



**Highways Future Project  
Outline Business Case - Addendum  
Southampton City Council**

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## **1. Introduction and Purpose**

- 1.1** This paper forms an Addendum to the original Outline Business Case (V0.5 May 2008) which set out the rationale and approach for implementing a Highways Service Partnership. The Addendum considers the forecast benefits and value for money of the Highways Service Partnership in light of the hard market information provided during the Highways Service Partnership (HSP) procurement process and the changed public sector context the Council finds itself in. Additionally, the paper sets out a number of key commercial issues which have arisen through the dialogue and details the options available in order to assist the Council in making an informed decision.
- 1.2** In summary, this Addendum will assess whether there is still a business need to implement a new service delivery model for highways and the potential benefits and value for money (VFM) from implementing the HSP.
- 1.3** This Addendum will inform Senior Officers' and Members' decision making with regard to closing the competitive dialogue process and calling for Final Tenders.
- 1.4** The Council received priced Invitation to Submit Detailed Solutions (ISDS) submissions from three bidders as part of the competitive dialogue procurement process in October 2009. The information provided by these submissions has been used to inform this Addendum.

## **2 Addendum Objectives**

- 2.1** This Addendum will build on the original Outline Business Case (May 2008) and Cabinet and Council Reports, it will not update the original OBC in its entirety, nor will it re-visit the established positions and outcomes (e.g. it will not re-run the Critical Success Factor Options Appraisal – unless deemed necessary on the basis of the below paragraphs).
- 2.2** The key elements of the project and the proposed approach within the Service Agreement<sup>1</sup> will be covered as will any areas which have substantially altered since the OBC.
- 2.3** Any key issues still requiring resolution will be considered, the options analysed and a recommendation made where applicable for the most appropriate way forward.
- 2.4** This Addendum will outline the Benefits Realisation Strategy.
- 2.5** This Addendum will set out the Project Delivery Strategy and summarise the project development to date.
- 2.6** This Addendum will also address the points raised within the Local Partnerships Health Check Review.

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<sup>1</sup> The Service Agreement comprises the contractual documents which the Council and Service Provider will ultimately enter in to. The SA will include all contractual clauses, service specification and requirements, and financial and payment mechanisms.

### 3 Background

**3.1** The Highways Future Strategic Business Case (SBC) reviewed a long-list of options for the future delivery of highways services. An options appraisal determined that the model which best met the Critical Success Factors for the future of the Highways service was a long-term public/private partnership. The alternative options considered and rejected were:

- 3.1.1** Do-Nothing
- 3.1.2** Public/Public Partnership
- 3.1.3** Strategic Partnership
- 3.1.4** Externalisation
- 3.1.5** Fully in-house

**3.2** A Cabinet meeting of 29<sup>th</sup> October 2007 approved the further development of the preferred option i.e. a Public/Private Service Partnership.

**3.3** The original OBC for a HSP was completed in May 2008. Subsequently, the outputs and conclusions from the OBC were used to inform the Cabinet and Council Reports of June 30<sup>th</sup> and July 16<sup>th</sup> 2008 which recommended the following:

#### **Cabinet**

- (i) *To agree the proposed scope and phasing of services to be commercially market-tested as part of the Council's procurement of a Highways Partnership.*
- (ii) *To agree the commencement of a competitive dialogue procurement process for a Highways Partnership up to and including the closure of Competitive Dialogue but prior to the Call for Final Tender, within the following parameters:*
  - a) *The Partnership shall take the form of a Full Integration Model with the preference being a Service Partnering Contract*
  - b) *That a TUPE employment model, including retaining LGPS, will be the preferred method of staff transfer to the Highways Partnership subject to financial considerations*
  - c) *The contract shall be for a minimum of 10 years with the possibility to extend for up to a further 5 years dependent upon performance.*
  - d) *The proposals will be affordable, represent value for money and present an acceptable level of risk sharing and allocation of risk.*
  - e) *The competitive dialogue process will be the procurement process used.*
- (iii) *To recommend that the Council agree to the commitment of the existing Highways capital and revenue budgets for the period of the partnership contract, as set out in section 40, along with any additional funding approved as part of the budget process.*
- (iv) *To recommend that the Council approve the addition of £100,000 to the 2008/09 Environment & Transport Portfolio revenue budget, from General Fund balances, to meet the implementation costs of the Highways Service Partnership and to note the additional resource requirements for 2009/10 and 2010/11, as set out in section 42, which will need to be included when the budget for those years is approved.*
- (v) *To note the estimated range of net benefits from the partnership contract, as*

set out in section 44, and the forecast that an average net saving of £443,000 per annum is realistic over the 10 years of the contract.

- (vi) To delegate to the Executive Director of Environment in consultation with the Executive Director of Resources and the Solicitor to the Council to take all action necessary to implement the recommendations in this report, to procure the engagement of professional external advisors as necessary, to undertake the further procurement processes required to procure a Highways Partnership, to issue Contract (OJEU) Notice and the Invitation to commence dialogue and in due course to bring forward final recommendations to Cabinet at Call for Final Tender stage.

#### **Council**

- (i) To agree to the commitment of the existing Highways capital and revenue budgets for the period of the partnership contract, as set out in section 40, along with any additional funding approved as part of the budget process
- (ii) To approve the addition of £100,000 to the 2008/09 Environment & Transport Portfolio revenue budget, from General Fund balances, to meet the implementation costs of the Highways Service Partnership and to note the additional resource requirements for 2009/10 and 2010/11, as set out in section 42, which will need to be included when the budget for those years is approved.
- (iii) To note the estimated range of net benefits from the partnership contract, as set out in section 44, and the forecast that an average net saving of £443,000 per annum is realistic over the 10 years of the contract.
- (iv) To note that this will form an addendum to the Council's Policy Framework, i.e. an addendum to the Best Value Performance Plan.

### **3.4 Procurement Process**

**3.4.1** Since the above recommendations were approved, the Highways Future Project Team has initiated a competitive dialogue process with private sector highways service providers. Engagement with the market has enabled the project team to produce a well-developed service specification, contract and payment mechanism and has also provided evidence and information supporting the original OBC.

**3.4.2** The procurement is currently at detailed solution stage (ISDS) of the competitive dialogue process. ISDS bids were received from three bidders on 15<sup>th</sup> October 2009. Evaluation is due to be completed in mid-November. Further dialogue will continue with remaining bidders until early 2010. Call for Final Tender is scheduled for early February 2010.

**3.4.3** Nine bidders submitted Pre-Qualification Questionnaires in September 2008. Five bidders were shortlisted for the competitive dialogue process.

**3.4.4** These were:

**3.4.4.1** Amey

**3.4.4.2** Atkins

**3.4.4.3** Balfour Beatty

**3.4.4.4** Colas and Mott McDonald (CMM)

**3.4.4.5** MGWSP

- 3.4.5** The commencement of the Outline Solution (ISOS) stage was originally scheduled for November 2008. However, at this time speculation arose that a further unexpected bidding round for Highways Maintenance PFI Credits would be announced by the Department for Transport (DfT) prior to Christmas 2008 due to unallocated PFI Credits becoming available. Therefore, a decision was taken to 'wait and see'. No announcement was forthcoming from DfT. Although speculation continued that a further round would be announced the Council decided to commence the ISOS stage with a view to reviewing the situation again between ISOS and ISDS stages.
- 3.4.6** Atkins withdrew from the process after the first round of ISOS dialogue meetings. Atkins determined that the objectives of the Council for the Partnership did not align with their business model. The Council's potential interest in a PFI bidding round was also cited.
- 3.4.7** Three bidders were shortlisted for the detailed solutions (ISDS) stage. These were:
- Balfour Beatty
  - CMM
  - MGWSP
- 3.4.8** Prior to commencement of ISDS the Council reviewed the situation with regard to Highways Maintenance PFI Credits. It was determined that despite continuing assertions to the contrary from DfT it was unlikely that a further round would be announced in the short-term and therefore the procurement of the HSP should continue. However, this delayed the release of ISDS documents by approximately one month.

## **3.5 Social and Economic Climate**

- 3.5.1** Since the original Outline Business Case (May 2008) the Council's financial context has altered as a result of the 'credit crunch' and the subsequent recession and immediate and impending restrictions on public spending. The Council is reviewing its entire budget and seeking significant savings from all service areas, including highways.
- 3.5.2** The consequence of this, for the Highways Future Project, and the procurement of the HSP, is an impact on revenue affordability and potential amount of capital which the Council can commit to the Contract. Simply, a reduced budget will reduce the level of efficiencies and the potential increase in output that can be achieved.
- 3.5.3** While the financial context has deteriorated there is still a strong public will for maintenance of the highways network. In a recent Place Survey when asked what services most needed improving 'road and pavement repairs' placed second in a list ahead of crime, clean streets and decent housing.<sup>2</sup>

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<sup>2</sup> IpsosMori Poll for CSS July 2009. Question asked 'Thinking about this local area, which of the things below, if any, do you think needs improving. Top mentions (from 20%).



## **4. Strategic Context and Business Need**

**4.1** In May 2008 the OBC concluded that there was a strong business need to improve the city's Highways and that the improvement aligned with the wider objectives of the Council and the Region.

### **4.2 Business Need to improve and maintain the overall condition**

**4.2.1** On reviewing the OBC it is clear that while benchmark information has shifted there is still a clear business need to maintain and improve the overall condition of the network as well as the ongoing statutory need to manage, maintain and improve the highway network for the safe and convenient movement of people and goods. The core objectives of the Service are to deliver a safe, serviceable and sustainable network which contributes to the wider objectives of asset management, integrated transport, corporate policy and continuous improvement.

**4.2.2** The highways service has made further progress and improvement<sup>3</sup> since the production of the OBC however, further improvement in service delivery and the condition of the network is still necessary.

### **4.3 Highways Contribution to key strategic objectives and benefits.**

**4.3.1** At a national level the Department for Transport (DfT) sets strategic policy disseminated through documents such as the "Transport Ten Year Plan" published in 2000, and provides guidance to other public bodies on the development of regional and local transport strategy, including the production of the Local Transport Plan.

**4.3.2** However, in the work undertaken to develop the Local Transport Plan it has been recognised that the potential contribution of the local highway network extends far wider than simply the delivery of transport strategy. It is fundamental to the economic, social and environmental well being of the community. LTP 3 will continue to stress these benefits.

**4.3.3** At a local level the City Council has developed a Corporate Plan and more recently the City of Southampton Strategy, which articulates a 20 year vision for Southampton and identifies a number of key strategic objectives.

**4.3.4** Well maintained local transport assets, including roads, footpaths, bridleways and cycle paths, are essential not only for the delivery of better transport outcomes but also to underpin the delivery of these wider strategic objectives. They encourage walking and cycling and contribute to road safety outcomes. They promote the quality and comfort of bus services, improve journey ambience, minimise wear and tear to vehicles and promote better environmental outcomes including emissions and noise. Well maintained roads, footways, footpaths, street furniture and public rights of way, make an important contribution to the quality and liveability of public spaces.<sup>4</sup>

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<sup>3</sup> National Highways and Transport Public Satisfaction Survey. Mori. 2009.

<sup>4</sup> Well Maintained Highways – Code of Practice for Highway Maintenance

**4.3.5** Effective management of the local road network has the potential to aid regeneration, social inclusion, community safety, health and the environment, all of which support the City's aspirations to become the region's economic, social and cultural driver. However, this will need a planned long-term programme of investment, efficiently managed and supported by an appropriate delivery model, especially if the city is to develop;

- "An attractive and stimulating environment"
- "A supportive business environment"
- "A sense of place"<sup>5</sup>

**4.3.6** Therefore the outline strategy for the Highways Service, approved by members in March 2007, has been initially identified as:

**4.3.6.1** "To deliver significant and sustained improvements in the highways infrastructure of Southampton in order to enable the delivery of the Authority's "City of Southampton Strategy" by 2026."

**4.3.7** To do this will require substantial additional investment in the infrastructure, with early indications suggesting a figure in excess of £150 million to be spent on the carriageway and footway network over a ten year period

#### **4.4 Critical Success Factors (CSF's)**

**4.4.1** Critical Success Factors (CSFs) were identified for the OBC options analysis. The options analysis using the CSFs identified that a Fully Integrated Partnership was the best Partnering Model available to the Council.<sup>6</sup> For ease of reference the CSFs which the long-term Partnership will best deliver are:

- Ability to respond positively and rapidly to changes in service requirements and demands
- Ability to deliver improved value for money
- Ability to improve financial control
- Ability to improve asset management
- Ability to derive economies of scale
- Ability to provide additional investment in technology
- Ability to deliver innovative, customer focused, quality driven service
- Ability to deliver reduced environmental impact and carbon footprint

**4.4.2** On further examination the Critical Success Factors appear to remain pertinent, as do the scores allocated, and therefore the result of the original options appraisal remains valid. The original Options Analysis is attached at Appendix 1 for ease to reference.

<sup>5</sup> The City of Southampton Strategy

<sup>6</sup> It should be noted that the Strategic Business Case set the case for a Partnering Model being the best service delivery model for the Council. The OBC determined the best form of Partnering Model. This is an Addendum to the OBC.

## 5 Scope of Services

**5.2** In order to assist the Council in determining the optimum scope of services for the Highways Partnership an independent scope review was commissioned jointly by the Head of Highways and Head of Neighbourhoods (available on request) and was undertaken by Kingsclere Associates to determine, on the basis of objective evidence, which services should be included in the Partnership. In considering the question, the review focussed on: current service delivery; achievability, deliverability and focus; including commercial and financial considerations. Its conclusions were also drawn from two relevant case studies, dialogue with service providers and existing service performance information.

**5.3** The Independent Scope Review recommended the following:

<b>In-scope services</b>	<b>Possible Inclusion</b>	<b>Out-of-scope services</b>
Highway planned and routine maintenance Highway Capital Projects Highway management functions (street works) Traffic signs Traffic signal maintenance Highways Business Support Bridges and structures design and works Gulley cleansing Parking surfaces	Third Party liability claims Urban traffic control (ROMANSE)	Fly tipping Grounds maintenance Graffiti removal Highways verges and trees Street cleansing Street-lighting Parking enforcement Refuse and waste disposal Planning and Sustainability Environmental health and protection Highway events management

Table 1 – Independent Scope Review: recommended scope of services for highways partnership

**5.4** Members considered the Independent Scope Review. These deliberations informed the Cabinet and Council Report (30/06/08\_16/08/08) recommendations on scope. Procurement commenced<sup>7</sup> outlining a scope as set out in Table 2, below, with the caveat that this would be reviewed prior to Final Tenders if any demonstrable benefits transpired as a result of dialogue for the inclusion or removal of any of the proposed services. In particular, the services in bold would be raised during dialogue and the exact dividing line of these services would be determined through dialogue (i.e. the service could be partially in-scope and partially out-of-scope depending upon the final specification).

<b>In-scope services</b>	<b>Out-of-scope services</b>
Highway planned and routine maintenance Highway Capital Projects Highway management functions (street works) Traffic signs	<b>Urban traffic control (ROMANSE)</b> <b>Transport Policy and Strategy</b> Fly tipping Grounds maintenance Graffiti removal Highways verges and trees

<sup>7</sup> Based on the Cabinet and Council Report recommendations an OJEU notice was placed which covered the in-scope services identified in Table 2, as well as all generic highways services and references to Bridges and Structures. This provided flexibility to bring other highways related services in scope if necessary.

Traffic signal maintenance Highways Business Support Gulley cleansing <b>Parking lines and signs</b> <b>Third Party Claims</b>	Street cleansing Street-lighting Parking and parking enforcement Refuse and waste disposal Planning and Sustainability Environmental health and protection Highway events management Bridges and structures design and works
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Table 2 - Procurement: Scope of Services

**5.5** In summary, the dialogue has not provided any information or demonstrable benefits (i.e. quantifiable VFM) to compel the Council to fundamentally revisit the scope of services to be included within the HSP. However, throughout the dialogue and in the process of developing the service specifications the Council has firmed up its requirements in a number of areas.

**5.6 Transport Policy and Strategy**

**5.6.1** Responsibility for Transport Policy and Strategy currently resides outside of the Highways Division and within the Planning and Sustainability Division. In order for the Council to retain control of its strategic approach to transport it is recommended that the Transport Policy section remains out of scope of the HSP.

**5.6.2** However, while the Council will retain control and direction, the HSP will be required to inform policy and strategy decisions using their knowledge of the network and therefore there will be a close working relationship between Policy and the Service Provider, managed by the Highways Client Team. Additionally, if the Transport Policy section does not have the in-house capacity or resources to develop Policy or Strategy documents the Service Provider will be able to step-in. Simply, the Council will always own and direct Transport Policy and Strategy but the production and consequent delivery can be delegated, where appropriate, to the Service Provider.

**5.7 Bridges and Structures**

**5.7.1** Bridges and Structures design and management is currently delivered by the Capita Strategic Services Partnership (SSP). The bridges maintenance and capital programmes are delivered through a framework contract which is managed by the SSP.

**5.7.2** During the dialogue, Bidder’s expressed a desire to deliver design and maintenance work. The synergy between Highways, and Bridges and Structures Design and Maintenance presents an opportunity to achieve additional efficiency savings (over and above that which would be achieved from combining the constituent client functions for these services). However, this would need to be offset against any costs incurred as a result of removing the delivery of design and maintenance work from the SSP contract.

**5.7.3** The project team raised this possibility internally in order to at a minimum explore the approximate cost of removing the aforementioned service from the SSP contract. The Project Board referred this matter to the SSP Governance Framework.

The view expressed by the SSP Client was that it would not be appropriate for this option to be explored further given the wider SSP context.

## **5.8 Parking lines and signs**

**5.8.1** Parking lines and signs was not included within the lump sum service element of the ISDS specification. The service is relatively reactive and low value per annum yet requires a high service level to enable the Council to enforce Fixed Penalty Notices. Therefore, bidders were asked to submit pricing to deliver a comparative level of service to that which the Council currently receives. The average price submitted by bidders was not competitive<sup>8</sup> and therefore it is recommended that this service is out of the HSP scope and continues to be managed by Parking and Enforcement Services.

## **5.9 ROMANSE**

**5.9.1** ROMANSE (Road Management System for Europe), the council's intelligent traffic control system was determined to be out of scope of the HSP, however the Council was keen to understand from bidders any benefits of including within the HSP.

