Meeting: **Finance Sub-Committee**

Date: **22 June 2016**

Title: **Update on the financial review of PFI schemes**

Authors: **David Anderson** Tel: 0191 643 5722

Service: **Finance Service**

Wards affected: All

---

1. Purpose of the Report

1.1 At a previous meeting of Finance Sub Committee, the following query was raised:

- 'In light of pressure that has arisen on Schools PFI, an update is requested on the financial review of PFIs which is already underway including consideration of the VFM challenge points in the contract and therefore any pressures there may be on current budget provision.'

2. Recommendations

2.1 Finance Sub Committee are asked to note the content of the report.

3. Detail

Schemes

3.1 The Authority has five PFI / LIFT schemes currently running. These are the Schools PFI scheme, Housing PFI (North Tyneside Living), Street Lighting PFI and the LIFT schemes at Dudley/Shiremoor (two buildings delivered under one scheme) and Whitley Bay. The key information about the schemes is contained in Table 1, below:

Table 1 : PFI and LIFT schemes

Scheme	Operational Start	End of Scheme	On / Off Balance Sheet (IFRS)	Total cost of scheme Unitary Charge (UC) £m over liife	PFI Credits* £m pa	2015/16 Unitary Charge payment £m	2015/16 Outturn £m	Sinking Fund Reserve at 31/03/16** £m
Schools PFI	2003/04	2034/35	ON	124.210	2.687	4.169	0.037 Over budget	1.823
Housing PFI	23/01/15	01/02/42	ON	287.120	7.693	5.009	0.003 Over budget	10.251
Street Lighting PFI	01/07/04	05/07/29	ON	134.058	1.701	5.434	0.079 Over budget	0.421
Dudley & Shiremoor LIFT scheme	11/02/08	15/02/33	ON Dudley OFF Shiremoor	25.150	0.747	1.143	0.017 Over budget	1.692
Whitley Bay LIFT scheme	02/04/13	24/03/38	ON	24.840	0.545	0.752	(0.011) Under budget	1.050

* PFI credits are form of funding received annually from central government to part finance the scheme. They are a grant rather than a loan and a as such are not repayable by the Council.
** The sinking fund reserve and how it functions is discussed at 3.7. The balance on the Housing PFI scheme is high during the first few years of the scheme as the Unitary Charge increases as individual housing schemes are completed. As there are schemes still to be completed, there is additional surplus compared to the fixed PFI credit amount .

3.2 Schools PFI - 2016/17 is the fourteenth year of a thirty year PFI contract for the construction, maintenance and operation of four schools in the borough. The buildings and any plant and equipment installed in them will transfer to the Authority for nil consideration at the end of the contract. The schools involved in the scheme are Burnside Community High School, Coquet Park First School, Marine Park First School and Western Community Primary School. The key factors that impact on the financial cost of the scheme are the effects of inflation on the operational costs, pass through costs for utilities and the effects of the five-year benchmarking of services. The last benchmarking took place in 2015/16, and the impact of the increase in the cost of grounds maintenance and cleaning are addressed in the 2016/17 budget.

3.3 Street Lighting PFI - 2016/17 is the thirteenth year of a twenty five year PFI contract for the replacement, maintenance and operation of street lighting provision in the borough. The assets will transfer to the Authority for nil consideration at the end of the contract. The key impact on the financial cost of the scheme is the cost of utilities, which are re-procured on a rolling basis between six months to two years to prudently manage the risk of market fluctuation. There is also an inflationary increase on operational costs, but there is less economic volatility around this aspect of the scheme.

3.4 Housing PFI - 2016/17 is the fourth year of a twenty eight year PFI contract for the construction/ refurbishment, maintenance and operation of twenty six sheltered accommodation schemes in the borough. The assets will transfer back to the Authority for nil consideration at the end of the contract. The key impact on the cost of the scheme is the effect of inflation on operational costs.

