

Report to:	EXECUTIVE CABINET
Date:	29 July 2020
Executive Member / Reporting Officer:	Councillor Leanne Feeley – Executive Member (Life-Long Learning, Equalities, Culture and Heritage) Tim Bowman Assistant Director, Education Tom Wilkinson Assistant Director, Finance
Subject:	PFI SCHOOLS
Report Summary:	Five PFI built schools in Tameside are currently seeking to convert to Academy Status, three High Schools, Alder, Mossley Hollins and Hyde and two primary schools, Pinfold and Arundale. We have received Academy Orders for all these schools. Tameside has 10 PFI schools in total through 3 separate contracts.
Recommendations:	<p>Board is asked to recommend to Executive Cabinet subject to the Academies/DfE agreeing to indemnify the Council in advance for the external legal costs, which will be incurred for undertaking this process:</p> <ul style="list-style-type: none"> (i) Agree that the Council's no longer has an in-principle objection to the academisation of PFI schools in relation to the absence of an indemnity from the DfE to hold the Council harmless from any costs incurred by the academy(s) that the Council by default is required to make good under the PFI contracts. (ii) Agree that the potential conversion of PFI schools be considered on a school by school basis adopting the due diligence as set out in this report (iii) Note that final decisions on each potential Academy conversion will require an Executive Cabinet decision. (iv) Note that the legal costs of dealing with this matter including those of the Council and any Banks/funders are likely to be between £100 and £150K.
Corporate Plan:	This report supports the starting-well priority of the Corporate Plan, specifically the hope and aspiration objective. It is consistent with the Schools' Strategy agreed by Executive Cabinet in August 2018.
Policy Implications:	These are set out in the report.
Financial Implications: (Authorised by the statutory Section 151 Officer & Chief Finance Officer)	<p>PFI contractual payments are funded in part by delegated budgets to schools, this element of funding will no longer be paid to the Council, but to the Academy Schools directly once they convert.</p> <p>There is a financial risk of Academies not making payment in line with the contractual agreement with the Council. For context the contractual values for the 2020/21 payments made to the council are £5.2m, of this £2.7m is payable by schools proposed to convert to Academy. The amount of payments due over the rest of the contract life is estimated to be £49.9m for the converting schools.</p> <p>To minimise risk of non-payment a robust contract monitoring function needs operate to ensure that any contractual failings on</p>

either side are recorded and dealt with in a timely manner to reduce the likelihood of late payment.

The PFI contract includes penalties for poor performance by the PFI provider and a robust disputes process if there are elements of poor performance. There are also penalty clauses in the contract for late payment of the unitary charge by the Council.

A legal agreement should be in place between the schools concerned and the Local Authority clearly laying out the financial responsibilities of the Academy, the legal agreement between the Academy and the Council should seek to replicate the late payment penalty charges for any late payments from the Academy Trusts which the Council will then charge the trust.

Approval of the proposed accounting treatment should be confirmed with the external auditors prior to the Academy Transfer date.

PFI contracts are complex in their nature and the conversion process will need approval of the main scheme lenders to the holding PFI companies. Such contract novation's can be expensive. It has been agreed that the converting schools will fund these costs from the grant funding they receive to enable academisation.

Legal Implications:

(Authorised by the Borough Solicitor)

The legal documentation issued by the DfE seeks to ensure that the Academy is liable for making the payments due to the Council for it to pass on to the PFI provider. In a circumstance when all PFI schools are academies, the Council would act as an intermediary between the academy and the PFI company and ultimately guarantor.

To date the Council's position has been that in order to consent to any PFI conversion the Council are held harmless/indemnified for (a) the legal costs to the conversion process and the Council insist that these be met by the converting schools and (b) all liabilities under the contract caused by the default of the school by the DfE on the basis that Academies and MATs generally have limited Funds to the extent of grant monies provided by the DfE whereas the liability under the PFI agreements extend to tens of millions of pounds.

