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| **Report To:** | **SCHOOLS FORUM** |
| **Date:** | 23 October 2018 |
| **Reporting Officer:** | Tom Wilkinson – Assistant Director Finance |
| **Subject:** | **TAMESIDE PFI SCHOOLS ACCOUNTING REVIEW** |
| **Report Summary:** | This report provides and update in relation to the review of accounting and charges for the PFI Schools within the Tameside Borough. |
| **Recommendations:** | Members of the Schools Forum are requested to note the contents of the report. |
| **Links to Community Strategy:** | Effectively calculated and targeted resources will improve access to a quality education experience for all our children. |
| **Policy Implications:** | Expenditure is in line with financial and policy framework. |
| **Financial Implications:**<br>**(Authorised by the Section 151 Officer)** | The financial implications are containing within the body of the report at section 3. |
| **Legal Implications:**<br>**(Authorised by the Borough Solicitor)** | The contractual arrangements for the PFI agreements are detailed as to the financial arrangements and there are agreements that sit below that between the schools and the Council as the Council was required to enter into the agreements for the delivery and maintenance of the schools and the liability remains with it. |
| **Risk Management:** | The correct accounting treatment of the Dedicated Schools Grant is a condition of the grant and procedures exist in budget monitoring and the closure of accounts to ensure that this is achieved. These will be subject to regular review. |
| **ACCESS TO INFORMATION** | **NON-CONFIDENTIAL**<br>**This report does not contain information which warrants its consideration in the absence of the Press or members of the public.** |
| **Background Papers** | The background papers relating to this report can be inspected by contacting Christine Mullins – Business Partner:<br>Telephone:0161 342 3216<br>e-mail: christine.mullins@tameside.gov.uk |

## 1. BACKGROUND AND INTRODUCTION

1.1 Tameside Council agreed to undertake a review of the schools Private Finance Initative (PFI) contracts in August 2016. For various reason this review did not go ahead. In December 2017 the Financial Management Team undertook a review of the accounting for the contracts, at the request of schools within the contracts

1.2 PFI was introduced in the 1990's and Local Authorities were pushed down this route if they needed to rebuild or replace existing schools, with other more conventional delivery routes unavailable. The concept of PFI was for the Local Authority to contract with the private sector, with suppliers bidding to design, build, finance and operate the required buildings, and thus ensuring that efficiencies were inherent in the design and operation of the building. It also required the buildings to be maintained to a minimum standard, meaning that they remained fit for purpose and in good condition at the end of the contract, when they were usually handed back to the commissioning local authority. The contracts entered into were typically 25 to 30 years.

1.3 Tameside entered into a number of Schools PFI contracts under two different regimes;

- The Hattersley Scheme, this is an old style contract before the introduction of the Building Schools for the Future programme. This contract is operated by Interserve, and covers 3 schools; Alder High School, Pinfold and Arundale Primary Schools. The contracts were entered into in 2001/2 for a 30 year period.

- Building Schools for Future (BSF) contracts, which formed part of the then Labour Governments school rebuilding programme. These contracts were more sophisticated than the earlier PFIs and required participating local authorities to enter into a strategic partnership with a private sector supplier which was delivered and managed through a Local Education Partnership (LEP). Tameside's LEP partner was Carillion. There were two contracts covering Mossley Hollins High School, St Damian's, Denton Community College, Hyde Community College, White Bridge, Elm Bridge and, Thomas Ashton special school. The first contract was initially put in place in 2010/11 and was for 25 years.

1.4 In addition to the above PFI contracts there is also a Facilities Management Contract only in place with Samuel Laycock and New Charter Academy Schools. The contract is similar to PFI but the original build of these sites were funded by a direct grant.

1.5 The LEP's were a mandatory part of getting funding for a PFI school on BSF contracts. The LEP was a special purpose vehicle that was established to ensure the schools were delivered as per the contract, the Tameside LEP is called Inspired Spaces (Tameside) Ltd, and its shareholders were:

- 80% owned by Carillion – (Now owned by Amber Fund Management)
- 10% owned by TMBC
- 10% owned by BSFi (since sold to INPP – owed by Amber Fund Management)

1.6 The Financial Management team's accounting review of PFI contracts covered a number of areas including, the contractual payments to the LEP, the contributions made by schools, the financial assumptions of the financial modeling to date and the reserve accounts held as part of the operation of the schemes.

1.7 A PFI contract typically operates on a number of funding streams which seek to offset the costs of the contract expected over the life of the contract. The costs of the contract are reflected in the unitary charge (UC), which is a single payment made to the project companies to allow them to finance, build and operate the school buildings. The majority of the charge relates to financing costs (interest and debt repayment) with approximately 40% relating to the operation of the buildings.  This 40% element is uplifted by inflation.