**5.9.2** Early dialogue was initiated with bidders on the benefits of including the ROMANSE services within the scope of the contract. Bidders were asked at outline solution stage (ISOS) to provide any evidence or examples, from other contracts, where they had delivered demonstrable benefits through the inclusion of similar traffic control services. No strong cases were forthcoming over and above a general increase in turnover being beneficial overall. At a pre-ISDS Review Project Board confirmed that the service should not be included within the scope of the ISDS documents.

**5.9.3** Therefore, it is recommended that ROMANSE remains outside of the HSP scope and continues to be managed as a separate service.

## **5.10 Street Cleansing and Grounds Maintenance**

**5.10.1** Street Cleansing was identified as an out-of-scope service. The Independent Scope Review identified the service as high performing and low cost and therefore questioned the value of inclusion.

**5.10.2** The inclusion of these services has been re-questioned since the original decision not to include within the scope of services. However, OJEU Notice restrictions preclude the inclusion of these services in the HSP. Legal advice states that the inclusion of these services, given their relative value against the overall contract value would likely breach EU procurement regulations. Furthermore, the rationale for exclusion at the outset of the project still stands and has since been compounded by other initiatives within the service area.

## **5.11 Third Party Claims – against the Council**

**5.11.1** Third Party Claims (TPC) - claims made against the Council due to the state of the highways - can be split into two elements; the handling of the claims; and, the risk or liability for the claims.

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<sup>8</sup> ISDS prices benchmarked against existing rates were not competitive

**5.11.2** Currently, claims against the Council are investigated by Highways and handled by the Council's Insurance section. Highways' pays a substantial sum from its existing budgets (thus reducing potential spend on the network) to the Council's Insurance section to cover administrative costs of delivering this service and the payments for claims made against the Council as a result of the condition of the highways network or failure to meet service levels. Only claims over £100k are paid through Insurance and therefore the Council is effectively self-insuring.

**5.11.3** The majority of successful claims against the Council are as a result of the Council not achieving service levels (e.g. inspecting a defect yet not repairing within the required timescales). Under the HSP the Service Provider will be contractually obliged to meet the required service levels and therefore a significant reduction in successful claims and payouts is anticipated. The current service levels and those under the contract are similar and in-line with the Highways Code of Practice, the reduction will be from the Service Provider increasing compliance with those service levels and being able to better demonstrate and evidence that these levels had been achieved.

#### **5.11.4 Proposed Approach**

**5.11.4.1** The key principle underpinning the HSP approach is for the management and stewardship of the highways service and network to be passed to the HSP Service Provider. This encourages the Service Provider to adopt a holistic approach to service delivery. Therefore, the current position within the HSP Service Agreement is for the majority of the risk (i.e. pay outs) of claims made against the Council to be transferred to the Service Provider. This entails the Council including a sum of money within the overall affordability budget, effectively transferring that element of budget out of Council control.

**5.11.4.2** This approach acts as an additional incentive (over and above the Performance Framework described below) to the Service Provider to ensure that all specified service levels are met. If the required service levels are not met the Service Provider is exposed to a potential increase in claims; if the claims can be reduced below the allowance for claims pay-outs the Service Provider has made within their business model then there is an increased profit.<sup>9</sup>

**5.11.4.3** Passing the risk of claims pay-outs to the Service Provider incentivises them to ensure service levels are met. At ISDS the Council proposed passing the handling of claims to the Service Provider in order to present control of the process to the Service Provider. This reduces the risk to the Service Provider of the Council not handling a claim adequately so that a pay-out is successful despite the Service Provider fulfilling its obligations.

**5.11.4.4** However, the responses provided by bidders through ISDS did not provide the Council with a level of confidence and clarity over the mechanics of the handling process; E.g. there will be claims which do not fall simply to the Council or the Provider and a process for allocating and then managing these claims will need to be clearly

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<sup>9</sup> Superficially, while allowing the Service Provider to retain unspent allowances for claims may seem like the Council is not benefiting from reduced claims, the competitive tension of the procurement encourages the bidders not to 'pad' these allowances within their business model. Additionally, this is the trade-off against the Provider taking the risk of claims increasing.

laid out. Therefore, the Council is seeking to retain a greater control over the claims handling process.

**5.11.4.5** This approach would leave the Council with a residual liability for any successful claims made against the Council due to inadequate service levels or materials specified. This risk here is relatively low as the service levels specified meet the guidelines laid down in the Highways Code of Practice. Only a Court is in a position to overrule the adequacy of the Highways Code of Practice.<sup>10</sup>

**5.11.4.6** The key risk to the Council in adopting this approach is that the Service Provider seeks to pass back the responsibility for payment of claims, most likely through a loophole within the Service Agreement. In this scenario the Council would have allocated a financial sum to cover residual claims yet would not have accounted for claims passed back from the Provider. This is a clear risk, however, it is one which can be mitigated through clear and robust drafting of the Service Agreement. Additionally, it would be prudent to retain a risk sum, over and above the sum retained for expected claims, to cover these eventualities.

### **5.11.5 Alternative approaches**

**5.11.5.1** An alternative approach to dealing with claims against the Council would be to retain all liability for claims made against the Council due to the state of the network. The number of claims is again likely to reduce as the Service Provider will still be required to meet service levels and will have access to more robust record keeping for provision of evidence to the Council.

**5.11.5.2** However, the additional incentive for the Provider to meet service levels and reduce claims is removed as there are no opportunity costs available.

**5.11.5.3** With no liability for meeting service levels, over and above the contractual mechanisms for not achieving against the performance framework, there is less inducement for the Service Provider to achieve those service levels.

### **5.11.6 Position for Final Tenders**

**5.11.6.1** Evidence from the dialogue process has demonstrated there is a significant VFM argument to include the transfer of Third Party Claims to the Service Provider<sup>11</sup>. There is a risk of the approach not being clearly defined, therefore allowing the Service Provider to pass back responsibility for claims. However, this risk can be mitigated by establishing prior to selection of Preferred Bidder a clear and detailed process, controlled by the Council, and retaining an element of risk contingency.

**5.11.6.2** On the basis that the Proposed Approach delivers value for money, as demonstrated via ISDS submissions, and that the risk of the approach can be effectively managed, it is recommended that this is the position included in the Final Tender documents.

<sup>10</sup> <http://www.roadscodes.org/>

<sup>11</sup> Both remaining bidders included a significantly reduced sum for TPC within their ISDS models. Not specified here for Commercial Confidentiality reasons.

## **5.12 Third Party Claims - Claims made by the Council against third parties**

**5.12.1** Third Party Claims (TPC) - claims made by the Council against third parties for damaging the network - can also be split into two elements; the handling of the claims; and, the risk or liability for the claims.

**5.12.2** Currently, claims made by the Council are managed by Highways. It follows that the service should be managed by the Service Provider within the HSP (as there would be not be the required level of resource to do so internally). It is also logical therefore for the risk of recovery of these claims to rest with the Service Provider.

**5.12.3** The Council is transferring the management and maintenance of the network to the Service Provider and will recompense the Service Provider for this through a lump sum payment (section 6.3.3.). The Service Provider will be responsible for repairing all defects within specified timescales. It is sensible that the recovery of monies for damage to the network is the responsibility of the Service Provider (with a clause restricting the Service Provider chasing sensitive claims without Council's express permission) to act as an incentive to recover costs.

## **5.13 Service Interfaces**

**5.13.1** The HSP will encounter a number of key interfaces with other Third Parties to which the Council is contracted to. These interfaces will require careful management and would be managed in the first instance by the respective Client Functions. It is expected that this management requirement will be reduced overtime, as relationships between the two client functions mature.

### **5.13.2 Street Lighting PFI (Tay Valley Lighting)**

**5.13.2.1** The Street Lighting PFI is scheduled to commence in April 2010. A five year Core Investment Period (CIP) programme will commence soon after. The key interface between the PFI and HSP will be the coordination of the Capital Programme and CIP. The coordination of these programmes will be managed by the integrated HSP and PFI Client Team (section 9.2).

**5.13.2.2** The second area of interface is the coordination of emergency responses. The HSP will have overall responsibility for coordination – in the event that emergency incidents affect more than one service area i.e. street light and highway.

### **5.13.3 Strategic Service Partnership (SSP) (Capita)**

**5.13.3.1** There will be a number of key interfaces between the HSP and SSP; ICT; Customer Contact, and Bridges and Structures.

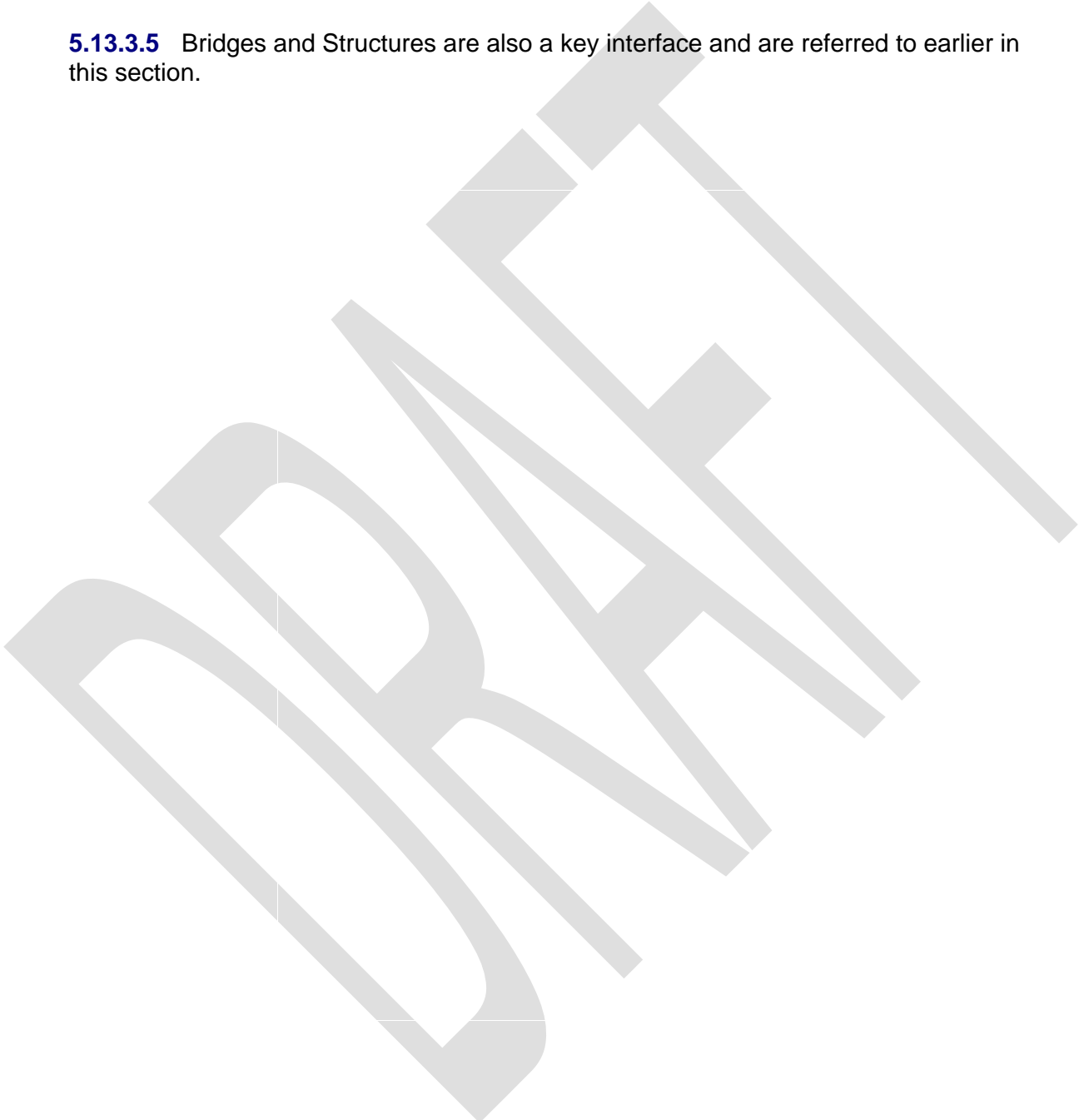
**5.13.3.2** The project team has worked with all of the SSP Client Reps to ensure that the specification between the HSP and SSP does not overlap or duplicate and neither does it leave gaps between service requirements. Additionally, the positions reached within the HSP Service Agreement documents have been designed to ensure minimal impact on the SSP in terms of contract variations.



**5.13.3.3** ICT solutions will be delivered by the HSP. Hardware will be provided by the HSP. Software will also be provided by the HSP for all Highways Services. However, the Service Provider will be required to interface with a number of corporate systems.

**5.13.3.4** Customer Contact will continue to be routed through Actionline. Actionline will continue to work as it currently does, however, calls will be passed to the Service Provider where applicable.

**5.13.3.5** Bridges and Structures are also a key interface and are referred to earlier in this section.



## 6 Financial

### 6.2 Affordability

**6.2.1** The original Outline Business Case identified an Affordability figure of approximately £14.2m per annum.

<b>Capital</b>	£7.51m
<b>Revenue</b>	£6.69m
<b>Total</b>	£14.20m

**6.2.2** Further detailed work and the impact of the current financial climate have led to revised affordability figures. These revised figures are detailed below.

**6.2.3** The affordability figures have been constant since the start of the procurement process. However, there is a risk that the Council's current major cost savings review will impact on affordability, in particular, revenue affordability which will require a fundamental review of service specification requirements, thus impacting on timescales. Additionally, any uncertainty surrounding affordability will potentially lead to bidders including risk premiums within their pricing models.

**6.2.4** Affordability is also subject to any changes or clarifications to the 'in-scope' services. Although, this is expected to remain relatively constant.

#### 6.2.5 Capital Affordability

**6.2.5.1** The Council's funding strategy identifies £6.0m to be invested in structural maintenance and capital improvements to the highways infrastructure for each year of the initial ten year contract. However, the Council reserves the right to vary this level of investment during the life of the contract.

**6.2.5.2** In addition, it is anticipated that the Service Provider will be asked to deliver other capital projects each year of the contract. For information, the value of these other capital projects in the financial year 2009/10 is estimated at £1.6m.

**6.2.5.3** The Council's 2010/11 Capital Programme is estimated to be approximately £8.4m in total.

#### 6.2.6 Revenue Affordability

**6.2.6.1** The Council has estimated £2.7m (2009/10 prices) per annum can be realised from existing revenue expenditure and income budgets by transferring responsibility for delivery of these services to the Service Provider, after estimated client side costs.

## 6.3 Payment Mechanisms

**6.3.1** The HSP Service Agreement is split into four Sections with each section comprising a number of service elements; Business Sustainability; Maintaining Network Value; Enabling Network Use; and, Enhancing Network Use.

**6.3.2** Payment for services is based on two mechanisms:

**6.3.2.1** Lump Sum - Business Sustainability; Maintaining Network Value; Enabling Network Use (what is currently routine and reactive maintenance, winter service, gully cleansing, business support, asset management)

**6.3.2.2** Target Cost - Enhancing Network Use (what is currently the Capital Programme).

### 6.3.3 Lump Sum

**6.3.3.1** The Lump Sum will be paid for from the revenue affordability. This will provide the Council with a high-level of price certainty over the life of the contract as well as the transference of risk in achieving service levels and the avoidance of on-going negotiation through the life of the contract. Services under Lump Sum are relatively constant and fixed and therefore it a Lump Sum approach is deemed to be the best value approach for the Council.

**6.3.3.2** The Council is effectively guaranteeing the revenue affordability to the Service Provider. However, if revenue budgets are altered during the life of the contract then this will lead to a review of the Service Provider's Lump Sum cost. Additionally, while bidders have been informed that any reduction on capital spend is Service Provider risk, a significant reduction in the capital budget would have a knock-on effect on the Lump Sum service requirements<sup>12</sup> and would therefore lead to a review of the Lump Sum cost.

**6.3.3.3** The Lump Sum will be based on the Service Provider delivering the specified service levels. These specified service levels are similar to the existing service levels, delivered by highways and in-line with the Highways Code of Practice. However, the performance against these service levels is greatly increased. Appendix 2 details the specified performance levels to be achieved by the Service Provider.

**6.3.3.4** On an annual basis, across all the categories of service, performance targets will be set. For each of the targets, the relevant KPIs will be confirmed by the Council and will be used to measure performance of the Service Provider.

**6.3.3.5** Should actual performance be below target performance as measured by a KPI, then the relevant financial deduction will be calculated. The level of financial deduction associated with a failure in achieving target performance will be dependent on the severity of the failure; a marginal failure may mean that a small/no financial deduction is made; for a significant or large failure, then heavier financial deductions will be applied. The precise level of deductions for different degrees of failure will be calculated on an individual KPI basis; a schedule containing provisional deduction regime is to follow.

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<sup>12</sup> For example, if the capital budget is significantly reduced there will be less resurfacing schemes, this will lead to an increase in maintenance liabilities under the Lump Sum services (e.g. significantly more defect, such as pot holes, to repair).

**6.3.3.6** Depending on whether the KPI measures performance on a weekly, monthly, quarterly, annually or any other period basis, then deductions will be calculated within 7 days of the end of the period being measured (see clause 10 of the Heads of Terms document for more details). The financial deductions made for KPIs will be on the basis of a proportion of the lump sums for each of the categories of service and using a weighting approach.

**6.3.3.7** The Council will limit the maximum level of deductions (excluding PRDs) to 30% of the total annual agreed lump sum payment.

**6.3.3.8** The total deductions across all the categories of service will be aggregated on a monthly basis, and this will be set off against the total lump sum payment (aggregate of all the lump sum payments for all the categories of service) to calculate the net payment from the Council to the Service Provider for a particular month.

### **6.3.4 Target Cost**

**6.3.4.1** The Council's capital programme will be delivered under a Target Cost approach.

**6.3.4.2** An Annual Target Cost (ATC) will be set for each Contract year by the Council in conjunction with the Service Provider and with reference to the Annual Plan. The Annual Plan will contain services that will be geared to supporting the Council's aspirations that work is done on roads to make road condition converge to the relevant upper quartile performance measure for that type of road using a holistic asset management approach. Beyond that, it is expected resources will be released from a particular type of road programme to other types of roads to support convergence to the relevant performance target for that type of road.

