The private finance initiative: a guide for Fire and Rescue Authorities
The Guide

This guide has been written specifically for Fire and Rescue Authorities (FRAs) as an introduction to the Private Finance Initiative (PFI). It aims to give an insight into what these arrangements involve and some of the issues relating to this form of procurement. It should help stakeholders and those new to PFI to understand what is involved.

PFI has been used already by a number of FRAs to deliver a range of projects including:

- The building and maintenance of new fire stations
- The building of training facilities and the provision of facilities management services including maintenance, cleaning, catering, janitorial and training services
- The procurement of a vehicle fleet and equipment and the management of this specialist equipment
- The building and maintenance of a community safety centre
- The building and maintenance of community safety shops
- Refurbishment and management of existing accommodation including fire stations, headquarters, workshops, training departments and control room functions.

The guide is intended to be an introduction to the basics of PFI. If you have more detailed questions there are some further contact points and sources of information listed at the end of this guide.

Introduction

PFI is a method of procurement by which partnerships can be developed between the public and private sectors. These initiatives can deliver various projects, including the design and development of new assets, the refurbishment of existing assets as well as the provision of associated services, such as repairs and maintenance.

Each PFI project is different depending on local circumstances. However there are some common threads, which run through all projects, which are described below.

- A PFI contract with a private sector partner (PSP) will typically last around 25 to 30 years. It is unlikely to achieve value for money if the operational period is less than 25 years.
- The authority will devise an ‘output specification’ which sets out what the PSP is expected to achieve in delivering services through the assets.
- The PSP is paid a fixed amount over the course of the contract and on an availability and performance basis. This is known as the unitary charge or unitary payment.
• If the PSP fails to meet any of the agreed standards it will lose an element of its payments until standards are improved.

• If the PSP does not perform the public sector can ultimately terminate the contract.

Some of the benefits of using PFI include:

• Experience to date has shown that where PFI has provided a service, the FRA has the assurance of knowing that the assets and services will be provided to agreed standards for the life of the contract.

• As a FRA does not make a payment until the service commences, the PSP has an incentive to finish construction on time.

• A FRA can benefit from the commercial, financial and technical expertise of the PSP.

• Risks can be allocated to those best able to manage them.

• PFI contracts will specify that the building or equipment must be returned to the Fire and Rescue Authority in prime condition.

Some cautionary notes about PFI are:

• A PFI project involves significant financial complexity and will require the procuring bodies to appoint financial and legal advisers to complete the transaction. Projects need to be above a capital value of £20 million to qualify for central government support. This is because government views this as the minimum level at which projects will be attractive to the market and achieve best value for money. FRAs may need to consider taking forward joint projects with others in order to achieve this level of capital value.

• PFI procurement costs are likely to be more expensive than conventional procurement costs. There are a number of reasons for this, including the fact that everything is resolved up-front before contracts are signed, contracts include service and maintenance over the 25 to 30 years of the projects life etc. PFI is unsuitable for projects where the provision of facilities and services does not involve substantial capital assets.

• PFI should only be pursued where it offers genuine value for money and not pursued because of affordability considerations. An options appraisal will be required to demonstrate PFI is the most appropriate procurement route.

What is a PFI contract?

The standard template of a PFI contract is an agreement whereby a PSP (or SPV - see below) provides an asset for the public sector in the first few years of the contract. Thereafter the SPV provides the necessary services to maintain and operate the asset at an agreed level for the remainder of the contract, together with
any additional services that may be required. In return for this the PSP receives a fixed level of payment, linked to its performance in meeting agreed standards of provision. Funding to assist with the capital element for these projects is given by central government in the form of what are known as ‘PFI credits’.

In order to bid for the work the PSPs generally form consortia. To provide the asset required by the contract they will borrow the necessary capital from a funding provider and pay off the debt over the majority of the contract life. In doing so they are dependent on the income from the contract to fund the debt and interest payments. The consortia will also put a percentage of equity funding into the project. It is therefore in their interests to ensure that they do not incur financial penalties and maintain the contract standards.

What are PFI Credits?

PFI credits are allocated to projects by government departments, in this case Communities and Local Government (CLG). These assist with the capital costs of the project. The credits provide Revenue Grant Support to FRAs from CLG for the length of the contract.

How will Fire and Rescue Authorities manage the process?

Effective management is crucial to the successful delivery of a PFI procurement. Effective management structures need to be in place to control the process, to ensure that timetables are kept to and to ensure that decisions are taken on time.

4ps Fire and Police Procurement provides detailed guidance and model documentation for the preparation and procurement stages of the project. The pack includes examples of management structures and the roles of offices, members, stakeholders and advisors. CLG also provides transactor support to advise on resourcing and management structures as well as overall project support at each stage.