3.5 Dudley and Shiremoor LIFT Scheme - 2016/17 is the ninth year of a twenty five year Local Improvement Finance Trust (LIFT) contract for the construction, maintenance and operation of a joint service centres at Dudley and Shiremoor. At the end of the twenty five year contract, the Authority has the right to purchase the buildings, plant and equipment from the operator. The key impact on the cost of the scheme is the effect of inflation on operational costs.

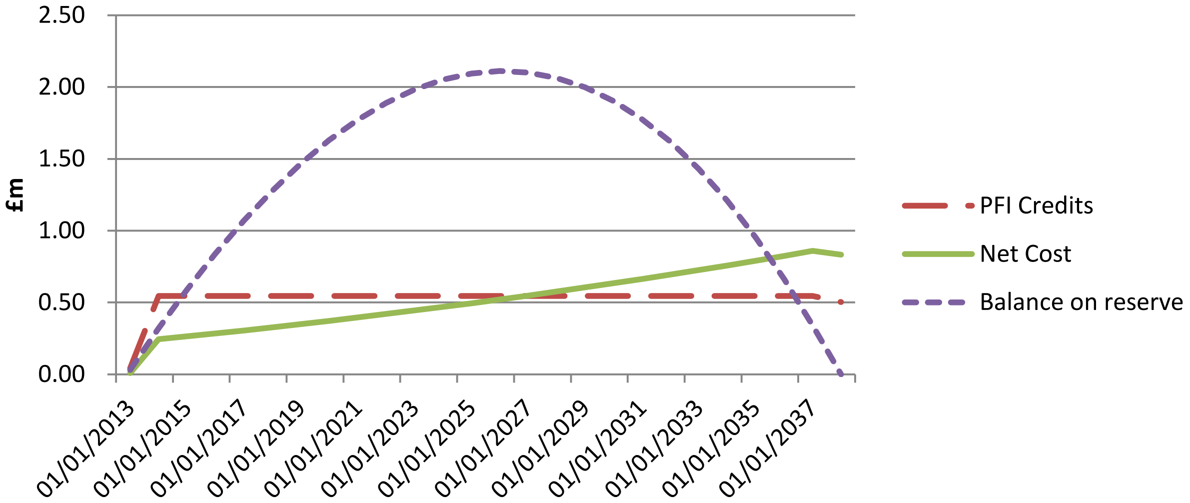
3.6 Whitley Bay LIFT Scheme - 2016/17 is the fourth year of a twenty five year LIFT contract for the construction, maintenance and operation of a joint service centre at Whitley Bay. At the end of the twenty five year contract, the Authority has the right to purchase the building, plant and equipment from the operator. The key impact on the cost of the scheme is the effect of inflation on operational costs.

Sinking Fund Reserves

3.7 In all the Authority's PFI and LIFT schemes, the funding from central government is received as PFI credits. PFI credits are paid annually as an annuity, meaning that they are a fixed annual amount, calculated without any increase for inflation over the life of the scheme. The operational costs of the schemes increase with inflation, with the reserve being established to smooth this variance.

3.8 In order to illustrate, the initial sinking fund model for the Whitley Bay LIFT scheme is at Figure 1, below.

Figure 1 : Whitley Bay LIFT Scheme



3.9 The three lines shown are the PFI credits received, a horizontal line as they remain fixed over the life of the scheme; the net cost of the scheme, being the difference between costs and budget, which rises with inflation and the balance on the reserve, which is the curve.

3.10 In early years, it can be seen that the level of PFI credits is higher than the net cost of the scheme, so the surplus is put into the reserve. This builds over the life of the scheme until the point is reached where net costs are higher than the PFI credits. From this point on, the funds in the reserve are used to support the scheme, with a final balance of zero at the end of the scheme.

3.11 In this way, the PFI credits are applied relative to the cost of the scheme, rather than when they are received, which serves to smooth the cost of the scheme over its life.

3.12 In each year, the sinking fund model for each scheme is updated for actual costs, which reflect the actual level of inflation as well as any other variations that have occurred in the scheme. If inflation is below the modelled rate (2.5%), then the scheme benefits from lower costs. If inflation runs higher than the modelled rate, then additional contributions will be required going forward to meet the higher costs.