**6.3.4.3** A Guaranteed Maximum Cost will also be set for each Contract year, which will be 105% of the ATC.

**6.3.4.4** A cost sharing mechanism may be applied at the end of each Contract Year to reflect the differences (if any) between the ATC and aggregate total costs payments by the Council to the Service Provider.

**6.3.4.5** Should the total costs before any deductions be above the ATC but below the GMC, then the additional costs above the ATC will be shared between the Council and the Service Provider on a 25%/75% basis, and subject to the satisfactory performance of relevant KSIs.

**6.3.4.6** Any costs above the GMC will be borne fully by the Service Provider.

**6.3.4.7** Should the total cost before any deductions be below the ATC, then the Council will share savings with the Service Provider on a tiered basis, but subject to a 'collar' of 10% of underspend. Below this collar, there will be no savings shared with the Service Provider. For example, the Council intends to use the following approach to sharing under spends with the Service Provider

Difference between the total cost and the ATC	The Service Provider's percentage share of under spend
Under spend less than 10%	25%
Under spend greater than 10%	0%

## 6.4 Value for Money and Forecast Financial Benefits

**6.4.1** The original Outline Business Case identified a gross and a net benefit to the Council over a ten year contract period. This was calculated using a % saving (derived from benchmark data from other similar contracts) against the estimated value of the contract (£14.20m per annum).

**6.4.2** The net costs were based on an implementation cost of £1m and an annual client cost of £284k.

£000	Optimistic		Realistic		Pessimistic	
	Gross Benefit over 10 years	Net Benefit 10 years	Gross 10 yr	Net 10 yr	Gross 10 yr	Net 10yr
	11360	7270	8520	4430	7100	3010

**6.4.3** It should be noted that the financial benefits identified were not identified as 'cashable savings'. Instead the figures illustrated the increased output the Service Provider could expect to achieve through the realisation of efficiencies.

## 6.5 Updated Value for Money and Financial Benefits based on ISDS submissions

**6.5.1** The Council received three priced ISDS submissions in October 2009 as part of the competitive dialogue procurement process. This provided the Council with a lump sum price against the revenue affordability. Additionally, the Council were provided with four priced capital schemes to be compared against the estimated cost of delivering the schemes using the Council's current service delivery arrangements. Using the average pricing from the two bidders selected for the final stage of dialogue the following average % savings were demonstrated against current costs.

	% Efficiency	
<b>Lump Sum</b>	11	% saving against Revenue Affordability
<b>Sample Schemes</b>	10	% saving on against sample scheme estimated cost

## **Pricing**

- 6.5.2** It should be noted that the figures in this Appendix are based on the Invitation to Submit Detailed Solution (ISDS) prices received by the Council and that Bidders are not bound in any way to the prices they submit at this stage of the procurement process.
- 6.5.3** Prices received in response to Call for Final Tender (CFT) will be more robust as they can only be amended for 'fine tuning'. However, experience of similar contract negotiations is that there is often 'price creep', sometimes significant, between selection of a Preferred Bidder and contract award driven for example by amendments or corrections to the TUPE information and inventory data provided by the Council. Although under this procurement the Council is not warranting the TUPE information or inventory data in order to minimise the risk of 'price creep'
- 6.5.4** As part of the procurement process the Council will run an 'affordability check' before closing dialogue and calling for final tenders. If this process suggests that final tenders will not be affordable, dialogue won't be closed and discussions will be re-opened with bidders which could result in a dilution of the service we are able to afford.
- 6.5.5** Following selection of Preferred Bidder any significant renegotiation of the service is not permitted under procurement regulations so the Council would have to find additional resources to fund any price movement.
- 6.5.6** The services for which the Bidders will be requested to submit final tenders are split between revenue services for which a lump price has been requested and capital projects whereby Bidders will be asked to price for a number of capital projects that they will then be required to deliver for that price if they are chosen as the Council's Highways Partner. The following sections explore the revenue and capital elements of the contract in more detail.
- 6.5.7 Revenue Services - Lump Sum price and Ad hoc Services**
- 6.5.8** Appendix 3 sets out the Optimistic, Realistic and Pessimistic position for the revenue lump sum element of the contract. The affordability level is measured by the 2009/10 revenue budgets of in-scope services of £3M, less assumed client side costs of £300,000. This represents the baseline position and although it may be impacted by the 2010/11 budget proposals, the purpose of this appendix is to measure potential efficiencies against the baseline. Should affordability levels be reduced by the budget process, this just means that there are less savings to re-invest back into the service.
- 6.5.9** Based on the ISDS figures that were submitted, the scenarios presented in the table are based on :-
- Optimistic – The figure of £2.4M is the best price submitted at ISDS, however, this is being used as the optimistic position at this stage to reflect the fact that there is often 'price creep' between submission of prices at ISDS and the final agreed tender price and there are still some elements of service specification are being finalised.

- Realistic – This allows for elements of price creep as part of the final stages of negotiation and the Call for Final Tender (CFT).
- Pessimistic – This assumes that there would be no savings arising from the revenue element of the contract. This is considered to be a worse case scenario as dialogue with the bidders and their previous price submissions would indicate that some level of efficiency savings should be achieved on this element of the contract.

## **6.6 Capital Projects – Target Cost**

- 6.6.1** As part of the ISDS process, Bidders were asked to price a target cost for a number of capital schemes that have already been delivered or are being delivered. These prices have been compared to actual or forecast cost to give an indicative level of efficiency.
- 6.6.2** The figures that were returned showed that a 10% efficiency saving on these capital schemes could be made based on a saving of £80,000 on total actual / estimated cost of £800,000. The assumption that a 10% saving could be delivered across the whole of the highways capital programme (£7.6M per year) for 10 years has then been applied to give an expected (optimistic scenario) efficiency of £7.6m (10% of £7.6m per annum for 10 years) as shown in Annex 1.
- 6.6.3** Clearly, this is a significant assumption to make and therefore is a major potential risk, which will be mitigated in part by the process to be followed for CFT, which is discussed below.
- 6.6.4** In terms of a realistic scenario, an assumption has been made that a saving of 5% can still be made given that an external partner with surety of a 10 year contract will invest in new technology and will be able to plan works across the City in a cohesive and efficient way. The net savings of £3.8M are shown in Annex 1.
- 6.6.5** However, it is also recognised that given that Bidders are not bound by the prices submitted at ISDS that the efficiency savings could be significantly overstated. The pessimistic position is therefore based upon target prices submitted from unsuccessful Bidders and extrapolates these over the 10 year period. In this scenario the prices are £19M higher than the baseline position and clearly has a major impact on the overall value for money of the contract.

## **6.7 Net Efficiencies**

- 6.7.1** For each of the scenarios, the cost of the procurement exercise have been deducted to show a net position which ranges from a saving of £9.3M to a cost of £20.3M. However, it should be noted that the Council's capital resources are fixed and therefore in such a scenario it would mean less works were completed rather than having to find additional funding.

## **6.8 Public Sector Comparator**

**6.8.1** In external procurements such as this, it is usual to prepare a Public Sector Comparator (PSC) to sit alongside the results of the procurement. Inevitably, without the in house service undertaking a full bid in line with the procurement process, the PSC can only ever be a high level exercise based on specific assumptions.

**6.8.2** Annex 1 to this Appendix sets out a PSC for Highways based on the following assumptions :-

- There would be no need to implement the client side structure and existing structures could be changed to make efficiency savings in service delivery.
- Many of the performance indicators for the Revenue Lump Sum services are either not being met by the in-house service or are not currently monitored. In submitting their prices for ISDS bidders have had to cost for meeting the enhanced performance standards as set out in the tender documents. It is likely that there would be an additional cost to the in-house service in meeting these standards and therefore an assumption of an additional 5% has been added to the current cost of service.
- Another important part of the procurement is highways insurance claims and Bidders view that these could be significantly reduced if the performance standards are met and highway defects fixed to avoid future claims. Again based on current performance it is anticipated that more resources would be required to achieve the performance targets associated with claims limitation.
- It has been assumed that no additional costs or savings would be made in respect of provision of the capital programme as the Council would either have to secure a short term partner (as it has done in the past) or it would have to carry out tendering processes for the capital programme over the course of the ten year period.
- If the procurement of a Highways Partner were stopped then £350,000 of procurement costs would be saved in 2010/11, however alternative arrangements would need to be put in place over the ten year period which is likely to be more expensive in the long term.

**6.8.3** The overall position for the PSC shows a net cost of £2M based on the high level assumptions shown above. Whilst it is difficult to produce any sort of accurate figure for the PSC, the work that was undertaken during the feasibility study to assess the best delivery method for delivering highways concluded the existing service delivery model did not have the capacity, resource or expertise to adapt to new, more effective and efficient ways of working. In short, the existing service model did not meet the critical success factors identified for the medium to long-term delivery of the service.

**6.8.4** These points mean that it is highly likely that any in house bid would be at best at a break even position compared to the current service provision (assuming efficiencies could be made to cover the increased service standards) which is still not as favourable as either the Optimistic or Realistic Scenarios.



**6.8.5** It should also be pointed out that the greatest scope for efficiency savings lies within the capital element of the service and this is already predominantly delivered through the private sector. If the Council were to decide to continue with the in-house option, we would then need to undertake additional tender exercises (at extra cost) for the capital element of the service provision.

**6.8.6** Whilst it is accepted that at this stage, these are based on the ISDS submissions, the CFT will ensure that Value for Money is secured and delivered in a variety of ways as part of the next phase of the procurement process, which is discussed in the next section.

**6.9 Value for Money**

**6.9.1** One of the key issues throughout this procurement process has been ensuring that the Council has measures in place to achieve Value for Money within the contract. One of the biggest areas is the delivery of the capital programme and whilst the ISDS submissions showed that savings were achievable, this must now be flowed through into a process that can be delivered throughout the contract period.

**6.9.2** In order to achieve this, at CFT the bidders will be asked to price a number of schemes (12 to 15) that they will actually have to deliver in the first six months of the contract (subject to similar price creep risk up to contract award).

**6.9.3** After this period, each year an annual plan of capital work will be agreed by the Provider and the Council and the Provider will submit target prices in a similar way to the CFT process. Using the information collected from the ISDS and CFT processes, the council will be able to check these prices against a growing database of schemes and if future years target prices are higher they can challenge this with the Provider. Furthermore, the lack of competitive tension inherent within this process can also be mitigated to some extent (but not fully) by benchmarking, a strong client, open book accounting and non exclusivity protection which enables the Council to request the Provider to seek other quotes for comparison purposes or in extreme circumstances put the work out to competition.

**6.9.4** For the Revenue Lump Sum Services the position is slightly more straightforward as the position after current dialogue and CFT should only be varied if there are clarification points prior to contract signature and therefore VFM for this element of the contract is easier to measure.

**6.9.5** As an example of the increased output the Council may receive from the HSP the below table sets out in additional resurfacing lengths which could be delivered. These figures are based on 2009/10 Highways Road Treatment Spend the following additional resurfacing would be delivered over the ten year life of the contract.

Road	Optimistic (km)	Realistic (km)	Pessimistic (km)
principle roads	3.9	1.95	11.7
principle footways	3.1	1.55	9.3

classified roads	3.17	1.585	9.51
classified f/way	1.06	0.53	3.18
unclassified roads	3.15	1.575	9.45
unclassified fways	1.34	0.67	4.02
surface treatments	5.7	2.85	17.1
<b>Total</b>	<b>21.42</b>	<b>10.71</b>	<b>-64.2</b>

## **6.10 Other Financial Risk Issues**

**6.10.1 Clarity of Specification** - Experience of similar contracts is that post contract award the Provider will exploit any ambiguities in the contract documents, for example the services specification. This can lead to increases in price, lower quality of service than expected, and the diversion of management time for both parties.

**6.10.2 Changes in Service Requirements** – If the Council requires the Provider to change elements of service provision either due to local circumstances or changes in legislation etc. it is likely that the provider will be able to adapt to these changes very quickly, however, the change in plans / specification will almost certainly come at a greater cost than if the Council was adapting to the changes itself.

**6.10.3 Future Budget Savings** – Large scale procurements such as this, BSF, Street Lighting PFI and the SSP often help to contribute to corporate savings. However once annual revenue budgets in particular are contractually committed, the only scope for future savings is to reduce the service standards, which means that additional pressure is put on a smaller base of expenditure in order to find savings.

## **6.11 Conclusion**

**6.11.1** The Outline Business Case Addendum sets out a number of reasons why it is felt that entering into a long term arrangement with a Highways Partner will be advantageous to the City Council and the management of the Highway Network.

**6.11.2** This section deals with the financial aspects of the proposed Partnership and in particular, whether or not the arrangements will deliver Value for Money for the residents of the City. In reality due to the nature of the contract arrangements and the target cost approach to capital in particular it is not possible to guarantee (even after the next stage of the procurement process) that Value for Money will be delivered over the ten year period of the contract.

**6.11.3** However, the figures that will be returned as part of the CFT will give an added level of surety to the numbers and the arrangements within the contract for dealing with capital scheme pricing mean that there is a solid framework in place for ensuring the Council can influence the cost of future capital schemes provided by the Highways Partner.

**6.11.4** On this basis therefore it is recommended that the Council proceeds to the next stage of the procurement process.

## 7 Commercial Approach

**7.2.1** There are some positions set-out within the draft Service Agreement which may not deliver the best value for money for the Council in the context of the deal, however, it may be that the flexibility the Council retains by setting its position in this way is worth more than the additional VFM which could be delivered by adopting the alternative approach.

### 7.3 Guaranteed Capital Funding

**7.3.1** The Council set out early in the dialogue process that the anticipated capital affordability is not guaranteed. This position was taken in order to retain maximum flexibility for the Council given the deteriorating financial climate and increasing Council budget gap. Bidders were however informed that the Council would consider guaranteeing an element of the capital income on an annual basis if there was a sufficient value for money argument.

**7.3.2** At ISDS stage bidders were encouraged to submit a non-evaluated Optional Proposal which the project team anticipated would include an option based on a guaranteed capital income value especially given the encouragement to bidders during the dialogue process. This however was not forthcoming.

**7.3.3** If a level of capital turnover is not guaranteed by the Council then the Service Provider will be required to consider the likelihood that the Council will not allocate, or reduce, any capital works for one or more years. In doing so the Service Provider may include a risk allowance to recover minimum overheads and profit (or at least reduce losses) if the turnover falls below a set level. In this scenario the Council can mitigate the impact by informing the Service Provider of a proposed reduction in capital spend as early as possible, thus enabling the Service Provider to manage out these losses.

**7.3.4** Guaranteeing a level of revenue and capital turnover provides certainty to the Service Provider. This certainty enables greater forward planning and programming which provides a more effective and efficient capital spend programme.

**7.3.5** Additionally, guaranteeing a level of capital turnover opens up a further option for the Service Provider to fund increased capital spend from their own balance sheet in the first few years of the contract in the knowledge that this can be offset through the guaranteed income stream in later years.

### 7.4 Sensitivity Analysis

**7.4.1** A sensitivity analysis has also been undertaken on a straight line basis to determine the level of financial benefits which would be delivered if the capital spend reduced to £3m per annum.

£000	Optimistic		Realistic		Pessimistic	
	Gross Benefit over 10 years	Net Benefit 10 years	Gross 10 yr	Net 10 yr	Gross 10 yr	Net 10 yr
£7.6m pa capital	10260	8960	6156	4856	2052	752
£3.8m pa capital	5724	4424	3132	1832	1296	-4

**7.4.2** It should be noted in relation to the above table that a reduction in capital spend would likely lead to an increase in Lump Sum cost as bidders would be required to consider the increased maintenance requirements arising as a result of less resurfacing and structural improvement schemes.

**7.4.3** Given the Council's current major cost savings review could impact significantly upon the revenue affordability a further sensitivity analysis has been undertaken on the assumption that the revenue budget will be reduced by £250k<sup>13</sup>.

£000	Optimistic		Realistic		Pessimistic	
	Gross Benefit over 10 years	Net Benefit 10 years	Gross 10 yr	Net 10 yr	Gross 10 yr	Net 10 yr
£2.7m pa revenue	10260	8960	6156	4856	2052	752
£2.45m pa capital	7760	6460	3656	2356	-448	-1748

**7.4.4** If the revenue budget does fall then it should be noted that if applied to existing service delivery a further decrease in service performance would result. Therefore, the difference between current performance and performance under the HSP would be greater. Additionally, the project team would look to review the service levels specified to ensure that a vfm solution was provided by bidders.

**7.4.5** When a 50% reduction in capital is combined with a £250k reduction in affordability the financial benefits forecast is as set out in the table below.

£000	Optimistic		Realistic		Pessimistic	
	Gross Benefit over 10 years	Net Benefit 10 years	Gross 10 yr	Net 10 yr	Gross 10 yr	Net 10 yr

<sup>13</sup> See Appendix 3 – revenue reduced by £250k per annum, capital retained at £7.6m pa

<b>Current Affordability</b>	10260	8960	6156	4856	2052	752
<b>50% Capex and £250k revenue reduction</b>	3224	1924	362	-938	-1204	-2504

## 7.5 Options Appraisal

**7.5.1** Since ISDS the Council has requested bidder's updated prices for their ISDS submission on the basis of the Council guaranteeing Target Cost Services expenditure up to a certain level, specifically against two scenarios:

**7.5.1.1** (a) The impact of guaranteeing a minimum level of expenditure to the Provider of **£3m per annum** for the minimum period of 10 years of contract duration;

**7.5.1.2** (b) The impact of guaranteeing a minimum level of expenditure to the Provider of **£6m per annum** for the minimum period of 10 years of contract duration.

**7.5.2** Initial responses from both bidders suggested that their was at best a marginal benefit in contractually guaranteeing a level of capital funding on an annual basis. Further dialogue with both bidders reinforced the lack of value for money argument for justifying a guaranteed capital fund.

**7.5.3** Both bidders confirmed through dialogue that there was no risk allocation included within the pricing to reflect the fact that there were no contractual guarantees on funding levels. This is a standard market position which bidders are used to managing. The Service Provider would manage the risk of reduced capital funding through advanced planning and reallocation of resources, and generation of other income, therefore avoiding the need to include a risk premium.

**7.5.4** Bidders also confirmed that guaranteed funding would not increase economies of scale as the forward works/advanced capital programme is not known (i.e. it is not known what to buy in years 2/3/4/5 etc)

**7.5.5** Additionally no proposals for potential solutions which would become available by guaranteeing the funding have been strongly argued for by bidders through the dialogue. For example, guaranteed funding would enable an up-front capital investment funded from the Service Provider's balance sheet. However, if the Council wished to bring spend forward, the additional funding would be more competitively funded from the Council's own balance sheet, or Council borrowing. Unlike a PFI, there would be no additional funding provided from central government which would off-set the higher borrowing costs of the private sector.

