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| Cabinet Member for Strategic Planning and Transport and Cabinet Member for Finance and Resources | Ref No. SPT05(09/10) |
| Street Lighting PFI – Selection of Preferred Bidder and Commercial and Financial Close | |
| July 2009 | Key Decision: Yes |
| | Part I |
| Report by Executive Director - Customers and Communities and Director Finance | Electoral Divisions: All |

Executive Summary

The County Council is procuring the substantial replacement of most of its street lighting stock through a Private Finance Initiative (PFI) together with Hampshire County Council and Southampton City Council. A bid for PFI investment in street lighting was approved by the Department for Transport (DfT) in January 2008. As the project involves joint procurement with Hampshire and Southampton ("South Coast" PFI) decisions taken need to reflect a partnership approach.

The PFI covers the investment, maintenance and operation of street lighting over 25 years. This report details the key components of the final specification and outlines the final stages of the joint procurement process including the selection of a single Preferred Bidder and the subsequent work leading to "Commercial and Financial Close" of separate contracts for each Council.

Following extensive negotiation with both bidders, it is expected that bids will meet or exceed the Council's technical requirements. The specification demands that new lighting will make use of more energy efficient technology which, along with continued use of part night lighting and further use of cutting edge dimming technology, will result in at least an energy neutral solution. The key challenge now is to ensure the bids do not exceed the affordability threshold.

Recommendation

As both the specification and the affordability threshold have been agreed by Members, subject to further consultation when the bids have been evaluated, it is recommended that the Cabinet Members for Strategic Planning and Transport and for Finance and Resources, delegate authority to the Executive Director - Customers and Communities and the Finance Director to finalise the terms, select the Preferred Bidder and let the contract, subject to:

- (i) The service offered meeting the Council's requirements as set out in the final specification; and
- (ii) The service offered being within the available budget of £7.5m per annum as set out in this report.

1. Background

- 1.1 The PFI procurement approach is based on funding a 25 year contract with capital investment to replace all street lighting columns, illuminated signs

and bollards currently over 15 years old during the first 5 years of that contract period, and revenue support for maintenance to keep the service performing to the required standard. The Service Provider will also have an obligation to hand back lighting columns at the end of the 25 year contract with a residual life of at least 5 years. The procurement process is being run jointly with Hampshire County Council and Southampton City Council. The outcome of the procurement will be the selection of a single Service Provider with separate and discrete contracts for each Council.

- 1.2 In December 2007 the Cabinet Members for Highways and Transport and Finance and Resources approved the following:
 - The procurement budget;
 - The full commitment of existing street lighting revenue budgets for the duration of the contract term;
 - The funding of the base case affordability gap for the duration of the contract term;
 - The commencement of the competitive dialogue stage of the procurement process through to selection of preferred bidder; and
 - The Council entering into a joint working agreement with Hampshire County Council and Southampton City Council.

- 1.3 Approval was granted by DfT in January 2008 to permit the formal procurement to proceed. In March 2008 the Cabinet Members for Highways and Transport and Finance and Resources approved the following:
 - The procurement process;
 - The intention to define the objective of achieving three separate but near identical contracts with the same service provider;
 - The provision of dimming facilities for part of the night-time lighting period subject to trials and detailed specifications of requirements; and
 - That the determination of the evaluation framework for assessing bids during the procurement be delegated to the Executive Director - Customers and Communities in consultation with the Cabinet Members.

- 1.4 The procurement has taken longer than anticipated for a number of reasons, including, significantly, the following:
 - A delay in the approval of the Outline Business Case by DfT;
 - The Competitive Dialogue procedure which demands that the Contracting Authorities have identified a solution capable of meeting its needs which is sufficiently developed not to require further negotiation before the Call for Final Tender (CFT) is issued;
 - The complexity of a 3 Council procurement which has not been attempted before on a street lighting PFI project;
 - Emerging carbon efficiency legislation requiring some changes to the specification;
 - Bidders taking longer than anticipated to understand and respond to our requirements; and
 - Delay in the approval of derogations from standard form contracts by Partnerships UK (PUK).

