Forward Plan reference number: N/A

Report title: Termination of the Tendring PPP Contract for 12 Primary Schools in Tendring	
Report to: Cllr Finch, Leader of the Council	
Report author: Nicole Wood, Executive Director for Finance and Technology	
Date: 17 December 2019	**For:** Decision
Enquiries to: Karen Williams, Head of Finance; Place and Public Health	
County Divisions affected: All Essex	

Confidential Appendix

This report has a confidential appendix which is not for publication as it includes exempt information falling within paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972, as amended.

1. Purpose of Report

1.1. In 2001 the Council entered into a Public Private Partnership (PPP) agreement relating to the refurbishment, construction and maintenance of 12 primary schools in Tendring (the “Contract”).

1.2. A review of the Contract in 2017 identified that ECC and the schools concerned could save money by voluntarily terminating the Contract. Cabinet approved this recommendation on 17 July 2018 (**FP/170/06/18)**.

1.3. Cabinet delegated authority to the Cabinet Member for Finance, Housing and Property (in consultation with the Cabinet Member for Education and Skills, Executive Director for Finance and Technology (S151 Officer), the Director of Education and the Director, Legal and Assurance (Monitoring Officer)) to approve the decisions set out in paragraph 2 of that decision paper. The approval of those delegations and the recommendation for further delegations is the purpose of this report.

2. Recommendations

2.1 To approve:

(a) A reduction to the capital programme of £0.5m to align the estimated maximum termination compensation which is attributable to capital expenditure to the budget allocation in the capital programme;

(b) A drawdown from the Schools PFI and A130 PFI reserves of £7.6m and £10.323m respectively to fund the revenue expenditure associated with the termination compensation and adviser costs of £350,000;

(c) The use of capital financing resources to fund the capital expenditure, those resources to be applied in the most cost-effective manner to reduce the overall cost of financing the capital programme;

(d) That no replacement facilities maintenance contract is put in place at the affected schools such that the schools are responsible for facilities maintenance from the termination date in the same way as other maintained schools and will be part of ECC's school capital maintenance programme;

(e) That until the 28 December 2022, the School will not need to make the per pupil contribution in the event that ECC determines that capital maintenance is required pursuant to the capital maintenance programme.

2.2 To note that the final termination compensation payable to the Contractor will not be known until after the termination date but to note the estimated final termination compensation as at the date of this report and set out in the Confidential Appendix;

2.3 To delegate authority to:

(a) The Executive Director of Finance & Technology, in consultation with the Leader of the Council, to agree the final validation of the financial assumptions by ECC's advisor, Local Partnerships, and the approval of the true up adjustment to the termination compensation and therefore the final termination compensation payable to the Contractor following receipt of the audited accounts post termination of the Contract;

(a) the Director for Legal and Assurance (Monitoring Officer) to agree the terms of any deed of termination between the Contractor and ECC if such a deed is more beneficial to the Council than relying on the provisions in the Contract that survive termination;

(b) the Director for Legal and Assurance (Monitoring Officer) to issue any necessary certificates under section 3 of the Local Government (Contracts) Act 1997 which may be required.

3 Summary of issue

3.1 It should be noted that the termination of the Contract is a complex process and as at the date of this report there are a number of outstanding factors that may affect the final termination compensation payable to the Contractor. This report sets out the risks and the likely maximum termination compensation that may be payable to the Contractor as known at the date of this report. There may be risks and liabilities post termination where ECC is unable to recover any liability from the Contractor or which are not known at the time of writing this report.

3.2 ECC has five schools' PPP/PFI contracts. Under these agreements a private contractor paid the cost of capital work for the school - either building new schools or refurbishing existing buildings, in return for which ECC commits to pay for borrowing and buy maintenance services from the contractor for a defined period of time.

3.3 All five PPP/PFI projects were reviewed in 2017 to identify whether significant savings could be generated through financial restructuring. The Tendring PPP Contract was the only contract to generate a saving to ECC if it was terminated which represented value for money for the Essex tax payer.