**7.5.6** On the basis that no value for money arguments have been provided through the dialogue process the recommended position is that the Council does not contractually guarantee any level of capital funding. This is particularly sensitive given forthcoming budgetary pressures on the public sector.

## **7.6 Overhead Recovery**

**7.6.1** Guaranteeing capital turnover also enables a more appropriate cost allocation between Lump Sum and Target Cost services. The Service Provider will have fixed overheads to deliver both the Lump Sum services and the Target Cost services. Without a guaranteed capital sum to allocate the overheads associated with the delivery of Target Cost schemes to, the Service Provider will look to recover overheads for Target Cost schemes via the Lump Sum.

## **7.7 Contract Length and Contract Extensions**

**7.7.1** It was recommended in the Cabinet and Council Reports of 2008 that the contract be for a period of 10 years with the possibility to extend for up to a further 5 years. The recommendation was based on soft-market testing to determine what potential bidders viewed as an optimum length of contract, benchmarking against other similar contracts and also on the Council's SSP contract length. 10 years with a potential 5 year extension was a significant length in order to allow enough time for efficiencies to be driven out of the service, to encourage providers to invest in the service and to allow a strong partnering relationship to be established which will facilitate innovation in service delivery, again leading to efficiency savings.

**7.7.2** The OJEU notice was placed on the above basis and this now dictates that the Council must award a contract within these parameters. However, there has been no rationale articulated through the dialogue process to reconsider the length of contract.

**7.7.3** The contract can be extended for a period of up to five years. Currently, the Service Provider could earn extensions based on performance against the specified KSIs (and earned extensions can be removed if KSIs are subsequently not achieved). However, even if the Service Provider achieves all specified KSIs and the extensions are 'earned', the Council retains the right not to grant the extension.

**7.7.4** This current position drives bidders to either; price the contract on a 10 year basis meaning up front investment, efficiencies etc must all be recovered within the 10 years; or, price over a longer period but add in a risk premium in case the Council decides not to extend the contract even though the Service Provider has achieved the requisite KSIs.

**7.7.5** This approach provides the Council with maximum flexibility on contract length, however, a better value for money solution would be for the contract extensions to be guaranteed if they are earned (bearing in mind the Service Provider, as well as being able to earn extensions, can lose the extensions if performance deteriorates). Bidders would therefore be able to take a view on their ability to achieve the extensions with the risk being substantially within their control and an element of risk pricing could be removed. This would consequently allow bidders to price over a longer period.

**7.7.6** Providing the Service Provider is delivering satisfactorily the likelihood that the Council will be seeking to terminate the Contract at year ten is relatively low. If the Service Provider has not performed satisfactorily, then the KSIs are unlikely

to have been achieved and therefore the Service Provider will not have earned any extensions.

- 7.7.7** Speculatively, the only currently obvious potential reason for the Council not wanting to extend beyond year 10 if the Service Provider is performing is if additional funding which requires an alternative service delivery model (e.g. PFI) becomes available. Yet there are break clause provisions within the contract to deal with this scenario which could be invoked if required (although at a cost to the Council).
- 7.7.8** It is also noted that a longer contract delays the need for a costly re-procurement.
- 7.7.9** The below table indicates the forecast financial benefits of a 15 year contract in comparison to a ten year contract. This is based on a simple model of the savings realisable by extending for a further 5 years. It does not consider any additional VFM from guaranteeing contract extensions if earned. It is noted that the financial benefits are demonstrated against the existing delivery arrangements and by revisiting the market in 10 or 15 years time, additional savings may be achievable, although likely limited as the Service Provider will have driven out the majority of inefficiencies.

£m	Optimistic		Realistic		Pessimistic	
	Gross Benefit over 15 years	Net Benefit 15 years	Gross 15 yr	Net 15 yr	Gross 15 yr	Net 15 yr
<b>15 Years</b>	15545	14245	9327	8027	24872	4918
<b>10 Years</b>	10260	8960	6156	4856	4104	2804

## 7.8 Third Party Income

- 7.8.1** The approach proposed under the HSP is for the Service Provider to guarantee a level of Third Party Income over the life of the contract which is deducted directly from the Lump Sum the Council pays to the Service Provider. If income falls below the Service Provider’s guaranteed levels then the Service Provider will be liable for the shortfall. However, if the Service Provider generates income over and above the forecast income levels then there is a mechanism whereby the profit will be shared between the Service Provider and the Council.
- 7.8.2** The Council currently generates income from third parties through the statutory authority delegated to it under the New Roads and Street Works Act and Traffic Management Act, as the Highways Authority, to levy penalties and fees for use or damage to the network.
- 7.8.3** Additionally bidders are encouraged to generate income from other Third Party works, and again the Council would take a share of the profits.

- 7.8.4** As bidders are being asked to bid back a level of Third Party Income the level of risk premium associated with the approach is negligible.
- 7.8.5** In taking responsibility for Third Party Income the Service Provider will be required to provide an efficient and effective service to ensure that the minimum forecast levels are achieved and it is also incentivised to generate additional income. While the Council no longer bears risk of reduced income levels.
- 7.8.6** It is however noted that this approach does lead to a loss of control for the Council over Third Party Income guaranteed by the Service Provider in that the guaranteed income is being used to deliver the service specification set out within the Service Agreement. Income generated over and above this level will be shared with the Council and therefore the Council will be able to direct this spend as appropriate.<sup>14</sup>
- 7.8.7** The alternative approach would be to ask the Service Provider to collect the income on the Council's behalf and then pass the income back to the Council. The Council would then use this to off-set the Lump Sum payment (effectively a longer, more administratively burdensome process to achieve the same end as the approach above).
- 7.8.8** This alternative approach would mean the Council retained the risk of income reductions but would also retain control of all income generated (minus the cost of the Service Provider collecting the income). However, the incentive for the Service Provider to achieve and exceed forecast would be reduced.<sup>15</sup>

## **7.9 Accommodation**

- 7.9.1** The Council is currently running a separate project to relocate all services from its Town Depot site to a new depot site, called City Depot. All highways services will relocate from Town Depot and Castle Way to the new City Depot. As part of the City Depot project it has been instructed that the HSP must use this site.<sup>16</sup>
- 7.9.2** City Depot will not be available until October 2011, approximately one year after the start of the HSP. Therefore, the Service Provider has been offered use of the Council's Castle Way office and Town Depot until City Depot is available.<sup>17</sup>
- 7.9.3** The current position is that the Council will offer accommodation to the Service Provider rent free and will also pay all reasonable service and utilities costs. The alternative option would be to levy a charge to the Service Provider for use of the accommodation. However, this charge would simply be passed straight back through to the Council as part of the cost of the service, perhaps with a

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<sup>14</sup> Albeit, any income generated from NRSWA or TMA must be spent on highways/transportation projects and this would be applicable whether the Council entered into a HSP or any other service delivery arrangement

<sup>15</sup> A lesser incentive in this scenario would be to agree a forecast income level for the Service Provider to meet and attach deductions if this was not achieved.

<sup>16</sup> As part of the City Depot Project directing the SP to use the site was deemed to be more cost-effective than asking SP to procure its own site as well as enabling the Council to retain ultimate control of the depot at the end of the HSP contract.

<sup>17</sup> As part of the Council ASAP Project (Accommodation moves) Highways has been scheduled to move from Castle Way by September 2011. If City Depot is not ready then there will be an impact on ASAP. However, this would be a risk to the ASAP project regardless of the HSP project.



margin on top. Therefore, there is no strong rationale for altering this current position.

## **7.10 Pensions**

**7.10.1** The Council's policy is to require<sup>18</sup> that any staff transferring from direct Council employment are provided with the an opportunity to continue their Local Government Pension Scheme (LGPS) Membership.

**7.10.2** Through the procurement bidders have been forthcoming in offering to secure Admitted Body Status with the Hampshire Pension Fund in order to provide transferring employees with an opportunity to remain within the LGPS scheme if they so wish.

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<sup>18</sup> Subject to Procurement Regulations

## 8 Payment and Performance Regime

- 8.2** A comprehensive performance regime has been developed by the Council which will incentivise the Service Provider to achieve the required performance levels and ensure that the Council does not pay for a sub-standard level of service.
- 8.3** The principles underpinning the performance regime have been dialogued with bidders during the procurement process.
- 8.4** The Council seeks to have an appropriate allocation of risk and responsibilities between the Council and the Service Provider to incentivise satisfactory performance against the Council's requirements as articulated in the Service Information document. In overall terms the Council is seeking for the Service Provider to deliver a service that secures efficiency gains over the life of the Contract whilst maintaining or improving upon the service levels as required by the Service Information document.
- 8.5** This incentive regime will require satisfactory performance to be achieved through the setting of targets, against which actual performance will be measured and a combination of financial and non-financial remedies will be employed should actual performance fall below target performance. In return the Service Provider will secure a defined return from the Contract.
- 8.6** Secondly, and notwithstanding the above, the Council seeks to have in place a set of performance levels that is challenging but achievable.
- 8.7** To achieve a full payment, the Service Provider will be required to deliver services under the Contract which meet the relevant performance targets. Failure to meet these target levels of performance may result in, amongst other things, adjustments to payments through the use of deductions. Thus payment to the Service Provider will be based on the payment due to the Service Provider less relevant deductions.
- 8.8** The Council may apply other non-financial remedies due to actual performance below the target levels.
- 8.9** The Council also envisages that financial deductions may escalate for worsening/persistent unsatisfactory performance as measured against the requirements in the Service Information document.
- 8.10** Additionally the Contract is expected to incentivise the Service Provider to provide holistic and strategic good performance across the life of the contract by allowing the Service Provider to earn and then release contract extensions beyond the initial 10 years life of the Contract, subject to Council agreement.
- 8.11** The Service Provider will employ a self monitoring approach to monitor the performance under the Contract, but with certain mechanism in place for the Council to undertake additional monitoring/audit and intervention in certain circumstances. A significant component of the self monitoring approach will be based on the performance of the Service Provider using performance indicators, comparing these with target levels of performance. Depending on the nature of these indicators, some performance is self monitored on a weekly, monthly,

quarterly and/or annual basis. A full list of the indicators which comprise the Performance Framework is shown in Appendix 2.

## **8.12 Performance Management Measurement Principles**

**8.12.1** Performance Management Measurement will be focussed primarily through the use of performance indicators. This will be used to assess the level of deductions that will need to be made as well on a monthly basis to calculate the payment from the Council to the Service Provider. Performance measurement will also be used to establish whether any extensions to the Contract should be applied.

**8.12.2** There are three tiers of performance indicators which will be used to measure actual performance against target performance level for relevant aspects of the service.

**8.12.3** On an annual basis, the Council and the Service Provider will meet to review the use of performance indicators including the continued appropriateness of these indicators, whether there will be 'promotion' and 'relegation' of indicators and the absolute level of performance for each of the indicators. The Council also reserves the right to change, on a period basis the mix of indicators across all three tiers by introducing new indicators or removing existing indicators, as it deems fit.

### **8.12.4 Key Strategic Indicators (KSIs)**

**8.12.4.1** KSIs are generally output and outcome based and will be used to measure the Service Provider's performance against strategic objectives of the Council across the entire service.

**8.12.4.2** The primary purpose of KSIs is to determine whether extensions to the contract have been earned and also then can be released at the Council's discretion and to determine whether the Service Provider is able to access the 'share costs' provisions with respect to 'target cost' services.

**8.12.4.3** KSIs will be weighted to reflect the relative importance of each on the basis of High, Medium or Low importance.

### **8.12.5 Key Performance Indicators (KPIs)**

**8.12.5.1** KPIs are generally output based but some are input based and will be used to measure the Service Provider's performance against the operational aspects of the Contract.

**8.12.5.2** The primary purpose of KPIs is to quantify the financial deductions that will be applied to the payment to calculate the net payment to be made, should the Service Provider's performance fall below the target levels outlined in the Service Information document.

**8.12.5.3** In total, it is anticipated that there will be a manageable number of KPIs. The performance under each KPI will be measured and this variable will be used within a formula (by applying an appropriate weighting) to calculate the level of deduction, if any, that should be applied to payment in a particular month, to determine the net payment to the Service Provider.

## 8.12.6 Other Performance Indicators (PIs)

**8.12.6.1** PIs are generally input based/service based and are geared to measuring the operational aspects of the service but do not result in the ability to earn or deploy contract extensions nor impact on deductions. Instead they are to be provided by the Service Provider to the Council to allow the Council to understand the operation of the Contract across all areas but on an information basis only.

**8.12.6.2** PIs will be reviewed on an ongoing basis by the Council to assess whether satisfactory performance against the measures found in the Service Information document have been achieved and should there be persistent poor performance in one or more areas then one or more PIs could be 'promoted' (at the discretion of the Council) to become KPIs as outlined above.

## 9 Contract

**9.2** Following the strategic decision to proceed with the Highways Futures Project through a partnership approach (using a non-incorporated joint venture model), the project team selected the Highways Agency Managing Agent Contract Form of Contract ("MAC") as the most appropriate base document that, following project specific revisions, was the most suitable to underpin the scope of services and standards of delivery required by the Council.

### 9.3 Key factors for assessment process

**9.3.1** In order to assess the options and make a decision as to which form of contract would be suitable for use by the Council, the project team considered that the contract would have to allow for the following factors:

**9.3.1.1** it would underpin and encourage a collaborative working relationship between the Council and the Service Provider;

**9.3.1.2** it would allow for the delivery of works and services in the context of the Council's functions and responsibilities as a highways authority;

**9.3.1.3** it would allow for different methods of payment in respect of a wide variety of works and services;

**9.3.1.4** it would set up a performance management framework which rewarded excellent service and penalised poor performance;

**9.3.1.5** it would allow for flexibility in budget levels and the range of services being provided;

**9.3.1.6** it would contain provisions relating to staff transfer under TUPE and associated provisions required for pensions arrangements; and

**9.3.1.7** it would incorporate governance arrangements which enabled the Council to remain in control of corporate policy but at the same time benefit from private sector innovations in order to deliver those corporate policies.

### 9.4 Industry standard forms

**9.4.1** In the light of the factors listed above, the project team assessed the following industry standard forms of contract and came to the following conclusions:

**9.4.1.1** JCT forms of contract - all options within the range of forms comprising the JCT suite of contracts were considered to be inappropriate as they are primarily used for the delivery of accommodation schemes on a one-off basis (save for the Term Contract which does cater for repeat works/services being delivered over a period of time but is not suitable for civil engineering based works/services).

**9.4.1.2** ICE forms of contract - all options within the range of forms comprising the ICE suite of contracts were considered to be inappropriate as although they are used widely in the civil engineering sector they are designed for the delivery of one-off projects and therefore do not cater for the management of long-term partnering arrangements.

**9.4.1.3** Engineer, Procure and Construct contracts (for example, MF/1, IChemE forms and FIDIC forms) - all standard forms of EPC contracts were considered to be inappropriate as they are commonly used for the delivery of process plants and are therefore inappropriate for the management of long-term partnering arrangements.

**9.4.1.4** SoPC4/PFI forms of contract - whilst one of the benefits of SoPC4/PFI forms of contract is that they do create a long-term relationship between the authority and provider, commonly projects delivered through PFI are for the construction and operational management of an asset (be this a facility such as a hospital or a structure such as a bridge) where it is possible to 'fix' a specification and contract sum at the outset of the contract period. The inherent lack of flexibility in the SoPC4/PFI model does not lend itself to the long-term partnering arrangement required by the Council where budgets and policy requirements may well alter on an annual basis (particularly in relation to capital expenditure on schemes) and as a result this form of contract was considered to be inappropriate.

**9.4.1.5** NEC forms of contract - all options within the range of forms comprising the NEC suite of contracts were considered to be inappropriate for use (including the Term Services Contract) without the incorporation of a large number of changes to the legal terms and the structure of the technical specification. The project team noted that the Highways Agency had itself recognised that in the context of the motorway and trunk road network no option within the wide range of NEC suite of contracts was appropriate for the delivery of either one-off projects or long-term maintenance arrangements without a considerable number of revisions and in order to address this problem commissioned its own external advisors to produce amended forms of contract to become its own Model Contract Documents for two separate purposes: the Early Contractor Involvement Form and the Managing Agent Contract Form.

**9.4.1.6** Highways Agency ECI form of contract - the ECI Form is considered to be unsuitable as it is used for the delivery of single projects rather than for long-term maintenance arrangements.

**9.4.1.7** Highways Agency MAC form of contract - following an analysis of the various industry standard forms, the project team selected the MAC as the most appropriate starting point for the development of a contract for the Council.

## **9.4.2 Use of a bespoke contract**

**9.4.3** Once the MAC had been selected as the most appropriate form of industry standard form contract, the project team assessed whether the use of a bespoke form of contract would provide a better solution than the MAC. Whilst the project team noted that benefits would be derived from having a bespoke form of contract, the fact that the MAC contained many of the contractual processes required for a long-term partnering arrangement whilst being accepted by the private sector market outweighed the benefits of starting from scratch with a bespoke contract that would have been viewed with suspicion by the market with the possible outcome of restricting the number of bidders and/or the inclusion of higher levels of risk contingencies in costs.

## **9.4.4 Using the MAC for Southampton**

**9.4.5** The standard form of MAC has been revised in order to reflect the Council's service specification, payment mechanism and revenue and capital funding sources, all of which differ from the particular requirements/constraints of the Highway's Agency. The revisions have been necessary to ensure that the contractual terms are consistent with the service specification and financial provisions, however, the underlying contractual processes are very similar to those employed by the Highway's Agency in

order to take advantage of the benefit noted above of positive engagement with the private sector market.

