the BSF scheme following submission of the Outline Business Case early in 2005. These approvals were overseen and approved by previous cabinet reports. The plans for BSF have been developed to the stage where the Authority is now in a position to submit the Final Business Case (FBC). Legal advice has been received to the effect that the Final Business case contains commercially sensitive information and has therefore been distributed as a confidential agenda B paper. The FBC has been prepared in accordance with standard DCSF guidance.
- 2.1.2 Members should note that due to the commercially sensitive nature of the information contained within the FBC it has not been possible to share the full document with Union colleagues. A version has been circulated for comment with the financial sections deleted however unions have stated that they do not feel that this gives them sufficient information to comment properly on the FBC and that they do not consider this to represent appropriate consultation. Regular meetings attended by the Corporate Director

and/or Project Director have been set-up with unions to continue dialogue on the BSF programme in general and additional meetings have been set-up to consider those issues specific to staff transferring under the TUPE regulations.

- 2.1.3 DCSF require that a further business case is submitted prior to the BSF Contracts being signed at Financial Close. This is known as the Final Business Case (FBC). This business case is reviewed and approved by DCSF and is not submitted to PRG. DCSF approval is required before the Council can enter into the contracts with the Miller Consortium and DCSF require formal approval of the FBC through the Council's political processes before final sign-off.
- 2.1.4 The purpose of the FBC is to provide an overview of the project and summarise the procurement process that has taken place. It sets out the affordability position, details the risk allocations achieved and associated negotiated contractual position. It also confirms all statutory processes associated with the project have been concluded.
- 2.1.5 DCSF require approximately five weeks to review and approve the FBC. All Councils involved in the BSF process are therefore required to submit a Final Business Case several weeks before the contracts have been finalised. Inevitably aspects of the project might change following submission of the FBC and this is recognised by DCSF. Any material changes to the project before Financial Close will need to be reported to DCSF within the five week approval process.
- 2.1.6 The contents of the FBC are as follows:
- a) Project Overview – this section summarises the objectives of the overall programme. DCSF seek clarity that the scheme that has been procured meets these overall objectives, and remains largely as described in the OBC.
 - b) Procurement/Competition – this section provides brief details of the procurement process including a timetable to reach Financial Close.
 - c) Finance and Affordability – this section sets out the affordability position of the Phase 1 project.
 - d) Risk Allocation and Accounting Treatment – this section sets out the risk allocation of the project. In particular it details the risk allocation associated with the PFI scheme, and confirms that an 'off balance sheet' position has been reached in relation to the PFI scheme.
 - e) Contract and Payment Mechanism – this section summarises the contractual framework and any derogations that have been made to the national standard form BSF contracts. Derogations are only allowed for project specific reasons, or, with prior approval from Partnerships for Schools, in order to align the contracts with the current BSF market position.
 - f) Stakeholder Consultation – this section summarises the consultation that has been carried out and its outcomes.
 - g) Statutory Processes – this section outlines the status of the statutory processes, particularly those that need to be concluded prior to Financial Close.
 - h) Appendices – detailed supporting information is included in appendices including the affordability models, paper to the District Auditor on accounting treatment and derogation tables for all contracts.

