TYNE AND WEAR FIRE AND RESCUE AUTHORITY **Item No**

MEETING: 15TH JUNE 2009

SUBJECT: NEFRA COLLABORATIVE PFI PROJECT : PROGRESS TO FINANCIAL CLOSE

JOINT REPORT OF THE CHIEF FIRE OFFICER, FINANCE OFFICER AND CLERK TO THE AUTHORITY

1 INTRODUCTION

1.1 Members of the Authority have received regular reports regarding the NEFRA Collaborative PFI Project. The most recent report of 16th March 2009, detailed the difficulties affecting the Project as a consequence of the current economic climate, in particular the resulting increase in the costs of providing funding for the Project and the consequential adverse effect on the affordability of the Project.

1.2 As set out in the report of 16th March 2009, a meeting was held on 20th March 2009 with representatives of Communities and Local Government (CLG) in order to discuss the affordability of the Project and to seek a way forward. Following that meeting, it was agreed that a robust examination and challenge of the current position and costs would be undertaken by NEFRA and the Selected Bidder (Collaborative Services Support) and be supported by CLG. The aim was to mitigate where possible the recent cost increases without impacting upon the integrity and quality of the Project and to ensure that any delays to the Project were minimised. CLG indicated that following the completion of this robust analysis, that they would consider allocating additional PFI credits to the Project in order to reduce the financial impact upon the Authorities.

1.3 That work has been completed and a response has been received from CLG. Consequently, the Project, with the approval of Members, can now proceed to Financial Close.

1.4 The purpose of this report is therefore to:

i) Seek approval to the submission of the Final Business Case to CLG, following the outcome of the submission and representations to CLG to address the increased affordability gap;
ii) Authorise officers to conclude and execute the relevant documentation in order to enter into a Public Private Partnership arrangement under the terms of the Government's Private Finance Initiative.
iii) Authorise officers to conclude and execute the relevant documentation in order to enter into a Co-operation Agreement with County Durham and Darlington Fire and Rescue Authority and Northumberland County Council.

2 PROJECT SCOPE

2.1 The Project includes the provision of new community fire stations located in Bishop Auckland and Spennymoor (DDFRA), Pegswood and West Hartford (NCC), as well as a new headquarters on the West Hartford site and in relation to this Authority a new community fire station at Tynemouth.

2.2 As well as the design and build of the new facilities, the contract will include for the provision of a number of facilities management services which will be undertaken over the twenty five year concession period. These services include:

i) Property Maintenance (day to day as well as planned)
ii) Cleaning and janitorial;
iii) Security;
iv) ICT infrastructure;
v) Site and grounds maintenance; and
vi) Furniture, fittings and equipment.

2.3 It is currently anticipated that Financial Close will take place during June 2009, following which CSS will commence site mobilisation and preparation. This will then be followed by the construction phase with the new community fire station at Tynemouth anticipated to be completed during June 2010, following which the facilities management services will be provided for the operational phase of the Project.

2.4 Members will be aware that the new Tynemouth Community Fire Station is being built upon the existing site. To maintain operational functionality the existing fire station can only be demolished following the transfer to the new Community Fire Station. Following the demolition process and site recovery the remaining facilities, namely the training fire house and garages, will be constructed on the former fire station site. It is anticipated that this element will be completed during November 2010.

3 FINAL BUSINESS CASE

3.1 Approval of the Final Business Case (FBC) by CLG is a requirement for the provision of PFI credit support to the Project. The FBC builds upon the information provided within the Outline Business Case and confirms the scope and cost of the solution that will be delivered in order to meet the strategic aims of the Authorities. The FBC comprises eight sections and a number of supporting appendices. These eight sections are:

Section A	Project Objectives
Section B	Competitive Dialogue Procurement Procedure
Section C	Compliance with HM Treasury / CLG / 4ps Guidance
Section D	Stakeholders Engagement and Commitment
Section E	Financial Issues and Affordability
Section F	Risk Allocation and Accounting Treatment
Section G	Contract (Project Agreement) and Payment Mechanism
Section H	Post Contract Management and Performance Monitoring

A hard copy of the FBC is attached for the information of Members.

3.2 As referred to within paragraph 1.2 following the meeting with CLG on 20th March 2009 a robust examination and challenge of the current position and costs was to be undertaken in order to explore ways to mitigate the increase in affordability gap. The annualised affordability gap, before taking into consideration the availability of existing revenue budgets for services that will in the future be provided by CSS and as reported to Members on 16th March 2009 is c. £1,526,000 (2008/2009 price base), an increase of c. £354,000 from the position at final tender stage.

3.3 A series of meetings and detailed re-examination of all elements of the Project has been undertaken over the last six weeks with support provided by CLG in order to assist with the challenge aspects and to ensure from CLG's perspective that everything that reasonable could be done, had been done before CLG would consider providing additional PFI credit support.

3.4 As set out within Section E of the FBC, following the completion of the options exercise, a reduction in the annualised affordability gap of c. £40,000 has been achieved. In addition, CLG, following consideration of the Authorities' submission and consultation with the Minister, have agreed to provide an additional £4.322m of PFI credit support. This increases the level of PFI credit support from that approved at OBC stage of £37.9m to £42.222m. The effect of this additional PFI credit support is to reduce the Project's annualised affordability gap by c. £255,000.

3.5 In overall terms therefore, there is a remaining increase in the annualised affordability gap of c. £59,000, which the Authorities will be required to meet. The Tyne and Wear Fire and Rescue Authority's share being c. £10,000, giving a total annualised contribution as set out in the FBC of £160,319.

4 FINANCIAL IMPLICATIONS

4.1 As set out in paragraph 3.5, the additional annualised contribution for TWFRA is £160,319. Additionally, as a consequence of design development since the appointment of CSS as Selected Bidder, there have been a number of minor changes to the requirements in respect of Tynemouth, which result in an additional annualised cost of c. £4,000. These changes have included refining the design of the fire house, the provision of additional data points, and the provision of audio visual equipment for the community facilities.

4.2 In summary, therefore, the overall anticipated annualised affordability gap for the Authority is c. £164,319. This represents an increase of c. £9,319 above that approved by the Authority at its meeting on 3rd November 2008.

4.3 Members will recall from the report of 16th June 2008 appointing CSS as the Selected Bidder, that the Authority retained ground condition risk in respect of the element of the site that the contractor was unable to survey due to the existence of the current fire station building. The contractor has undertaken further due diligence with regard to site conditions which has resulted in the assessment of more adverse ground conditions. As a consequence the proposals have been refined from grouting the existing site to rafting the existing site. The amended proposals represent a significant cost to be borne by the Contractor, with the element to be borne by the Authority limited to the portion of the site covered by the existing footprint of the fire station. The cost is capped at £48,500 and only becomes payable on the date of service commencement of Tynemouth community fire station. As previously reported to Members, this cost will be met from the Development Reserve.

Ongoing Risk Issues

4.4 There are a number of specific risks that will remain with all three Authorities up to Financial Close, during the construction phase and the operational period. These risks reflect the standard guidance and approach in respect of PFI schemes.

Interest Rates

4.5 The Authorities bear the risk of changes in interest rates up until the date of Financial Close whereupon this risk is borne by the Contractor. The financial information contained within this report is based upon an assumed interest rate of 4.5%. At financial close this rate will be fixed upon the rate available in the money markets at that time for a project of this nature. Any reduction in interest rate from the assumed 4.5% will result in a financial benefit to the authorities (i.e. a lower unitary charge) whilst an increase would result in additional cost. Currently the interest rates being secured for other PFI projects are around 4.3%.

Funding Terms

4.6 As reported to Members within a number of previous reports increases in funding terms being offered by the commercial banks are a risk borne by the Authorities. These are likely to be fixed once the Project has secured approval through the funders' internal credit committees. This process is currently underway. Funding terms have been relatively stable recently, and at this stage there is no indication of any further increases.

Changes to works and services

4.7 Any changes that the Authorities require to the works or services that the Authorities have currently specified to be provided by the Contractor may result in additional costs. In accordance with the terms of the Project Agreement, the Authorities must agree the costs associated with any changes. Payment for agreed changes may either be by additional one-off payments to the Contractor or through an ongoing increase in the unitary charge.

Inflation

4.8 This is a shared risk. Part of the unitary charge is fixed as it relates to fixed costs, which are generally the financing costs of the Special Purpose Vehicle. The remainder of the unitary charge is variable, generally operating costs including salaries and premises costs, and is indexed each year in line with

RPIX. The split of the unitary charge that is subject to indexation will not be determined until Financial Close, as the interest rate secured at that time will affect the level of fixed costs and hence proportion of fixed costs included within the submission. The Authorities retain the risk of movements in energy prices and for business rates throughout the contract term.

5 LEGAL POWERS AND CERTIFICATION

5.1 The Local Government (Contracts) Act 1997:

- confirms local authority powers to enter into a wide range of contracts;
- empowers authorities to issue certificates for partnership contracts confirming them to be correctly entered into and enforceable; and
- provides for compensation to contractors if contracts are nevertheless rendered void by the courts.

The Act was introduced to address concerns of the private sector about entering Public Private Partnership contracts with local authorities.

5.2 Regulation 7(3) of the Local Authorities (Contracts) Regulations 1997 requires that certificates issued under the 1997 Act by joint fire authorities must be signed by the Chief Finance Officer of the authority or a person, who, as respects all or most of the duties of his post, is required to report directly or, is directly accountable to the Chief Finance Officer. It is recommended in this case that in addition to the Authority's Finance Officer, the Deputy Finance Officer also be authorised to sign such certificates on the Authority's behalf in the absence of the Finance Officer.

5.3 It cannot be ruled out that the personal liability could attach to the Certifying Officer, although in the absence of dishonesty or bad faith or recklessness or even negligence, the risk must be considered small. Nevertheless, the fear of personal liability is a very real one for the officer concerned, who will therefore be concerned that he is protected by a valid indemnity from the Authority. This principle also applies to other officers who may be required to provide similar assurances.

6 KEY PROVISIONS OF THE AGREEMENT

Contract Standardisation

6.1 The Project Agreement has been drafted to be consistent with PFI Contract Guidance on Standardisation of PFI Contracts (SoPC4) issued by HM Treasury (HMT), and specific guidance in respect of Fire and Police PFI projects issued by CLG / 4ps. The main objectives of standardisation are:

- to promote a common understanding of the main risks which are encountered in a standard PFI contract;
- to allow consistency of approach and pricing across a range of similar projects; and
- to reduce the time and costs of procurement by enabling all parties concerned to agree a range of areas that can follow a standard approach

without extended dialogue.

6.2 Additionally, following the issue of updated refinancing provisions by HMT, which provide for authorities to receive a greater share of any refinancing gain, the Project Agreement has been amended to include these.

6.3 The expectation from HMT and CLG is that the guidance should be followed. Any derogation from HMT guidance needs to be approved. There are no derogations for the Project, save for a minor amendment to correct a typographical error which is accepted by HMT on all projects.

Agreement Structure

6.4 The Agreement is structured around the basic framework of an initial phase during which the construction works will take place followed by a 25-year service contract for the provision of facilities management services.

6.5 The contractual obligations of the Contractor are to provide the works and services in accordance with the Agreement (including the Output Specification), all relevant approvals, consents and restrictions and all legislation and guidance. The Contractor, as is usual in PFI projects sub contracts its' works and service obligations to Sub-Contractors. The Authority does not pay for such directly but does so by paying for services through a Unitary Payment (unitary because it relates to elements of both capital and service cost repayment) throughout the remaining life of the contract. Appendix 1 provides a commentary on the main terms and conditions of the Agreement.

6.6 In addition to the Agreement there are a number of ancillary documents making up the totality of the legal arrangements between the parties and incorporating the interests of other parties such as the Funders (Sumito Mitsui Banking Corporation (SMBC) and Norddeutsche Landesbank Girozentrale (NORD LB)), and the Sub Contractors.