A number of residual risks remain with the Council in its liability to pay the PFI provider, its reliance on the continued income in the form of PFI credits, the DSG regulations allowing the top slice and collection of the academy's contribution. This has not been a problem with those PFI schools that have converted elsewhere, but some residual risk remains. The likelihood of these materialising are low. However, in light of the Council's position and the residual liability, the Council's external auditor previously raised this as a risk in its annual report dated 28 August 2013 and received by the September 2013 Audit Panel. Consequently, the Council agreed that it would only agree to circumstances where it was provided with a DfE indemnity. The DfE do not agree to provide an indemnity but advise that in the 7 years since the Council's external Auditors made their recommendation, they have given greater comfort to Local Authorities in their standard documentation.

Tameside Council has no objections in principle to schools becoming academies but cannot subsidise any costs for any works associated with any conversions, particularly PFI's where the costs can be substantial.

Where schools wishing to convert are PFI's the Council needs to ensure that once the schools have converted that the authority has no additional liabilities, cost or risks if the school or the Trust fails to make the payments or is in breach of the contract in any way.

It was agreed that in order to enable the Cabinet to review its current stance in light of the external auditors concerns on record, external legal advice will be obtained on the strength of the DfE's covenants/commitments set out in their standard documentation and the risks that would be retained by the Council. Independent external legal advice was obtained which is set out at **Appendix 3** to this report.

Whilst no decision is risk free the question that members are required to ask themselves is whether the benefits achieved by academisation outweigh those in the event that the Council is required to pick up the financial risks in circumstances where it will not have control.

Members need to consider whether this is an appropriate risk balance and/or share bearing in mind that on an enforced academy by the DfE because school inadequate DfE bear the risk but where the Local Authority looking to support and intervene before inadequate is an outcome, the Council carry the risk for the remainder of the PFI contract some 15 or more years. Before the Council can consider particular proposed academisation it would be beneficial to first agree the Council's policy in relation to the academisation of PFI schools which will largely depend on the council's appetite for risk.

There are a number of risks associated with the conversion of a PFI School to Academy status:

1. The financial risk that the contractual documentation leaves a gap in the amount payable to the Council; and the amount the Council has to pay under the PFI Agreement. Every effort will be made in the documentation governing the academisation to minimise the risk of non-payment by the academies but as with all legal agreements there are can be no 100% guarantee and any mechanism would require dispute resolution requirements etc to be in place which would still mean that the Council could face 'cash flow' issues as such mechanisms take time to conclude.
2. The risk of the Academy not making payments to the Council, for which the Department of Education only offering an assurance rather than in indemnity, which could see the Council exposed to unrecoverable costs as such an assurance is not legally binding;
3. By entering into the Department of Education's documentation, the Council would become contractually obliged not just to the PFI Company for compliance with the PFI Agreement, but also to the Academy to comply with the obligations, effectively adding an additional layer of obligations which could lead to

dispute i.e. the PFI Company might be happy with the Council's performance, but the Academy could argue that it feels the Council is not performing.

4. Whilst the Department of Education's contractual documentation requires the Academy to comply with/not put the Council in breach of the PFI Agreement, the Council would have no control over this and so the Academy could put the Council in breach of the PFI Agreement, without a sufficient or effective indemnity from the Department of Education to deal with such a breach.
5. The Council will also have to ensure that there is a robust contract management process for the PFI contract in order to monitor performance, manage payments and manage any disputes
6. The Council will also have to be aware that the academised PFI schools may also seek to move away from services being delivered under the PFI arrangement which could have consequences for the viability of the arrangement as a whole.
7. Further the Council will also have to be aware of the external audit issues as set out in the financial implications and it would be advisable that the external auditor's advice is sought in relation to each PFI academisation particularly in relation to the impact on the that the transfer may have on the council's overall budgetary position and the outcome of the annual external auditors reports.

Once the council has established its principle or policy in relation to the academisation of PFI's generally then detailed financial due diligence will be required in order that Members can be sighted on the potential financial consequences relating to the academisation.

Due diligence should also be undertaken in relation to any existing contractual and financial issues between the school and the council/PFI contract to establish any existing liabilities.

Members also need to be satisfied that the benefits outweigh any proposed risks namely how the academisation will increase the Council's ability to deliver its schools' strategy, increase our ability to be a credible, effective and trusted partner to schools and the DfE and most importantly support the sustainable improvement of schools in the borough to the benefit of children, young people and their families

Ultimately it will be a policy decision of the Council to accept such risks, or to require further protection from the Department of Education; and should the Council agree to proceed, then individual conversions would have to be carefully scrutinised to ensure that the individual risks associated with different PFI Agreements are managed and risks mitigated and be subject to further Cabinet consideration and decision making.