3.4 The Contract was entered into in October 2001 and has around 13.5 years left to run, ending in 2033. Under the Contract:

- The Contractor built four new schools and refurbished eight existing schools at a capital cost of £16.6m – all the works were completed by 2004; and

- The Contractor is required to provide building maintenance, grounds maintenance, cleaning and caretaking facilities management (FM) services at a cost of around £0.8m per annum.

3.5 The affected schools are listed in Appendix 1.

3.6 In July 2018, Cabinet decided to enact its right under the Contract to issue a voluntary termination notice to terminate the Contract early for value for money reasons. That notice was issued to the Contractor on 28 September 2018 and a termination date of 28 December 2019 was agreed in accordance with the Contract.

3.7 The termination of the Contract creates a saving to ECC because of the following unique factors:

- The Contract is complex to administer as it involves 12 separate schools and is a relatively low value for PPP/PFI projects.

- The termination provisions in the Contract are less expensive than for other comparable PPP/PFI contracts.

- 100% of the cost is linked to RPI (other projects are typically 50%) and the current RPI outlook for the remainder of the Contract is unfavourable.

- No PFI credits are received from DfE meaning that ECC will not lose any funding from central government if the Contract is terminated.

- The cost of some of the services were reviewed in 2018 and significant cost increases resulted.

- The Contract provisions are inflexible and do not easily allow for modifications of buildings or changes in status of the schools. ECC has to pay project management, legal and funder’s fees if things change.

3.8 Under the Contract, ECC currently pays £3.7m per annum. This sum will increase each year by RPI until 2033 and may be adjusted further at certain points in the Contract when costs are reviewed to reflect changes in the cost of services in the market generally. The costs paid cover the facilities management services provided by the Contractor, the repayment of borrowing undertaken by the Contractor during the construction and a return on investment for the Contractor.

3.9 ECC is liable contractually for the payments under the Contract however ECC's County fund does not currently bear these costs. The costs are paid by:

- A contribution from the dedicated schools grant (DSG) at £2.8m per annum which is comprised of an enhanced budget share in the delegated budget of the 12 schools in the Contract which is subsequently paid back to ECC by those schools;

- Contributions from the 12 schools' budgets of circa £0.8m per annum which broadly reflects the budget for FM which the schools would otherwise receive.

3.10 After the Contract has terminated, these existing funding arrangements will continue as if the Contract had remained in place until its natural conclusion and ECC will use the enhanced budget shares to pay for the cost of prudential borrowing to fund the termination compensation. This is permitted under Schedule 2 of the School and Early Years Finance (England) Regulations 2018. The retained element will be shown in the budget statement for the affected schools. The schools will no longer need to contribute their budget for FM costs.

3.11 The current funding arrangements are set out in a Governing Body Agreement (GBA) which will cease to exist post termination. A letter of memorandum will replace the GBA going forward. As at the date of this report whilst none of the schools have committed in writing to ECC retaining this funding, this is not unexpected given this is the week before the Christmas break. Following extensive engagement, it is expected that all of the schools will commit to the revised arrangements before or shortly after the termination date. If the schools do not agree to the MOU, the enhanced budget share will not be paid to the schools and ECC will seek to enter into an agreement with Schools Forum under a top slice arrangement. With the potential introduction of the hard school national funding formula further consideration will be given to the mechanism to distribute the enhanced budget share under a future revised formula mechanism.

3.12 Should any of the schools convert to an academy in the future, ECC will need to delegate the funding to the Academy and invoice for it.

3.13 Early voluntary termination requires ECC to pay a termination sum calculated in accordance with the Contract to ensure that the Contractor is no worse off than it would have been had the Contract run to its natural end date. The termination sum is still subject to change because it is contingent on the outcome of a number of outstanding matters and receipt of information as set out below:

- ECC and the Contractor are currently adjudicating the value of the discount rate that is to be applied to calculate a portion of the termination sum. The outcome of this adjudication will confirm the adjudicator's view of what discount rate is to be applied in calculating the value of equity compensation payable to AST. If the outcome is not in ECC's favour consideration will be given to whether to formally challenge the adjudicator's decision. At the date of this report, the outcome of the adjudicator has not yet been issued. For this reason, for the purposes of establishing the maximum termination sum that may be payable under the Contract, a discount rate of 11.51% has been applied when calculating the estimated termination sum payable in respect of equity outstanding.

