Sandwell and West Birmingham Hospitals NHS Trust
Midland Metropolitan Hospital Project
Outline Business Case

Appendix 10b VfM Assessment

Sandwell and West Birmingham Hospitals NHS
NHS Trust

TRUST BOARD (PRIVATE SESSION)

DOCUMENT TITLE:	**MMH - Financing Options and Value for Money**
SPONSOR (EXECUTIVE DIRECTOR):	**Graham Seager, New Hospital Project Director/ Director of Estates**
AUTHOR:	**Graham Seager, New Hospital Project Director/ Director of Estates**
DATE OF MEETING:	**26 September 2013**

EXECUTIVE SUMMARY:

The purpose of this paper is to describe the current position regarding a range of potential financing options, outline the approach to value for money assessment of financing options and the planned actions relating to the Midland Metro Hospital MMH.

REPORT RECOMMENDATION:

The Board is invited to discuss the contents of the report.

ACTION REQUIRED *(Indicate with 'x' the purpose that applies)*:
The receiving body is asked to receive, consider and:

Accept	Approve the recommendation	Discuss
		X

KEY AREAS OF IMPACT ***(Indicate with 'x' all those that apply):***

Financial	X	Environmental		Communications & Media	
Business and market share		Legal & Policy		Patient Experience	
Clinical		Equality and Diversity		Workforce	

Comments:

ALIGNMENT TO TRUST OBJECTIVES, RISK REGISTERS, BAF, STANDARDS AND PERFORMANCE METRICS:

21st Century Facilities- New Hospital Project

PREVIOUS CONSIDERATION:

None

Sandwell and West Birmingham Hospitals NHS
NHS Trust

MMH - FINANCING OPTIONS AND VALUE FOR MONEY

Report to the Trust Board - 26 September 2013

Purpose:

The purpose of this paper is to describe the current position regarding a range of potential financing options, outline the approach to value for money assessment of financing options and the planned actions relating to the Midland Metro Hospital MMH.

Options:

There are a number of different options available to fund capital developments in the NHS and each may be more applicable to certain types of projects than others. The main options are:

- Cash surpluses;
- Borrow from FTFF (when FT);
- PDC or Loan from Department of Health (via ITFF);
- Borrow from other sources (bank, pension fund, council);
- Borrow via project finance (PFI) possibly with European Investment Bank;
- Charitable fundraising;
- Mixed financing economy (obtain funding from a number of sources).

Issues:

Each source of funds brings different issues to consider:

- Availability (given SWBH status, project size);
- Applicability (project size, type of project);
- Deliverability (guarantees, alternative use);
- Cost of funds;
- Value for Money of the solution.

Market position- other Trusts:

When starting to consider options it is helpful to understand what other trusts are doing and lessons learnt/ approaches, it is believed that:

- Alder Hey recently signed a PFI project for their major hospital development which was part funded through surplus, private finance (private placement bond) and EIB. Consideration was given to alternatives to PFI;
- Royal Liverpool is anticipating financial close on their PFI for a major hospital redevelopment which will be part funded by a loan from DH, private finance (source currently being determined through the funding competition) and EIB. Consideration was given to alternatives to PFI;

- Royal National Orthopaedic Hospital which is waiting on TDA approval to close dialogue on their PFI for a partial site redevelopment. Funding will be a mix of private finance and public money (bridge funding to cover future land sales). Consideration is being given to alternatives to PFI;
- Clatterbridge redevelopment which may be funded via Trust funds, FTFF and charitable contributions. The vast majority of funding required is available within the Trust;
- UCLH used Trust surpluses, FTFF and Charitable contributions to fund the development of a cancer centre;
- North Tees and Hartlepool, as understood, has been trying different routes for a few years, from promised public money which did not materialise, to a competitive procurement to create a major new hospital using a pension fund loan which has stalled to the current position which is understood to be that they are now intending to use PF2;
- A number of Trusts that have a number of smaller projects with alternative use have created a strategic estates partnership with a private sector participant.