- 2.1.7 The Council has finalised its Final Business Case and will be in a position to submit this to DCSF on 31 July subject to Cabinet Approval. This will allow the timetable to reach Financial Close in early September to be maintained. However it is important to recognise that it still allows for amendments to be made prior to Financial Close being achieved.
- 2.1.8 It has been critical to close down aspects of work prior to submitting the FBC. In the **technical work stream** the BSF build programme has reached the stage where there is agreement on the key aspects of the technical plans for each of the schools in phase 1. Further technical information is required to finalise financially critical details of the solution and this will need to have been reached by Financial Close. All of the four schools in Phase 1 of the programme have now signed off on the school designs in the form of Governor Agreements.
- 2.1.9 The **legal work stream** has been leading on final negotiations in respect of a series of legal contracts that underpin the BSF partnership arrangements, phase 1 construction programme (both PFI and Design and Build) and the phase 1 ICT managed service. These legal documents are based on a set of templates issued by Partnerships for Schools (PfS) and Partnerships UK (PUK) to all Authorities in the BSF programme. Negotiations are largely concluded with the exception of a limited number of commercial issues. The Council, in partnership with Partnerships for Schools, has an agreed negotiation strategy to resolve these final issues with the Consortium. Local derogations to the standard legal contracts have been negotiated to take into account project specific issues in respect of local schemes. The derogations for the Leicester BSF programme have been approved by Partnerships for Schools and will be formally signed off by PfS and PUK as part of the FBC process.
- 2.1.10 The **Finance Work stream** has reviewed the overall affordability position in respect of the Authority and its school partners. The affordability position has been included in the FBC, based on the position at Preferred Bidder stage and subsequent concluded negotiations which took into account the re-design of Fullhurst, the cost changes at Beaumont Leys, asbestos and price indexation. On-going negotiations in respect of the issues outlined in this report are not yet concluded and these will have some impact on the affordability of the project. The Council is currently actively engaged in the final commercial negotiations to minimise the impact of these issues and ensure that risks subsequent to financial close can be controlled within budgets and contingencies.
- 2.1.11 The Governing Bodies of each of the four Phase 1 schools have now signed the School Governing Body Agreements setting out the school's financial commitment to BSF contracts for the 25 year term of the contract.

2.2 Risk Analysis

- 2.2.1 Any major building programme such as BSF carries a variety of risks. The various work stream leads and their teams have developed a risk matrix covering the known potential risks contained in the programme.

- 2.2.2 Alongside the risk identification and mitigation work being carried out by the Council, Grant Thornton LLP have assisted the Council in developing an understanding of the potential financial impact of the risks associated with the BSF and ICT Procurement Programme.
- 2.2.3 Relevant Council personnel and advisors have been broken down into key workstreams - Technical, Legal, Financial etc. - and provided feedback as to
- the deemed probability of each identified risk occurring;
 - the best, most likely and worst case financial impact of each risk if it occurred; and
 - whether identified risks are 'one off' in nature or have the potential to recur.
- 2.2.4 Using a specialised simulation modelling package (@Risk) Grant Thornton have then used this data to arrive at indicative risk valuations for the Phase 1 schools. As this exercise is an iterative process, these results are now being shared with the various workstreams in order to review input assumptions and make any appropriate changes. This will allow a further iteration of the modelling work to be undertaken to generate a realistic assessment of the likely risk that the Council is exposed to in the BSF programme.
- 2.2.5 On completion the Council will be well-placed to take an informed view as to potential budgetary overruns on both the Phase 1 and future phases. Grant Thornton can then assist the Council in establishing a suitable cash reserving strategy such that contingency funding is available for drawdown in the event that risks materialise.
- 2.2.6 With the size of the BSF programme and the overall cost of the projects, a significant risk contingency is inevitable. The project team are continuing to refine the risk matrix and similar projects will be benchmarked. A final report will be presented to the Project Board and Cabinet in September when final sign-off on the project will be sought. In broad terms though the programme currently has three main areas of risk.
- 2.2.7 These are :-
- Risks associated with the programme post FC
 - Risks in delay in reaching FC
 - Risks associated with not proceeding with the programme

2.3 Risks associated with the programme post FC

- 2.3.1 The risks associated with the programme post FC are those detailed within the risk matrix attached to the FBC and are common to many major capital build projects. These risks are inherent in the BSF programme and will be managed by a comprehensive programme of mitigations as described in the risk matrix.

2.4 Risks in delay in reaching FC

- 2.4.1 The risks associated with any delay in reaching FC are twofold. Firstly there is a financial risk related to any delay due to inflationary pressures on the fixed construction price. The Council's agreement with the Consortium is that inflation, using pre-agreed indices can be applied for every quarter of delay to Financial Close beyond 31 March

2007. The Authority has so far managed to negotiate a significantly reduced impact in respect of these inflationary pressures however as the costs to the building contractor increase so does the pressure to the Authority.