2. Service Specification

- 2.1 The procurement has been steered by a Joint Project Board overseen by a Members' Task Force consisting of Cabinet Members from each authority. In West Sussex, both the Cabinet and Strategic Environmental Services Select Committee have been briefed regularly on progress. The final specification on which the CFT was issued therefore reflects the key objectives set by the Council for the procurement.
- 2.2 Through negotiation we have arrived at a position with both bidders that all residential road lighting will be excellent quality "white" light, while traffic routes will be lit with good quality "yellow" appearance light. All Low Pressure Sodium, poor quality "orange" light will be replaced. The reason for this position is because of predicted relative increase in both maintenance costs and energy consumption if white light is specified for traffic routes. Design principles for the two categories are different and the European codes allow relaxations in the requirements for residential roads that are not allowed for traffic routes with the result that the currently less efficient "white" light sources are less attractive on traffic routes. Of our current inventory of 67,500 street lights, it is intended that 80% will be replaced and by the end of the Core Investment Period 49,550 (73%) will be white light units.
- 2.3 A major concern for Members has been to seek to achieve energy efficiency. To achieve the reduction in the significantly increased energy consumption that was originally predicted, the bidders have been instructed to design their proposals to only increase lighting levels in accordance with the Output Specification in those areas susceptible to crime above the UK average, on major traffic routes and in town centres. Bidders have been instructed to submit bids which will deliver at least an energy neutral solution. In addition as noted in 2.2 above, bidders will offer technical lighting solutions that provide whiter light to give better face and colour recognition and improve the feeling of safety.
- 2.4. Bidders have also been instructed to provide apparatus that has the ability to dim or adjust lighting levels and lighting times. Current arrangements for part night lighting in low traffic density areas will continue. This project has given the County Council an increased opportunity to reduce the energy required for lighting without impacting residents' night time use of the outside environment.
- 2.5 An assumption in the model is that it is unlikely that the requirement for lighting levels will remain unchanged for the 25 years of the contract and although there has been little demand for some of the technologies required to achieve some of the Council's aspirations, there is flexibility in the contract, if West Sussex County Council so wishes, to introduce new technologies as soon they are fully tested and proven, although this would be at additional cost.

3. Sustainability Strategy

- 3.1 Many of the challenges of emerging Government policy on carbon reduction and carbon trading were already County Council priorities and therefore had been incorporated in the West Sussex County Council element of the specification. The aim of the West Sussex County Council approach to

sustainability within the PFI scheme is primarily towards improving safety while achieving at least an energy neutral outcome (improved standards, with more columns but no overall increase in energy consumption). Through the setting of requirements and negotiations of detailed technical proposals with bidders, this aim is on track to be achieved. The PFI contract makes provision for continued use of part night lighting in accordance with current policy and local views expressed through District, Borough and Parish Councils.

- 3.2 The columns removed will be the Provider's responsibility but part of the evaluation of the bidders' solutions will be on sustainability issues. Most column materials are recyclable with metals being melted down for reuse and concrete being broken up for road base.

4. Parishes and Districts Consultation

- 4.1 Parishes and Districts have been kept fully informed of the specifications as they developed and their views have been incorporated in negotiations with the bidders. Likely costs have been communicated to the parishes and these figures will be refined when bidders' final submissions have been received. Costs to the parishes are unlikely to show any more than a marginal increase over the original estimates.

5. Client Management

- 5.1 PFI contracts are complex. A high volume of investment will take place in the first five years of the contract period. After that there is a 20 year maintenance regime. Throughout the contract period there are well defined Performance Standards to be achieved with a predominantly financial remedy for any performance failure in the form of a reduced payment to the Service Provider. Other remedies exist for more serious failures to achieve contract compliance.
- 5.2. Monitoring and supervision of the PFI contract therefore requires an effective Client Management team. The size and balance of skills has been examined and it has been determined that the contract can be effectively monitored by the existing street lighting team. There will therefore be no requirement to transfer West Sussex County Council staff to the Service Provider. West Sussex will continue to work with Hampshire and Southampton to explore all options to keep client costs to a minimum.

6. Resource Implications and Value for Money

- 6.1 In deciding to proceed down this procurement route, other sources of funding were investigated. In the current financial climate, the PFI is the only way of accessing Government funding to replace a deteriorating street lighting stock. For this service no other funding option is cost effective for the County Council in comparison to PFI although both bidders have been asked to submit proposals should the financial market not be providing value for money at the time the Councils are ready to proceed to Financial Close.
- 6.2 PFI credits of £225m have been allocated to the project with West Sussex County Council's share being £87m. DfT have declared themselves content

for specific Council allocations to be redistributed if necessary within the ceiling of £225m. These will translate into a grant payment that will cover the capital costs of the contract.