#### **9.4.6 Managing the risks**

**9.4.7** Concerns have been raised in relation to two factors associated with using an amended form of MAC contract for the project: firstly, the lack of case law for the underlying NEC form of contract and, secondly, the skills and knowledge of the Council in order to use the final form of contract in the operational context. Addressing these factors in turn:

**9.4.7.1** Lack of case law - whilst it is true to say that there is a lack of case law for the NEC forms of contract and that this may be interpreted as a potential risk factor, the same criticism would be true of the SoPC4 form of contract which is, of course, used as the starting point for the majority of all PFI schemes within the UK; an alternative perspective to there being a lack of case law for the NEC forms of contract would be to say that the forms of industry standard contract which are supported by a large body of case law are difficult to interpret which is why they have attracted such a large amount of litigious activity between client and contractor and that the simplicity of the language in the NEC forms of contract and collaborative ethos has acted to minimise the number of disputes and therefore case law. However, neither of these responses (nor the perceived risk factor), focuses on the fact that there is no standard form of contract that can be taken off the shelf which is both supported by case law and is appropriate for use by the Council without amendment. Accordingly, the decision to use an amended version of the MAC was taken to ensure that the Council used as a base document a form of contract that has been accepted by the construction and engineering industry and as a result is supported in a wider sense by operational precedent for employers and the contractor market.

**9.4.7.2** Operational management - the importance of operational management has been a core driver in the procurement process to date. The Council rather than the external advisors has controlled the procurement process and decision-making in the development of the service solution. This has been achieved by Council officers leading each of the technical, finance and legal work streams to ensure that the external advisors are able to transfer skills and knowledge throughout the procurement process. Wider participation within the highways department (and other relevant service areas) has been achieved by involving relevant officers in the collation of information and development of the technical specification, representation at dialogue sessions with bidders and the evaluation of bidder's solutions. The purpose of this involvement is to ensure that knowledge of the procurement is disseminated amongst the Council prior to operational commencement. Furthermore, prior to and during the mobilisation phase training sessions will be run to pass knowledge to the Council team responsible for managing the partnership with the Service Provider to ensure that a positive approach to contract management based on knowledge of the relevant contractual mechanisms is established at service commencement to ensure full benefit is obtained from the procurement.

### **9.5 Contract and Client Management Arrangements**

**9.5.1** The Council acknowledges the requirement for an intelligent and robust client and contract management function.

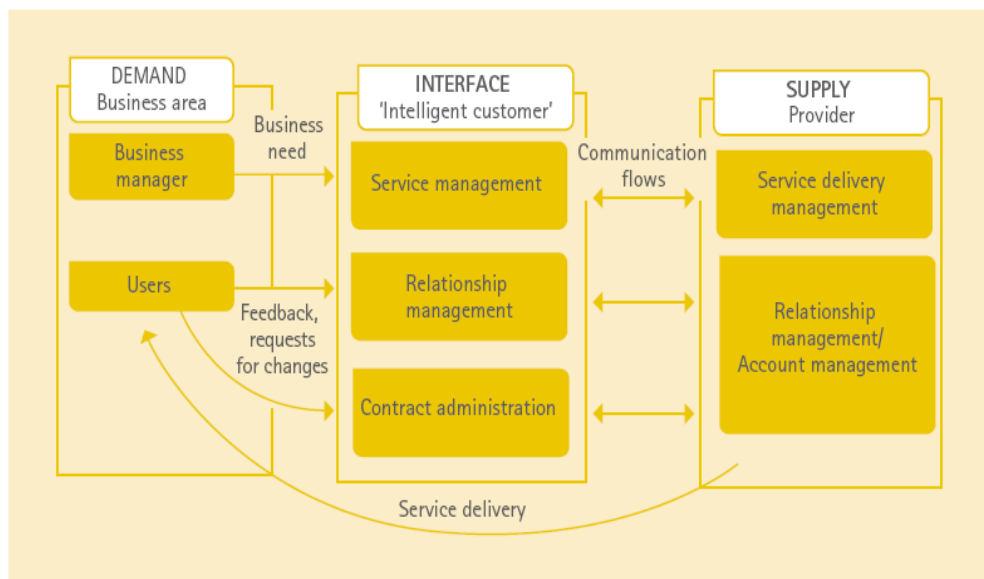
**9.5.2** An integrated 'Partnerships Unit' has been established to client and contract manage both the Street Lighting PFI and the Highways Partnership. A Highways Partnerships Manager has been recruited to head this unit.

**9.5.3** The Street Lighting PFI Client Team has been recruited in time for the commencement of mobilisation (December 2009) and service commencement (March/April 2010). The Street Lighting PFI Client Team was established on the basis of an external independent report which examined the most appropriate structure to manage the PFI.

**9.5.4** It is intended that the HSP Client Team structure is in place at Final Tender stage and a 'Shadow Client' will be appointed by time of Preferred Bidder.

**9.5.5** The key core functions of a Contract and Client Management Team are as follows:

- Service Delivery Management - ensures that the service is being delivered as agreed, to required level of performance and quality
- Relationship Management – keeps the relationship between the two parties open and constructive, aiming to resolve or ease tensions and identify problems early
- Contract Administration – handles the formal governance of the contract and the changes to contract documentation

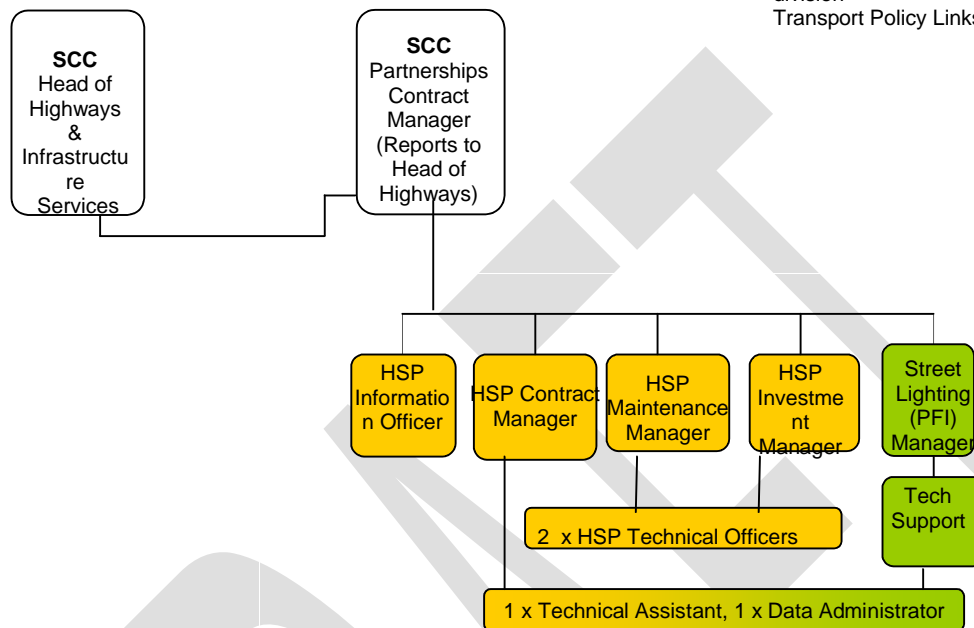


**9.5.6** However, in considering the wider function of the Division another key function should also be included in the core functions:

- Policy, Strategy and Service Development – takes a strategic view on the development of the contract and service within the wider business objectives.



- Key**
- HSP Client/Contract Team
  - SCC Staff
  - Street Lighting PFI Client Team
  - Enabling Support across division
  - Transport Policy Links



**9.5.7** All affordability and financial benefit calculations have taken into account the cost of the HSP Client Team.

	<b>FTE</b>	<b>Grade</b>	<b>Annual</b>	<b>Total Salary</b>	<b>25% on costs</b>	<b>Total Cost</b>
Partnerships Manager (split across Street Lighting and HSP)	0.5	13	55,000	27,500	6,875	<b>34,375</b>
Managers	3	12	39,855	119,565	29,891	<b>149,456</b>
Officers	2	8	22,221	44,442	11,111	<b>55,553</b>
Admin	2	6	16,054	36,000	9,000	<b>45,000</b>
Info Officer (Split across PFI and HSP)	0.5	8	22,221	11,111	2,778	<b>13,888</b>
<b>Total Staff Costs</b>						<b>298,272</b>

## 10 Benefits Realisation Management

**10.2** The benefits expected as an outcome of the implementation of the HSP were set out within the Original Outline Business Case and June 2008 Cabinet Report. These expected benefits were as follows:

**10.2.1** Driving out inefficiencies in service delivery which can be reinvested back into the highways network to improve condition

**10.2.2** Securing investment in the service delivery infrastructure;

**10.2.3** Increasing the capacity and resources available to deliver the service;

**10.2.4** Securing economies of scale;

**10.2.5** Increasing the service performance level; and

**10.2.6** Maintaining and improving the customer focus

**10.3** This section revisits the originally identified benefits and sets out the measurement methods and processes that will be used to monitor and assess the realisation of benefits. The main tenet underpinning the approach to benefits realisation and measurement is to ensure adequate benchmarks are known prior to contract award.

**10.4** A more detailed Benefits Management Strategy, Benefit Profiles and Plans will be created based on these principles.

### **10.5 Driving out inefficiencies in service delivery which can be reinvested back into the highways network**

**10.5.1** This benefit requires the measurement and tracking of efficiencies and VFM comparatively between the existing service delivery model and the HSP. Additionally, the impact on the condition of the network must be considered in any benefits tracking.

**10.5.2** There are therefore three components to the overarching benefit of improving efficiency and VFM; efficiency and VFM from Lump Sum Services; efficiencies and VFM from Target Cost Services; and, condition of the network.

**10.5.3** The benefits therefore can be articulated as follows:

- Reduced cost of delivering equivalent Lump Sum services (Revenue);
- Reduced cost of delivering Target Cost (Capital) Schemes; and
- Improved condition of the network.

#### **10.5.3.1 Reduced cost of delivering equivalent Lump Sum services (Revenue)**

**10.5.3.1.1** As has been described above, the Council's revenue affordability budget is based on the current cost of delivering the existing services which will be included under the Lump Sum services of the HSP.

**10.5.3.1.2** Existing budgets are approximately £3m (£2.7m affordability + £300k client costs). ISDS submissions demonstrated (see above Value for Money and Forecast Financial Benefits section) a significantly reduced cost of delivering the same services under the HSP (with improved service levels). Bidders were able to deliver a reduced fee due to the inefficiencies currently embedded within the service and the introduction of more efficient ways of working.

**10.5.3.1.3** The Lump Sum will be fixed for the life of the contract unless the Council amends the service specification or if any other Compensation Events require a review. Therefore, if the Lump Sum price agreed at the outset of the contract is below the Council's affordability for the same services, VFM will be demonstrated.

### **10.5.3.2 Reduced cost from delivering Target Cost schemes**

**10.5.3.2.1** As set out in the Value for Money and Forecast Financial Benefits Section above sample scheme prices submitted by bidders at ISDS stage demonstrated a reduction in the cost of delivery of sample schemes when compared to existing arrangements.

**10.5.3.2.2** At Final Tender stage bidders will be required to cost between 12-15 Sample Schemes which the successful bidder will be expected to deliver. The Council will have these same schemes priced as if they were to be delivered using its existing service delivery arrangements. This will enable a VFM comparison between existing arrangements and the HSP.

**10.5.3.2.3** The sample schemes provided at Final Tender stage will be used as a benchmark for all future Target Costs schemes. Over the life of the contract, as more sample schemes are priced and delivered, a 'Library' of schemes will be compiled and used as a benchmark to assess value for money.

**10.5.3.2.4** However, the Target Cost schemes delivered are not uniform over the life of the contract and there will be components of Target Cost schemes where the Library of schemes can not be referenced to ensure VFM is being provided. In these instances the Service Provider will be required to secure three quotes to demonstrate that the price being provided is VFM. The Council will also retain the right to tender high value capital schemes to ensure that the Service Provider is delivering competitive prices.

### **10.5.3.3 Improved condition of the network**

**10.5.3.3.1** Despite a robust process to ensure VFM is being delivered against Target Cost schemes it is intended to measure the condition of the network via an assessment of the depreciated asset value. This will demonstrate that the delivery of capital schemes through the HSP is a more effective and efficient delivery model and is therefore VFM.

**10.5.3.3.2** To measure the improved condition of the network the Council will calculate the asset value at a point prior to the HSP and forecast an asset value, based on 2-3 profiles of anticipated capital spend, after 10 years and 15 years as if under existing service delivery arrangements. At Final Tender Bidders will also be asked to calculate an asset value on the same basis but utilising their own asset approach to, in theory, demonstrate that under the HSP the same level of resources will deliver an improved output.

**10.5.3.3.3** This approach is relatively innovative and still requires development prior to Final Tender stage. If this is not achievable for Final Tender Stage the Council will still be able to measure the impact of the HSP on the condition of the Network through measurement of National Indicators for the Condition of Carriageways and Footways. Similar to the above the Council will be able to forecast an improvement in condition

based upon 2-3 spend profiles. An improved target will then be specified for the Service Provider to achieve over the life of the contract.

**10.5.3.3.4** Whichever approach is taken the target required will be part of the Performance Framework and will attract either service deductions or contract extensions.

## **10.6 Increased investment in the service delivery infrastructure**

**10.6.1** This benefit will be measured through the identification of investment and expenditure within the Service Provider's Lump Sum Pro-forma.

**10.6.2** Investment in the infrastructure (such as new fleet, plant, ICT) was evident within the bids submitted at the ISDS stage of the procurement process. In comparison the Council has no plans for investment into the service delivery infrastructure.

## **10.7 Increased capacity and resources available to deliver the service**

**10.7.1** The HSP will utilise the experience and expertise which the Service Provider will bring from the private sector. The Service Provider will be able to utilise wider resource and expertise in a way which the Council can not currently do.

**10.7.2** The capacity and resources available to deliver the services will be tracked through measurement of the resources channelled into the service from outside of the original TUPE transferees. It is expected that there will be a significant number of additional resources with experience of working within the private sector and across other similar public sector contracts.

## **10.8 Securing economies of scale**

**10.8.1** This is an Immediate Outcome of the implementation of the HSP and will deliver the benefit of driving out inefficiencies in the service to be reinvested back in the network. The outcome will be measured through detailed analysis of the Lump Sum and Target Cost schemes; the reduced cost of delivering these services will be in part due to the increased buying power and more efficient supply chains of the Service Provider.

## **10.9 Increasing the service performance level**

**10.9.1** A detailed Performance Framework (Appendix 2) has been developed which specifies the required performance levels for the Service Provider. The Performance Framework also provides the current performance levels which are significantly below the required levels under the HSP.

**10.9.2** All of these performance levels will be measured by the Service Provider on a regular basis and reported to the Council's Client and Contract Management Team.

## **10.10 Maintaining and improving the customer focus;**

**10.10.1** A Key Performance Indicator focuses on the Service Provider's customer management performance. This will be managed as part of the wider Performance Framework.



## 11 Project Delivery Strategy

**11.2** The strategy for the competitive dialogue procurement process has been to use the Outline Solutions stage to validate at a high-level the direction of the OBC.

**11.3** The intention of Detailed Solutions is to focus on developing the final service solutions and also on more detailed financial elements which will provide specific evidence demonstrating the VFM which can be delivered by the market.

**11.4** After the submission of ISDS bids a report will be taken back to Project Board, Senior Managers and Cabinet for approval to close dialogue and issue Final Tenders.

**11.5** At Final Tender stage the intention is for the service solutions to have been substantially agreed and therefore the key focus will be on the price competition. At each stage the evaluation criteria will be drafted to reflect the purpose.

### 11.6 Timetable

**11.6.1** The original OBC set the timetable for the commencement of the HSP as September 2010. The current forecast start date is now October 2010. This slippage in the timetable can be attributed to the unforeseen speculation surrounding a proposed additional bidding round for Highways Maintenance PFI credits. As described in Section 2 above the commencement of both ISOS and ISDS stages were postponed as the Council took a 'wait and see' approach to the potential announcement of the PFI credit bidding round.

**11.6.2** The current timetable is now as follows:

Stage	Start	Finish
Post ISDS Submission Detailed Dialogue	Mon 23/11/09	Fri 26/02/10
"Cabinet Approval (to Close Dialogue, Issue CFT and Delegate Authority to appoint PB with evaluation criteria)"	Thu 15/10/09	Mon 18/01/10
Call for Final Tender	Wed 18/11/09	Fri 02/04/10
CFT Evaluation and PB Selection	Fri 02/04/10	Mon 10/05/10
PB Fine-tuning	Tue 11/05/10	Mon 07/06/10
Cabinet Approval to Award Contract	Mon 07/06/10	Mon 07/06/10

### 11.7 Project Governance Structure

**11.7.1** The Project Governance Structure is attached as Appendix 4.

**11.7.2** A Project Board meets on a monthly basis to guide and steer the project, make decisions and provide scrutiny and challenge to the project.

**11.7.3** A Project Team meets on a monthly basis to ensure that actions and issues are addressed in order to deliver the project within the parameters set by the Project Board.

## **11.8 Dialogue Team**

**11.8.1** A Dialogue Team/Core Project Team has also been established. This team consists of the Project Manager, Technical, Financial and Legal Leads and respective external advisors. This team acts as the interface between the Bidders and the wider Project and Council.

## **11.9 Project Challenge and Scrutiny**

**11.9.1** Aside from the regular challenge and scrutiny provided by the Project Board and the formal decision stages which the project has been through (Cabinet and Council decisions 2008) the project has also been subject to a number of other challenges to ensure it is delivering in a manner to which it should.

### **11.9.2 ISOS to ISDS Checkpoint Report**

**11.9.2.1** Prior to the commencement of ISDS the Project Board requested that a review of the project was undertaken to identify any key issues. The report and response is attached as an Appendix 5 and 6.

### **11.9.3 Audit Commission Risk Reviews**

**11.9.3.1** The Audit Commission acts as an external and independent risk advisor to the Project Board, delivering Progress Reports and attending Project Board meetings at key stages within the project.

**11.9.3.2** A Progress Report and Project response will be issued to the Council's Audit Committee. The Progress Report Response Dialogue is attached as Appendix 7.

### **11.9.4 Local Partnerships Health Check**

**11.9.4.1** Project Board also requested that a Local Partnership Health Check was undertaken prior to Final Tenders. The Health Check took place over 18/19<sup>th</sup> November 2009. The Health Check Report and Response is attached as Appendix 8.