Co-operation Agreement

6.7 There is also a Co-operation Agreement which underpins the "contractual" relationship between the three Authorities for the operation of the Project and sets out the obligations of each Authority to the others. Key areas included are:

- Authorities' Representatives and role / Authorities' Liaison Group for monitoring ongoing contract performance;
- Change Process, including cost / savings sharing of agreed changes;
- Compensation Events that are Authority or site specific;
- Compensation on Termination;
- Timing and share of payment of contributions towards the unitary charge to the Lead Authority and receipt of, and then payment of, PFI grant by the Lead Authority;
- Refinancing – how gains (if any) will be shared;

These are set out in more detail in Appendix 1.

6.8 The Authorities are required to enter into a Co-operation Agreement to establish the legal relationship between Tyne and Wear Fire and Rescue Authority and the other Authorities and arrangements for how the Project will be monitored and managed on the basis that each Authority bears the costs and risks of its part of the project.

7 RECOMMENDATIONS

7.1 The Authority is recommended to:

a) Members to note and endorse the Final Business Case;

b) Approve the arrangements for the NEFRA Collaborative PFI Project on the basis of the financial terms and general principles contained within this report;

c) Authorise the execution of the following documents (collectively known as "the Agreements"):

- The Project Agreement and its Schedules, being the principal agreement to be entered into between the Authorities and Collaborative Services Support NE Limited ("Project Co.");
- The Direct Agreement, being the agreement entered into between the Authorities, SMBC, Nord LB ("the Funders") and Project Co ("the Direct Agreement").
- The Collateral Agreements to be entered into between the parties set out below:
  - The Authorities, Shepherd Construction and John Laing Integrated Services;
  - The Authorities, Nappers and Shepherd Construction;
  - The Authorities, [relevant member of professional team} and Shepherd Construction;
  - The Authorities and John Laing Integrated Services; and
  - Any other Collateral Agreements required under the terms of the Project Agreement.
- The Independent Certifier Deed of Appointment to be entered into between the Authorities, Project Co., the Funders and Gleeds;
- The Co-operation Agreement being the agreement being entered into between (1) the Authority (2) Northumberland County Council and (3) Durham and Darlington Fire and Rescue Authority in relation to the relationship between the Authorities for the duration of the Project ("the Co-operation Agreement"); and
- Any other agreements, certificates, acknowledgements, waivers, notices, letters or other documents incidental to the documents listed above or to the Project or otherwise necessary or desirable in connection with the Project.

d) Authorise the Finance Officer (Keith Beardmore), or in his absence, the Deputy Finance Officer (George William Blyth) to certify that the following contracts are intra vires in accordance with the Local Government (Contracts) Act 1997:

- The Project Agreement and its Schedules: and
- The Direct Agreement

e) Authorise the Chairman (Thomas Wright), or the Clerk (David Smith), or the Deputy Clerk (Robert Crawford Rayner) to execute the Agreements under seal on behalf of the Authority and agree that their execution of the Agreements should conclusively demonstrate approval by the Authority of the Agreements in their final form;

f) Authorise the Chief Fire Officer (Iain Bathgate), Finance Officer, Deputy Finance Officer, Clerk and Deputy Clerk ("the Relevant Officers") as appropriate to take all necessary action in connection with the agreements, in consultation with Dickinson Dees LLP, the Authority's legal advisers in relation to this Project; and where appropriate in consultation with the Chairman of the Authority, or in his absence, the Vice Chairman of the Authority;

g) Agree that the Authority will indemnify any of the Relevant Officers in respect of any claims and costs relating to the Contract arrangements, provided that the Officer has acted reasonably and within the ordinary course of their duties.

Background Papers

Previous reports to the Authority in relation to the NEFRA Collaborative PFI Project

Appendix 1

Commentary on Main Terms and Conditions

Section A – Payment Mechanism

Payment and Performance - Key Principles and Objectives of the Payment Mechanism

(a) The payment mechanism has been developed in accordance with HMT's 'Standardisation of PFI Contracts' version 4 guidance and sector specific guidance issued by 4ps / CLG and follows a consistent structure to the Authorities' service specification.

(b) The payment regime is designed to provide incentives for the Contractor to deliver services to the standards set out in the Authorities' service specification.

(c) The Authorities will pay the Contractor to the extent that the services provided meet the requirements contained within the Authorities' service specification. Payments will continue for as long as the Contractor provides services that meet the requirements contained within the service specification. If services are not provided in accordance with the service specification, then payments will be reduced. The deductions to the Contractor's payments will reflect the severity of the failure and loss to the Authorities.

(d) Payments are initially made to reflect the value of the existing services provided. As the facilities come on line, payments increase to reflect the level of services and facilities provided.

(e) The payment mechanism has been prepared on the basis of the appropriate allocation of risk and responsibilities between the Authorities and the Contractor.

(f) The payment mechanism is based on deliverable and robust terms, which are capable of attracting debt finance in an appropriately structured project company.

(g) The payment mechanism does not include over burdensome monitoring requirements for either the Contractor or the Authorities.

(h) The payment mechanism has specific provision for deductions in relation to:

- Unavailability of accommodation;
- Unavailability of accommodation but used;
- Impeded mobilisation of an operational response due to the actions (or non action) of the Contractor;
- Performance shortfall deductions where services are not performed to standard;
- Repetition deductions, increased deductions applied for recurring or continuing failures; and
- Reporting failure deductions which arise if the Contractor fails to provide monitoring information on the performance of the contract.

Section B – Project Agreement

The Project Agreement is drafted in accordance with the 4ps' Model Contract for Fire and Police Projects and SoPC4 Guidance. The Project Agreement does not contain any derogation from SoPC4 Guidance save for a minor amendment to correct a typographical error, which is accepted by the HM Treasury across all projects.

1) Commencement and Duration

The Project Agreement commences from the date of Financial Close and covers both the Works Period, where the Contractor constructs the stations and a 25 year Service Period where the Contractor provides the facilities management services.

2) Termination

The Project Agreement can be terminated in the following circumstances:

- Authority termination on Contractor default (including insolvency and persistent breach), and a serious health and safety incident;
- Contractor termination on default by the NEFRA Authorities;
- Termination for "Force Majeure";
- Voluntary termination by the NEFRA Authorities;
- Termination for corrupt gifts and fraud; or
- Termination for a breach of the refinancing provisions.

The consequences of termination depend on the circumstances that resulted in termination. The amount of compensation payable on termination is dependent both on the reason for the termination and a wide range of other practical, legal, time-related and financial factors. The detailed mechanism for calculating compensation on termination is set out in a schedule to the Project Agreement.

3) Relief Events

The Project Agreement includes Relief Events drafted in accordance with SoPC4 Guidance.

Relief Events are events that are not within the control of the Contractor, which prevent performance by the Contractor of its obligations at any time, in the respect of which the Contractor would bear the financial risk in terms of increased costs and deductions under the payment mechanism but would be relieved from termination. Relief Events include fire, lightning, storm, tempest, earthquakes, riot, and within this scheme also include any failure or shortage of power, fuel or transport, any official or unofficial strike which affects the employees of the Contractor or its sub-contractors, any blockage or embargo, failure of any statutory undertaker to carry out works or services and the discovery of fossils and antiquities.

4) Indemnities

The proximity of the relationship between the parties (ie the NEFRA Authorities and the Contractor) means that either may from time to time infringe the rights of the other, whether as a result of specific breach of the contractual requirements or otherwise. This might, for example, be by way of damage to property or persons or might arise because the actions of the indemnifying party exposes the other to actions from third parties.

The Project Agreement applies indemnity provisions to cover the various circumstances in which loss or damage might arise. The Contractor indemnifies the NEFRA Authorities and all of the Authorities Related Parties against all liability for death and personal injury, loss of or damage to property, breach of statutory duty and all other actions and claims demands etc. made against the NEFRA Authorities by third parties which arise out of the acts or omissions of the Contractor in relation to the Project.

5) **Compensation Events**

The Project Agreement contains provisions that provide the Contractor with compensation if specific events occur during the construction phase. These are termed “Compensation Events”. Where delay or loss is incurred as a result of a Compensation Event, the Contractor is entitled to apply to the NEFRA Authorities to recover such losses, request such extension of time and/or such relief from its obligations under the Project Agreement as is appropriate.

6) Insurances

The latest SoPC version 4 guidance is being followed with regard to insurance.

The Contractor is required to hold certain specified insurances, professional indemnity insurance and any other insurance required by law. Insurance proceeds from the required insurances are specified under the Agreement, to be applied by the Contractor in repairing, reinstating or replacing the assets in relation to which the proceeds were received.

The insurance policies must be composite; that is each insured party (primarily the Special Purpose Vehicle (SPV) and the NEFRA Authorities) have a separate interest in the policy. To the extent that Insurers are entitled to deny a claim this will not in itself prejudice or limit the cover available to the other insured parties. Each insured party is therefore “ring fenced” from the acts of the other insured party(s).

Although the claims that arise under the policies will ultimately fall to be dealt with by the Insurers the Agreement has been structured so that:

- the NEFRA Authorities will be notified of all claims in excess of an agreed threshold that arise under the policies and the Contractor will provide appropriate details of such claims;
- the NEFRA Authorities are obliged to give reasonable assistance in the conduct of claims;

All claims arising in respect of the insurances falling within the applicable excess or above the indemnity provided will be met by the Contractor.

The Contractor is liable for any increase or decrease in the insurance premium payable upon renewal of those insurances specified in the required insurance schedule save for where the insurance review procedure identifies an exceptional cost or an exceptional saving in the renewed premium, whereupon the NEFRA Authorities will bear or benefit from 85% of such exceptional cost or exceptional saving.

7) TUPE and Pensions

The commencement of the PFI contract services will bring about a transfer of employment for staff of the NEFRA Authorities currently employed in providing facilities management services to the affected stations. This transfer is governed by the Transfer of Undertakings (Protection of Employment) Regulations 1981 (as amended) ("TUPE"), which means that the employees' contracts of employment transfer upon the same terms and conditions as applied prior to the transfer. TUPE imposes obligations in connection with such transfers e.g. consultation with the staff involved.

The terms of the Project Agreement recognise contractually the position in law. It is usual in such transactions for the parties to recognise that the consequences of certain liabilities of the transferor employer (in this case, the Authorities) should not pass to the transferee. What this means practically is that the Authorities indemnify the Contractor against these effects. An example would be in respect of any injury at work prior to transfer. It clearly would be both unusual and inappropriate for the cost of this liability to pass.

TUPE currently does not protect pensions provision. However, the NEFRA Authorities would be exposed to breach of contract claims from transferring employees if they did not provide for the continuance of pension provision post-transfer. With the opening up of the Local Government Pension Scheme to private sector contractors who provide services to local government (within the terms of the relevant regulations) the Authorities and the relevant local administering body can agree to admit the Contractor to the scheme as an Admitted Body under the terms of an Admission Agreement. The Agreement recognises this and places contractual obligations on the Authorities and the Contractor to take steps to achieve this. The Contractor will submit an application for admission to the South Tyneside Pension Fund.

8) Step-In

The first instance where this would apply is where the NEFRA Authorities wish to step-in, in certain specified circumstances e.g. where there is serious risk to the health and safety of persons, in an emergency or to carry out a statutory duty. The Contractor is relieved of its obligations to provide services during a period of Authorities step-in. If the NEFRA Authorities step-in is not as a result of any breach by the Contractor, the NEFRA Authorities will bear any costs incurred during this period. However, if the NEFRA Authorities step-in is a direct consequence of a Contractor breach, the Contractor will bear any costs incurred by the NEFRA Authorities during this period.

The second instance is where the Funders may step-in. This can occur where the Contractor is in default of its obligations under the financing agreements with the Funders (principally its payment obligation) or where the NEFRA Authorities have served notice of termination.