- Two swaps are in place which hedge against interest rate and RPI market movements and both of these will be wound up before the Senior Debt is paid by ECC to the Contractor as part of the termination compensation. ECC's swap advisers, Pegasus Capital, are liaising with the Funder (Dexia) to try to ensure lowest value is achieved at point of termination although ECC has no control over this process. Lowest value will be affected by the liquidity of the interest rate and RPI markets on the day of termination and also any major announcements on the day.

- Negotiations continue with both the Contractor and its sub-contractors in respect of TUPE and potential redundancy costs. Insufficient information has been provided to date to allow the cost to be valued with certainty however, contractually redundancy costs and claims fall to AST. Action may need to be taken after termination of the Contract to recover these costs if they occur.

- Certain elements of the termination sum can only be quantified when the audited Termination Accounts have been issued by the Contractor within 90 days of the date of termination and ECC has undertaken due diligence to verify the accuracy of those accounts.

- Settlements may be agreed between ECC and the Contractor that reduce the termination compensation payable by ECC and reduce the liability of the Contractor in the future. A settlement may be reached, for example, on maintenance issues that are outstanding at the date of termination or on the length of time pursuant to which ECC can claim against the Contractor in the future. These settlements may only be agreed shortly before the date of termination or may not be agreed at all.

Further details of the financial implications of the termination are set out in paragraph 5 of this report. Negotiations continue with the Contractor to ensure that value for money is secured on behalf of the Essex taxpayer.

3.14 A number of options were considered for the provision of facilities maintenance at the schools going forward and it is recommended that, at the point of termination, the 12 schools will be in the same position as other maintained schools. The schools will put in place alternative contracts with effect from the date of termination (e.g. security arrangements). They will also become part of ECC's school capital maintenance programme.

3.15 ECC have assessed the condition of the schools' estate and held the Contractor to account throughout the notice period through to termination to ensure the estate is transferred across to ECC in line with the conditions set out in the Contract. It may however be necessary to claim against the Contractor in the future for any unknown defects or issues that have not been resolved prior to termination.

3.16 Using Treasury Green Book principles the value for money assessment of this Termination on the whole public sector purse gives rise to an estimated discounted saving of at least £5.5m on a worst case basis.

3.17 In addition to the saving, the termination has the following benefits to the twelve schools:

- The schools will have more flexibility in terms of managing their budgets so they will have more freedom to choose FM services.

- They will be able to change buildings to meet teaching requirements without incurring fees to change.

- As with most PFI contracts, the provisions are inflexible and do not easily allow for modifications of buildings or changes in the status of the schools to academies. Such changes attract Project Management fees, together with legal and funder's costs. Contractually, the Authority is in a weak position to control such costs.

3.18 Local Partnerships have updated their value for money assessment as at November 2019. Their view remains that this is a value for money transaction. However, their final report will not be issued until the final termination sum is concluded post the termination accounts.

3 Options

The options are as follows:

3.1 Option 1 – Proceed with the Termination

Option 1 is the recommended option. The value for money assessment of the termination of this Contract identifies that it is value for money for the Contract to be terminated even on a worst-case termination compensation scenario.

Termination of the Contract also provides the schools with more flexibility in terms of how they operate the school site and manage their FM provision. It allows them to make changes to the accommodation and the provision of FM services without incurring excessive costs as a result.

However, the termination is complex due to the nature of the Contract and there may be liability in the future which ECC would need to seek to recover from the Contractor. It is also the case that, at this stage, the final termination compensation is not yet known and may not be known until 3-4 months after termination.

3.2 **Option 2 – Negotiate a withdrawal of the termination**

This option is not recommended as it may not be deliverable and the parties are sufficiently far advanced in the steps that need to be taken before termination such as alternative contracts for the schools and handover of facilities maintenance services and equipment. ECC has already incurred costs in proceeding to this point.