APPENDIX – ADDENDUM TO OUTLINE BUSINESS CASE

Appendix 1 – Service Delivery, Detailed Options Appraisal Outputs

Highways Post 2009 Strategy - Partnership Models										
<i>CRITICAL SUCCESS FACTORS-Key factors required for the successful delivery of the project objectives through partnership within the private sector</i>		WEIGHTING	OPTION 1		OPTION 2		OPTION 3		OPTION 4	
Flexibility - ability to support both the "flexible" and the long term delivery model		5	1	5	1	5	2	10	3	15
Ability to respond positively and rapidly to changes in service requirements and demands		5	1	5	2	10	2	10	3	15
Ability to deliver improved value for money (Includes added value and Com benefits)		5	1	5	2	10	2	10	3	15
Ability to improve financial control		4	1	4	1	4	2	8	3	12
Ability to improve asset management		4	1	4	2	8	2	8	3	12
Ability to improve maintenance management		4	1	4	2	8	2	8	3	12
Ability to derive economies of scale		3	1	3	2	6	2	6	3	9
Ability to provide additional investment in technology		3	1	3	1	3	2	6	3	9
Ability to deliver an innovative, customer focused, quality driven service		3	1	3	1	3	2	6	3	9
Ability to deliver reduced environmental impact and carbon foot print for service		3	1	3	1	3	2	6	2	6
<b>TOTAL SCORES</b>			39		60		78		114	
<b>%AGE SCORE (= SCORE divided by (WEIGHTING x SCORE))</b>			33%		51%		67%		97%	
<b>DELIVERY OPTIONS</b>										
OPTION 1	Virtual Partnering									
OPTION 2	Co-located									
OPTION 3	Partial Integration									
OPTION 4	Full Integration									
WEIGHTING is a range from 0 to 5 where 0 = no impact and 5 is major impact										
SCORING is a range of 4 from 0 to 3 where 0 = no impact; 1 = peripheral contribution; 2 = some contribution; 3 = major and demonstrable delivery of objective										
Areas shaded in grey are data input cells. The rest of the calculations are automatic										
A red total score is the best case scenario but should be balanced against the whole life cost and the risk analysis elements										
Project objectives shaded green are "gateway" objectives and require a score of 1 or more for the appraisal to continue. A score of 0 against any gateway objective automatically rules out an option										

APPENDIX – ADDENDUM TO OUTLINE BUSINESS CASE

## Appendix 1 – Partnership Model, Detailed Options Appraisal Outputs



### Highways Post 2009 Strategy - Partnership Models

#### CRITICAL SUCCESS FACTORS -

*Key Factors required for the successful delivery of the project objectives through partnership with the private sector*

	WEIGHTING	OPTION 1	OPTION 2	OPTION 3	OPTION 4	OPTION 5	OPTION 6	OPTION 7	OPTION 8	OPTION 9	OPTION 10
Sustained commitment of Both Parties at a senior level	4	2.00 8.00	2.00 8.00	1.00 4.00	2.00 8.00						
Drives cultural synergy and shared values	3	1.00 3.00	1.00 3.00	2.00 6.00	3.00 9.00						
Secures genuine and effective empowerment	5	1.00 5.00	1.00 5.00	2.00 10.00	3.00 15.00						
Supports effective alignment of structure and processes	5	1.00 5.00	1.00 5.00	2.00 10.00	3.00 15.00						
Maximises potential benefits to both parties	4	1.00 4.00	1.00 4.00	2.00 8.00	3.00 12.00						
Secures appropriate resource capacity and capacity building	4	1.00 4.00	1.00 4.00	2.00 8.00	3.00 12.00						
Enables learning and development within the partnership and internal and external networking	3	1.00 3.00	1.00 3.00	2.00 6.00	3.00 9.00						
Supports effective communication, engagement and management of expectations,	5	1.00 5.00	2.00 10.00	3.00 15.00	3.00 15.00						
<b>TOTAL SCORES</b>		<b>37</b>	<b>42</b>	<b>67</b>	<b>95</b>						
<b>%AGE SCORE (= SCORE divided by (WEIGHTING x SCORE))</b>		<b>37%</b>	<b>42%</b>	<b>68%</b>	<b>96%</b>						

#### DELIVERY SOLUTIONS

*INPUT DESCRIPTION OF ALL OPTIONS (These will cascade through all worksheets)*

OPTION 1	Virtual Partnering
OPTION 2	Co-located
OPTION 3	Partial Integration
OPTION 4	Full Integration
OPTION 5	
OPTION 6	
OPTION 7	
OPTION 8	
OPTION 9	
OPTION 10	

*WEIGHTING is a range from 0 to 5 where 0 = no impact on delivery of project objectives, 1 = Negligible Impact, 2 = Minimal impact, 3 = Significant Impact 4= Major Impact and 5 is catastrophic impact.*

*SCORING is a range of 4 from 0 to 3 where 0 = no impact; 1 = peripheral contribution; 2 = some contribution; 3 = major and demonstrable delivery of objective*

*Areas shaded in grey are data input cells. The rest of the calculations are automatic*

**A red total score is the best case scenario but should be balanced against the whole life cost and the risk analysis elements**

**Extract of Performance Levels in HSP contract**

**Appendix 2**

Category		Key Strategic Indicator	Key Performance Indicator	Performance Indicator	Current Performance	Target
Highways Asset Inventory			% accuracy of asset inventory (within 2 years)		Not currently monitored	95%
Inspections	Safety Inspections & Surveys of carriageways, footways and surface car parks		% carried out to timetable		59% (indicative 07/08 figure - no current measure available)	98%
Repairs	Repairing Category 1 Defects		% of Category 1 Defects made safe within 24 hours on the highway infrastructure		66%	98%

Repairs	Repairing Category 1 Defects		% Category 1 Defects to Highway Infrastructure permanently repaired within 28 days unless included within an agreed programme of works.		66%	98%
Repairs	Repairing Category 2 Defects			% Category 2 Defects to carriageway, surface car park and footway permanently repaired according to agreed (by the Employer) programme of works	Not currently monitored	98%
Incident Responses			% Incidents made safe from time of notification (Note: this is a measure of making safe, or if access is prevented, then measure of attendance). Times under which incidents to be addressed: - Operational hours (7am to 6pm): 1 hour - Out of hours (6pm to 7am): 2hrs		Not currently monitored	100%

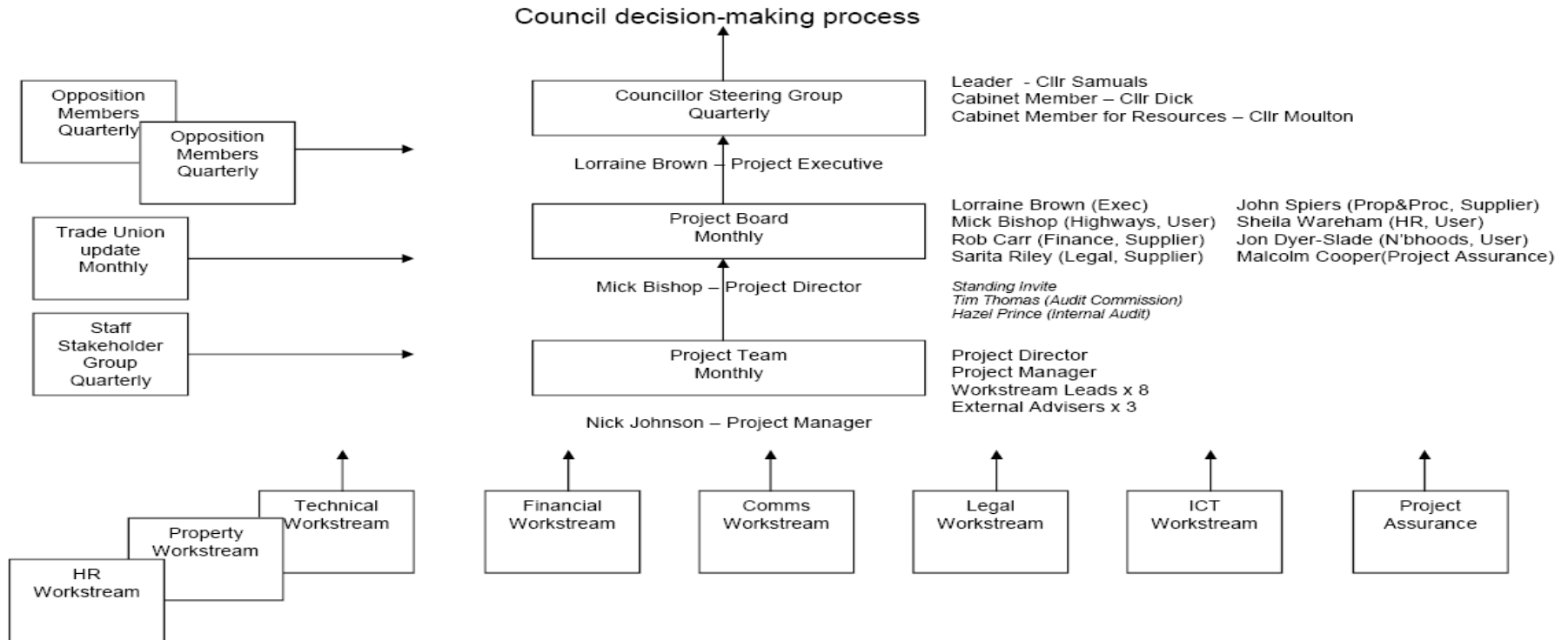
Customer Services (cont)		% of total correspondence (email / post / SMS text) handled according to the Employer's Customer Charter at paragraph 1.3.8 of Annex 10 of Schedule 2		98%	99%
Scheme Delivery		-	% of Schemes identified in the Annual Plan which are completed in accordance with Clause 13 of the Service Agreement	36% (April – Dec 2008)	95%
Scheme Delivery		□	Employer has 'full satisfaction' with Schemes completed in accordance with Clause 13 of the Service Agreement measured using the Highways Agency's Toolkit	Not currently monitored	100%

Scheme Delivery		-	% sustainable materials used	Not currently monitored	75%
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**Highways Partnership - 10 Year Financial Summary**

	<b>Optimistic £'000</b>	<b>Realistic £'000</b>	<b>Pessimistic £'000</b>	<b>PSC £'000</b>
<b><u>Revenue Lump Sum</u></b>				
Current Cost	30,000	30,000	30,000	30,000
Less Client costs	(3,000)	(3,000)	(3,000)	
Net Affordability	27,000	27,000	27,000	30,000
Bid Cost	24,000	25,650	27,000	31,250
<b>Efficiency (Saving) / Cost</b>	<b>(3,000)</b>	<b>(1,350)</b>	<b>0</b>	<b>1,250</b>
 <b><u>Capital Target Cost</u></b>				
Current Cost	76,000	76,000	76,000	76,000
Bid Cost	68,400	72,200	95,000	76,000
<b>Efficiency (Saving) / Cost</b>	<b>(7,600)</b>	<b>(3,800)</b>	<b>19,000</b>	<b>0</b>
 Total Efficiency (Saving) / Cost	 (10,600)	 (5,150)	 19,000	 1,250
Less Procurement Costs	1,300	1,300	1,300	750
<b>Net Efficiency (Saving) / Cost</b>	<b>(9,300)</b>	<b>(3,850)</b>	<b>20,300</b>	<b>2,000</b>

# Appendix 4





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## Appendix 5

**SUBJECT:** Highways Futures - Checkpoint Review  
**DATE:** 18 June 2009  
**RECIPIENT:** Highways Futures Board

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### SUMMARY:

- i. This report outlines the findings from the first checkpoint review which has been undertaken prior to the issuing of the Invitation to Submit Detailed Solutions.
- ii. Overall the review has highlighted that the project is being managed in an effective manner and it is making reasonable progress.
- iii. In recent years due to the general scaling down of highways work undertaken using directly employed council staff the critical mass needed to provide an effective service is no longer available. Partnering offers the opportunity to address this situation bringing in additional experienced well trained staff with the backing of professional civil engineering organisations
- iv. There are some issues outlined in the report which raise slight concerns and in particular the achievement and demonstration of efficiencies which need further detailed consideration. Currently there is insufficient evidence to confirm the scale of the potential benefits. In addition the flexibility of the partnership will need to be carefully assessed to balance the potential benefits from the commitment of funding against any future pressures on the council's resources.
- v. A full evaluation of these issues would be best addressed following the evaluation of the detailed solutions at the close of the competitive dialogue in January 2010.
- vi. Based upon the evidence reviewed **and subject to the justification of the level of the anticipated service benefits that could be forthcoming from the partnership and the overall non financial benefits**, the project can proceed to the implementation of the competitive dialogue stage.

### BACKGROUND

1. On the 21 May the Highways Futures Board confirmed the need to undertake a checkpoint review with the following objectives
  - Revisit the proposed scope of the project
  - Revisit the Critical Success Factors identified in the Outline Business Case
  - Revisit the risk assessment undertaken at OBC
  - Consider if any additional/new risks since the OBC fundamentally alter the risk profile of the project.
  - Revisit the financial case for the Partnership – including all cost of delivery and implementation (spend to date and forecast spend)

- Consider Partnership deliverables identified by bidders ISOS responses against those identified in OBC
  - Consider the robustness of the Project Governance and Management Structures
  - Consider the robustness the delivery of the procurement process.
2. This review has been conducted through a combination of the examination of key documents available on the extranet site plus interviews with a number of staff engaged in the project.

## DETAILS

### Scope of the project

3. The scope of the project was agreed by council following consideration of the findings of an independent study completed in March 2008. At this stage there is no new evidence to suggest that the scope of the project should be changed and it is anticipated that any proposals received as part of the ISDS process to alter the scope of the project will have to be assessed on their merits in conjunction with the opportunity afforded by the wording of the OJEU notice.

### Critical Success Factors

4. Of the ten critical success factors for the service delivery model most are deliverable and the following matters are noted.
- *The ability to deliver improved value for money* - not clear at this stage and needs a comprehensive review following the close of the competitive dialogue. The processes for assessing the performance based lump sum arrangements and further details are set out in the Economic Case below
  - *To derive economies of scale* - again this has not yet been quantified and needs to be evaluated through the ISDS process.

### Risk Assessment

5. This has been managed in line with the SCC systems and appears to be generally under control.
6. It is noted that risk 55 in the OBC - failure to demonstrate or maintain competitive with existing controls of limited vfm measures has an action to manage the risk by introducing comprehensive effective vfm measures. Evidence that this action has been implemented has not been found and the risk does not appear explicitly in the current Risk Register last updated on the 10/05/09.
7. There is evidence of significant slippage in the programme which is not been reflected in the end date of the project. There are risks associated with reducing the time-scales for future activities in either being able to complete the activity to the appropriate standard or not completing the activity in reduced time resulting in project over run. Consequences of slippage need to be highlighted especially if a principle of contract commencement at only either the start or mid year is a prerequisite for the project.

## Economic Case

8. There has been a significant reduction in the scale of the funding that would be available to the partnership when compared to the figures highlighted in the OBC and reported to the June 2008 Cabinet. The original figure of £14.2m has been reduced to nearer £10m. This appears to be mainly due to the treatment of street lighting activities which have now been excluded. The lower sum has coincidentally been identified in the earlier documentation as being the level of investment just to prevent further deterioration of the highway asset. Therefore the only overall improvements in the condition of the highway are likely to be of the order of the net benefits that can be derived from the new arrangements.
9. The annual net financial benefit has been calculated at £443k (3% of total spend) based upon a pragmatic savings estimate of 6% on investment of £14.2m. (The percentage figure comes from benchmarking data which does not appear to have been subjected analysis to substantiate that this is the appropriate for the Southampton situation.) As the level of expenditure through the contract is likely to be nearer to £10m the annual saving reduces disproportionately to £275k (2.75% of total spend), assuming the same implementation and 2% client monitoring costs. Clearly based upon these calculations the indications are that the potential financial benefits which would be transferred into investment in the highway could be marginal.
10. Through the ISDS process additional financial information will become available although it should be noted at this stage that due to the nature of the pricing of the documents it is unclear if this will in fact provide a clear picture of the value of the efficiencies that will be delivered through the partnership arrangement. This situation will arise due to nature of the arrangements for the management of the partners' performance. It will be measured against the achievement of performance indicators in return for a lump sum payment.
11. In addition capital projects will be measured upon sample schemes and evaluation of the ISDS will be measured against a basket of schemes priced using the current highways contractors charges. Clearly there must be rigorous examination throughout this exercise to ensure that the basis for any baseline data is accurate as it will be used for all future evaluations. Whilst having good technical and management foundations these arrangements are unlikely to enable the efficiencies to be clearly identified. In fact it may not be until the end of the partnership that the scale of the efficiencies can be measured in a meaningful way.
12. Returning to the issue of guaranteeing future levels of investment the current LTP funding only has a short period to run and in the current economic climate future years funding is uncertain. This situation is compounded by current round of council savings where the Highways and Parking Services Division has been set a total two year target of £1.124m over the next two fiscal years. The delivery of these savings will be focussed upon the out of scope highway and parking services however this may not be achievable and therefore reductions could be required in the funding being available to the partnership.
13. The approved recommendations in the 2008 Cabinet and Council reports included the commitment to the principle that existing budgets for the delivery of in scope services is committed to the partnership. This apparent contradiction needs to be addressed within the current round of savings.

### **Deliverables**

14. The bidders ISOS responses do not appear to provide any evidence that the service deliverables that the council is seeking to secure would not be available. The key issue relates to the availability of the funding to access these services.

### **Project Governance and Management Structures**

15. A good project management arrangement has been established with clearly defined roles and responsibilities. External advisors are being employed in accordance with best practice. Care needs to be taken to ensure that decision making is undertaken objectively and that there is no bias towards companies that are currently employed to undertake any of the services. This could be introduced inadvertently through the use of cost data derived from one of the existing contractors to create a benchmark against which bidders will be measured. A further minor issue is whether the structure of the proposed contract provides the best vehicle or is simply one that the technical consultants are most familiar with.

### **Procurement Process**

16. Following the Competitive Dialogue process is being managed very competently and anecdotal evidence is that bidders confirm this is the situation.

### **Property**

17. The relationship with the successful completion of the relocation of Town Depot project may become critical to the success of the Highways Futures project as the provision of the highways depot by the council may have a significant impact upon the efficiencies that are delivered. There is an expectation that a solution will be available in the next two weeks, however if this is not forthcoming there is a possibility that the overall benefits of the partnership will be significantly reduced. In addition if short term accommodation is required to house the service provider until the permanent site is available is likely to adversely effect the potential benefits.