In either case, the Funders have the ability to step-in and attempt to rescue the project. They will do this by looking for a substitute Contractor to whom the contract can be novated. In the meantime they will appoint a Contractor to carry out services pending transfer. During such time they are subject to the same obligations as the Contractor. If the Funders choose to step-in, they are also bound to settle any outstanding liabilities of the Contractor. These obligations and rights are found within the Direct Agreement between the Funders and the NEFRA Authorities.

9) Assignment, Sub-Contracting

Under certain circumstances the parties are able to transfer the Project Agreement to third parties. The Project Agreement provides that:

- The NEFRA Authorities may not assign their rights and obligations under the Agreement to any person other than a person (being a single legal entity) having the legal capacity, power and authority to become a party and perform such obligations.
- The Contractor may not transfer the Project Agreement (or any part of the Project Agreement) unless the NEFRA Authorities consent to the proposed transfer. The Contractor is entitled to engage alternative sub-Contractors. Any such Sub-Contractors must be approved by the NEFRA Authorities prior to appointment. The Contractor will remain responsible for all its obligations under the Agreement.

10) Refinancing

Throughout the life of the contract, there may be a refinancing of the contract by the Contractor that may result in a lower cost to it either through more favourable interest rates prevailing or because the risk profile is lower post construction. The NEFRA Authorities must approve any restructuring or changes (such approval not to be unreasonably withheld or delayed). In line with latest HM Treasury Guidance (latest update issued in April 2009), the Project Agreement gives the Authorities either a 50%, 60% or 70% share of any refinancing gain depending on the size of the refinancing gain when considered in aggregate. The NEFRA Authorities can choose how they will receive their share in the benefit of such refinancing i.e. through a lump sum payment or a reduced unitary charge for the remainder of the contract period.

11) Changes to Works or Services

Changes to the works or services and/or an increase or reduction in the number of stations may be necessary to cater for changes in the NEFRA Authorities' requirements that could not be anticipated or quantified at contract signature, or changes imposed by external factors for which the NEFRA Authorities have retained responsibility.

The Contractor may also propose changes either to the service requirement itself or to the way it delivers the service. In such circumstances, the NEFRA Authorities will be formally consulted prior to the implementation of the changes.

The Agreement permits either the NEFRA Authorities or the Contractor to propose Changes to the Agreement during the term. An SoPC4-compliant Change Protocol has been introduced as a new schedule. This splits Changes into three types depending, in the main, on size. If the NEFRA Authorities wish to propose a Change then there will be limited circumstances in the Agreement under which the Contactor will be permitted to reject such change; however Changes that are of a catalogue/call-off nature (Low Value Changes) must be implemented. The Medium Value Change procedure requires a detailed individual response from the Contractor which takes into account the necessities, consequences and estimated costs of the Change. The response is then discussed and agreed by the parties before it is implemented. There are funders' rights of due diligence but these have been restricted as these Changes are Authority-funded. High Value Changes require a two stage procedure in which an outline solution is offered in stage 1, at the Contractor’s risk, which allows the NEFRA Authorities an overview of the costs and implications of the change before the provision of the detailed stage 2 solution. Once agreed, the Contractor can implement its solution accordingly. Again, funders due diligence costs are capped. The NEFRA Authorities will have the right, in certain circumstances, to carry out Change itself but this right is restricted.

The Contractor is entitled to refuse to comply with certain types of proposed change by the NEFRA Authorities. These include where the Change would cause any existing consents to be revoked, materially or adversely affect the Contractors ability to deliver the Works or Services (and the Change Protocol has not compensated for this), would affect health and safety, or required the Change to be provided in an unreasonable timescale or in a way that infringes legislation or good industry practice.

For Low Value Changes the NEFRA Authorities will fund the cost of the Change. For other changes the NEFRA Authorities can agree to fund the costs of the change or request the Contractor to fund the variation, however, if the Contractor (using its reasonable endeavours) is unable to secure an offer of funding the Contractor will not have to carry out the change unless the NEFRA Authorities agree to fund the change.

In respect of Medium or High Value Changes, when the Contractor’s estimate has been confirmed and funding obtained the Unitary Charge may be adjusted where applicable so that either party is in no better or no worse position and, where necessary, the Agreement will be amended to reflect the change.

Where the request for a Change comes from the Contractor, then, as in the NEFRA Authorities change procedures, a notice must be served detailing the nature of the proposed change, indicating whether it is a Low, Medium or High

Value Change. In this case they will include details of the consequences and any saving together with a detailed breakdown and justification of the Contractor's reasons.

If the NEFRA Authorities accept the proposed changes the parties must agree the details and make any necessary changes to the Project Documents. The NEFRA Authorities are entitled to reject the proposed changes and are not under an obligation to give reasons for their decision. Where the Change causes a reduction in the Contractor's costs, the Unitary Charge shall decrease so that any savings are shared with the NEFRA Authorities. The Unitary Charge can only increase as a result of a Contractor Change if the NEFRA Authorities expressly agree.

12) Change in Law

Changes might arise because of a change in law. Over 25 years, inevitably changes could have quite an effect upon the costs. The SoPC4 guidance position is to recognise that the impact of changes should be shared between the parties. The starting point is that general changes in law should be a Contractor risk. For example, if corporation tax is to increase generally, then that is a matter for the Contractor.

Other changes in law known as Qualifying Changes in Law might specifically discriminate against PFI contracts, contracts relating to fire and rescue services or increase the cost of carrying out this type of work. Here the Agreement allows either party to write to the other to express their opinion which opens a discussion between the parties in order to agree ways to either mitigate the qualifying change in law or agree any change to the works and/or services required to comply with the qualifying change in law.

13) Warranties

There are a number of warranties given by the Contractor:

- The Contractor is duly incorporated and has the power to enter into and exercise its rights and perform its obligations under the Agreement
- The Contractor is not involved in any litigation or proceeding which may materially adversely affect its ability to perform its obligations;
- All information provided to the NEFRA Authorities is true and complete in all material respects;

The Contractor must also satisfy itself in relation to data disclosed by the NEFRA Authorities as no claim may be made against any of the NEFRA Authorities in this respect.

The only warranty provided by the NEFRA Authorities is that their TUPE data is factually correct and identifies the relevant employees.

Section C - Co-operation Agreement

The Co-operation Agreement governs the relationship between the individual NEFRA Authorities.

The Co-operation Agreement regulates the relationship between the NEFRA Authorities by placing obligations on them to regulate how they co-operate with each other and perform their obligations under the Project Agreement. The Co-operation Agreement includes provisions relating to the establishment of a project liaison group, the establishment of representatives between each Authority and a Dispute Resolution Procedure.

The Co-operation Agreement identifies the Lead Authority for the project. The Lead Authority serves as the Authority who co-ordinates all of the NEFRA Authorities interaction with the Contractor and manages the payment of the Monthly Unitary Charge. It is agreed that Northumberland County Council will act as the Lead Authority. The Co-operation Agreement allows the Lead Authority to invoice the other Authorities for their share of such administrative costs incurred in this role.

There is an apportionment model included in the Co-operation Agreement, which details how the Unitary Charge is apportioned between the three NEFRA Authorities. Any deductions to the Unitary Charge are applied in accordance with the apportionment model unless the station which is the subject of any adjustment or deduction is used exclusively by only one of the Authorities.

The rights of the parties in relation to termination of the Project Agreement are set out along with a procedure for agreeing each Authority's contribution to any compensation on termination payable to the Contractor on termination of the Contract.

Each of the Authorities have the right to propose changes in accordance with the Change Protocol under the Project Agreement although depending on the value of the Change, the request must either go through the Lead Authority or be submitted to the project liaison group in accordance with the terms of the Co-operation Agreement. The project liaison group can discuss any proposed change and there are grounds for refusal along with the ability to refer any dispute to the Dispute Resolution Procedure set out in the Co-operation Agreement. The consequences of a change to the individual Authorities are set out accordingly. The Co-operation Agreement also includes guidelines for the Authorities to address any changes suggested by the Contractor or any proposed refinancing.

NORTH EAST FIRE AND RESCUE AUTHORITIES

Tyne and Wear | County Durham and Darlington | Northumberland

NEFRA
Collaborative PFI Project

Final Business Case

May 2009

Contents

HMT / PRG - OBC Evaluation Review

1. The NEFRA Collaborative PFI Project received approval to the Project Outline Business Case (OBC) from the Department for Communities and Local Government (CLG) and the HM Treasury's Project Review Group (PRG) following the PRG meeting on the 20th July 2006. The letter from CLG dated 28th July 2006 confirmed the allocation of £37.9m PFI credits. Other than complying with CLG Local Government PFI Project Support Guides, the Fire and Rescue Service Circular 31-2005 and the use of the Fire & Rescue Standardised PFI Procurement Pack documentation no conditions were applied to the granting of PFI credits. A copy of the letter is included in Appendix A of this Final Business Case (FBC).

Executive Summary

1. The Project

The participating three Fire and Rescue Authorities are:

- Tyne and Wear Fire and Rescue Authority (TWFRA) - Project Lead Authority
- Durham and Darlington Fire and Rescue Authority (DDFRA)
- Northumberland County Council (NCC)

The Project provides for the provision of a replacement community fire station at Tynemouth for Tyne and Wear Fire and Rescue Service (TWFRS); the provision of new community fire stations at Bishop Auckland and at Spennymoor for Durham & Darlington Fire and Rescue Service (DDFRS) and new community fire stations at Pegswood and West Hartford together with an Administrative Headquarters also located at West Hartford for Northumberland Fire and Rescue Service (NFRS). The Project provides for the associated facilities management of the new buildings consisting of building maintenance, cleaning, landscaping and security services for a period of 25 years.

2. The Competitive Dialogue process

Following the Competitive Dialogue procurement process commencing with the OJEU Notice and PQQ stage, when 11 potential Bidders responded, six bidders were invited to respond to the Invitation to Participate in Dialogue (ITPD). These responses were evaluated and three bidders were Invited to Continue the Dialogue (ITCD) process. The Bidders responses at ITCD (Part 2) stage were again evaluated in accordance with set criteria. Two bidders were Invited to Submit Final Tenders (ITSFT) and two robust bids were received. Following detailed evaluation Collaborative Services Support (CSS) was chosen as the Selected Bidder. Financial Close is targeted for 18 June 2009 with the start of a phased commencement of services in May 2010, with all facilities being completed by July 2010, and all post completion works concluded by 1 November 2010.

3. Term of Contract

The contract term proposed is 25 years from the date of the Planned Service Commencement of the first facility.

4. Value for money and Affordability

The PFI procurement route demonstrates value for money and the Project is forecast to deliver annual revenue savings to NFRS, which were anticipated to be a benefit of delivering the Project.

The first year Unitary Charge including utilities as per CSS's financial model submitted as part of their ITSFT bid is £3.962m, excluding National Non-Domestic Rates.

The Authorities were allocated £37.9m of PFI credits following approval of the OBC, which equates to £2.965m per year. Following receipt of bids and despite the Authorities managing a competitive, commercial procurement process, the overall cost of bids received has been greater than that previously estimated. The Project has been subject to the volatility of the wider financial markets and principally as a consequence of the increase in cost of funding being offered by the commercial debt providers there has been a significant impact on the cost of the Project. These cost increases have not been restricted to this Project, and are being experienced by a number of PFI Projects across different sectors. On the basis of the bid submitted from the winning bidder, namely CSS, which was the most economically advantageous to the Authorities, and following further work undertaken with CSS and with CLG, in order to mitigate the increased costs on the Project, an increased allocation of PFI credits of £4.322m in total has been agreed. The allocation of additional credits will assist the Authorities to meet the financial implications of the Project and to continue to deliver and invest in the ongoing provision of Fire and Rescue Services generally. In addition to the PFI credits the Authorities are able to utilise existing revenue budget provision to meet the requirements of the unitary charge.

5. Estimated economic and non-economic benefits of the Project

The Project will allow the Authorities and their communities to enjoy the benefits of improved accommodation, which has been designed and located to meet the strategic objectives of modernising the Constituent Fire and Rescue Authorities. In addition, the Project will assist in delivering significant annual revenue savings through efficiencies for NFRS.