Market position- changes to PFIs of the past:

The NHS PFI market has changed in recent years, trying to eliminate some of the problems associated with PFI in the past:

- Type of financing: The major change is the mixed economy of financing. All of the current and most recent projects have included up to about 40% of the funding requirement from health sector funding sources, thus reducing the cost of capital but with an expectation of no decrease in the risk transferred and thus improving the Value for Money position;
- Sources of finance and pricing: Historically funding was available for large projects from banks or a public issued bond (usually via a monoline insurer to provide some protection to the bond holder). It is believed that Alder Hey was funded by 3 non- health sources: EIB (traditional source of funding of PFI projects), a pension fund and a life assurance fund (both non-traditional funding sources). There are now a number of different products in the market offering different solutions and this has created competitive tension on pricing;
- Inflation risk: This is the first round of NHS PFIs that have used a partially indexed unitary charge. This means the Trust pays a higher annual charge in year 1 but the increase over time is less- eg instead of 100% of the unitary charge increasing by RPI only 40% might be (project specific) with the remaining 60% fixed. The variable amount will be linked to the value of FM services, SPV running costs and lifecycle obligations. The Trust therefore has more certainty over future costs and less exposure to RPI risk.

Market position- Value for Money:

The approach to value for money continues to change:

- For the first MMH OBC, we assessed VfM solely considering the quantitative assessment, that is discounted risk adjusted cash flows for the PSC (Public Sector Comparator) compared to the anticipated PFI;
- In a later update we used the qualitative assessment and the HMT TQAT model (Treasury Quantitative Assessment Tool);

- Following discussions between HMT and NAO, the TQAT model is no longer to be used and the focus is on the qualitative assessment and risk adjusted cash flows. Guidance will be issued by end of December 2013.

MMH position and actions:

The Trust is undertaking a number of steps as described below. It will:

- Review requirements and associated costs and likely PFI tariff;
- Undertake a quantitative assessment comparing the PSC to the PFI, using a specific contract (eg possibly P21) to assess risk- this work will be via a workshop setting;
- Prepare evidence if available for the risk assessments (challenge is most large hospitals have been PFI so no direct comparators);
- Review and strengthen the qualitative assessment undertaken in the past.

Recommendations

The Board is asked to discuss the above issues; this consideration will be supplemented at the Board with a brief presentation.

Sandwell and West Birmingham Hospitals NHS
NHS Trust

TRUST BOARD (PRIVATE SESSION)

DOCUMENT TITLE:	**MMH - Financing Options and Value for Money**
SPONSOR (EXECUTIVE DIRECTOR):	**Graham Seager, New Hospital Project Director/ Director of Estates**
AUTHOR:	**Graham Seager, New Hospital Project Director/ Director of Estates**
DATE OF MEETING:	**31 October 2013**

EXECUTIVE SUMMARY:

The purpose of this paper is to update the Board on the approach being taken to explore if PF2 represent a Value for Money solution to fund the new hospital build.

REPORT RECOMMENDATION:

The Board is invited to discuss the contents of the report

ACTION REQUIRED *(Indicate with 'x' the purpose that applies)*:

The receiving body is asked to receive, consider and:

Accept	Approve the recommendation	Discuss
		X

KEY AREAS OF IMPACT ***(Indicate with 'x' all those that apply):***

Financial	X	Environmental		Communications & Media	
Business and market share		Legal & Policy		Patient Experience	
Clinical		Equality and Diversity		Workforce	

Comments:

ALIGNMENT TO TRUST OBJECTIVES, RISK REGISTERS, BAF, STANDARDS AND PERFORMANCE METRICS:

21st Century Facilities- New Hospital Project

PREVIOUS CONSIDERATION:

None

Sandwell and West Birmingham Hospitals NHS
NHS Trust

MMH - Financing Options and Value for Money

Report to the Trust Board (Private Session) – 31 October 2013

Purpose

The purpose of this paper is to describe the overall approach to assessing Value for Money (VfM) of PF2 for funding the MMH, present the update on the qualitative VfM analysis which has been completed as well as an update on the quantitative analysis.