### **TIMESCALES:**

The programme presented to Council in July 2008 outlined a programme with service commencement in September 2010. Currently the project is about to issue the ISDS in week 44 when it was originally programmed for week 26 indicating slippage of 18 weeks. Despite this fact the programmed end date remains unaltered. The expectation appears to be that that the time will be made up by reducing durations of many of the remaining activities when compared with the original programme. This approach needs to be justified as the original durations reflected the activity durations proposed in 4ps guidance. Clear evidence needs to be provided that the current slippage can be recovered without compromising the end solution. In addition the cost of the delivery of the project to-date is higher than the original profile and combined with the programme being behind time highlights the risk that the cost of completing the project through to Financial Close may be outside the agreed financial envelope.

**Further Information Available From:**

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## Appendix 6

**SUBJECT:** Highways Futures – Response to Checkpoint Review  
**DATE:** 2<sup>nd</sup> July 2009  
**RECIPIENT:** Highways Futures Board

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### INTRODUCTION:

- i. This report considers the findings of the Checkpoint Review and provides a response to the key issues highlighted prior to providing a recommendation to the Board (12.3).

### SUMMARY OF CHECKPOINT REVIEW

- ii. Overall the Checkpoint Review highlighted that the project is being managed in an effective manner and it is making reasonable progress.
- iii. In recent years due to the general scaling down of highways work undertaken using directly employed council staff the critical mass needed to provide an effective service is no longer available. Partnering offers the opportunity to address this situation bringing in additional experienced well trained staff with the backing of professional civil engineering organisations
- iv. There are some issues outlined in the report which raise slight concerns and in particular the achievement and demonstration of efficiencies which need further detailed consideration. Currently there is insufficient evidence to confirm the scale of the potential benefits. In addition the flexibility of the partnership will need to be carefully assessed to balance the potential benefits from the commitment of funding against any future pressures on the council's resources.
- v. A full evaluation of these issues would be best addressed following the evaluation of the detailed solutions at the close of the competitive dialogue in January 2010.
- vi. Based upon the evidence reviewed the project can proceed to the implementation of the competitive dialogue stage.
- vii. This review was conducted through a combination of the examination of key documents plus interviews with a number of staff engaged in the project. The Review is attached as an Appendix to this report.

### 1.BACKGROUND

- 1.1 It is worth noting the project/procurement/contract development strategy undertaken to date and moving forward as this will assist in contextualising this report.
- 1.2 There are three key stages to the competitive dialogue procurement process: outline solutions; detailed solutions; and final tenders.
- 1.3 To commence the procurement process an Outline Business Case (OBC) was produced identifying the most appropriate long term delivery model and the benefits this model would deliver.

- 1.4 The most appropriate model was determined using an options appraisal based on a number of Critical Success Factors. Continuing with current arrangements was considered as one of the options. However, the current service deliver model was not deemed to meet the CSFs as impressively as a long-term, fully integrated Partnership approach.
- 1.5 The second element of the OBC was to consider whether the option delivered benefits to the Council over and above other the models and justified the investment decision.
- 1.6 The aim of the outline solution stage was to seek information from bidders at a high-level that the expected benefits were achievable and deliverable on the basis of indicative contracts and specifications.
- 1.7 The aim of the detailed solution stage is to confirm that these benefits are deliverable, with bidders committing to providing a cost for delivering against a detailed contract and specification.
- 1.8 At final tender the Council will request final bids against a fully developed contract and specification having confirmed, via dialogue, that the business case is valid and the expected benefits will be delivered.

## 2 **Identified Benefits**

- 2.1 Before responding to the points raised in the Checkpoint Review it is useful to outline the benefits identified as part in the report agreed by Cabinet and Council and a brief summary of the current position/deliverability based on further knowledge and experience from the project team and outline solutions from bidders. These are set out below.

- 2.2 a. Driving out inefficiencies in service delivery which can be reinvested back into the highways network

The Outline Business Case identified efficiencies of between 5-8% on a budget of approx £14m. This has now been revised down to approx £10m, therefore absolutely the efficiency level will decrease. However, relatively, they do not.

At outline solution stage bidders suggested from previous experience that there was between 10-25% efficiencies which could be driven out of the service. It should be remembered that when talking about 'efficiencies' it is not a reference to a cashable efficiency gain but an indication of increased output.

As part of detailed solution stage bidders will be asked to price a number of sample capital schemes (within a wider capital programme context). These will also be priced by the Council as if they were being delivered using current arrangements. This will clearly show the % difference between current arrangements and the Partnership.

- b. Securing investment in the service delivery infrastructure;

The Outline Business Case suggested that the provider would commit 7% of the total value of the contract to delivering the service.

All of the bidders identified that they would invest in the service delivery infrastructure – for example, fleet, ICT, and plant.

- 2.3 c. Increasing the capacity and resources available to deliver the service;

The remaining three bidders are all major companies in the industry and therefore can draw on a wealth of resources to meet demand, increasing, decreasing or flexing (subject to contractual clauses) as required.

- 2.4 d. Securing economies of scale;  
This is closely linked to a) and will be demonstrated through costing of the sample capital scheme pricing at ISDS, and lump sum pricing.
- 2.5 e. Increasing the service performance level;  
Performance Levels have been specified and the provider will be contractually obliged to meet these performance indicators. If they do not, there will be payment deductions. The performance targets at detailed solution stage will represent a significant improvement on current service and performance levels.
- 2.6 f. Maintaining and improving the customer focus:  
There are performance indicators around customer service, additionally there are method statements which will be contractual and will set out how the provider will approach customer focus and engagement.

### 3 **Cultural Change**

- 3.1 The key element underpinning the Partnership's ability to significantly reduce inefficiencies and deliver increased outputs and outcomes in comparison to the current service delivery model is the significant cultural change which the private sector would bring. This would be demonstrated in, for example, the more multi-disciplinary maintenance teams and the greater focus on productivity. This cultural change is difficult to quantify, yet undeniable.

### 4 **Alternative Options**

- 4.1 It is prudent to also identify the alternative options to a Highways Partnership at this point. There is no identified alternative/contingency option as such. The original Strategic Business Case identified a number of options which would need to be revisited. The existing highways contracts can be extended until September 2012 which would enable business as usual while the long-term strategy was reconsidered. It is acknowledged that the Council should consider a fall-back option.

## 5. RESPONSE TO REVIEW

### 5.1 **Critical Success Factors**

The Review highlights the deliverability of all the Critical Success Factors (CSFs). The CSFs were used for the OBC options analysis which identified the long-term, fully integrated Partnership as the most appropriate long-term option. The Review does not highlight any issues with the options appraisal in relation to either the process or the outputs and outcomes.

- 5.2 For ease of reference the CSFs which the long-term Partnership will best deliver are:
- Ability to respond positively and rapidly to changes in service requirements and demands
  - Ability to deliver improved value for money
  - Ability to improve financial control
  - Ability to improve asset management
  - Ability to derive economies of scale
  - Ability to provide additional investment in technology
  - Ability to deliver innovative, customer focused, quality driven service
  - Ability to deliver reduced environmental impact and carbon footprint

On further examination the Critical Success Factors appear to continue to be pertinent, as do the scores allocated, and therefore the result of the original options appraisal remains valid.

- 5.3 The Review did raise the following points in relation to the Critical Success Factors:
- *'The ability to deliver improved value for money - not clear at this stage and needs a comprehensive review following the close of the competitive dialogue. The processes for assessing the performance based lump sum arrangements and further details are set out in the Economic Case below'*
  - *'To derive economies of scale - again this has not yet been quantified and needs to be evaluated through the ISDS process.'*
- 5.4 It is correct that the ISDS stage of the procurement will provide additional information to further confirm and clarify the above two points (which were confirmed by bidders at outline solution stage). However, It should be noted that the Critical Success Factors must be considered in the context of the options appraisal, specifically, the comparative nature of such.

## 6 **Economic Case**

- 6.1 The Review notes that there has been a significant reduction in the scale of the funding that would be available to the Partnership. The original figure of £14.2m has been reduced to nearer £10m (this figure may be reduced further due to the need for further efficiency savings across the Council). The Review also notes that the potential financial benefits which would be transferred into investment in the highway could be marginal.
- 6.2 It is indisputable that the level of funding available to the Partnership has reduced since the original business case. However, at this point it is pertinent to note that the Partnership was based on the premise of improved quality of service for the same level of funding and the 'efficiency' figure identified was not intended as a 'cashable' figure. Instead the figure identified was intended to demonstrate the increased output that could be delivered by a Partnership model.
- 6.3 Therefore, the key consideration is whether a Partnership can deliver improved service for the same funding.
- 6.4 The OBC identifies an increased gross output of between 5-8% (against the Review figure of 2.75% net figure on pragmatic figure of 6%)
- 6.5 The Review notes that the 5-8% does not appear to have considered Southampton specific circumstances. 5-8% was identified as a demonstrable figure from similar contracts using Audit Commission data. The council's advisers, along with the project team, deem a 5-8% increase in output to be a cautious estimate of what can be achieved in the SCC context given the relatively un-modernised nature of the service – particularly in relation to the maintenance revenue side of the service currently delivered primarily in-house. This is evidenced in the fact that in highways comparative surveys SCC performance levels are consistently in the bottom quartile. Indeed at ISOS, bidders identified, from previous experience on similar contracts, efficiencies of between 10-25%.
- 6.6 The Review correctly notes that through the ISDS process additional financial information will become available. However, the Review also asserts that due to the nature of the pricing of the documents it is unclear if this will in fact provide a clear picture of the value of the efficiencies that will be delivered through the partnership arrangement. This is not an unreasonable assertion, nevertheless, the ISDS information will clearly provide a good indication of whether the Partnership will deliver 'more for the same', as explained below.



- 6.7 Firstly, bidders will be provided with an affordability threshold for the lump sum element of the service which is the same as the Council's current budget. For this same budget the Partnership will have to meet performance targets which are significantly higher than the Council's current performance targets. For example, our current PI on inspections and surveys of carriageways, footways and surface car parks carried out to timetable is 59%. The service provider will be required to hit 98%.
- 6.8 A further point to note here is that there will be payment deductions if the Partnership does not achieve the specified targets. Therefore, the Council will not pay for a level of service it does not receive.
- 6.9 Secondly, at ISDS, capital projects will be measured upon sample schemes. The cost submitted by bidders at ISDS will be compared to the cost of delivering these schemes using the Council's current arrangements. The Review noted that the scale of efficiencies can not be measured in any meaningful way until the end of the Partnership, however, it is clear from the above that from the outset whether the Partnership can deliver capital schemes more efficiently will be transparent.
- 6.10 Finally, as part of this procurement the Council is developing an innovative approach to assessing network value. Bidders will be required to set out their approach to asset management and identify the asset value at the end of the contract. This, again, will be compared to the output the Council can achieve using its current arrangements. Although this is unlikely to be available until final tender stage.
- 6.11 Taking into account the above it is clear that at the submission of ISDS there will be clear evidence identifying the Partnership's capacity to deliver 'more for the same', or not.

## **7 Delivering Value for Money/Commercial Approach**

- 7.1 The Review notes that current LTP funding only has a short period to run and in the current economic climate future years funding is uncertain. This is compounded by the requirement for Highways and Parking Division to deliver £1.124m over the next two fiscal years. There are also proposals to bring forward some capital budget from 10/11 to 09/10.
- 7.2 Any reduction in current budgets will reduce the level of service deliverable by the Partnership. In simple terms the quality of service and performance levels set for the Partner will be need to be reduced. For example, instead of requiring a 98% level for inspections and surveys of carriageways, footways and surface car parks carried out to timetable, the Council will only be able to afford 75%.
- 7.3 A lower budget for the Partnership will also potentially impact on the interest of bidders in the contract, consequently affecting the competitiveness during the bidding process. This could impact on the level of investment bidders are willing to commit to the Partnership.
- 7.4 The Council must consider the level of control and flexibility it wishes to retain over the Partnership. Additional value can be driven from the Partnership through the guarantee of a fixed income capital income per annum. This would allow the Partnership to front-end investment and capital works – at ISOS one bidder identified a £5m value to a guaranteed income level. Similarly, guaranteeing contract extensions, provided performance levels are met, would deliver VFM.

7.5 The Project Board and ultimately Members will need to consider whether the decreased flexibility which the above would entail is offset by the magnitude of vfm savings.

## **8 Project Governance and Management Structures**

8.1 The Review noted that care needs to be taken to ensure that decision making is undertaken objectively and that there is no bias towards companies that are currently employed to undertake any of the services. There has been no suggestion of this to date and all appropriate measures have been taken to ensure that no advantage or disadvantage is provided to incumbent contractors. Any procurement risks such as these are closely monitored by the Project Manager and the Legal team.

8.2 The Review noted that an unfair advantage could be introduced inadvertently through the use of cost data derived from one of the existing contractors to create a benchmark against which bidders will be measured. This has been considered and discussed by the project team and is considered an appropriate approach.

8.3 The Review also noted that a further minor issue is whether the structure of the proposed contract provides the best vehicle or is simply one that the technical consultants are most familiar with. The type of contract being used is one familiar with the industry and this was the primary driver for selecting it. The external legal advisors are comfortable with the contract approach.

## **9 Risk Assessment**

9.1 The Review highlights that risk 55 in the OBC - failure to demonstrate or maintain competitiveness with existing controls of limited vfm measures has an action to manage the risk by introducing comprehensive effective vfm measures. Evidence that this action has been implemented has not been found and the risk does not appear explicitly in the current Risk Register last updated on the 10/05/09. This is noted. The contract documents have been developed with vfm implicitly within them.

## **10 Property**

10.1 As acknowledged in the Review the relationship with the successful completion of the relocation of Town Depot project may become critical to the success of the Partnership as the provision of the highways depot by the council will reduce the cost overheads of the bidders. In addition any short term accommodation required to house the service provider until the permanent site is available will increase the cost to the Council.

10.2 However, it should be noted that if the Council does not provide a site for the Partnership and accommodation is instead provided by the Partner this will mean a reduction in the Councils own relocation costs from not having to provide highways space.

## **11. TIMESCALES:**

11.1 The Review notes a slippage in the timetable set out in the original Cabinet report of 18 weeks, yet the programmed end date remains unaltered with the time made up by reducing durations of many of the remaining activities. The Review states that the new timescale needs to be justified with clear evidence being provided that the current slippage can be recovered without compromising the end solution.

- 11.2 The current agreed timetable has shortened some activities. The initial mobilisation period of 6 months was purposefully generous and was identified as contingency if required. The revised mobilisation period of approximately 4 months is more typical (2-3 months being not untypical) and has been confirmed as adequate by bidders.
- 11.3 The other area of significant reduction between the original timetable and the revised current timetable is the amount of time allocated for CFT - previously 20 weeks now 10 weeks. The reduction in the amount of time required for CFT has been possible due to the increased amount of time available at the front end of the procurement (due to delays identified above) enabling the project team to develop contract and specification documents to a much greater level.
- 11.4 The current programme identifies the selection of preferred bidder during the local election purdah period. In order to be able to appoint preferred bidder prior to this point delegated authority within set parameters can be sought enabling officers to appoint preferred bidders. This approach requires consideration and ratification by the Council's legal department.
- 11.5 The Review notes that the cost of the delivery of the project to-date is higher than the original profile and combined with the programme being behind time highlights the risk that the cost of completing the project may be outside the agreed financial envelope. Mainly this is due to the revised approach to the procurement as identified in the above paragraph which has required more adviser time to develop contract and specification documents. Additionally, project staffing has been filled on a temporary basis, until recently, due to the uncertainty regarding the ongoing nature of project posts caused by the potential PFI.
- 11.6 Finally, the Cabinet report noted that the delivery cost would be in the region of £1-1.5m and the final figure was dependent on a number of factors such as the final length of the procurement process, the complexity of contract negotiations and the resolution of any issues which may arise.

## **12. Conclusion and Recommendation**

- 12.1 The Checkpoint Review correctly identifies that currently there appears to be a marginal economic case for the implementation of the Partnership. The economic case will become much clearer once ISDS submissions are returned.
- 12.2 Attention should however be drawn to the overall benefits package that the model will deliver. The OBC and outline solution stage gave no major cause for concern that these benefits would not be forthcoming, provided the contract and specifications are drafted appropriately.
- 12.3 Weighing up these two factors, and also taking into consideration the alternative options it is recommended that the Board agree to the commencement of the ISDS stage of the dialogue with a view to reviewing the case again prior to call for final tenders.