6. Project fit with other Local Authority policies and strategies

The OBC describes the corporate and project objectives as embodied in the Fire and Rescue National Framework Agreement 2005/06. These corporate and Project objectives are set out in Section A of this Final Business Case.

A key aim of the Authorities is to enable full engagement with, and improve safety (including fire and road) in, local communities. The new fire stations provide the facilities and flexibility to meet the specific needs of local communities in this respect, through education, prevention and collaboration, as well as providing effective intervention and protection services. This contributes to Local Authorities' aims for improved social cohesion, reduced anti-social behaviour and the building of safer, stronger and sustainable communities.'

Throughout the Competitive Dialogue process the Authorities strategic aims and business needs have been made clear to bidders and as a result it is envisaged that the NEFRA Project will enable the Authorities to deliver those strategic aims.

7. Quality of service delivery arrangements

The provision of new purpose built facilities will enhance the Authorities ability to deliver more focussed services in line with their strategic agenda by:

- Reducing operational costs, without prejudice to the maintenance of appropriate levels of service within the area served by each Authority.
- Assisting in the achievement of Best Value in the day to day operations of each Authority.
- The inclusion of new facilities within the five new community fire stations with direct access to the public to specifically address the fire safety and community safety agendas.
- Support the equality and fairness at work policies.
- Improved internal communications and better management brought about by a centralised headquarters facility at West Hartford for NFRS.
- Further developing the synergies that exist between the emergency services and other health and community specialists and to improve public safety by extending the relationship with the North East Ambulance Service by the delivery of ambulance services at designated community fire stations.
- The ability to build upon existing practice and create new opportunities for joint training initiatives with the other emergency services.
- Combining operational and technical services in new purpose built accommodation that will improve efficiency and effectiveness.
- Meeting the requirements of Northumberland County Council's 'Workwell' initiative for improved flexible working solutions.
- Improving collaboration with TWFRS through shared services, training, stores provision and management engineering and equipment maintenance services
- The provision of modern facilities will enhance the service resilience.

8. Summary of Performance standards and targets

The Project provides for the delivery of 'hard' Facility Management Services to all the new facilities throughout the 25 year operating period. In addition the Contractor will be responsible for cleaning and waste management, security, and external grounds maintenance as well as the IT infrastructure (cabling and containment). The Authorities have retained the catering provision, as the transfer of this service to the Contractor did not provide value for money.

The provision of these hard and soft facility management services to the new facilities by the Contractor will substantially enhance current levels of service. Cleaning and waste management services will be provided at the community fire stations over seven days each week. Increased levels of security by means of the use of CCTV and 24/7 security monitoring by the FM provider will protect the assets of the Authorities as well as providing safety for personnel working late or on their own.

SECTION A - Objectives of the Project

Does the final scheme meet the objectives set at the outset?

Yes. The overall aims of the NEFRA Collaborative PFI Project remain unchanged and as detailed in the OBC and are as follows:

- To make Community Fire Safety the primary focus of each Authority, placing fire and casualty reduction at the centre of policy and activity.
- To implement a process of continuous improvement in operational efficiency and effectiveness linked to revised standards of fire cover, consistent with each Authority's IRMP.
- To demonstrate Best Value by co-operation and collaboration between the Authorities, their neighbours and other agencies.
- To provide effective personnel management and in supporting equality, diversity, dignity and respect.
- To nurture high standards and consistency in the provision of services.
- To ensure the highest standards of contingency arrangements to mitigate major incidents.

The three Constituent Authorities believe that the NEFRA Project will meet these objectives.

Is the Project essentially that originally approved at OBC stage

Yes. The scheme approved at OBC consisted of the provision of five new fire stations, located at Tynemouth, Spennymoor, Bishop Auckland, Pegswood and West Hartford (including an administrative headquarters). Each of the community fire stations includes Community Safety, and Training facilities. The Project also includes a new Headquarters built on the same site as the Community Fire Station at West Hartford for NFRS and which provides for the rationalisation of facilities and increased efficiencies between the operational and administrative elements of the Service.

The Project therefore remains as originally approved at OBC stage.

The capital costs of the Project excluding land acquisition costs at the OBC stage in July 2006 were estimated at that stage to be £25,096,056 at Q2 2008 prices. These have been adjusted using the updated BCIS index due to Project time delays to £26,195,263m at Q1 2009 prices. The Selected Bidder capital cost at £26,049,958 is marginally lower than the adjusted OBC estimate, which reflects the benefit to the Authorities of the Competitive Dialogue bidding process.

Facility management services to be provided consist of building maintenance, security, external grounds maintenance, cleaning and waste management, furniture and non-specialised equipment plus IT infrastructure.

Section B - Competitive Dialogue Procurement Process

The Project has followed the Competitive Dialogue process from commencement and throughout the procurement path and has been subject to a strong competition and robust competitive process.

- **OJEU stage**

  Following the OJEU Notice the Authorities received eleven PQQ submissions. The eleven submissions were evaluated with the six named below, which attained the highest scores, being selected to submit further information (Invitation to Participate in Dialogue - ITPD):

  - Blue 3
  - CSS
  - Robertson Group
  - CSES
  - Pinnacle
  - Interserve

- **Invitation to Participate in Dialogue**

  The six bidders were invited to Participate in Dialogue (ITPD) and were invited to respond to focussed questions and supported by draft contract documents. On receipt and evaluation of the written responses from the six bidders by the NEFRA Project Team, including the external advisers, the Authorities selected the following three contractors to progress to the Invitation to Continue the Dialogue stage. These were all strong and experienced bidders with PFI experience and strong funding support.

  - CSS
  - Pinnacle
  - CSES

- **Invitation to Continue the Dialogue**

  The ITCD stage was divided into two parts with the ITCD Part 1 submissions forming an informal stage based primarily on technical design and facility management and operational elements. At the end of the ITCD Part 1 stage feedback was given to each bidder on the strengths and weaknesses of their proposals. The ITCD Part 2 formed a formal bid submission covering design, capital costs, legal and financial data and was formally evaluated against set criteria. All three resourced their ITCD Part 1 and Part 2 bids to an acceptable level. During the ITCD Parts 1 and 2 bid stages the Authorities structured regular consultative interface between the bidders and the User Groups and the content of the bids reflected the benefits of this good practice. Comprehensive design solutions were required as part of the bidders proposals and these were provided together with detailed financial and legal information. The bids were checked for compliance and completeness in accordance with the evaluation criteria. Following the evaluation, two bidders were selected to progress to the Invitation to Submit Final Tender (ITSFT) stage, namely:

- CSS
- CSES

A debrief was held with Pinnacle to outline the shortcomings in their ITCD submission.

- **Invitation to Submit Final Tenders**

The ITSFT stage provided for the two selected bidders, namely CSS and CSES to submit their final proposals. Part of the process involved the agreement on technical, financial and legal matters so that the Authorities gained assurance that the ITSFT bid would reflect the agreed position between each bidder so that the Dialogue stage of the procurement process could be closed. There has been involvement from lawyers acting for the funder and negotiations on the key issues in the Project Agreement. The Authorities recognise the benefits of the recent drafting guidelines issued by HMT and 4ps in this respect.

- **Identification of Selected Bidder**

The ITSFT bids were submitted to the Authorities in April 2009 and were checked for compliance and completeness. The two bids were subject to a detailed evaluation across all aspects of the bid proposals, covering technical, legal and financial matters by the NEFRA Project Team including the external advisors. Both CSS and CSES were invited to make short presentations on their submissions to the Chief Officers and Authority Board Members. Following the evaluation process reports were presented to each of the three Authorities as appropriate, for approval to the Selected Bidder. All three Constituent Authorities and the Regional Management Board agreed that CSS provided the most economically advantageous solution. In qualitative terms the designs generated by CSS for the community fire stations were generic and innovative and resulted in an external appearance which matched the Authorities wish to make a visual statement to the community as well as recognising the change in emphasis from fire intervention to fire prevention. The external appearance of the new Headquarters for NFRS at West Hartford reflected some of the design concepts adopted for the community fire stations and the plan form is well integrated with the new community fire station combined on the same site at West Hartford.

The NEFRA Project Team supported by the external advisors considered that the CSES bid was well developed, but in overall terms the technical solution presented was marginally inferior to that of CSS and additionally, their capital costs were higher so presenting a much more expensive solution and an un-affordable proposal. Appendix B sets out the headline capital, lifecycle and FM costs for the ITSFT stage and compares this to the position at OBC updated to reflect the proposed date of financial close.

A recommendation for CSS to be appointed as Selected Bidder was made to the Authorities during the period 16 - 20 June 2008 and unanimous approval was received. The Regional Management Board also endorsed the recommendation to appoint CSS.

CSES was notified following the Authorities' decision and a de-brief meeting was held in July 2008.

- **Actions to Financial Close**

  The final discussions with CSS have progressed well with regular milestone meetings being held and supported by subgroups dealing with specific elements of the scheme such as legal, financial and technical, which covered matters including Construction and Services and Change Protocol. The amount of discussion on these matters has been minimal due to the use of the Competitive Dialogue process to finalise terms and agreed positions as part of the ITSFT bid stage.

  Full and Reserved Matters planning approvals have been secured from the relevant Planning Authorities for all five sites with only standard non-onerous conditions applied. The conditions that were applied related to approval of external materials, method statements for the construction works on site, and for the layout of site compounds etc., the management of the external landscaping and final approval to green technology measures to be applied by the Contractor. All such conditions are the responsibility of the Contractor. Where conditions involve the participation of the Authorities, such as the provision of Travel Plans, these have already been submitted.

  The withdrawal of NIBC the funding bank originally selected by CSS, from the PFI market delayed the signature of the Selected Bidder letter. Revised terms for the new funder, namely SMBC (Sumitomo Mitsui Banking Corporation) were received and analysed by NEFRA’s internal and external financial advisers. In addition, to ensure the availability of sufficient private sector funding for the required full range of banking facilities, another commercial debt provider has been appointed. The funding solution for the Project is jointly provided by SMBC and Nord LB (Norddeutsche Landesbank Girozentrale) with each bank providing 50% of the total requirement. The Authorities approval to these revised terms and to the change of Funder was approved by the Authorities in appropriate Governance methods.

  It is currently anticipated that commercial close of the Project will be undertaken in early June 2009. A summary of the key milestones remaining to be completed is attached at Appendix C.

Section C - Compliance with CLG and 4ps guidance

Throughout the procurement process NEFRA have followed and complied with the guidance set out in the Police and Fire & Rescue Services procurement pack prepared by 4ps in conjunction with CLG, and HM Treasury Standardisation of PFI Contracts Version 4. The key contract documentation, namely the Project Agreement, the Output Specification, the Payment Mechanism and Change Protocol all are drafted using the standard model clauses. In addition during all stages of the procurement process contact has been maintained with representatives from CLG and 4ps and guidance obtained on various matters. Representatives of 4ps attended the ITSFT legal clarification meetings to ensure compliance with good practice.

In accordance with SoPC4, provision for the benchmarking of soft services is not included within the Project Agreement. The Project Agreement allows for the market testing of cleaning and grounds maintenance services every five years in accordance with the procedure set out in the Model Contract.

As part of the Competitive Dialogue undertaken, NEFRA sought approval for one derogation to the Project Agreement. This is within clause 54.1.2, which sets out matters associated with changes to the financing agreements. PUK confirmed their agreement to the deletion of the word “Additional” in the context of Permitted Borrowing.

HM Treasury issued updated guidance in October 2008 in respect of the refinancing provisions within SoPC4, and this has been incorporated into the Project Agreement.

At ITCD Part II and at ITSFT bid return stage, reports were submitted to each of the three Authorities as well as the Regional Management Board for approval. Copies of these reports were provided to CLG.