Overall Approach

As discussed in a previous paper, it is understood that HM Treasury (HMT) will be issuing new guidance on VfM of PF2 by the end of December 2013 but this will not be available in time for the MMH project given our current timetable. HM Treasury have confirmed that they will be requiring both qualitative and quantitative analysis. The last available guidance we are aware of is the November 2008, issued by the Department of Health (DH) titled Treasury Value for Money Assessment for PFI: Guidance for NHS build schemes, this is considered by the project team to be a basis analysis.

The process is to determine which procurement option is better VfM and we will be assessing a public sector procurement option (design and build) with funding from a public funding source compared to the anticipated PFI solution. If the quantitative analysis suggests PFI is better VfM then the qualitative assessment is considered and must also demonstrate the PFI proposition is appropriate.

Current Position

The Trust produced an OBC which was approved by the Strategic Health Authority and which provided a VfM analysis which concluded PFI was the appropriate procurement route. In order to obtain Trust Board approval as well as the DH and HMT, a fresh assessment of the VfM analysis is required.

Without prejudice to the outcome and given the complexity in developing and agreeing the quantitative assessment, we have revisited the qualitative assessment should it be required.

Qualitative Analysis

Previous HMT guidance for the qualitative analysis contained a number of questions to assess if PFI is viable, deliverable and achievable (contained in the November 2008 guidance referred to above). We have used the responses prepared in the past for the SWBH OBC and have updated these with additional responses and reflecting PF2. The initial outcome of this exercise is attached as appendix 1. As we move forward and if the quantitative analysis is positive this will be subject to further review.

Quantitative Analysis

The quantitative analysis activities have begun with two project team workshops at which each HMT identified risk was considered, focused on the potential consequence, impact and probability of each occurring. Following further analysis and Net Present Value calculations, the most significant, eg those

with the greatest financial impact, will be considered further seeking evidence to support such valuations.

Recommendations

The Trust Board are asked to consider the approach being taken to evaluating value for money of a PF2 solution to fund the new hospital build

Graham Seager

Director of Estates and New Hospital Project

APPENDIX 1

Value for Money: Qualitative Assessment (October 2013)

Issue	Question	Y / N
VIABILITY For PFI to be viable the investment objectives and desired outcomes need to be translatable into outputs that can form the basis of a contract and a sound payment mechanism; for example the quality and quantity of the outputs need to be ones that can be measured. Many services areas can be described in contractual terms, but some areas will be inherently 'non-contractible' as outputs.		
Project level outputs	**Is the project delivery team satisfied that a long term contract can be constructed for this project? Can the contractual outputs be framed so that they can be objectively measured?** The contract will follow the requirements of DH Standard Form as amended by SOPC4 reflecting the new requirements set out by HM Treasury in PF2. Service outputs have been developed and can be objectively measured.	**Y**
	Is the requirement deliverable as a service and as a long term arrangement? Can the contract describe the requirements in clear, objective, output-based terms? The Trust's requirements can be delivered as a service and must be as a long term arrangement. Again, the contract describes the construction and service requirements in clear, objective, output-based terms.	**Y**
	Can the quality of the service be objectively and independently assessed? The Project Agreement sets out in clear terms the Trust's service requirements and incorporates measurable performance standards, objectively and independently. The requirements of the Contract can and will be appropriately assessed using both an independent tester and the contractual requirements of the payment mechanism. There is a clear description of the requirements of the construction and the Facilities will need to comply with those requirements in order for the independent tester to declare them complete. The service output specification, against which the provider will be assessed, contains clear and measurable KPIs. Failure to meet any of these KPIs results in a deduction to the monthly payment. The Trust has experience of successfully delivering another PFI project, understands the contract and the obligations of the various parties involved and has the skills to manage the contract and relationship with the provider.	**Y**
	Is there a good fit between needs and contractible outcomes? The Trust has established its requirements and the service specifications which will measure the outcomes required. These requirements and service specifications have been tested with stakeholders in user consultation sessions and based upon previous PFI procurement and delivery experience. The development of the design and construction specification has involved a significant representation of the Trust staff.	**Y**
	Can the contract be drafted to avoid perverse incentives and to deliver quality services? The contract is drafted and avoids perverse incentives whilst delivering	**Y**