### **Further Information Available From:**

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## Appendix 7

**Highways Futures Project**  
**Audit Commission: Progress Report. Highways Partnership project**  
**Council Response**  
**V02 170909**  
**Audit Commission Comments 171109**  
[Project Team Comments 291109](#)

Para/Risk No.	Audit Commission Report	Council Response (17/09/09)	Further Action (17/09/09)
Para 5	<p><i>Given public sector finance constraints this investment figure is now likely to be nearer £10m and the annual net financial benefit has reduced to £275k.</i></p>	<p>The annual net financial benefit (an attempt to quantify the anticipated % output increase against annual turnover) identified in the original Outline Business Case (OBC) was a prudent illustrative figure provided to assist the decision on whether to market test (i.e. Commence the procurement process), or not, the Council's strategy. A key objective of the procurement process is to judge the benefit which the Partnership will deliver.</p>	<p>No further action is necessary in relation to this specific point.</p> <p>TT) Lack of quantification as to how vfm will be judged in relation to the proposed partnership. Needs to be financial qualification as to the level at which the scheme will not be considered financially viable.</p> <p><a href="#">SCC – ISDS submissions have identified a quantifiable financial benefit and VFM case.</a></p> <p><a href="#">Outline Business Case Addendum provides further information and measurement methodology for VFM. Cabinet Report scheduled for Feb 2010 will identify the minimum required benefit.</a></p>

<p>Para 10</p>	<p><i>The maximum benefits which can be expected from any new arrangements are likely to be those relating to changed working practices and any economies of scale a future commercial partner might bring.</i></p>	<p>Only a PFI or a significant increase in capital funding can deliver significant improvements to the network. In the absence of significant additional funding this alternative strategy was developed 'with the aim of improving service levels, maximising existing resources and delivering efficiency savings to be reinvested back in the network.' .....</p> <p>.....'The partnership will ensure that the Council is making best use of its existing resources, however it must be noted that it will not eliminate the identified investment gap.' (Cabinet 30/06/08-Council 16/07/08).</p> <p>It should be remembered that over and above the cost/vfm benefits that the Partnership will bring there are a number of other more qualitative benefits such as the major cultural change which will be delivered, the improvement in service performance, the access for staff to wider learning and development, the ability to access wider market expertise, the development of stronger links with local training providers, the development of the local economy through development of sub-contractor and</p>	<p>No further action is necessary in relation to this specific point.</p> <p>TT) In the light of the reduced investment since the Initial Business Case the Council appears to be introducing new non-financial criteria by which it will judge potential bidders. If this is the case such criteria should be agreed with Members.</p> <p>SCC – Non-financial benefits referenced are not 'new', identified in Cabinet Report 30/06/08 and original OBC.</p> <p>Benefits Realisation Plan detailed in OBC Addendum.</p> <p>To be referenced in forthcoming Cabinet Report.</p>
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		supply-chain relationships.	
Para 11	<i>A comparison with the percentage client monitoring costs in respect of the existing Capita Strategic Services Partnership (SSP) contract might provide clarity, given the apparent marginal financial gain, indicated in the current cost-benefit analysis work by the Council.</i>	<p>An allowance has been made by the Council for Client Monitoring costs. This has been deducted from the affordability figure.</p> <p>The SSP client approach was examined and considered as part of the development of the Highways Client Team (which also incorporates the Street Lighting PFI client). The role of the client for the Highways Partnership will not be an exact replica of the SSP approach given the differing nature of the services but it is acknowledged that since previous discussions with SSP Client team there are likely to be further lessons to be learned.</p>	<p>Review the client approach in the context of the SSP client approach and costings.</p> <p>TT) The Council should in the course of its review calculate the net savings which it might expect given its proposed level of annual investment.</p> <p>SCC – Client costs have been determined using a number of comparator benchmarks. Required budget for client costs is top-sliced from affordability budget and therefore forecast savings are net of client costs (the savings are not funding the client team).</p> <p>Addressed in detail in OBC Addendum. To be referenced in forthcoming Cabinet Report.</p>
Para 12	<i>...contractual liability will mean that [the Council] is unable to further reduce the annual expenditure, without at the very least incurring performance decreases.</i>	<p>There is a difference between Capital spend and Revenue spend.</p> <p>The proposed contract approach does not guarantee a level of Capital spend for the Partner. Therefore, the Council has the flexibility to amend the capital budget on an annual basis (Commercially it would be better to</p>	<p>No further action is necessary in relation to this specific point.</p> <p>TT) Whilst this is understood the Council still needs to ensure that if either its annual capital or revenue budget diminishes that its client side costs are not greater than the annual</p>

		<p>guarantee a capital budget).  The revenue budget will be fixed for the life of the contract, guaranteeing a fixed service level for the life of the contract. If the Council wishes to adjust the revenue budget this will be possible, however, as noted, this would require a reduction in service.  This is not substantively different from the current position. Although a renegotiation would be required, the open book accounting approach and benchmarking clauses would support the Council to ensure vfm was still being delivered. Positively, the impact on the service performance, and the road network as a result of a budget reduction would be much clearer and better understood than currently.</p>	<p>savings generated by the contract.  SCC – Same comment as above – client budget is top-sliced from affordability budget.  However, it is acknowledged that there will be a fixed overhead/cost which will be incurred to fund a client team regardless of the level of spend channelled through the Service Provider. (i.e. there will always be a requirement for a set number of client posts to manage the contract)</p>
<p>Para 12</p>	<p><i>It should also be noted that commercial tenderers are required to take a profit based view to any contract and any possibility of changes to the affordability envelope usually results in an increased risk premium, which diminishes further infrastructure or performance gain for the Council.</i></p>	<p>This is why it is important that through the procurement process the Council does not change its affordability. Affordability has been consistent since the commencement of dialogue despite the current Council budget saving requirements. If the Council requires further budget reductions which affect the affordability then bidders are likely to price some risk. Thus the short-term saving will have a disproportionate</p>	<p>Council to consider whether further budget savings should be required from in-scope highways services.  TT) The Council's response needs to be shared with Members to inform decision-making in respect of the decision to award the contract.  SCC – affordability regularly reviewed.</p>

		affect on the reduction in service able to be provided by the Partnership (ie reduction in affordability = reduced budget available for service delivery + increased risk premium)	To be referenced in forthcoming Cabinet Report.
Risk 1	<i>Does the Council consider that the strategic approach in respect of highways provision now being placed before them is in the best interest of the Council and its citizens and is affordable over the course of the contract?</i>	There is still no other alternative for delivering increased service improvement over the same condensed time-frame for the same up-front cost. The affordability of the Partnership will be demonstrated, or not, through the submission of detailed solution bids (ISDS). At this point a decision will be required, based on information from the procurement process, on whether the Council should proceed to Final Tender stage. The Council is confident that the information provided at ISDS will be sufficient to make a judgement on the benefits of the Partnership.	No further action is necessary in relation to this specific risk.  TT) Noted.
Para 13	<i>One of the ten Critical Success Factors (CSFs) is the ability to 'Deliver improved value for money' and the lack of clarity as to how this will be delivered is highlighted in the Council's 'Checkpoint Review'. Another CSF to 'Derive economies of scale' is subject to similar concerns.</i>	It is not felt that there is any lack of clarity over how any of the CSFs will be delivered through a Partnership. For example, 'improved value for money' will be delivered through more efficient working practices and processes and greater productivity. Whilst economies of scale will be delivered through the Partners increased buying power in the market and better sourcing and supply-	No further action is necessary in relation to this specific point.  TT) It is the specific measurements/indicators attached to these CSFs which need to be determined.  OBC Addendum identifies how these benefits will be measured.



		chain management.	
Risk 2	<i>If the Council proceeds to the ISDS stage what measures and ongoing monitoring arrangements will it put in place to make sure that value for money is assured?</i>	<p>ISDS Submissions will assist the Council in assessing VFM in a number of ways:</p> <ol style="list-style-type: none"> <li>1 bidders must deliver a level of service much greater than the Council currently delivers for the same (or less) cost.</li> <li>2 Bidders must price for delivering sample schemes. These prices will be compared against how much it would currently cost the Council to deliver these schemes.</li> </ol> <p>After the submission of ISDS bids the Council will determine whether to continue to Final Tender stage. Final Tender stage will require the resubmission of information at ISDS plus additional information which will further support VFM and the demonstration of benefits. Appendix A expands on how the project will assess Value for Money.</p>	<p>No further action is necessary in relation to this specific risk.</p> <p>TT) Noted.</p>
Risk 3	<i>What steps is the Council taking to ensure continuity of service provision should the highways partnership not come to fruition for whatever reason?</i>	<p>If the Partnership does not come to fruition then service continuity will be maintained through the existing in-house resource and the existing contracts which can be extended until September 2012.</p>	<p>No further action is necessary in relation to this specific risk.</p> <p>TT) Noted.</p> <p><a href="#">SCC – Forthcoming Cabinet Report will</a></p>

		<p>If the project were to cease the Council would be required to consider the future direction of the service. Business as usual would continue along with, possibly, one of the following options are:</p> <ul style="list-style-type: none"> <li><b>4</b> Explore possibility of further PFI credits;</li> <li><b>5</b> Procure further contracts for works and design consultancy (likely 5 year minimum);</li> <li><b>6</b> In-house service transformation programme reviewing all service processes, technologies, performance levels, resource requirements etc;</li> <li><b>7</b> Joint/Regional working</li> </ul>	<p>identify impact of not continuing with this approach and provide a range of practical considerations.</p>
<p>Risk 4</p>	<p><i>What steps is the Council taking to ensure that its financial scenario planning is kept up to date to ensure that it understands the financial ramifications of any decisions which it takes?</i></p>	<p>The financial ramifications of the Partnership will be reviewed after the submission of ISDS bids and prior to Call for Final Tender (if the Council has approved the move to this next stage). However, it is not clear from a project perspective whether the Council is considering the implications of its wider financial planning process on the project.</p>	<p>The Council considers how the implications on the Partnership project of its wider financial planning process are taken into account.</p> <p>TT) This interdependency needs to be made clear to Members.</p> <p>SCC – This issue has been raised at Project Board level and within Service budget setting process.</p> <p>To be referenced in forthcoming Cabinet Report.</p>

Draft

**Local Partnerships Health Check**

**Version number:** Final

**Date of issue to PO:** 30<sup>th</sup> November, 2009

**Authority:** Southampton City Council

**Local Partnerships Health Check dates:** 18th & 19th November 2009

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**Local Partnerships Health Check Team:**

Paul Bryans  
David South

Draft

**In order to promote full and frank exchange of views during the review process and for the purposes of deliberation and production of the recommendations contained herein, this Health Check report is confidential to the project owner in their capacity as employee of the procuring authority.**

Local   
Partnerships

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## **Background**

### **The aims of the project:**

The objective of the project is to implement a new highways service delivery model which will deliver the following outcomes:

1. Increase the capacity and resources available to deliver the service;
2. Secure investment in service delivery infrastructure (i.e. plant, M.I.S);
3. Secure economies of scale;
4. Drive out operational inefficiencies in service delivery (capital and revenue element) and reinvest in the network;
5. Increase the service performance level;
6. Maintaining and improving customer focus; and
7. Regenerate the highway network.

### **The driving force for the project:**

The Council's current highway network and service delivery infrastructure requires significant investment to reverse its current decline.

To secure additional investment in the highways network the Council submitted a bid to the Department for Transport (DfT) for Highways Maintenance PFI Credits in September 2006. The DfT informed the Council in December 2007 that this bid was unsuccessful.

A Strategic Business Case (SBC) identified that the most suitable alternative vehicle for service delivery was a long-term (i.e. 10 years) partnership with a private sector service provider.

### **The procurement status:**

The ISDS stage bids have been received from 3 bidders.

## **Purpose and conduct of the Local Partnerships Health Check**

### **Purpose of the Local Partnerships Health Check:**

The primary purpose of a Local Partnerships Health Check is to confirm that the project is in a robust position – that is, in principle it meets business need, is affordable, likely to achieve value for money, deliverable, has been executed through appropriate processes and is likely to deliver the benefits sought within the constraints identified.

### **Conduct of the Local Partnerships Health Check:**

This Local Partnerships Health Check was carried out on 18<sup>th</sup> and 19<sup>th</sup> November, 2009 at the request of the Project Owner, Lorraine Brown. The team members are listed on the front cover.

The Health Check consisted of a document review by the members of the Health Check Team, prior to an update by the project team and a programme of interviews with key stakeholders.

## Conclusion

The Health Check Team finds that the project would benefit from the following actions before proceeding to the next stage of dialogue for the procurement:

1. A further Options Appraisal, including all relevant cost implications of the chosen procurement route and key contract positions, should be undertaken;  
*Scc Comment – Outline Business Case Addendum undertakes further options analysis on procurement route and contract positions.*
2. The Council should make an informed decision as to the appropriateness or not of agreeing a minimum guaranteed annual Capex figure;  
*Scc Comment – Outline Business Case Addendum considers this option..*
3. The Project Team should undertake a Benefits Realisation Review;  
*Scc Comment – Outline Business Case Addendum reviews Benefit Realisation.*
4. The Project Board should review the skills and capacity of the Project Team, including the involvement of the proposed Project Management Team in the procurement;  
*Scc Comment – understand that 'Project Management Team' in this context actually refers to Contract Management Team. Outline Business Case covers this issue*
5. The Project Team should consider capturing the Project Delivery Strategy in a single document; and  
*Scc Comment – Project Delivery Strategy section included in the Outline Business Case Addendum.*
6. The Project Risk Register should be reviewed and updated to ensure that all the relevant risks are: captured, appropriately allocated and managed.  
*Scc Comment – a project risk register is actively managed to ensure appropriate management of risk. Risk Register attached to Outline Business Case addendum. Further risk workshops arranged to review in detail.*



## Findings and recommendations

The following four headings were considered the most appropriate for this report:

### 1: Procurement approach

The Health Check Team were impressed that the Council had decided to tackle the poor Highways infrastructure through an innovative medium-term contract (the “Proposed Solution”) and that bids have now been received from three contractors on this basis. The Proposed Solution was developed as the next best option to the unsuccessful bid for PFI Credits and followed soft market testing.

The Proposed Solution is intending to use a hybrid contract which will require development specifically for the project and which is likely to be complex to draft and negotiate, and require careful management throughout.

*Scc comment – this is noted and addressed in Outline Business Case Addendum.*

The Health Check Team understands that the Council wishes to maintain maximum flexibility in the contractual arrangements regarding annual Capital Expenditure commitments. There was no evidence that the cost implications of such a high level of flexibility had been quantified and accepted by the Council. The Proposed Solution addresses concerns about affordability in future years but the possible implications for VFM do not appear to have been fully worked up. The Council will need this information to enable informed decisions to be made concerning the procurement.

*Scc comment – this is noted and addressed in the Outline Business Case Addendum.*

The Health Check Team considers that the project would benefit from the Project Board undertaking a Benefits Realisation Review to ensure that all the possible benefits expected by the Council can be managed, measured and realised.

*Scc comment – this is noted and addressed in the Outline Business Case Addendum*

### 2: Assessment of the proposed solution

The Health Check Team found that Options Appraisal work undertaken to date (and set out in the PID) has been limited in scope generally to the working arrangements with the contractor. For the current stage, key decisions will require to be informed by a new Options Appraisal covering the Proposed Solution. Without such a review it is not possible to fully demonstrate that the Proposed Solution will deliver optimum value for money. The Health Check Team believes that it is not too late to undertake such an appraisal at this time.

*Scc Comment – it is understood, as explained during the review de-brief by the Review Team and as per the conclusion No.1 that the proposed Options Appraisal refers to a review of key commercial decisions for the Proposed Solution (e.g. to guarantee a level of capital expenditure). This is addressed in the Outline Business Case Addendum.*

The Proposed Solution currently appears to lack the ability to articulate appropriate cost allocation between revenue (“lump sum”) and Capex items and thus is unlikely to demonstrate that value for money will be delivered.

*Scc Comment – this is noted and the approach (specifically to require the Service Provider to include all local overhead in the Lump Sum element of the service) will be considered for the Final Tender stage. This commercial issue is also noted in the Outline Business Case Addendum.*

### **3: Risk management**

The Council has, not unreasonably, sought to retain total flexibility in the Proposed Solution with regard to discretionary Capital Expenditure but has not so far been able to establish a minimum guaranteed Capex level. The financial risks of following this current strategy do not appear to have been captured in any formal way. This could have profound implications on pricing and thus value for money through the proposed contract life.

*Scc Comment – this is noted. ISDS submission prices provided a vfm solution in comparison to the Council’s existing service delivery arrangements with no guarantee of Capital Expenditure. Bidders have been asked to resubmit their ISDS prices in the context of a £3m guaranteed capital expenditure scenario and £6m guaranteed scenario. An options analysis is considered as part of the Outline Business Case Addendum.*

The Project Team are aware of potential risks to existing service continuity during the procurement and leading through to commencement by the new service provider. This will need to be developed into an appropriate and acceptable Risk Mitigation Strategy.

*Scc Comment – this is noted. While the Council have considered the risks to existing service continuity a further risk workshop has been arranged to revisit this mitigation strategy and a formal Risk Mitigation Strategy will be implemented.*

The risk that the procurement might fail should also be addressed and an appropriate Risk Mitigation Strategy developed.

*Scc Comment – there is always a risk that a procurement may fail. It is understood that the Review Team did not feel that there was any reason why this project was more susceptible to procurement failure than any other major procurement. There is already a contingency in place should the procurement fail to ensure service continuity and provide sufficient time for the Council to consider future options.*

### **4: Readiness for next phase**

The Project Team recognises that additional resources and skills will be required to deliver the project to time, quality and within budget, and also before it enters the operational phase. The Health Check Team were advised that appointment of key members of the Project Management Team is underway and that, once recruited, they will be involved in the remaining procurement stages.

*Scc Comment – it is understood from the de-brief provided by the Review Team that this point actually refers to Client and Contract Management and not the Project Team and that the reference to delivering the ‘project to time, quality and within budget’ is a reference to the post contract award phase and not the procurement phase. On this basis the point is noted and addressed in the Outline Business Case Addendum.*

The strategic issues identified in this Health Check should be addressed by the Project Board before the project is ready to enter the next phase of procurement. Additionally, we recommend that the Project Delivery Strategy should be captured in a single document.

*Scc Comment – this is noted. During the de-brief the Review Team were unable to articulate what the components of a Project Delivery Strategy were. Nevertheless, a Project Delivery Strategy section has been included in the Outline Business Case Addendum.*

## Appendix A Purpose of Local Partnerships Health Check

The Health Check should consider some of the following issues (depending on the stage the project has reached):

- Is the business case satisfactory and up to date?
- Are the scope and outcomes clear?
- Do we have the right skills?
- Is it supported by stakeholders, how has this been approached?
- Does it contribute to the Authorities strategy?
- Are there resources for the next stage?
- Do we have authority to proceed?
- Are the internal project costs known and monitored?
- Is there a realistic financial forecast of the overall cost?
- Have the risks been identified, ownership allocated and managed?
- Do we have the correct project structure and can the project team and its structure deliver?
- Is the project plan realistic?
- Can the benefits in the business case be delivered by the contract?
- Have all approaches been investigated?
- Is the procurement approach appropriate?
- Has the procurement been appropriately managed?
- Are the specifications of requirements correct?
- Is there continuing stakeholder support?
- Is the business ready for implementation?
- Are the contract management procedures satisfactory and is there sufficient resource?
- Has all of the appropriate project documentation been produced in accordance with authority procedures?
- Are the business benefits still deliverable?
- Has all testing been successfully completed?
- Is the business ready for implementation?
- Are plans for managing implementation and operation in place?

## **APPENDIX B**

Interviewees

<b>NAME</b>	<b>ROLE</b>
Lorraine Brown	Exec Dir of Environment (Project Owner)
Nick Johnson	Project Manager
Rob Carr	Head of Finance
Mick Bishop	Head of Highways & Parking (Project Director)
David Wilkes	Internal Finance Lead
Simon Collison	Internal Legal Lead
Andrew Mckie	Buro Happold
Sukhvinder Duggal	PwC
Jonathan Turner	Bevan Brittan
Tim Thomas	Audit Commission
Brad Roynon	Chief Executive
Cllr Matthew Dean	Executive Member for Environment and Transport
Cllr. Simon Letts	Labour – Chm. Audit & Scrutiny Committee
Mark Roberts (scheduled but unable to attend)	Unison