NEFRA selected their external consultants using the OJEU process at OBC stage and as a result of analysis of the responses and interview the following advisors were appointed to provide services to Financial Close:

Legal	Dickinson Dees
Financial	PricewaterhouseCoopers
Lead and Technical	Mouchel

In addition the NEFRA Authorities had the benefit of PFI procurement knowledge from representatives of Sunderland City Council Legal, Treasurers and Property Departments, gained through the previous PFI projects the Council has undertaken. Further, the Project has benefitted from the experience gained in conjunction with TWFRS officers in relation to its operational PFI project. Appropriate internal advice and support was provided and continues to be provided to the respective Authorities by financial, legal and property specialists within Northumberland County Council and Durham County Council.

From the earliest stages of the Competitive Dialogue process the Authorities, advisors and Bidders were made aware of the need to comply with the guidance documentation issues by 4ps and CLG and CABE on achieving design quality in public buildings. The use of the CLG Design Guide ‘Achieving Design Quality’ was adopted from the earliest stages of procurement. Two design workshops were held with stakeholders and two workshops held on Design Quality Indicators (DQI) using the DQI Fave process. The DQI workshops were co-ordinated and managed by Dr

John Kamara a Senior Lecturer at Newcastle University School of Architecture, an accredited DQI facilitator. Bidders were allowed to attend the workshops but on a listen only basis. The outcome of the designs achieved with the Contractor is that a BREEAM rating of ‘very good’ has been achieved on all five sites based on the 2006 BREEAM criteria. It is proposed that a further stakeholder review meeting be held when the stations are fully occupied in order to ascertain if the design objectives have been met.

The Authorities, together with external technical advice as appropriate, will closely monitor the detailed design and quality of workmanship during the construction phase to ensure that the new facilities on completion and during the operational phase are maintained in order to represent the highest quality of design.

Section D - Stakeholder Consultation

Stakeholder consultation

Extensive consultation has taken place throughout the Project with trade unions, Local Authorities, local Members of Parliament, the general public and all the Authorities employees. The process has involved public meetings, press releases, consultative meetings with the respective trade unions, letter to MP's and Chairs of the Constituent Authorities. Consultation with the employees has been structured by the formation of representative user groups from all strata of the three Authorities, who have been involved in all stages of the Project from OBC through to the final negotiations. The unions responsible for staff transferring under the TUPE Regulations have been consulted at all stages of the Project and will be involved further with the Contractor and the Authorities during the transfer process.

Consultations have also been carried out with North East Ambulance Service in connection with the location of ambulance support services being operated from the new West Hartford Community Fire Station.

A copy of the Consultation Strategy is attached at Appendix D.

Governance arrangements

Need to set out here what these are, including updating members at each authority, RMB, chief officer board etc. A summary of the governance arrangements for the Project is attached at Appendix E.

Section E - Value for Money and Affordability

1. VALUE FOR MONEY

1.1 The demonstration of value for money is a key factor in the delivery of a successful PFI procurement project. In line with HM Treasury guidance, the Value for Money of the Project has been subject to continued assessment throughout the procurement phase to ensure that the Project can be delivered. Specifically, these checks included monitoring:

- The quality of the competition (between Bidders) through ensuring that a robust bidding process, with an appropriate number of recognised contractors with sufficient capability, capacity and experience at each stage, has been maintained throughout the life of the project. Section B covers in more detail the competitive dialogue process undertaken by the Authorities;
- The success in transferring to the private sector an appropriate level of risk, principally through using appropriate standardised documents which govern PFI projects (Standardisation of PFI Projects version 4 (SoPC4) and the Fire and Police Services Procurement Pack);
- The reasonableness and stability of costs emerging from the competition following the undertaking of an efficient procurement process. NEFRA through its external advisers and evaluation processes have ensured that the costs of the solutions developed at all stages of the project have been subject to rigorous assessment including the use of relevant comparisons and benchmarks.

2. AFFORDABILITY

2.1 Affordability is a key criteria used in order to determine whether a project is deliverable. The Authorities have examined the financial implications of the Project on their existing revenue budgets.

The financial implications of the Project are a function of the Unitary Charge payable to the contractor, and the PFI credits available from the Government.

2.2 Summary of the Affordability Position

Affordability Gap
The current economic conditions have impacted significantly upon the funding terms and hence the cost of the private sector finance required for the delivery of the Project, with a resultant significant increase in the cost of the Project to NEFRA. The Constituent Authorities have received updated reports advising of the financial consequence of the increase in funding terms and that until those terms are fixed just prior to financial close are aware that there may be further fluctuations. Taking into consideration the allocation of financial support from CLG (OBC and additional allocation), the existing resources, the changes in funding terms and interest rates and the additional resources that the Constituent Authorities have identified in order to meet the costs of the Project, then the Project is affordable to the Constituent Authorities. The Authorities continue to monitor on a regular basis potential external influences that may affect the eventual cost of the Project, and will continue to do so throughout the operational phase of the Project.

A considerable benefit of the scheme is that it enables the Authorities to strategically reposition stations and rationalise the number of operational staff required without compromising response times. As a consequence of this NFRS are able to make significant annual staff cost savings of c. £0.786m, which is then used to meet their share of the Project's annualised affordability gap, and results in an overall saving to NFRS through undertaking the Project. For both TWFRA and DDFRA, the Project requires additional financial resources in order that their relevant shares of the Project affordability gap can be met. Members have been informed at key stages of the Project of the potential financial implications that may arise from the project. The table below sets out the summary affordability position for each Authority.

	Project	DDFRS	TWFRS	NFRS
	£	£	£	£
Annualised Gap ITSFT	1,172,060	334,842	196,303	640,915
New Business Rates Costs	360,128	129,227	61,500	169,401
Sub Total	1,532,188	464,069	257,803	810,316
Existing Resources	1,287,830	159,494	107,484	1,020,852
Additional Contribution Required / (Saving)	244,358	304,575	150,319	(210,536)
Updated SMBC / Nord LB 4.5%				
Additional Contribution Required / (Saving)	354,000	115,000	59,000	180,000
Savings identified to mitigate increases in the Unitary Charge	40,000	13,000	7,000	20,000
Additional PFI credit Support	255,000	83,000	42,000	130,000
Final Authority Contribution Required / (Saving)	303,358	323,575	160,319	(180,536)

The above analysis is based upon financial models provided by CSS. The only changes between the models are in respect of the inclusion of the updated funding terms and lower swap rate and changes agreed in conjunction with CLG in order to mitigate some of the cost increases on the Project. No other changes have been made to any input costs in the financial models.

Taking the above into consideration, the annualised gap based upon the current financial model would be approximately £1,526,000 per annum, this is an increase of approximately £354,000 above the position at ITSFT stage.

PFI Credits

The Authorities received approval of an allocation of PFI credits of £37.9m following approval of the OBC in July 2006, which equates to £2.965m per year. Following receipt of bids and despite the Authorities managing a competitive, commercial procurement process, the overall cost of bids received has been greater than that previously estimated. The Project has been subject to the volatility of the wider financial markets and principally as a consequence of the increase in the cost of funding being offered by the commercial debt providers there has been a significant impact on the cost of the Project. These cost increases have not been restricted to this Project, and are being experienced by a number of PFI Projects across different sectors. On the basis of the bid submitted from the winning consortium, namely CSS, which was the most economically advantageous to the Authorities, and following further work undertaken with CSS and with CLG, in order to mitigate the increased costs on the Project, an increased allocation of PFI credits of £4.322m in total has been agreed. The allocation of additional credits will assist the Authorities to meet the financial implications of the Project and to continue to deliver and invest in the ongoing provision of Fire and Rescue Services generally. In addition to the PFI credits the Authorities are able to utilise existing revenue budget provision to meet the requirements of the unitary charge.

The Authorities have received reports as the Project has progressed including a recent report confirming that funding terms are not guaranteed at this stage of the Project and that these will not be confirmed until internal credit committee approval has been received from the funders. The Authorities are aware therefore that potentially there may be further cost increases as a direct consequence of increases in funding terms.

Similarly, the swap rate for the Project is not confirmed, and will be fixed at financial close. Current swap rates remain beneath the level currently modelled. The Authorities, in conjunction with their external financial advisers, continue to monitor fluctuations in funding terms in the market place and swap rates as these are the remaining key variables that will affect the cost, and hence affordability position, of the scheme. This will continue until financial close. Appendix F sets out benchmarking information in respect of funding terms.

A protocol has been agreed with CSS for financial close setting out the process and swap benchmarking exercise that will be used in the Project by the parties. This is set out at Appendix G.

Additional Financial Information

The following information details the shareholders in the SPV, the amount of equity to be injected and the split between debt and equity proposed at ITSFT stage. The actual split between debt and equity will only be fixed at financial close. The funders have imposed a 92:8 gearing ratio limit within their terms.

John Laing Investments Ltd equity injected at financial close £0.040m, sub debt injected 10 months following the final services availability date £2.906m.

Shepherd Securities PFI Ltd equity injected at financial close £0.010m, sub debt injected 10 months following the final services availability date, £0.727m.

Debt : equity split at ITSFT stage 91:9. No changes have been proposed in respect of this since this point in time and this is within the terms approved by the funders.

Third party revenue – no third party revenue has been proposed by CSS as part of the Project, nor is it envisaged during the term of the contract. Should however any opportunities be identified during the term of the contract then any revenues generated will be shared on terms to be agreed between the Authorities and CSS. The Project Agreement would be amended to reflect the agreed position.

Section F - Risk Allocation and Accounting Treatment

Risk allocation

A key feature of PFI is the allocation of risks to the party best able to manage them to ensure best value for money. A table providing a summary of the risks retained by the Authorities and those risks that have been transferred to the Contractor is included in Appendix I.

Accounting treatment

The outcome of the review of the accounting treatment undertaken by PricewaterhouseCoopers is set out at Appendix J. In line with the guidance letter issued by CLG on 18 November 2008, this has been completed in accordance with IFRS, which confirms that the Project is on balance sheet for the public sector.

Section G - Contract and Payment Mechanism

CONTRACT

Vires

The Authorities will give Local Government (Contracts) Act 1997 Certificates in relation to the Project Agreement and the Direct Agreement.

The Authorities have power to enter into the Project Agreement and the Direct Agreement pursuant to Section 1 of the Local Government (Contracts) Act 1997 and the contracts are made in pursuance of the Authority's legal powers pursuant to Section 1 and Section 3(1)(a) of the Fire services Act 1947, Section 26 of the Local Government Act 1985 and Section 111 of the Local Government Act 1972

Statutory Processes

Prior to the issue of the ITPD, the Authorities obtained outline planning consents for each of the sites. Subsequently CSS have applied for and received detailed planning consents for each of the five sites. No onerous conditions have been attached to the consents.

Key Contractual Issues

The ITPD and ITCD for this Project were issued in November 2006 and as such the Project Agreement was drafted to comply with the previous HMT guidance (SoPC3). With the issue of SoPC4 the Project Agreement was amended to reflect this updated guidance and to take into account the issue of the Fire and Rescue Service and Police Service Procurement Pack.

Project Agreement

The drafting of the Project Agreement has reached the stage where by the Authorities and its legal advisors are satisfied that all of the substantive issues have been resolved.

As set out in Section F, approval has been sought and received from PUK for one derogation from SoPC4.

Payment Mechanism

In accordance with the principles of PFI, the Authorities are procuring provision for the Design, Build, Financing and Operation (DBFO) of the new facilities. The Contractor will be expected to meet the service standards set out in the Output Specification. The Contractor will be paid on a monthly basis from the Commencement Date of Services to the end of the Contract Term, which is 25 years from the date of the first planned Service Commencement.

The Payment Mechanism has been prepared using the standard Fire & Rescue Service Procurement Pack document in conjunction with the external advisors and the Contractor. The general principles on which it is based are as follows:

- The Authorities will only pay for the services received so that payment will only be triggered when the services become available (when building work is complete and the Authorities are able to occupy and start operating from the facilities.)

- Payments will only continue for as long as the services are available.

- The need to transfer appropriate risk to maximise Value for Money

- The Payment Mechanism provides sufficient incentives to the Contractor to deliver the services to the standards in the Output Specification, whilst providing adequate protection to the Authorities and its partners for underperformance and consistent poor performance.