- 2.4.2 The second key risk associated with any delay in reaching FC is that the build programme relies on access to the school sites during the summer holidays. This is the optimum time in carrying out key elements of the build programme in respect of site preparation and is vital if the schools are to be delivered in the first quarter of 2009 as anticipated. Once this period is missed there are significant risks in respect of the impact that the delivery of the new facilities could have on educational attainment.
- 2.4.3 In order to mitigate the risk of delay, discussions have taken place with the building contractor in respect of an Early Works Agreement (EWA). This kind of agreement is not uncommon in build programmes, particularly where there is a time imperative in terms of delivery, and allows the contractor access to the site before the final contract is signed. This involves a degree of additional risk in that the build contractor will expect the Authority to underwrite the costs of the works that it carries out and should the Authority ultimately decide not to progress with the programme, the contractor would seek to recover its costs against an agreed programme of works.
- 2.4.4 Details of the Early Works agreement are currently being finalised. The scope will cover three phases, which are different for each of the separate schools. The Authority has the power to stop the progress of Early Works at any stage should it so decide.
- 2.4.5 The first phase of works takes us up to the end of August and cover aspects such as initial site set up and early design. The capped budget for this phase is circa £1.2 million.
- 2.4.6 The second phase continues through to the end of September and includes aspects of work relating to the prefabrication design of steel structures as well as completing site set-up and some preparatory work on site. The cumulative capped budget for this phase is circa £3.75 million.
- 2.4.7 The final phase continues beyond September and includes actual steel production and work on site. The capped budget for this stage is circa £6 million.
- 2.4.8 Work at Fullhurst is somewhat different to the other schools in that the Early Works programme also includes some aspects of asbestos survey and removal in phases 1 and 2.
- 2.4.9 Members should note that once FC is reached, currently targeted for the first week in September, then the EWA is superseded by the main contract and the costs of the EWA will be absorbed into the programme and do not represent additional cost.
- 2.4.10 As previously stated the risk to the Authority in respect of the EWA is in relation to FC either being substantially delayed or in FC not being reached due to a decision by the Authority not to proceed with BSF. In these circumstances the contractor would look to recover it's costs in respect of the EWA. Any costs would have to be proven on an open book accounting basis.
- 2.4.11 The Authority now has a form of words in respect of a legal agreement covering this EWA

and are finalising the details of the suggested build programme.

- 2.4.12 For the EWA to provide any major benefit then final negotiations and sign-off will be needed as soon as possible, but certainly before the end of July. Without this urgent sign-off the contractor will not be able to carry out the works required in the school holiday period.

2.5 Risks associated with not proceeding with the BSF programme.

- 2.5.1 Should the Authority decide not to proceed with the BSF programme then it faces a range of high level risks. These are both financial and reputational. There has been an estimated expenditure by the Authority in respect of the programme to date in the region of £2.5 million. There would also then be the set-up costs of any future BSF programme and potentially the defence of a claim by the consortium for lost bidding costs. It is unlikely that Leicester would be seen by either Government or the private sector as an attractive future partner for BSF or the planned Primary Sector developments that the Authority expects to be asked to submit proposals for later this year.

- 2.5.2 Last but certainly not least it would also mean that Leicester would have in all likelihood missed a once in a lifetime opportunity to transform its secondary estate. It would also have missed the opportunity to change the lives of future generations of young people in Leicester and it is impossible to quantify that cost in any form of risk analysis.

- 2.5.3 The Authority would also have lost the potential investment to Leicester's economy through the construction investment which will provide for significant numbers of new job creation in the phase 1 programme.

- 2.5.4 The contractor would also need to be reimbursed with the costs of any early works should the EWA be entered into as well as the reinstatement costs needed as a result of early works having taken place.

2.6 Key Outstanding Issues

- 2.6.1 There are still a number of issues that remain to be resolved in respect of the overall BSF programme before Cabinet gives approval to enter into a contract with the Miller Consortium and reaches Financial Close (FC). Ideally these issues would be resolved before entering into an EWA. However given the risks identified in paragraphs 2.4.1 to 2.4.3 it is felt that on balance we should proceed. These negotiations are ongoing and we must ensure that they reach a satisfactory conclusion before FC. The following represent those key commercial issues that may have an impact on the programme or on the final cost position.

2.7 ICT

- 2.7.1 There are three main issues in respect of ICT. The first relates to the provision of a data centre that will provide support to all phases of the programme. It is most cost effective to provide the full data centre in phase 1. However, this results in the full cost of the data centre being incurred as part of phase 1 to be recovered against the remaining phases. This therefore represents a risk if the other phases are not delivered. The Authority would however still have a considerable asset that could be utilised either for

other purposes or to support a replacement ICT solution for its secondary school estate. Options are currently being considered in respect of the funding for this data centre in order to ensure best value for the Authority. Notwithstanding these risks it is recommended to proceed with the procurement of the data centre within Phase 1.