- 6.3 In terms of the revenue budget, in December 2007 the Cabinet Members approved various parameters for the procurement to proceed. This included a commitment to maintain the base budget of £4.8m per annum at 2009/2010 prices for the 25 year duration of the contract term. As a result of the exceptional rise in energy prices additional budget has been allocated and the comparative budget in 2009/2010 is £5.9m. Members also approved the funding of the base case net affordability gap of up to £1.6m per annum at 2009/2010 prices. This gives a total of £7.5m per annum available to meet the ongoing costs of the PFI contract including energy. £0.6m of that additional amount is already included in the 2009/2010 base budget, because the service is expected to commence early next calendar year. The remaining funding is identified in the Medium Term Financial Strategy.
- 6.4 In view of the volatility of energy prices, market movement risk will stay with the Council and could result in additional costs over time.
- 6.5 Both bidders have been provided with the Council's affordability parameters and the amount of Government grant available. The procedure should one or both bids be submitted which are outside the affordability limits of the 3 Councils is set out below (see paragraph 9.3).
- 6.6 The delays during procurement have resulted in additional external advice requirements leading to some increase in costs for specialist financial, legal and technical services. Between 2008-2009 and 2009-2010, overall costs are expected to total £630k for West Sussex County Council. This is £130k above the original estimated and this will be found from within existing levels of budget provision in the Strategic Planning and Transport portfolio.

7. The Procurement Process and Timetable

- 7.1 The procurement is being conducted under EU Competitive Dialogue rules. The rules are prescriptive but the key characteristic is that all substantive points of principle must be resolved with both bidders before CFT. This is intended to avoid changes in scope or price after the preferred bidder is selected and while genuine competition still exists. The EU rules protect the client but also represent additional resources in negotiating contract terms with several bidders who may have a different approach to contract delivery, price and risk allocation.
- 7.2 Two interim bids were submitted in August 2008 as part of the iterative process. Subsequent negotiations under the EU process have led to the Councils reaching agreed technical, financial and legal positions with both bidders. An interim Final Business Case (FBC) and an initial list of derogations from standard form contracts were submitted for approval to DfT and PUK in February 2009. Following further negotiations, the list was finalised in mid May and approval having been received, the Councils issued a CFT on 12 June with responses due on 17 July. Both bidders have submitted proposals and a joint evaluation of bids is being conducted. It is anticipated that a Preferred Bidder will be selected during the week

commencing 17 August. A Final Business Case will then be submitted to the DfT who will confirm its funding approval and PUK will confirm that any derogations from previously established legal provisions in the contract are acceptable. The main approval criteria are achievement of the economic case, that the funding requirement does not exceed the amount of grant awarded, that the scheme provides value for money for the Councils and is deliverable and close to the standard form of PFI contract and risk transfer. Approval of the FBC will allow the Councils to confirm the selection of a Preferred Bidder and proceed to Commercial and Financial Close, which effectively is the letting of the 25 year contract.

- 7.3 Commercial confidentiality is a critical dimension of this procurement process, which is considerably more complex than conventional procurement, even of major contracts, due to the nature of PFI contracts and particularly joint procurement across three Councils. However, the selection of a Preferred Bidder following CFT under the Competitive Dialogue procedure is relatively straightforward. Therefore, it is proposed that if the conclusions and recommendations of this decision report are accepted by Cabinet Members that the Executive Director - Customers and Communities and the Finance Director, in consultation with the Cabinet Members for Finance and Resources and Strategic Planning and Transport, be given delegated powers to select a Preferred Bidder and let a contract within the parameters of affordability and service specification previously agreed by the Joint Members Task Force. If those parameters are not met, the Directors will refer the matter back to the relevant Cabinet Members for formal decision.
- 7.4 It is hoped that Commercial and Financial Close can be achieved by the beginning of November 2009. Thereafter a mobilisation period for new provider will precede a service commencement date early in the new year. This represents a challenging programme and it is impossible to rule out the chance of slippage. The scope for other delays due to events in the current financial markets is also very real, but impossible to quantify at this stage. However the timetable is being actively managed and the delegation arrangements provide some flexibility if this becomes necessary.

8. Joint Procurement

- 8.1. The entire procurement process has been a collaboration between Hampshire County Council, Southampton City Council and West Sussex County Council. Governance protocols have been put in place to facilitate these arrangements.
- 8.2. Cost savings have been achieved through the joint commissioning of external legal, financial, technical and insurance advisers and there have also been savings for the private sector bidders. However there have been additional costs accrued due to the extended timescale required to achieve full agreement within all three Authorities in areas such as specifications and degree of risk transfer. The overall value of the economies of scale is still being assessed based on the bids received.