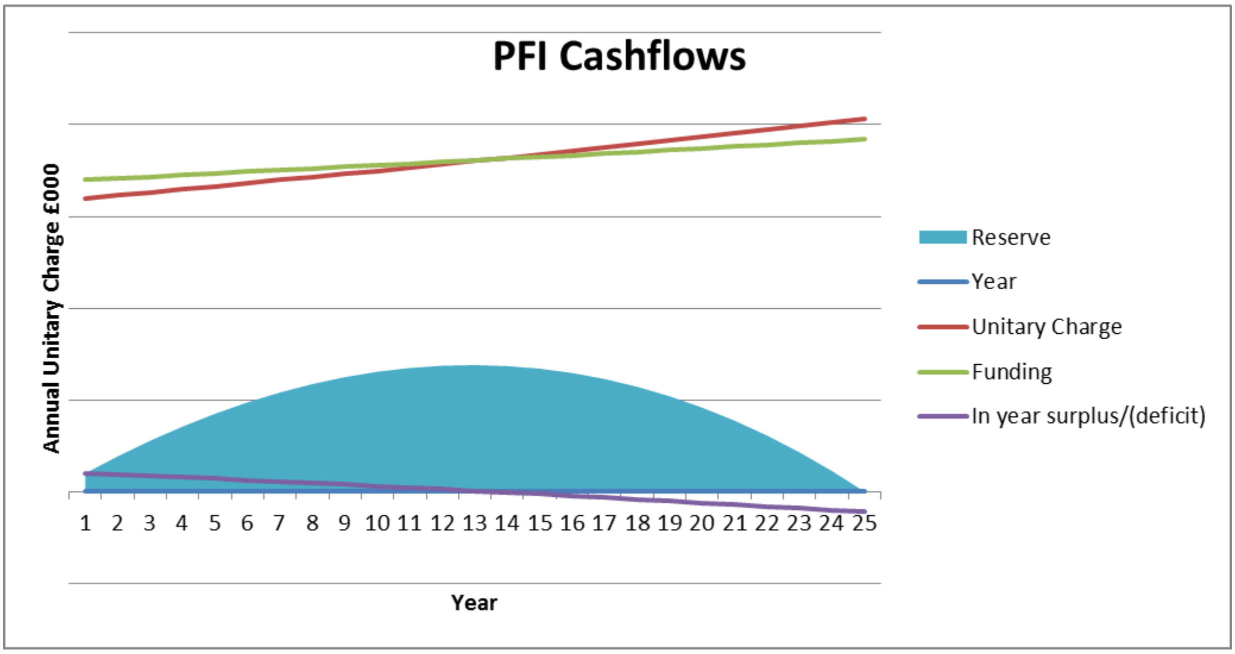
1.8 The unitary charge is funded by a number of income streams;
- PFI credits - fixed grant payment from central government, designed to cover the capital financing costs of the building,
- PFI school contributions, to reflect the operational costs,
- Schools devolved formula capital funding, because schools were fully maintained as part of the PFI contract,
- DSG PFI top slice,
- Schools letting income earned outside school hours
- and interest earned from money held in the PFI reserve.

1.9 All of these income strands are uplifted in line with RPIX with the exception of the grants from government.

1.10 The funding models usually meant that in the earlier years of the contracts, contributions are higher than costs, with the difference paid into a reserve that will take account of inflationary factors in later years that will need to be paid at a later date.

1.11 Due to the long term nature of the contracts, when looking at the financial modeling, there were a number of unknowns that impact on the affordability over the life of the contract. These include; interest received, RPIx, the level of devolved formula capital and the actual amount of lettings that actually take place.  Therefore estimates are made about expected future increases.in financial markets are usually only reasonably reliable in the shorter term i.e. 3 to 5 years ahead.  Chart 1 shows how the cash flows would typically flow over the life of a PFI contract.

**Chart 1 – Typical PFI cash flows**




1.12 The model described above is the model that is operating with Hattersley.  However with the BSF contract, there are some income streams that are not typical of PFI contracts.  In 2012/13 the Council took the opportunity to invest some of the PFI reserve into buying shares in the PFI project companies who operate the BSF schemes.  The investment returns from the ownership of the project companies have been paid back into the PFI reserve, and will continue to do so for the remaining life of the contract.

1.13 As shareholders of the project companies, the council also receives Directors Fees for sitting on the board; these fees are also paid into the PFI reserve.

1.14 The review carried out by Financial Management looked at all of the accounting transactions for the 3 types of contract. It covered all actual financial transactions made against those expected in the financial model, including;

- Checking all historical payments to the service providers
- A review of the RPIx factors in the past and updating those modeling forward.
- Checking the actual lettings to those projected
- Updating the interest actually received against those projected in the model
- The director fees. (BSF model only)
- Investment income received. (BSF model only)
- Review of all the penalty deductions and contract variation notices and charges to schools.
- Other contributions to the reserves.

1.15 The review found that there were some areas of the model that needed to be updated to reflect the actual figures, there had also been some errors in charging schools. The RPIX point has been incorrectly applied in some instances. The PAN for one school needed to be corrected and one school had been incorrectly charged for utility costs which are part of the contract. These corrections have been made and resolved with the schools concerned.