Section H - Post Contract Management and Performance Monitoring

The NEFRA Authorities have agreed to enter into a Co-operation Agreement, pursuant to the powers contained in Section 2 of the Local Government Act 2000, Sections 6,7 and 8, of the Fire and Rescue Services Act 2004, and the Local Government Act 1972, Section 11, in order to establish the relationship between the Authorities and how the Project will be monitored and managed by the Authorities.

The Cooperation Agreement details the arrangements for such matters as:

- i) Sharing of Costs
- ii) Reporting and Invoicing
- iii) Payment of costs, Unitary Charge etc.
- iv) Decision Making and Liaison Procedure, frequency of meetings etc
- v) Disputes resolution
- vi) Termination of the Project Agreement
- vii) Compensation Provisions
- viii) Refinancing
- ix) Severability

The Authorities have agreed that during the Construction period, the TWFRS Representative, will lead the management of the Project liaising directly with the Authority Representatives from DDFRA and NFRS throughout this stage. External Technical Support will also be contracted for this stage as considered appropriate.

Following Service Commencement at each of the five sites, the Authorities, under the terms of the Cooperation Agreement, appointed TWFRS as the Lead Authority to manage the operational phase of the Project. The Lead Authority will liaise directly and regularly with the other Authorities to ensure that the obligations under the Contract are effectively managed in accordance with the Contract.

Particular attention will be given to monitoring the performance of the Contract through the Payment Mechanism and the Change Protocol documentation. Reporting and the logging of non-performance or faults will be the responsibility of the FM provider but each facility will also keep a record of reported faults. The FM provider will submit on a monthly basis a report to the Authorities Representatives, which will include a record of the faults logged and the action taken. At the regular monthly meetings this record will be compared with the log from each location and any discrepancies resolved before payment of the monthly Unitary Charge is made. Where High Value Change Orders are required then the Authorities will seek advice and support where appropriate from external advisors and colleagues within specialist areas to ensure value for money is being obtained.

Appendix A CLG - OBC approval letter

Department for
Communities and Local Government

Alan M Turnbull
Fire Finance Policy Officer
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28 July 2006

J A Holmes QFSM MIFireE
Deputy Chief Fire Officer
Tyne and Wear Metropolitan Fire Brigade
Brigade Headquarters
P O Box 1HR
Pilgrim Street
Newcastle upon Tyne, NE99 1HR

Dear Alan,

PRG Endorsement of NEFRA PFI Project

I am writing to inform you that consideration of the outline business case (OBC) you submitted on 13 February 2006, together with the supplements submitted on 24 March 2006 and 11 April 2006 and subsequent additional information for the North East Fire and Rescue Authority (NEFRA) PFI project, has been completed. Following recommendation by the Department, the project was assessed at the meeting of the inter-departmental Project Review Group (PRG) on 20 July 2006. The PRG has endorsed our recommendation that your project should receive central Government support. It will appear in the next revised list of endorsed local authority PFI projects, available at www.local.odpm.gov.uk/pfi/index.htm.

On the basis of your OBC, we expect the PFI credits to be £37.9 million. Whilst we will consider requests for increases to that amount, you should not assume that such requests will be agreed and should consequently plan the further stages of the project's procurement on the assumption that no more will be forthcoming.

Support for this project depends on the project continuing to meet all the published criteria in the ODPM Local Government PFI Project Support Guide, available at www.local.odpm.gov.uk/pfi/sg0607.pdf and the criteria detailed in the Fire and Rescue Service Circular 31-2005. In particular, you are reminded of the requirements to negotiate a contract based on standardised contract documentation; comply with the Government's commitment to achieving "Better Public Buildings"; and share documentation with this Department or other local authorities procuring a similar project at no cost.

Standardised contract documentation should be taken to mean 'Standardisation of PFI Contracts' (Version 3), available at www.hm-treasury.gov.uk/sopc. Any derogations are expected to be exceptional and must first be agreed with HM Treasury in line with its 29 April and 19 July implementation letters. It is strongly advised that compliance with the standardised contract should be settled prior the appointment of a preferred bidder. You should note that a number of projects will be selected for a second stage review by PRG in the weeks leading up to selection of the preferred bidder. This will cover possible contract derogations, vfm and affordability.

Your project should reach financial close by no later than 28 March 2008. Failure to achieve financial close by this date could mean withdrawal of support for the project and you must therefore notify this Department with an explanation of the reasons if you should need an extension to the deadline.

The Department must be informed immediately if the scope, contract, need for credits, timetable, or any other aspect of the project is changed in any material way from the case agreed. If that happens you will need to obtain the Department's written agreement to all proposed changes in good time before the contract is signed. You will not be able to rely on existing letters as entitling your authority to a PFI credit and failure to secure prior agreement to deviations will invalidate any undertaking by the Department or PRG to support your scheme.

Please keep in touch with us about your project so that we can assess progress. We will monitor your progress during procurement and particularly at ITN and preferred bidder in line with your timetable. Once you are clear about the value of the eligible expenditure under the contract you may request a promissory note confirming the level of support you can expect to receive from the Department.

We will formally issue PFI credits on the basis of an approved final business case (FBC) and a letter confirming the date the contract was signed. The FBC should be sent to the Department once you are confident that its contents will not markedly change further. This should take the form of a short document stating where the business case remains as set out in the OBC and where it has changed, with a fuller explanation for any changes together with and the procurement process. However, you discuss your proposals beforehand with the Department.

Revenue support will be paid as set out in the Local Government PFI Annuity Grant Determination for the financial year in which grant is first claimed. The interest rate which will be applied in calculating grant for your project will be 6% and the scaling factor will be 1. Your authority will need to ensure that funds are available to cover that part of the payments to the contractor which will not be met by central Government.

Revenue support will start to be paid once the first permanent asset is completed. Revenue support is not intended to match or correlate directly to the payments that arise under a PFI contract. However, the Government is committed to supporting good PFI projects and to assisting the development of PFI in the local authority sector. Its policy is therefore to maintain revenue for PFI projects in the long term, consistent with the long-term nature of PFI contracts, even though formally such support cannot be guaranteed as it forms part of the annual Local Government Finance Settlement. Variations or termination of a PFI contract would not of themselves lead the Government to reassess the level of revenue support due other than in exceptional circumstances. More information on this is available in Section C of the ODPM guide to Local Government PFI Project Support referred to above.

This letter is without prejudice to any other consent that may be required, for example, in connection with planning legislation.

Yours sincerely,

Alan M Turnbull

Appendix B Supporting Financial Data

The table below provides a cost plan summary at the ITSFT stage.

	OBC (1) 2Q08	**OBC (2) 1Q09**	**CSS**	**CSES**
Tynemouth	£3,779,863	£3,945,421	£4,341,994	£6,306,331
Pegswood	£4,525,412	£4,723,625	£4,675,778	£6,211,833
West Hartford	£8,718,960	£9,100,850	£8,224,785	£10,202,807
Bishop Auckland	£4,273,669	£4,460,856	£4,643,093	£6,103,491
Spennymoor	£3,798,152	£3,964,511	£4,164,308	£4,923,727
Total (£)	**£25,096,056**	**£26,195,263**	**£26,049,958**	**£33,748,189**
Cost per m^2 (£)	£2,109	£2,201	£2,016	£2, 692

(1) The OBC figure has been adjusted with the BCIS TPI forecast for 2Q08 and 1Q09.

The lifecycle and occupancy costs have been assessed over the 25 year concession period and are set out in the table below:

	CSS	CSES
Life cycle (£)	£6.76m £523/m2	£8.0m £643/m2
Occupancy (£/annum) exclusive of utilities	£63.4/m^2	£84.5m^2

Summary of project construction costs – CSS

	Tynemouth	Pegswood	West Hartford	Bishop Auckland	Spennymoor
	£	£	£	£	£
1.Sub Structure	503,062	473,554	548,746	603,188	274,043
2.Alteration Works	Nil	Nil	Nil	Nil	Nil
3.Superstructure	1,020,199	1,051,419	2,038,000	971,607	904,479
4. Internal Finishes	134,436	140,639	316,557	132,418	136,561
5. Furniture/Fittings	177,624	262,231	579,456	190,555	180,499
6. IT	Nil	Nil	Nil	Nil	Nil
7. Services	838,280	995,678	1,923,746	945,312	945,313
8.External Works	352,773	492,644	760,579	415,555	453,708
9. Preliminaries	652,567	509,749	865,101	504,491	521,698
10. Contingencies	60,527	68,323	123,342	65,173	57,892
11. Inflation	201,737	218,556	378,932	214,787	186,977
12. Design fees	378,798	398,678	609,271	356,120	362,131
13. Statutory fees	Nil	Nil	Nil	Nil	Nil
14. Utilities Costs	21,991	64,307	81,055	33,887	12,007
Provisional Sums				200,000	129,000
Total	**4,341,994**	**4,675,778**	**8,224,785**	**4,643,093**	**4,164,308**

Summary schedule of areas (sq.m.)

Areas represent gross internal (i.e. total floor area measured inside external walls)

	OBC	CSS	CSES
Community Fire Stations	**M^2**	**M^2**	**M^2**
Tynemouth	1,469	1,723	1,651
Pegswood	1,651	1,850	1,783
West Hartford	3,847	4,139	4,090
Bishop Auckland	1,497	1,598	1,496
Spennymoor	1,497	1,598	1,496
Total GIFA	**9,961**	**10,908**	**10,516**

All areas exclude external buildings e.g. Fire House, Drill Tower & Auxiliary Garage

Appendix C Timetable to Financial Close

NEFRA PROJECT – TIMETABLE TO FINANCIAL CLOSE

KEY MILESTONES

<u>CSS – SMBC ACTIONS</u>

Appointment of Funders Legal Advisor		12 January 2009
Appointment of Independent Certifier		04 February 2009
Appointment of Insurance Adviser		19 January 2009
Appointment of Funders Model Auditor		14 January 2009
Agree Funding Documents		20 January 2009
Credit Agreement		30 January 2009
Sub Debt Agreements		30 January 2009
Letters of Credit		05 January 2009
Agree Funding Conditions Precedent		20 February 2009
Funders Credit Committee Approvals		
	NORD LB	08 June 2009
	SMBC part 1	27 May 2009
	part 2	08 June 2009

Judicial Review Period Expired		19 February 2009
Authority Board Approvals to FBC etc		
-	County Durham & Darlington FRA	5 June 2009
-	Northumberland Cabinet/County Council	09 February and 11 February 2009
-	Tyne & Wear FRA	15 June 2009
-	NEFR Regional Management Board	tbc June 2009 (AGM)

Financial Close **18 June 2009**

SERVICE DELIVERY – Based on a Start on Site date of 22 June 2009-05-26

Bishop Auckland (45 Weeks) 4 May 2010 : Post Completion : 5 July 2009

Spennymoor (47 weeks) 17 May 2010 :

Tynemouth (50 weeks) 7 June 2010 : Post Completion : 1 Nov 2010

Pegswood (51 weeks) 14 June 2010

West Hartford (56 weeks) 19 July 2010

Appendix D Consultation Strategy

1 **INTRODUCTION**

1.1 During the various stages of the Competitive Dialogue Procedure, the Authorities agreed a considered and consistent Public and Internal Consultation and Communications Strategy.

1.2 The Strategy detailed such subjects as:-

i) Location of community fire stations and HQ for Northumberland Fire and Rescue Authority.
ii) General design, functions and facilities.
iii) Construction programme.
iv) NEFRA's contribution to social, community safety and economic regeneration of respective areas, and, following ITSFT;
v) Details of Selected Bidder.