- 2.7.2 The second issue relating to ICT is that the current contract proposal is for a five year term for the four phase 1 schools only. Northgate, the ICT providers, have made an alternative commercial proposal of an eight year contract for all four phases, but the view of the Project Board is that the potential benefits gained through signing a wider contract are not sufficient when weighed against the risks of locking in to a longer term and wider deal at this early stage. (It should be noted that as part of the bidding process, Northgate have as requested provided financial models that cover the future phases, and these will form the basis of the contractual discussions for future phases).
- 2.7.3 The third issue in respect of ICT relates to the number of data outlets provided in each of the classrooms. The original ICT solution relied on the use of a higher provision of wireless technology and there are therefore a minimal number of data outlets currently in the design. The new ICT solution is less heavily reliant on wireless technology and in order to provide maximum flexibility in the learning environment it would be beneficial to increase the number of data outlets. This will however come with a cost, and we are currently negotiating with the contractor on the optimum number of outlets per school and the subsequent cost impact.

2.8 Technical Data

- 2.8.1 Although the overall design of the schools is agreed the detailed technical data sheets for each of the individual spaces within the building are required to be finalised before we reach FC, together with associated contractors proposals. Without this detail there is a risk that costs could increase should changes be required that have a cost impact. Millers are aware of this requirement and are working to a strict timetable to deliver the detailed information required before FC.
- 2.8.2 Agreement also needs to be reached with the Consortium as to the detailed mechanism for benchmarking the costs of the future phases of schools. The BSF partnership agreements provide a process for benchmarking and approving future schemes which provide protection to the Authority in respect of costing of future phases. The Authority needs to ensure that the design changes on the Design and Build schools and the subsequent agreed cost increases do not result in an increase in the basis for benchmarking future schemes.

2.9 Pensions

- 2.9.1 The preferred option for both the Authority and the Consortium is for the staff transferring under TUPE to retain the access to the Local Government Pension Scheme (LGPS) and the unions are strongly in favour of this option. This option requires the Consortium members to take on Admitted Body Status and these negotiations are currently ongoing as are the discussions around respective financial responsibilities.

2.10 Legal

- 2.10.1 The main derogations to the standard form contracts have now been established and discussions in principle with PfS have already taken place. There remain however a few issues that it has not been possible to reach a resolution on at this stage and discussions will continue in the lead up to FC. PfS have agreed that these derogations be noted at this stage and that as discussions progress the position in respect of these issues be confirmed.
- 2.10.2 The risk of a school seeking Trust status has been discussed with PfS and the Authority has written to the Secretary of noting the issue. This letter could then be returned to in the event that a school applied to the Secretary of State.
- 2.10.3 As we approach FC and the elements of the deal are finally agreed a letter will need to be sent to all the failed bidders informing them that we are about to enter into a formal contract. At this stage the failed bidders have a 10 day period in which to raise any challenge to the procurement process. This “stand still” period is referred to as the Alcatel period. Any challenges received will be formally acknowledged and considered. Any such challenge could impact on our ability to achieve FC.

2.11 Clientside

- 2.11.1 In order to support the ongoing development of the BSF programme a clientside team will be required and there will be the need for ongoing support from both in-house teams such as Property and Legal as well as some specialist support from external technical advisors. Proposals are being developed however the initial indications are that the cost of this clientside structure will exceed the £450k budget currently available. In order to ensure that this represent value for money the assumptions that underlie the existing costings are being challenged and a benchmarking exercise is being undertaken with other Authorities involved in BSF. Although it is expected that the initial cost assumptions will come down there is still a strong possibility that additional funding will be required to support the clientside infrastructure.

3. Recommendations

The Cabinet is recommended to:

- a) Approve the FBC and its submission to Partnerships for Schools with the caveat that should there be any material change to the Leicester programme then these changes will be submitted as an addendum to the report.
- b) Note the associated risks of the BSF programme and request that the risk matrix be further developed and a finalised report with a risk mitigation plan be submitted to its September meeting.
- c) Authorise an Early Works Agreement with the Miller Consortium in respect of Phase 1 schools on the basis set out in paragraphs 2.4.3 to 2.4.10 with details to be agreed by the Town Clerk in consultation with the Chief Finance Officer, Corporate Director C&YPS and the Lead Member.