1.16 A large element of the review was in relation to the BSF PFI reserve. When originally modeled, this reserve did not include the Council's share of the income generated from its later investment in the PFI project companies. This investment was taken as a proactive step by the Council, and is not a routine element of PFI schemes. There have been a number of year's returns on this investment and it has realised much higher returns than originally anticipated.

1.17 Without the investment income from the project companies, and the top slice of DSG these schemes would be unaffordable. However, the additional contributions mean that the projections for the level of reserves to the end of the contracts, i.e. in 25 years' time, would have resulted in a significant surplus. The model at financial close was based on a small surplus of £100k being left at the end of the contracts in the reserve for winding up costs.

1.18 The forecast surplus position has meant that some of these balances can be returned to all schools and academies in Tameside.

1.19 The amount given back to schools and academies is £3.5m in relating to years prior to 2018/19. There would also be an in-year rebate of £0.5m. The allocation of this money would be based on the same split as the contributions to the BSF PFI reserve had been and shown in **Appendix A**.

1.20 The split of the all schools element was allocated on a per pupil basis using the numbers as per census data in October 2017. All payments to schools and academies were made by the end of September 2018.

1.21 The Hattersley scheme review has confirmed that the payments by the school are at an appropriate level to afford the contract payments as they currently stand. The review did however uncover some funding that needed to be passed back to schools for penalty deductions. These have now been done.

1.22 The Greater Academy/Samuel Laycock contract has also been reviewed. This contract is different from the other two as the contract covers only the soft and hard FM elements of the contract. The review of contributions by school is again appropriate level.

## 4. INDEPENDENT VERIFICATION

4.1 Clearly it has been a big decision to return funds to schools when the contracts have so long to run, and any mistake or inaccuracy to the modeling could require there being a shortfall on the reserves at the end of the contracts. It has therefore been appropriate to ensure that the review has been robust. In order to give assurance that figures are correct, an independent review of the financial models and verification of our assumptions have been carried out by an external consultant who confirmed the figures to be correct.

## 5. NEXT STEPS

5.1 Since the start of the review there have been some significant changes with regards to the PFI contracts and associated areas. With the collapse of Carillion there is a new contractor, Robertson Group, providing services to the PFI estate.

5.2 A PFI project manager has been appointed by the Investment and Development service, whose role it is to manage the PFI contract on behalf of the council and schools.

5.3 As per the report presented to June 2018 forum a review of the LEP arrangements post July 2019 has been commissioned. The outcome of this may impact on these contracts.

5.4 The Assistant Director of Finance has also commissioned further review into the Hattersley PFI scheme to look to see if any cost efficiencies can be found from within the contract. There is also ongoing work relating to a benchmarking exercise of the Hattersley contract and outstanding contractual payments

5.5 There are 2 separate reviews underway with regard to the Samuel Laycock/Greater Academy. The first is a review of the contract and the cost of the contract which will be cover by the same consultant who are reviewing the LEP arrangements. The second review has been commissioned by the Investment and Development directorate, to look specifically at a condition survey of the equipment on site and to assist in informing an asset replacement, repair programme and lifecycle costs.

5.6 The outcome of these reviews will be fed back where appropriate.

# APPENDIX A

| | Prior Year Rebate | | | On-going Contributions | | | |
|---|---|---|---|---|---|---|---|
| **School** | **2018/19 DSG Contribution** | **% Split of DSG Contribution** | **Previous Years Rebate Due** | **% Split of DSG Contribution** | **Current Charge 2018/19** | **Reduction In Annual Charge** | **Revised Charge 2018/19** |
| Mossley Hollins | £593,280 | 14.93% | -£420,777 | 14.93% | £593,280 | -£64,771 | £528,508 |
| St Damians | £593,280 | 14.93% | -£420,777 | 14.93% | £593,280 | -£64,771 | £528,508 |
| Hyde Community College | £1,035,170 | 26.05% | -£734,184 | 26.05% | £1,035,170 | -£113,014 | £922,156 |
| Thomas Ashton | £208,724 | 5.25% | -£148,035 | 5.25% | £208,724 | -£22,787 | £185,936 |
| WhiteBridge | £331,460 | 8.34% | -£235,084 | 8.34% | £331,460 | -£36,187 | £295,273 |
| Denton CC | £1,144,552 | 28.81% | -£811,762 | 28.81% | £1,144,552 | -£124,956 | £1,019,596 |
| Elmbridge | £66,836 | 1.68% | -£47,403 | 1.68% | £66,836 | -£7,297 | £59,539 |
| **Total PFI Schools DSG** | **£3,973,301** | **80.51%** | **-£2,818,023** | **80.51%** | **£3,973,301** | **-£433,784** | **£3,539,517** |
| DSG Top Slice (All Schools) | £961,561 | 19.49% | -£681,977 | 19.49% | £961,561 | -£104,978 | £856,583 |
| **Total Funding** | **£4,934,862** | **100%** | **-£3,500,000** | **100%** | **£4,934,862** | **-£538,762** | **£4,396,100** |