1.3 The Strategy included:-

i) Joint press release from 3 x Chairs of Collaborative Authorities.
ii) Feature articles in local media, namely The Newcastle Journal, Northern Echo as well as Hexham Courant and similar specific media.
iii) Newsletters for the information of internal personnel as well as inclusion of appropriate material in publications such as Chief Officer's Bulletins, Service Gazettes etc.
iv) Open meetings for community members with representatives of relevant planning authority representation and Ward Councillors also in attendance.
v) Touring exhibitions with Service representatives in attendance in such venues as local schools, libraries and community centres.
vi) Exhibitions in mobile community safety vehicles also attending such locations as supermarkets and other prominent venues.
vii) Incorporation on Collaborative Fire and Rescue Services website(s).

1.4 The Strategy was also developed to incorporate:-

i) **Stakeholder events**, when a wide range of community representatives and representatives of relevant organisations and agencies attended a structured event. The bidders also attended these events to 'field' questions from the stakeholders.
ii) **DQI**, when the Authorities and relevant representatives of the community etc took part in both the FAVE and Pre-Construction workshops.

1.5 Further, publicity has been developed for the:-

i) Financial Close
ii) Construction, and
iii) Service Delivery Stages

1.6 In respect of ii) above, it has been negotiated to have web-cams installed at locations so that internal staff and community groups, especially schools, can monitor progress with the site(s).

1.7 Further at iii) above, open days for community groups are being considered. In addition a DQI exercise for 'In Use' has been tentatively approved by Members of the Authorities.

Appendix E

Project Governance

1. **INTRODUCTION**

1.1 The NEFRA Collaborative PFI Project involves the Fire and Rescue Authorities of

i) County Durham & Darlington
ii) Northumberland County Council and
iii) Tyne & Wear

1.2 Each of the Authorities has different governance arrangements, viz :-

i) County Durham & Darlington	:	Durham County Council with Unitary Authority; Darlington
ii) Northumberland	:	County Council with Cabinet Structure
iii) Tyne & Wear	:	Joint Board, with members from Constituent Authorities of North Tyneside, South Tyneside, Gateshead, Newcastle Upon Tyne and Sunderland (Lead Authority)

1.3 In addition the three Collaborative Authorities and with the Cleveland Fire and Rescue Authority are constituted under the auspices of the North East Fire and Rescue Regional Management Board.

1.4 As a consequence of these differing governance structures, the approval of reports to NEFRA follows a straightforward approvals route viz:-

i) Draft reports are considered by Chief Officers Board, as the originating body for reports to RMB.
ii) The Chief Officers present NEFRA reports to their respective Authorities. The reports are commonly drafted but tailored to their particular Authority.
iii) When approved by their respective Authorities, the reports are presented to the NEFR RMB for endorsement.

2.0 Reports which have been presented to the Authorities and RMB since the Appointment of the Selected Bidder are as follows:-

Title: 2008	D&D FRA	NCC		TWFRA	RMB
		EXEC	CC		
Appointment of Selected Bidder	23 June 2008	7 July 2008	9 July 2008	16 June 2008	11 July 2008
Project Update					
Management of the Project	30 Sept	3 Sept	8 Sept	15 Sept	16 Sept
Alternative Funder	Special	3 Nov	5 Nov	3 Nov	18 Nov
Management of Project	Special	3 Nov	5 Nov	3 Nov	18 Nov
Project Update	11 Dec	12 Jan	-	15 Dec	20 Jan
Funding Updates	19 March 2009	-	-	16 March 2009	26 March 2009
Approval of FBC, Resolutions etc	5 June 2009	9 Feb Then approved to FC	11 Feb Then approved to FC	15 June 2009	June 2009 AGM Date tbc

Appendix F Benchmarking of Funding Terms

The table below shows the revised funding terms offered by SMBC and Nord LB. These terms have been included within the latest financial models received from CSS. For clarity the NIBC terms are also included in the table below to identify the changes between the ITFST submission and the current models.

We have also provided details of current funding terms received from projects which have either closed or are in the process of obtaining credit committee approval in 2009.

Terms	NIBC (at ITSFT)	SMBC/Nord LB	Current Benchmark
Senior Debt Construction Margins	65 bps	275 bps	275 bps
Senior Debt Operating Margins	60 bps rising to 65 bps	240 bps rising to 270 bps	250 bps rising to 270 bps
Senior Debt Arrangement Fees	75 bps	200 bps	200 bps
Senior Debt Commitment Fees	26 bps	137.5 bps	137.5 bps
DSCR (min)	1.15	1.15	1.15
Equity Bridge Construction Margins	20 bps	175 bps	175 bps
Equity Bridge Arrangement Fees	40 bps	200 bps	200 bps

Appendix G Financial Close Protocol

Process to Financial Close and Benchmarking

1. Introduction

This paper represents the process and swap benchmarking exercise which will be used in the North East Fire and Rescue ("NEFRA") PFI Project (the "Project") by all relevant parties, including:

- Ernst &Young LLP ("Ernst & Young") as SPV's advisors;
- PricewaterhouseCoopers ("PwC") as the Authorities' financial advisors;
- SMBC Capital Markets ("SMBC CM") as a swap provider ("Swap Provider 1");
- Nord LB as a swap provider ("Swap Provider 2") and
- JC Rathbone Associates Limited ("Rathbones") as the swap rate benchmark provider.

The purpose of the swap benchmarking process is to seek to ensure that the senior debt swap rate offered by the Swap Provider 1 and Swap Provider 2 (the "Swap Providers") on the day of financial close is acceptable to the Authorities, based on a track record of benchmarking exercises, and that the relevant financial model is correctly updated with the swap rate at financial close.

The current timetable assumes an anticipated financial close of 27 May 2009. The process and protocols detailed in this paper are intended to ensure the execution of financing arrangements at financial close in a straightforward manner. This paper does not seek to provide a complete checklist of each and every process which will need to be completed before financial close (such as agreement of all contractual documents, confirmation of Swap Provider's credit committee approval, or final sign-off by the Authorities).

2. Programme for Financial Close Process

An initial benchmarking exercise will occur on 20 May 2009. The purpose is to ensure that the benchmarking protocol is effective, and to identify and resolve any problems.

The target differential between the quoted and benchmarked rates is less than 1 basis point and it is anticipated that the differential should remain constant throughout the benchmarking exercises.

Thereafter, further benchmarking exercises will be scheduled as agreed between the parties.

3. Swap Benchmark Protocol

The benchmarking exercises that are carried out prior to financial close will follow as closely as possible the financial close procedure, with the exception that the exercises need not be performed on location.

There may be additional procedures at financial close, which are detailed in the following section.

Provision of Swap Profiles

The swap profiles on which the pricing is to occur are circulated to all parties by Ernst & Young. It is expected that the profiles will be based on swap rates close to current market levels.

Agreement of the Senior Debt Swap Rate

- Based on the swap profile provided by Ernst & Young, Rathbones quotes a senior debt swap rate benchmark (fixed vs. Libor), excluding the applicable credit spread.
- SMBC CM and Nord LB shall simultaneously obtain a senior debt swap rate .
- The target differential between SMBC CM's and Nord LB's quotations and Rathbones's benchmark rate is less than 1 basis point.
- If the senior debt swap rate is agreed, and is within 10 basis points of the assumed rate used to produce the profiles, then the senior debt swap is agreed as transacted, on profiles to be provided by Ernst & Young as soon as the necessary model optimisation has been done.
- If the senior debt swap rate differs from that used to produce the profiles by more than 10 basis points, then Ernst & Young will circulate new swap schedules to all parties, and the above steps will be repeated.

Financial Model Optimisation

Subsequent to the benchmarking/dealing exercise, PwC and Ernst & Young shall optimise and re-run the financial model using the relevant swap rates to ensure that they agree the resultant figure for the Unitary Charge.

4. Day of Financial Close

On the day of financial close, the following actions are required:

- meet on location (and ensure the availability of telephone lines, printers) etc.;
- determine indicative senior debt swap rate for the purpose of producing swap schedules; distribute schedules to all parties by email;
- agree the Unitary Charge produced by the model using these rates;
- perform senior debt swap benchmarking as detailed above;
- when the swap rate is agreed on behalf of the Authorities, and if the current rates are sufficiently close to those used to produce the most recent schedules, the swap is transacted, i.e. the rate becomes the Agreed Swap Rate.
- upon confirmation by Ernst & Young of the Agreed Swap Rate, the agreed version of the financial model will be updated with the relevant rate in accordance with the model optimisation procedure, and the resultant debt profiles will be sent back to the Swap Providers and other parties (within 15 minutes of the confirmation of as the Agreed Swap Rate) as the final profiles for the swap which has been transacted at the Agreed Swap Rate;
- once agreed, the Schedules to the Agreements can be completed with the financial model outputs.

It is intended that the swaps shall be transacted no later than 4:00 p.m. on the day of Financial Close.

Appendix H Affordability and Bidder's Financial Models

Please see ITSFT and updated financial models previously provided.

Appendix I Risk Allocation Table

Risk Allocation Table

Risk Heading	Definition	Allocation
Design		
Planning costs/delays	Delays or modifications required after contract date	Shared
Design process – continuing development	Design has to be re-done or takes too long	Contractor
Change to design by operator	Design altered after outputs agreed	Contractor
Failure to building to design or meet output spec	Misinterpretation of design during construction / design does not take account of construction problems	Contractor
Design impact on operating costs	Resulting building costs more to run due to inadequate design	Contractor
Change to design by users/external	Alteration to output specifications staff are currently not in post	Authority
Construction		
Cost overrun	Overspend of original cost estimates	Contractor
Time overrun	Overrun with cost implications	Contractor
Unforeseen ground conditions	Ground conditions lead to increased costs	Contractor
Delay in accessing site	Contractor prevented from starting work	Shared
Site safety and security breaches	Penalties from safety standards; and costs of security break-in	Contractor
Third party claims	E.g. from loss of amenity or subsidence	Contractor
Compensation event	Public sector provides compensation under the contract	Authority
Relief event	Nobody's fault – no compensation or relief from deductions but relaxation from Contract termination	Shared
Specific legislative change	Local authority legislation changes drive cost increases	Authority
Non specific legislation change	General legislation changes drive cost increases	Contractor
Corporation tax change	Increases to tax rate	Contractor
VAT rate change	Increase to tax rate, but generally refundable to the Authority	Authority

Risk Heading	Definition	Allocation
VAT scope change	E.g. no longer a Vatable service input tax not reclaimable	Contractor
Contractor/ subcontractor default, bankruptcy	Litigation, delay, re-tendering	Contractor
Force majeure and termination due to force majeure	War or nuclear event	Shared
Poor project management	Poor co-ordination between contractors	Contractor
Contractor/ subcontractor industrial action	As stated	Contractor
Commissioning overruns	Building found to need additional work or time at commissioning stage	Contractor
Decant and temporary accommodation	Transfer of operations including temporary accommodation with full service standards met.	Shared
Public opposition to closing stations	Stations not approved for closure causing delay / project re-design	Authority
Availability and Performance		
Availability costs/ penalties	Opportunity costs of areas unavailable, translated to contract penalties	Contractor
Performance costs/ penalties	Opportunity costs of sub-standard facilities management, translated to contract penalties	Contractor
Latent defects (HQ)	Costs of correcting structural faults	Contractor
Latent defects (Fire Stations)	Costs of correcting structural faults	Contractor
Poor performance/ default of subcontractors	Subcontractors fail, causing costs and delay	Contractor
Operating costs/Lifecycle costs risks		
Operating cost incorrect estimation (volume)	More expenditure than expected on facilities management	Contractor
Operating cost price increases – between market testing	Prices go up more than inflation	Contractor
Operating cost price increases at point of market testing	As above	Authority
Life cycle incorrect estimation (volume)	More expenditure on replacing building elements thane expected	Contractor

Risk Heading	Definition	Allocation
Life cycle price increases	Materials/labour prices higher than expected	Contractor
Specific legislation changes	Local government legislation requires alterations	Shared
Non-specific legislation	General legislation requires changes to operation of facilities	Contractor
Corporation tax, employee costs & VAT changes	Changes to rules have input cost implications	Contractor
VAT: Change to public sector regulations	Public sector payments may not be recoverable	Authority
Employee or third party claims	Poor facilities management leads to accidents or ill health	Contractor
Obsolete buildings	Changes to user requirements make buildings inadequate, requiring capital variations or mothballing	Authority
Technological change	Increasing technology changes requirements or requires alterations – limited transfer of risk in line with output specifications	Shared
Energy tariff costs	Energy tariffs increase significantly during the contract. (But short and medium term fixed price agreements should be available, e.g. 3 years)	Authority
Volume of energy	Energy consumption varies during the contract	Shared
Demand/funding risks		
Required fire cover and buildings use lower than expected	Not enough demand, while facility costs are fixed	Authority
Government funding lower than expected	Authorities budget falls, e.g. FM efficiency targets, while facility costs are fixed	Authority
Funding risks	Interest rates and relationships with financiers post financial close	Contractor
Residual value risk		
Residual value of building is less than expected	Residual value falls to party who retains the asset	Authority

Appendix J Accounting Treatment

PRICEWATERHOUSECOOPERS

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89 Sandyford Road
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Facsimile: +44 (0) 191 269 3244
www.pwc.com/uk

Private and confidential
For the attention of Mr Alan Holmes
North East England Fire and Rescue Authority
Tyne and Wear Fire and Rescue Headquarters
Nissan Way
Sunderland
SR5 3QY

5 May 2009

Dear Sir

Accounting advice on the Collaborative Fire Stations PFI Project under International Financial Reporting Standards (IFRS)

The purpose of this letter is to set out our provisional judgement on the accounting treatment for North East England Fire and Rescue Authority ('NEFRA') in respect of its Collaborative Fire Stations PFI Project ('the Project') under International Financial Reporting Standards ('IFRS').