Risk Management:

These are set out in the report.

Background Information:

The background papers relating to this report can be inspected by contacting Tim Bowman, Assistant Director Education



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1. INTRODUCTION

- 1.1 Five PFI built schools in Tameside are currently seeking to convert to Academy Status, three High Schools, Alder, Mossley Hollins and Hyde and two primary schools, Pinfold and Arundale. We have received Academy Orders for all these schools.
- 1.2 The report sets out the issue in relation to the academisation of these establishments.

2. ACADEMISATION OF PFI SCHOOLS - BACKGROUND

- 2.1 A number of PFI schools have converted to Academy status across the country. To support this the Department for Education (DfE) has produced some standard documentation to aid the novation of contracts and the governing body agreements, to ensure that the PFI contracts and associated payment profiles remain intact. Additional funds are also provided to PFI schools seeking conversion, to mitigate increased legal costs.
- 2.2 To date the Council's position has been that in order to consent to any PFI conversion the Council are held harmless/indemnified for (a) the legal costs to the conversion process and the Council insist that these be met by the converting schools and (b) all liabilities under the contracts caused by the default of the school by the DfE on the basis that Academies and MATs generally have limited Funds to the extent of grant monies provided by the DfE whereas the liability under the PFI agreements extend to tens of millions of pounds.
- 2.3 The key issue causing the Council concern in relation to the academisation of PFI schools is an issue of financial risk. The Council is concerned that the conversion of PFI schools to academies (Model Documents) may leave TMBC exposed to certain risks that TMBC did not previously bear and/or was able to control.
- 2.4 In discussion with Department for Education officials have provided officers with the assurance that ultimately the Department of Education will step in to protect the Council from these risks but have not gone as far as to provide the council with an indemnity. Hence the concern that Members may consider that there is insufficient mitigation of the risk.
- 2.5 In order to clarify these issues Elected Members agreed to seek the necessary legal advice on the strength of the DfE's covenants / commitments set out in their standard documentation and the risks that would be retained by the Council, to enable the Cabinet to review its current stance on academisation of PFI.
- 2.6 The advice has been sought and discussed with elected members. In summary, the advice details the nature of the residual risks to the Council noting them reduced but not removed. This advice has been discussed by senior officers, with Executive Cabinet and shared with DfE officials.

3. FINANCIAL BACKGROUND

- 3.1 Tameside has entered into three separate contracts with private companies to design, build, and finance and operate 10 purpose built PFI schools. The contracts run for 25 or 30 years. The private companies that ultimately delivered the new schools were construction companies who formed a number of Special Purpose Vehicles (SPVs) for the delivery and maintenance of the schools.
- 3.2 SPVs were established to ring-fence the financial and operational aspect of the schools that were constructed to protect them from any risks that affected the parent companies and to

ensure that the contracts could be delivered over their respective terms. The SPVs therefore borrowed from the banks to finance the building of the new school, with Tameside Council having a contract to repay the SPV over the life of the contract (25 – 30 years) as well as paying the ongoing operational costs as per the contractual arrangements. These payments were made as a single Unitary Charge to the SPV to cover the costs of:

- Repayment of borrowing;
- Interest on borrowing;
- On-going running costs (Hard FM Costs - repairs, maintenance and Soft FM Caretaking, Cleaning Catering etc.);
- Lifecycle maintenance (Capital and revenue – to keep the building fabric, plant, equipment and scheduled assets in good condition throughout the term of the contracts and at the point of hand back).