9. Evaluation

- 9.1 The Joint Member Task Force has taken the view that the balance between price and quality scoring should remain at 30:70 and the detailed evaluation framework (amended to fit the final tender stage of the process) developed for earlier stages of the procurement be carried forward to evaluate the responses to CFT. The evaluation will be carried out jointly and scored on an overall project basis.
- 9.2 The selection of the Preferred Bidder must be based upon robust and transparent criteria. The detailed evaluation methodology and criteria were shared with the bidders in January 2009 in order that they have sufficient time to develop their bid strategy.
- 9.3 Where both Bidders submit affordable Standard Bids then the Bidder with the highest evaluation score will be selected. In the event that only one bid is affordable, both bids will still be evaluated and if the affordable bid meets the Councils' requirements, that bidder will be selected as Preferred Bidder. Should both bidders submit unaffordable bids, the Councils reserve the right to proceed with negotiating affordable solutions under the flexibility permitted under the Public Contracts Regulations 2006. Further formal Cabinet Member decisions would be required for West Sussex to proceed on that basis.

10. Risk Management

10.1 Procurement Risk

The currently assessed most significant risks associated with the joint PFI procurement have been identified as:

- a. Both bidders submit unaffordable bids
Detailed discussions and negotiation over many months, and the sharing of the affordability parameters with bidders has mitigated this risk as far as possible.
- b. Bidder(s) fail to secure funding
The events of the past months in the world's financial markets have made this risk more acute. However, with the maturity of the street lighting market and the relatively low risk of local authority PFIs, both bidders are confident that their banks will be able to support the project.
- c. The Preferred Bidder's funding terms change significantly
At contract signature the Service Provider will secure a loan to finance its investment programme at a fixed interest rate. Potential funders will bid their financial terms to inform the CFT price. The rates offered are normally held firm for a fixed period, but in times of market volatility there is a risk that rates offered at CFT will expire before contract signature and need to be re-submitted. In either case the Council may be exposed to risk of an interest rate increase (or decrease).

10.2 Risk Transfer

Under PFI schemes the risk of scheme design, installation, maintenance and cost overruns is retained by the Service Provider. However, some price risks remain with the Councils because the Service Provider cannot manage or price these for over 25 years. In particular the Council will be responsible for cost inflation in line with the Retail Price Index (RPI) in respect of operational costs. Typically this element is about 50% of the overall price. The Councils will also be responsible for energy price risk. The Service Provider will accept consumption risk based on the apparatus installed but cannot predict energy price volatility. The Councils will remain responsible for procuring energy. Additions to the assets (such as for new housing estate developments), variations from the contractors standard components or variations by the Councils to the lighting standard will all fall to the Councils (or third parties such as the developers). Standard rates will be specified to cover service changes which can be anticipated and evaluated, but some events or changes will need to be negotiated with the contractor. Where a contractor is not the local electricity Distribution Network Operator (DNO), contractors cannot guarantee speed of repair standards which require an electrical repair because this is outside their control. Although a national protocol for DNOs has recently been established, there is no sanction if the operator does not comply. The risk is that during the investment period, both the new and old columns may remain in place for a period awaiting connection. This risk remains with the Service Provider though, subject to caps on the deductions that can be applied. During the maintenance only part of the contract, a light remains out until repaired. Unless a waiving of performance standards is allowed in these circumstances, anticipated penalty charges are likely to be built into the contract price. However, this pricing risk must be weighed against the perception of poor performance going unpenalised and the possibility that pressure for change on regulators and the industry will result.

11. Customer Focus Appraisal

A Customer Focus Appraisal was carried out in March 2008 and a copy is attached

12. Crime and Disorder Act Implications

The successful implementation of the PFI project is expected to bring benefits in terms of reductions in crime and the fear of crime.

13. Human Rights Act Implications

Not applicable

14. Conclusions

14.1 The street lighting PFI procurement is in its final stages with two credible and deliverable bids likely to be received.

14.2 The challenge of emerging Government policy on carbon reduction and carbon trading has been addressed by changes to the service specification without affecting the overall integrity of the scheme.

- 14.3 The bids received at the Detailed Submission stage as clarified through the Competitive Dialogue process give confidence that the major procurement can be completed within the financial limits previously set by the Cabinet and within the PFI credits available.

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Background Papers: Customer Focus Appraisal

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