Issue	Question	Y / N
	quality services. The contract will follow the requirements of DH Standard Form enhances by the HM Treasury's PF2 changes. Using this standard document as a base and with the combined experience of the wider project team and its advisers, the Trust is confident that the contract has been drafted to avoid perverse incentives and deliver quality.	
	Does the project require significant levels of investment in new capital assets? This project requires significant investment, approximately £300m.	**Y**
	Are there fundamental issues relating to staff transfer? Would any transfer be free from causing any loss of core skills that have strategic and/or long term importance to the procuring authority? The Trust is transferring hard FM staff (just over 40 people) but will retain some staff to ensure the position of a knowledgeable client remains. Given the contract is for 30 years, the movement of the staff will not cause strategic difficulties. The Trust will continue to utilise some of the existing estate and therefore will continue to employ some hard FM staff as well as management level staff for managing the contract.	**N**
	Is service certification likely to be straightforward in terms of agreeing measurable criteria and satisfying the interest of stakeholders? Again, the contract contains measurable objectives which reflect the Trust's requirements. There are national standards which will be adhered to in the design and development of the Project (for example HMTs and HBNs). As part of minimising the carbon footprint the specification will also operate to the latest environmental standards. The Trust also adheres to high design standards as part of its design approach which will be included in the tender documentation issued to bidders. In addition, the process of certifying the operation of hard fm services should also be straightforward based on the fact that: a) The Output Specification is similar to many others which are tried and tested; b) The standards for FM delivery are consistent with those expected of the previous PFI existing within the Trust; c) The Trust will consider changes required to reflect the experience of other Trusts as well as its own experience of its PFI.	**Y**
	Does the project have clear boundaries (especially with respect to areas of procuring authority control)? If there are interfaces with other projects are they clear and manageable? The obligations of the provider are clear, design, construct, fund, insure and provide FM services (including lifecycle). The Trust intends to elect that the following services are also provided through the PFI: ground & gardens, snow clearance, external window cleaning, pest control. There will be an interface with the Trust in the provision of soft FM but this is a typical issue within the NHS PFI market with an acceptable position.	**Y**
	Can the service be provided without the essential involvement of authority personnel? To what extent does any involvement negate the risk transfer that is needed for VfM?	**Y**