3.3 The 3 contracts in place at Tameside are with two suppliers and through 3 SPV's; Pyramid – Covering Pinfold, Arundale and Alder Schools
Inspired Spaces Project Co 1– Mossley Hollins, and St Damians,
Inspired Spaces Project Co 2 – Hyde CC, Denton CC, Thomas Ashton, and Tameside Pupil Referral Service (Whitebridge and Elmbridge)

3.4 The unitary charge is paid directly by the council to Pyramid and Inspired Spaces (project companies) and are financed as follows;

- PFI Credits – grant from Government to cover costs of build, paid over 25 - 30 years.
- Contribution from Schools – to cover the cost of maintaining the schools
- DSG Top Slice to cover the lifecycle costs of building;
- Council contributions - this is only the case for the Inspired Spaces' Contract due to income received from Council shareholding in the SPV funded from DSG;
- Devolved Formula Capital
- Interest on cash balances from PFI related reserves;
- Third party income from lettings.

3.5 The income and expenditure flows in the financial model which forms part of the contractual documentation shows that at the end of the contract concession each SPV will hold £100k in cash which would then be returned to the schools. This means that the financial transactions are designed to balance over the life of the contract.

3.6 The contracts have provision for changes and variations that are funded separately either by the council, the school or jointly. This could include constructing additional teaching space or converting teaching space to better support future curriculum.

4. RISK AND CHALLENGES

4.1 The contractual obligations between the SPV's and Tameside Council will not change as a result of a school converting to Academy and therefore the financial risks associated with the PFI schemes will remain with the Council post academisation.

4.2 The PFI schools have raised a number of concerns about the operation of the PFI contracts with all of the schools unhappy about aspects of the performance of the contract. Currently the Council is in a position to charge schools directly for the costs of the contract. Following academisation, the Council will have to invoice the schools prior to receiving the schools element of the contributions.

4.3 The Council therefore runs the risk that if the converted schools do not consider the contract being delivered satisfactorily that the schools may decide not to pay the Council for the services with the Council and the school getting into a legal dispute about the payments

which even if the Council is able to resolve successfully could result in significant cash flow issues for the Council as a result of the delay in payment caused as a result of the dispute.

4.4 The school have clear responsibility for reporting any performance issue through the helpdesk so appropriate action can be taken by the PFI Contracts Manager, whose responsibility it is to hold the SPV to term of the contract and the payment mechanism. Although it is hoped that this will mitigate the risk of disputes it the risk still remains if the academies remain of the view that they are unwilling or indeed unable to make the payments.

4.5 The risk of none or late payment by the Academy Trust would therefore be a new risk to Tameside MBC as the schools would become separate legal entities as part of the conversion process. This could expose the Council to cash flow risk in the case of late payment by the trust, or paying contracts on behalf of the Trusts if they do not pay for the contracts in full. This could result in additional work and potential legal costs in pursuing recovery of these significant contractual costs and adversely affect the council's cashflow position. The following table sets out the PFI contributions that schools make to the PFI contract. The table following provides;

- The 2020/21 annual PFI contributions for all the schools under that contract and the contributions for the schools proposed to transfer to the trust outlined in this report
- The estimated schools contributions for the whole life of the contract, it should be noted that these are estimated as future payments are linked to RPI/RPIX inflation changes
- The schools contributions for the estimated residual life of the contract post 2020/21, again these are inflation linked.

	Estimated Whole Contract Contributions		2020/21 Annual Payments		Estimated Remaining Contract Period	
	Total School Cont's £	Cont's from Transferring Schools £	Total School Cont's £	Transferring Schools £	Total School Cont's £	Cont's from Transferring Schools £
BSF1	34,805,652	17,402,826	1,246,186	623,093	24,922,186	12,461,093
BSF2	84,403,303	31,341,465	2,926,778	1,087,189	62,922,059	23,373,201
Hattersley Scheme	30,945,141	30,945,141	977,419	977,419	13,995,566	13,995,566
Total	150,154,096	79,689,432	5,150,383	2,687,701	101,839,811	49,829,860

4.6 Clearly it is vital that the Council operates a tight and professional contract management of the PFI contracts and fosters a culture of transparency and trust between itself, the Academy Trust and the PFI providers but this is no guarantee that issues won't arise and that prompt and full payment will still be made by the academies.

4.7 As part of the External Audit findings report in 2012/13, Grant Thornton the External Auditors at the time raised the issue that PFI contracts would potentially need to be treated as an onerous contract. In accounting terms this would mean that the council would continue to pay for a contract it was no longer gaining benefit from. **Appendix 2** is an extract from the report for the relevant findings. This would mean a potential write off of the contractual service element to the Council's revenue account, which would have a serious impact on the finances of the Council. The issue was raised as an emerging accounting issue across most local authorities with PFI builds at the time.