4. FINANCIAL, LEGAL AND OTHER IMPLICATIONS

4.1 Financial Implications (*Steve Charlesworth*)

- 4.1.1 DCSF require five weeks to review the Final Business Case. This means that the Council is expected to present an affordability position before being in a position to reach financial close. The affordability position set out in FBC remains within the agreed parameters previously approved.
- 4.1.2 The final affordability position can only be concluded once final cost models have been provided by the consortium and negotiations on the outstanding issues detailed in this report concluded. Until these negotiations have been concluded the Chief Finance Officer is not in a position to give final assurance to Members in respect of the affordability position. This analysis will be included in the report to Cabinet in September prior to the programme reaching Financial Close.
- 4.1.3 The Early Works Agreement should enable the consortium to achieve the target dates for school handover and demonstrates a commitment by the Council to move the project forward as a priority and reduces the likelihood of a further inflation charge being made. The agreement, however, exposes the Council to cost risks should the project not proceed.

4.2 Legal Implications (*Joanna Bunting*)

- 4.2.1 These implications cover the general strategic agreements, the contracts to be entered into in respect of the first phase schools and the school governing body agreements and relates to the matters contained in the Final Business Case (FBC)
- 4.2.2 The Council has power to enter into the various agreements under the Education Act 1996, the School Standards and Framework Act 1998, the Local Government (Contracts) Act 1997 and section 111 of the Local Government Act 1972.
- 4.2.3 The procurement process has followed the negotiated procedure, with competition, under the regulations relating to the procurement of works and services. Three bidders were invited to negotiate, leading to the appointment of the Miller Consortium as preferred bidder. A reserve bidder has been appointed. The requisite "standstill" procedure will be observed before contracts are signed – this provides an opportunity for any aggrieved party to challenge the procurement before contracts come into force.
- 4.2.4 The PFI credit approval letter will need to be obtained but this will be done after government departmental approval of the FBC
- 4.2.5 The handling, or allocation of some risk issues remains to be negotiated.
- 4.2.6 Standardised contract documentation for BSF (where available) has been followed, with derogations. The design and build contract is a lump sum option, the contractors price includes the cost of the work of specified design items still to be finalised, in accordance with the reviewable design procedure under the contract. Most derogations have either been agreed or are non controversial but there remain some contractual issues to be negotiated. The terms of these contracts include a collateral warranty and step in

agreement with the main building sub contractor and design sub consultants. Sub contracts themselves have not yet been seen.

- 4.2.7 No interest in land is to be disposed of or transferred to the consortium. The Council owns all the land comprised in the sites of the schemes.
- 4.2.8 Staff will transfer under TUPE. The contracts contain provisions reflecting the obligations of the parties under the TUPE regulations, and also the statutory code on non TUPE transfers, two tier workforce and pensions issues, where this is relevant.
- 4.2.9 The necessary approvals have been obtained in respect of the proposed increase in the roll numbers at Soar Valley College.
- 4.2.10 The governing bodies of the schools and the Council have completed agreements in respect of the contribution by the schools from the budget delegated to them under the scheme for financing schools, and also the transfer of delegated responsibilities to enable the contracts to be operated.
- 4.2.11 The companies to be formed in which the Council will participate are not controlled or regulated for the purposes of the Local Government and Housing Act 1989 or the associated regulations. The Council will be appointing a director. The Council gives an indemnity to company directors it appoints in the form and in the manner described in the Cabinet resolution of 15 May 2006.

Further legal advice is given in the confidential addenda to this report.

5. Other Implications

| OTHER IMPLICATIONS | YES/NO | Paragraph Within Supporting information | References |
|-------------------------------|--------|---|------------|
| Equal Opportunities | NO | | |
| Policy | NO | | |
| Sustainable and Environmental | NO | | |
| Crime and Disorder | NO | | |
| Human Rights Act | NO | | |
| Elderly/People on Low Income | NO | | |

6. Risk Assessment Matrix

Risk Assessment Matrix attached as addendum to the final business case which is part of the confidential agenda B papers.

7. Consultations

Detailed within the final business case.

8. Report Author

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N.B Appendices not for publication