Issue	Question	Y / N
	The service can be provided without the essential involvement of Trust personnel and therefore does not negate risk transfer. However, in the case of issues which could affect clinical services or the Trust's reputation, the Trust can step in if required and recharge the provider.	
	Is the contractor able or likely to have control/ownership of the intellectual property rights associated with the performance/ design/development of the assets for the new service? It is unlikely that there will be intellectual property rights to the hard FM service provision.	**N**
	Will existing or planned elements within the scope of the project – or interfacing vitally with it – be complete before the start of the new service? The only planned development is the clearance of the land and it will be completed before the start of the new service. The Trust now owns all the land and whilst there are still a few tenants in situ, the site will be clear prior to the procurement commencement.	**Y**
Operational flexibility	**Is there a practical balance between the degree of operational flexibility that is desired and long term contracting based on up-front capital investment?** The Trust recognises that the delivery of healthcare will change significantly in the future and will procure facilities that provide for future flexibility (e.g. office accommodation is currently designed in potential future expansion space between critical departments eg Theatres and Critical Care). The preferred bidders design may create additional or alternative flexibility. The exclusion from the PFI of soft FM, I M & T and equipment in particular will secure the Trust's ability to respond to future service change. In addition, the Trust under PF2 is included the additional services mentioned earlier under a flexible arrangement. The cost of the services can be market tested and can be removed from the contract without any termination cost should the Trust wish to manage or provide those services direct.	**Y**
	What is the likelihood of large contract variations being necessary during the life of the contract? The Trust is not anticipating any large variations: however the contract contains variation clauses. Over a 30 year concession it is conceivable that changes to the delivery of the FM services may be required however it is anticipated that any such changes could be accommodated through the contract variation mechanisms and changes to the FM service would be relatively straightforward. Alterations to the facility are more complex and as such the Trust has incorporated a number of changes to the small works obligations to minimise the cost associated with small changes. Larger changes could be funded via a variation facility and can be costly to implement and therefore the flexibility of design becomes more important. Also, the Trust has existing retained estate and if the clinical services (fewer patients or improved efficiency etc) change resulting in a decrease in accommodation within the PFI then it can close existing accommodation.	**UnKn**
	Can the service be implemented without constraining the delivery of future operational objectives? The hard FM service can be implemented without constraining the delivery of future operational objectives.	**Y**
	Is there confidence that operational flexibility is likely to be maintained over the lifetime of the contract, at an acceptable cost?	**Y**

Issue	Question	Y / N
	The Trust has retained substantial operational flexibility by the exclusion of soft FM services. The cost of the main hard FM service is fixed for the contract period. In addition, the market for construction, maintenance and management of Hospital facilities is mature and the Trust has experience of delivering similar infrastructure/services.	
Equity, efficiency and accountability	**Are there public equity, efficiency or accountability reasons for providing the service directly, rather than through a PFI contract?** The Trust is not aware of any reasons of equity, efficiency or accountability that might indicate a preference for the direct delivery of services. The transfer of risk and responsibility is of value to the Trust. A number of potential options for the delivery of the Project have been considered as described within the OBC. The Trust is also mindful, but in no way reliant, of the assumption that in many programmes that new build accommodation projects are often considered to deliver the greatest VFM when they are procured through PFI. This is based on an assumption that on a whole life cost basis with risk transfer PFI provides the greatest level of VFM. On the basis of the available evidence, the Trust believes that there is no significant reason relating to public equity, efficiency or accountability reasons why the project cannot be delivered through PFI. The Project's scope relates only to the infrastructure of the new facility and hard fm services.	**N**
	Does the scope of the service lend itself to providing the contractor with "end-to-end" control of the relevant functional processes? Does the service have clear boundaries? The service is defined to cover the end-to-end requirements and has clear boundaries.	**Y**
	Are there regulatory or legal restrictions that require services to be provided directly? There are no regulatory or legal restrictions requiring the services to be delivered directly.	**N**
	Is the private sector able to exploit economies of scale through the provision, operation or maintenance of other similar services to other customers (not necessarily utilising the same assets)? Given the size of this scheme, it is unlikely that further economies could be made with other customers. Were this to be possible, the benefits would depend upon the private sector's other contracts in the area or through purchasing power.	**UKn**
	Does the private sector have greater experience/expertise than the procuring authority in the delivery of this service? Are the services non-core to the procuring authority? The private sector focuses solely on construction and on the delivery of hard FM services. The services are non-core to the procuring authority.	**Y**
	Is a PFI procurement for this project likely to deliver improved value for money to the health service as a whole, considering its impact on other projects? PFI has been demonstrated quantifiably to be value for money to the health service as a whole as well as to the Trust.	**Y**
OVERALL VIABILITY	**Overall, in considering with PFI, is the Trust satisfied that a suitable long term contract can be constructed, and that strategic and regulatory issues can be overcome?** The Trust is satisfied that the standard form contract (as amended for	**Y**