- The approach the Finance team propose to take in accounting for the asset is, if a PFI school transfers to an academy the contract should not be treated as an onerous contract. This is because the Council still derives benefit from the PFI contract which is a good quality well maintained school building for the duration of the contract.

- These schools enable the Council to dispel its statutory duty is to ensure a sufficient supply of good education places including early education and child care and sufficient local provision for pupils with enhanced learning needs.

These PFI schools will be part of that local provision of education places in the borough, and in educating Tameside's children and young people. Tameside MBC continues to receive benefit from the contracts once these schools convert to Academy and beyond the contract end date.

- 4.8 The accounting for has been proposed the current External Auditors (Mazars). The proposal is in line with the Accounting Code of Practice. The approach is also consistent with the approach other North West Local Authorities have taken including, Blackburn with Darwen, Rochdale MBC and Salford City Council.
- 4.9 The Action Plan also show in **Appendix 2**, outlined the need for a legal agreement to be put into place with regards to the on-going contractual payments and these becoming the responsibility of the Academy. Such necessary legal agreement will need to be in place prior finalising any PFI Academy Transfer.

5. PFI CONTRACT MANAGEMENT

- 5.1 The PFI contracts are relatively complex and do require active management by all parties. Irrespective of the academisation agenda the Council is committed to improving Contract Management arrangements to better support schools and improve value for money. The Council has recently appointed a new Contracts Manager with a revised job description to manage the contracts within a wider governance structure.
- 5.2 A review of the Pyramid Contract has taken place earlier this year and good progress is being made by all parties with a targeted action plan. Key areas of improvement and innovation are:
- Communication & information share
 - Quality of service – attention to detail
 - Contract & performance management
 - Lifecycle investment/Condition
 - Management of changes and variations
 - Damage/misuse

A similar process is going to be undertaken across the Inspired Spaces contracts shortly in collaboration with the schools. This will help place the contracts and contract awareness on a better footing ready for any transfer into an academy.

- PFI Contract management overview: There is a defined approach to PFI contract management structured around availability, scope, specification and performance. As described earlier in this report the Council (The Client) is required to pay a monthly unitary charge, however if performance and/or availability is outside of agreed parameters then a financial deduction may be applied. This is managed through a monthly performance reporting and review regime. Invoice values are then adjusted if appropriate, signed off and paid. If there is a disagreement between the Council and SPV then there is an escalation process within the contract.
- The SPV is responsible for maintaining the schools in good, clean, safe and usable condition and are responsible for associated costs based on fair wear and tear. However if something is damaged through misuse then the school is required to pay for the repair/replacement. This is an area of frequent disagreement which could become more difficult for the Council to manage when a school transfers to an Academy.

- For changes, variations and projects there is a structured change process that includes the scope, costs, ongoing maintenance/FM and confirmation of funding source and is all signed off before proceeding. Often with projects there is a need to adjust/change the scope or specification part way through, again there is a process for this within the contract. Any subsequent defects will be managed under the main PFI contract.

5.3 For the PFI Contracts to work effectively for the schools and to minimise the risk to the Council post transfer the relevant parts of the Council Contract with the SPV's should be contained within a back to back agreement with the Academy. The Academy will be required to have a nominated representative to liaise with the Councils Contract Manager. Performance should then be jointly reviewed on a monthly basis and any areas of disagreement should be raised before the invoice is signed off. These issues will then be managed by the Councils Contract Manager. An escalation process should be introduced within the Council/Academy agreement to help resolve any issues that are not able to be resolved via the Councils Contract Manager and Academy Representative.

5.4 By having robust contract and performance management arrangements in place and effective engagement with the Academy Representative this will reduce the risk to the Council and maintain a good service to the Academy.

6. THE SCHOOLS STRATEGY

6.1 This report has outlined the potential *financial* risks inherent in progressing the academisation of PFI schools. It has noted that these risks have lessened as more schools have converted nationally and as assurances from the Department for Education have strengthened, this is outlined in the correspondence received from Vicky Beer, Regional Schools' Commissioner. They have not been removed.