Typical management structures for PFI projects include some or all of the following:

- A **project board** or **steering group**, usually comprising the **senior budget holder** and **senior user**, with authority to sign off the project at each key stage.

- A **project sponsor** who knows the business and can make decisions about the project.

- A **project manager** to steer the procurement process and ensure everything is done within budget and on time.

- A **project team** of people with the skills to take the project forward (including lead/financial, technical, legal and insurance advisers).

What is the private sector's role?
The PSP is frequently a commercial organisation known as a Special Purpose Vehicle (SPV). This is a group of companies that have joined together to form a single organisation specifically for the purposes of bidding for a PFI contract. Essentially it is a shell organisation designed to fund the contract. Depending on what is included in the contract the SPV is likely to include:

- equity provider
- a contractor or builder
- a facilities management provider.

In most cases the SPV will be asked to design, build, finance, operate, and maintain existing or new fire and rescue service facilities.

Some PSPs may fund projects on their own balance sheet - in other words provide the funding themselves. However, more often, bidders use project finance from banks and other financial institutions to fund PFI contracts. During the selection process they will need to provide detailed financial models showing how, among other things, they intend to fund a project over the lifetime of the deal.

The procurement process

PFI procurement will be according to the EU's Competitive Dialogue process. It normally takes between 18 and 24 months from advertisement to contract award. Typical PFI procurements will go through the following processes:

1. **Planning**
   - Establish business need
   - Decide whether the project is suitable for PFI
   - Respond to CLG request for Bids to go on the FRS PFI Programme
   - Decide whether the project is affordable and likely to provide value for money
   - Submit an Expression of Interest document to CLG

2. **Outline Business Case**
   - If successful, develop an Outline Business Case (OBC)
   - Test market interest
   - Submit OBC to CLG for Ministerial approval and PRG endorsement
   - Obtain approval to proceed
   - Advertise in the Official Journal of the European Union OJEU

3. **Advertising**
   - Send out pre-qualification questionnaire to companies that respond to OJEU advert
   - Evaluate responses
   - Draw up a short list of bidders
   - Send out Invitation to Participate in Dialogue to shortlisted firms
Invitation to dialogue

- Clarification meetings with bidders
- Issue Invitation to Submit Outline Solutions (ISOS) from bidders

ISOS

- Evaluation, clarification and dialogue on submissions
- Shortlist for Invitation to Submit Detailed Solutions (ISDS)

ISDS

- Evaluation, clarification and dialogue on submissions
- If necessary, issue Invitation to Submit Refined Solutions

ISRS

- Evaluation, clarification and dialogue on detailed bids

Final Offers

- Consider readiness to close dialogue
- Close dialogue and call for final offers

Preferred Bidder

- Final offer submitted and evaluated
- Preferred bidder selected

Final Business Case

- Business case to CLG
- Ensure the project is still affordable, compatible with SoPC etc

Contract

- Contractual close
- Financial close
• Mobilisation. There will normally be a period of one, two or three years whilst new facilities are created
• Commencement of service provision

The above structure needs to be tailored on an individual project basis for timetable assumptions based on the size and complexity or project. Competitive dialogue will not be closed and final offers requested until the Authority is satisfied that those bids are capable of achieving Contract Award/Financial Close on the basis of the developed proposals. It follows that the final offer timescale will be short and should not contain new proposals.
What does a PFI contract contain?

The contract document – known as the project agreement – will consist of three main parts; the output specification, the payment mechanism and the contract terms.

- **The output specification** – This sets out what is expected of the SPV. It is written in terms of outputs or outcomes. This means specifying what the authority expect to see as the result of this project rather than how it expects that result to be achieved. This allows the PSP to bring innovative ways of thinking and working into the project.

- **Payment mechanism**– This has two main elements to it: availability standards and performance standards.
  
  - availability standards - these define when the asset is considered 'available for use'.
  
  - performance standards - these relate to any standards not covered by the availability standards, in general the service and maintenance standards.

- **Contract terms** – This contains the legal framework for the contract drawn up between the SPV and the FRA. HM Treasury issues guidance and model contract conditions which must be adhered to in drafting PFI contracts.

How does the Department decide which projects should be taken forward?

CLG issues criteria when bids are invited to go on the FRS PFI programme. In addition all local authority projects are reviewed by HM Treasury’s Project Review Group (PRG) at the OBC stage. The PRG also have criteria which need to be met based around bankability, affordability and risk allocation. CLG will compare different bids from various Fire Authorities against the criteria, some of which will be linked to the modernisation of the Fire and Rescue Service. In addition CLG will need to take account of the number of PFI credits available to support schemes.