This option is dependant on the Contractor agreeing to the withdrawal of the termination process which is not guaranteed.

Proceeding to remain in the Contract also does not represent value for money or give the schools the flexibility they need.

4 Next steps

4.1 The projected timescale is outlined below:

Milestone Description	Target Date
Cabinet member approval	16 December 2019
End of call in period	20 December 2019
Termination date ("T") and operational handover of schools	28 December 2019
Payment to settle senior debt and swap wind up	T +20 days
Final audited accounts issued	T + up to 90 days
Due diligence of final accounts	Latest April 2020
Final true-up adjustment to termination sum	Latest April 2020

5 Financial implications

5.1 The financial implications are outlined in the Confidential Appendix of this report.

6 Legal implications

6.1 ECC served a notice to terminate the Contract voluntarily and gave notice to terminate the Contract on 28 December 2019.

6.2 The Contract prescribes the procedure on termination including the provisions in the Contract that survive termination. In the event that a deed of termination cannot be agreed with the Contractor in a form that is acceptable to ECC prior to the Termination Date, then the provisions in the Contract that survive termination will govern the liabilities between the parties going forward.

6.3 There are staff employed on the Contract that will transfer to ECC or the relevant Governing Body by virtue of TUPE. ECC need to comply with the relevant legislation if making any changes to their employment terms post transfer.

6.4 The Contract prescribes the costs that are payable by ECC on termination of the Contract. If these cannot be agreed there is a dispute mechanism for challenging and agreeing such costs. Whilst some costs are known at this stage, the final compensation payment will not be known until receipt of the Contractor's audited accounts up to ninety days after the Contract has terminated and therefore the total termination compensation will not be known at the date of termination.

6.5 There are leases and licences to the Contractor that are in place for the relevant schools which will cease on the termination date.

6.6 There has been extensive engagement with the schools about the termination and the process going forward including the enhanced budget share and transferring staff. The schools have not yet committed formally to ECC's retention of the proposed budget share and there is a risk that formal agreement will not be reached.

7 Equality and Diversity implications

7.1 The Public Sector Equality Duty applies to the Council when it makes decisions. The duty requires us to have regard to the need to:

(a) Eliminate unlawful discrimination, harassment and victimisation and other behaviour prohibited by the Act. In summary, the Act makes discrimination etc. on the grounds of a protected characteristic unlawful

(b) Advance equality of opportunity between people who share a protected characteristic and those who do not.

(c) Foster good relations between people who share a protected characteristic and those who do not including tackling prejudice and promoting understanding.

7.2 The protected characteristics are age, disability, gender reassignment, pregnancy and maternity, marriage and civil partnership, race, religion or belief, gender, and sexual orientation. The Act states that 'marriage and civil partnership' is not a relevant protected characteristic for (b) or (c) although it is relevant for (a).

7.3 The equality impact assessment indicates that the proposals in this report will not have a disproportionately adverse impact on any people with a particular characteristic.

8 List of appendices

8.1 List of primary schools covered by the Contract
8.2 Confidential Appendix: Termination Sum and funding of termination
8.3 Equality Impact Assessment

9 List of Background papers

9.1 None.

I approve the above recommendations set out above for the reasons set out in the report. Councillor Finch, Leader of the Council	Date

In consultation with:

Role	**Date**
Councillor Gooding, Cabinet Member for Education and Skills	17.12.19
Director, Education **Clare Kershaw**	17.12.19
Executive Director for Finance and Technology (s151 Officer) **Stephanie Mitchener on behalf of Nicole Wood**	17.12.19
Director, Legal and Assurance (Monitoring Officer) **Katie Bray on behalf of Paul Turner**	17.12.19

Appendix 1
List of Primary Schools in the Contract

Boxted Primary
Bradfield Primary
Engaines Primary
Frinton Primary
Gt Bentley Primary
Harwich Primary
Highfields Primary
Oakwood Infants
St George's Primary
Tendring Primary
Two Village Primary
Wix Primary