6.2 Therefore the key issue for consideration is the balance of risk. The potential financial risks of progressing PFI academisations must be balanced against the risk to the implementation of the Council's schools' strategy agreed by Executive Cabinet in August 2018. This strategy asserted that the Council must have a clear voice in determining the future of all Tameside's schools and must be concerned with the long-term sustainability and viability of all its schools.

6.3 Partnerships between schools are vital to their success. They increase the sustainability of schools financially and provide a vehicle to share the highest quality practice and maximise the impact of outstanding leaders. In Tameside there are too many small or standalone academies and too many maintained schools not seeking formal partnerships with others.

6.4 Agreeing the academisation of these PFI schools, will increase the sustainability of our school system and increase its capacity for improvement. It will do this in two ways:

6.5 Firstly, it will enable the establishment of a new local MAT, the Tame River Trust. This is a central strategic objective of the schools' strategy "*For a relatively small number of outstanding locally led MATs who can work with the Local Authority to drive improvement.*" The Tame River Trust is an extension of an existing partnership between Droylsden Academy and Mossley Hollins High School which, since 2015, has shared an Executive Headteacher and a significant number of other key post-holders. Currently, the schools work in a Soft Federation, sharing leadership capacity and some back office functions (business management).

6.6 The two schools wish to deepen their partnership, to generate further efficiencies and formalise partnership working at all levels. However, they are unable to form a hard federation (with a single governing body) because one school is LA maintained and the other an Academy. Therefore the only route possible to the schools to deepen and

formalise their partnership is to join together as a Multi-Academy Trust. Alder Community High School and Hyde Community College also wish to join the Trust.

- 6.7 Secondly, it supports the growth of another *local MAT* the Victorious Academies Trust. Victorious Academies Trust was founded in January 2018 as the relaunch of the former Carillion Academies Trust. Seven schools are currently part of Victorious Academies Trust, six of these schools are in Tameside, and one is just across the border in High Peaks, Derbyshire. Two more Tameside primary schools, Pinfold and Arundale wish to join the trust. The Trust currently has just over 2,600 pupils. In order to be sustainable and to secure their capacity for improvement the Trust has an ambition to grow and to develop the hub of schools in Tameside.
- 6.8 The School Strategy agreed by Elected Members in August 2018 outlined a clear and ambitious vision for the Council to follow. The implementation of this strategy has enabled the Council to make significant positive steps forward with its relationships with key stakeholders and embed a more structured and effective model for school improvement.

7. THE BENEFITS OF COLLABORATION BETWEEN SCHOOLS

- 7.1 Our School Improvement Model in Tameside is based on three key principles:
- School leaders are best placed to run schools
 - School to school support is the best vehicle for improvement
 - Formal partnerships between schools provides the most effective and efficient model for long term improvement
- 7.2 A formal partnership should be understood as where two or more schools work together within a single governance arrangement. There are two types of formal partnership which fit this definition:
- **A hard federation** – a maintained school and an academy cannot form a hard federation
 - **A multi-academy trust (MAT)** – only a MAT can *sponsor* a failing school
- 7.3 The current school system in Tameside is not well planned – and therefore is neither efficient nor effective as it could be. If a Tameside school is rated inadequate and requires to be sponsored we have very limited local options to do this. Action must be taken to improve standards and to create a sustainable financial position. We have a significant (but time limited) opportunity to plan a more viable and more successful system. A third of Tameside Secondary school are PFI built (Alder, Mossley Hollins, Hyde, St Damian's, Whitebridge, Denton) – any planned future model of collaboration must include these schools.

8. DUE DILIGENCE TO BE UNDERTAKEN ON A SCHOOL BYSCHOOL BASIS

- 8.1 It should be noted that if Members are minded to agree recommendations then every PFI academy conversion will still be subject to due diligence including finance, legal and any issues in relation to the current delivery of services and payments under the PFI contract.
- 8.2 For these conversion it is proposed, that this decision is first presented at Executive Cabinet to assist in the making of the Executive Decision on the academisation.

9. RECOMMENDATIONS

- 9.1 As set out at the front of the report.