In addition authorities are required to look at the most economic, effective and efficient means of service delivery and PFI is just one approach to procuring services. Authorities’ bids should therefore explain why PFI funding provides the best value option, for funding this project and the other options considered. It is recommended that Authorities use Treasury’s Value for Money guidance, which can be found on their website [www.hm-treasury.gov.uk/ppp_index.htm](http://www.hm-treasury.gov.uk/ppp_index.htm)

How is the service paid for?

The FRA will pay a yearly ‘unitary charge’ to the SPV. The charge will be based on the availability and performance of the facilities and associated services, and deductions will be made for non-availability or poor performance.
• **Availability** relates mainly to the physical condition of the assets. Availability standards are defined at the beginning of the PFI process. An example of this might be ‘appliance bay doors must be functional at all times’. Failure to ensure this would lead to the authority being unable to provide its statutory duty and the fire station would be considered ‘unavailable’. If the asset or assets do not meet these standards then the SPV forfeits an element of the unitary charge relating to the asset or assets until the standards are met.

• **Performance** relates to how well the SPV carries out the services it is responsible for. A performance standard could be, ‘98 per cent of requests for emergency repairs to equipment must be answered in 12 hours to receive full payment’. If the SPV only answers 96 per cent of the emergency requests within 12 hours during a given time period then a certain percentage of its payment for that month would be deducted. There is usually a mechanism to increase the penalties if the standards continue to be below the requirement.

The payment mechanism will be structured to ensure value for money by reflecting the allocation of risks, and will be based on agreed standards and deductions.

**Allocation of risks**

All projects involve risk. It is the allocation of risks to the party **best able to manage them**, which allows innovative solutions in PFI deals and helps deliver value for money.

The PSP will be asked to be responsible for those risks that they are best placed to manage. They will not, for example, be asked to decide how many fire stations are needed – this is a decision for the FRA, but they will be responsible for ensuring that the agreed number are available to the required condition when needed.

At an early stage in the procurement the SPV will be provided with an indication of the likely risks and asked to confirm their willingness to accept significant risk transfer. Negotiations will normally focus on whether the proposed allocation of risks produces the best value.

**Who monitors the contract?**

The Fire Authority and the SPV will both need to monitor the level of service performance. Exactly who does what needs to be made completely clear from the outset and laid down in the contract details, including how any disputes should be dealt with.

**What happens at the end of the contract term?**

It all depends on the particular circumstances and the authority’s requirements but the options will be contained in the contract. In most cases the property reverts back to the FRA responsibility. There are provisions in place in the standard PFI contract to ensure that the asset is handed back to the FRA to an agreed standard.
Further information

Questions about the use of PFI in the Fire and Rescue Services should be directed to:

David Green for PFI projects for the Fire and Rescue Authorities at CLG.
Fire Service Improvement Team
Communities and Local Government
1/F2 Ashdown House
123 Victoria Street
London
SW1E 6DE

Tel: 020 7944 4523

In addition the FRS PFI Programme Transactor, Alan Burnett can offer advice on 07922 883120

www.communities.gov.uk/fire/runningfire/privatefinanceinitiative

The Private Finance Unit at HM Treasury is responsible for Government policy on PFI/PPP and can supply information on the subject. Contact details are:

Private Finance Unit
HM Treasury
1 Horse Guards Rd
London
SW1A 2HQ

Tel: 020 7270 4558
http://www.hm-treasury.gov.uk/ppp_index.htm

For general guidance on PFI in local authorities, contact:

4ps (Public Private Partnerships Programme)
Layden House
76-86 Turnmill Street
London
EC1M 5LG

Switchboard 020 7296 6777
www.4ps.gov.uk

The 4ps also publish a Procurement Pack on PFI for both Fire and Police PFI projects which provides extensive guidance and model documentation.

Glossary of terms

1. **FRA** – Fire and Rescue Authorities
2. **ISOS** – Invitation to Submit Outline Solutions
3. **ISDS** – Invitation to Submit Detailed Solutions
4. **ISRS** – Invitation to Submit Refined Solutions
5. **OBC** – Outline Business Case
6. **CLG** – Communities and Local Government
7. **PFI** – Private Finance Initiative is a procurement mechanism by which the public sector contracts to purchase quality services on a long term basis from the private sector so as to take advantage of private sector management skills.
8. **PPP** – Public Private Partnerships bring public and private sectors together in long term partnership for mutual benefit. The PPP label covers a wide range of different types of partnership including the Private Finance Initiative, the introduction of private sector ownership into state-owned businesses and selling Government services into wider markets.
10. **PSP** – Private Sector Partner.
11. **RSG** – Revenue Support Grant.
12. **SPV** – Special Purpose Vehicle. This is a group of companies that have joined together to form a single organisation for the purposes of bidding for a PFI contract.
13. **Value for money**: The Government’s procurement policy is that all public procurement of goods and services, including works, is to be based on best value for money – the optimum combination of whole life cost and quality to meet the requirement.