This letter is provided solely for the use of NEFRA. This letter, or a copy thereof, shall not be provided to any other person (other than your auditors) without our prior written consent which we may at our discretion grant, withhold or grant subject to conditions. In no event, regardless of whether consent has been provided, will we assume any liability or responsibility to any person to whom this letter is disclosed or otherwise made available.

Structure of this letter

This letter is structured under the following headings:

- The Project documents
- Current accounting developments
- Background to the scheme
- Assessment of the scheme under IFRS
- Required accounting for the transaction

The Project documents

The views expressed in this letter are based on the following documents:

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- Draft Project Agreement issued in 6740462_2(SB version - Project Agreement (28.05.08)).doc ('the Project Agreement');
- The payment mechanism issued in 8446352_2(SB Payment Mechanism - SB Version).doc ('the Payment Mechanism');
- The financial model generated by the entity selected as preferred bidder ('the Operator') and held in the spreadsheet 'CSS_NEFRA_Standard Bid_Financial Model.xls' ('the Model'); and
- Information provided by the Project Team.

We have not sought to verify the information in these documents and explanations against evidence from independent sources and we do not express any opinion on the Operator's assumptions or its ability to achieve its plans.

Current accounting developments

Introduction

The CIPFA/LASAAC Joint Board ('Joint Board'), which is responsible for developing the Local Authority Accounting Code of Practice ('the Code'), has proposed that the Code will fully comply with IFRS as implemented in the public sector from 2010/11. As a result of this decision, the Code will be developed under a new governance framework involving the Financial Reporting Advisory Board ('FRAB').

The Joint Board's 2009 Consultation Draft of the Code issued in November 2008 has proposed that local authority bodies will adopt similar principles for PFI and PPP projects to that adopted by the rest of the UK public sector under IFRS from 2009/10. The Joint Board intends that PPP/PFI principles will follow closely the application of the principles within IFRIC 12 (Service Concessions) ('the Application'), as set out in the text issued by FRAB for the Government's proposed International Financial Reporting Manual ('iFReM'). For this reason, the Department for Communities and Local Government ('CLG') now requires that all PFI and PPP project business cases include an assessment of the likely accounting treatment of the project under these IFRS provisions.

The Application presents a markedly different way of assessing the appropriate balance sheet treatment to that applying under the previously applicable United Kingdom Generally Accepted Accounting Practice ('UK GAAP') based standards and guidance in Treasury Task Force Technical Note 1 and Application Note F to Financial Reporting Standard 5 ('FRS 5 Note F') as it is based on control of the assets ('infrastructure') underlying a PPP/PFI project ('service concession') rather than risks and rewards of ownership. The Application will apply to the public sector body where the infrastructure has a useful life that is similar to or less than the length of the service concession.

Arrangements falling within the scope of the Application

Arrangements fall in the scope of the Application where:

(2)

PRICEWATERHOUSECOOPERS

- The public sector purchaser ('grantor') controls or regulates the services that the Operator must provide with the infrastructure, to whom it must provide them, and at what price; and
- The grantor controls, through ownership, beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the service arrangement.

For any service concession within the scope of the Application, the grantor will recognise the cost of the property plant and equipment underlying the service concession as a tangible fixed asset.

Arrangements falling outside the scope of the Application – lease accounting
However, where one or more of the above two criteria do not apply, the grantor must instead account for the arrangement in line with the general provisions of the Code. This is likely to include determining whether the arrangement contains a lease. While IFRIC 4 (Determining whether an arrangement contains a lease) will not be implemented within the Code for 2009/10, its principles may be relevant for 2009/10 and will be relevant for subsequent years. These principles are therefore set out below.

IFRIC 4 states that "an entity may enter into an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but conveys the right to use an asset (eg an item of property, plant or equipment) in return for a payment or series of payments". Determining whether an arrangement is, or contains, a lease under IFRIC 4 requires an assessment of whether:

- Fulfilment of the arrangement is dependent on the use of a specific asset or assets; and
- The arrangement conveys the right to use an asset.

An arrangement conveys the right to use an asset if any one of the following conditions are met:

- The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset; or
- The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset; or
- Facts and circumstances indicate that is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

If it is deemed that an arrangement contains a lease under IFRIC 4, the lease needs to be assessed under IAS 17: "Leases", to determine whether the lease is an operating lease or a finance lease from the perspective of the lessee, which would then determine whether the assets inherent to the scheme are on or off the balance sheet of the grantor.

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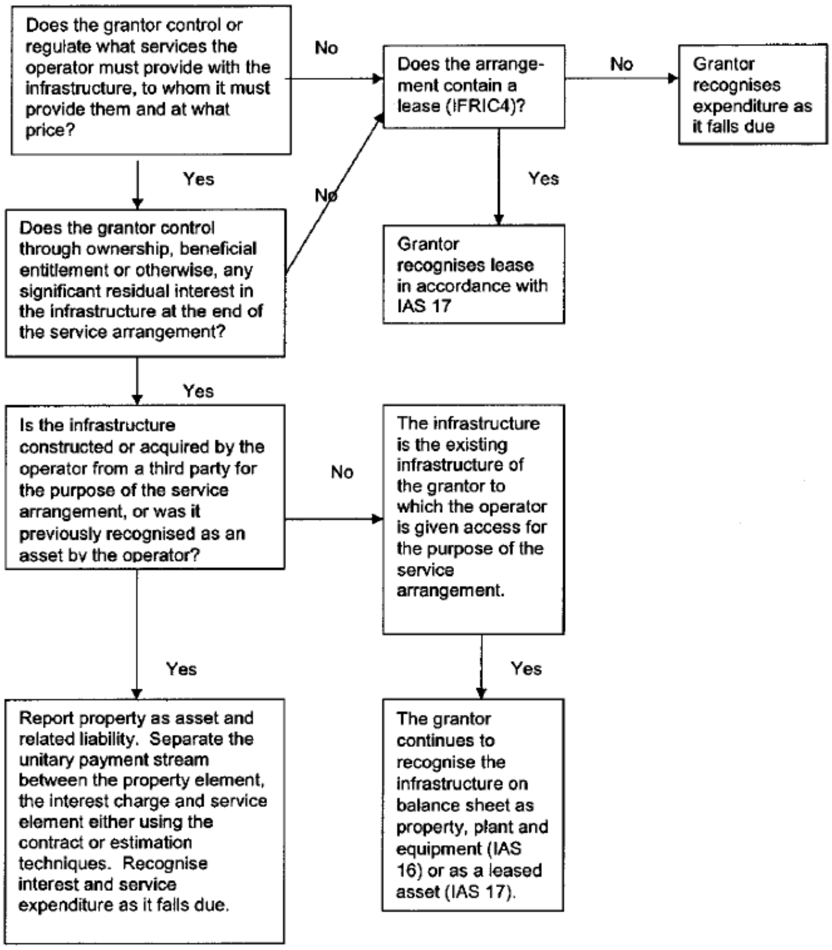
Decision flowchart

The flowchart below illustrates the method for assessing service concession arrangements under the Application:



Background to the Project

We understand that agreement between NEFRA and the Operator on the Project's commercial and financing terms ('Financial Close') is expected to be reached by May 2009. Following Financial

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Close, the Operator will arrange for the construction of the Project's underlying newly created property. The Model states that the construction works are expected to be completed by 31 July 2010. Following the completion of construction, the Operator will be required to make the Project assets available to NEFRA for use as fire stations. In return, NEFRA will pay the Operator Unitary Charge in return for which the Operator will operate and maintain the assets to agreed standards. The annual Unitary Charge due to the Operator will vary from a base amount determined in the Project Agreement and held in the Model according to changes in the Retail Prices Index excluding mortgage payments ('RPI-x'). The Operator will be required to make the assets available until 17 January 2035 ('the Term').

The Model states that the Operator's cost of constructing the Project property is approximately £30,474 million, including development and financing costs and rolled up interest. These amounts are all included in the Operator's financial asset balance in the Model which applies UK GAAP accounting under FRS 5 Note F.

Assessment of the scheme under IFRS

We now consider how NEFRA should account for the Project under IFRS. According to the flow chart on page 4, this first requires consideration under the Application, due to the nature of the Project.

Accounting under the Application

Table 1 below assesses whether the Project arrangement falls within the scope of the Application based on the criteria outlined above:

Criterion	Assessment
Does the grantor control or regulate what services the operator must provide with the infrastructure, to whom it must provide them and at what price?	The Operator will be required to design construct and operate the Project facilities, making them available to NEFRA for use as fire stations. In addition, the Payment Mechanism provides for how much NEFRA must pay the Operator for the use of the Project assets. However, the Payment Mechanism does not allow the Operator to charge users for access to the assets. The Model shows that no revenue from third parties is included in the Operator revenue. This criterion therefore applies to the Project.

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Criterion	Assessment
Does the grantor control any significant residual interest in the infrastructure at the end of the service arrangement?	The Project Agreement provides in clause 3 that it will terminate automatically at the end of the Term. This means that the Operator will no longer have any responsibility for the assets after the Term has ended. In addition, Clause 47 of the Project Agreement states that the Project assets will be handed back in a condition appropriate to their age and use. Taking this handover provision into account, and comparing the length of the Term (27 years) with the industry standard design life of new assets (60 years) lead us to the conclusion that the Project assets' residual interest will be significant. This criterion therefore applies to the Project.

Conclusions

The above table shows that the Project arrangement falls within the scope of the Application since both of the above criteria apply.

NEFRA should therefore record the Project property as a tangible fixed asset in accordance with the applicable fixed asset standard in force – and record and measure the associated long term liability to pay for the asset in accordance with the applicable leasing standard in force. As at the date of this letter, these standards will be Financial Reporting Standard 15 and Statement of Standard Accounting Practice 21 respectively. However once the SORP fully implements IFRS, these standards will become International Accounting Standards 16 and 17 respectively.

The primary responsibility for the accounts of NEFRA rests with its management who will need to determine the accounting treatment of the scheme in consultation with its external auditor.

If you wish to discuss any aspect of this letter or require further help or advice, please do not hesitate to contact Janet Eilbeck on 020 7804 9178 or Peter Dymoke on 0131 260 4115.

Yours faithfully

Janet Eilbeck

Janet Eilbeck
Partner
For and on behalf of PricewaterhouseCoopers LLP

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