Issue	Question	Y / N
	SOPC and PF2) has been constructed to offer a suitable long term contract. There are no strategic or regulatory issues to be overcome.	
DESIRABILITY **PFI can provide better risk management and produce incentives to develop innovative approaches to output delivery. Consistent high quality services can be incentivised through performance and payment mechanisms. However, risk transfer is priced into the contract. The purpose of these questions is to consider whether the benefits of PFI are likely to outweigh any additional costs and disadvantages.**		
Risk management	**Bearing in mind the relevant risks that need to be managed for the project, what is the ability of the private sector to price and manage these risks?** The project is straightforward and likely bidders will have priced and managed risks in the past. We would expect there is a wide range of contractors who will be familiar with the design and development of such facilities – as such, they will also have substantial experience of managing the risks associated with these projects.	**Strong**
	Can the payment mechanism and contract terms incentivise good risk management? The standard form payment mechanism and contract terms have been designed to incentivise good service delivery and management of risk. HMT has issued a payment mechanism and output specification to be used with PF2. The Trust is reviewing these documents to consider the acceptability and to identify if there are alterations to the risk transfer and if this is acceptable or not (if not then the team will seek to agree changes with HMT who have already accepted the concept that the NHS may have specific requirements. The Trust is also reviewing and updating the payment mechanism and output specifications to reflect lessons learnt on the existing PFI.	**Y**
Innovation	**Is there scope for innovation in either the design of the solution or in the provision of the services?** The Trust has prepared an output based specification. The private sector has scope for innovation in either design of the solution or in the provision of the services	**Y**
	Does some degree of flexibility remain in the nature of the technical solution/service and/or the scope of the project? Flexibility remains on the technical solution but the scope of services has been described.	**Y**
	Does a preliminary assessment indicate that there is likely to be scope for innovation? Soft market sounding suggest potential bidders may approach the project in ways that indicate there is scope for innovation while still meeting the Trust's vision and specification.	Y
	Could the private sector improve the level of utilisation of the assets underpinning the project (e.g. through selling,	Y

Issue	Question	Y / N
	licensing, commercially developing for third party usage etc)? There is an opportunity for a commercial development with third party usage but not from core space. The Trust will decide on the management of the TPI opportunities (such as shops) as may conclude it is better value for money to manage the contract internally.	
Contract duration and residual value	**How far into the future can service demand be reasonably predicted? What is the expected life of the assets? What are the disadvantages of a long contract length?** The Trust has undertaken a detailed market analysis and has worked closely with PCTs considering future activity considering demographics, epidemiology and models of care. The asset is expected to last 60 years. The disadvantage of a long contract length is the cost of change. The design requirements will encourage flexibility so that use and volume of activity can change without significant cost.	
	Are there constraints on the status of the assets after the contract end? The assets at the end of the contract revert to the Trust in Condition B. It is intended that the assets will continue to be used as a hospital after the end of the concession.	
	Given the possibility of changes to the requirement, the assets and the operating environment, is it possible to sustain value for money over the life of the contract utilising as appropriate, mechanisms such as benchmarking and technology re-fresh? **See also para 2.5 below.**	Y
Incentives and monitoring	**Can the outcomes or outputs of the investment programme be described in contractual terms, which would be unambiguous and measurable?** The contract (in particular the output specification and payment mechanism) is clear about the outputs required and the standards to be met and these are unambiguous and measurable.	Y
	Can the service be assessed independently against an agreed standard? Each service specification contains performance standards which can be measured and independently assessed.	Y
	Would incentives on service levels be enhanced through a PFI payment mechanism? The payment mechanism will provide an incentive to meet the service levels, through the potential to face significant reductions in payment due to under performance. The whole payment is at risk of poor performance.	Y
Lifecycle costs	**Is it possible to integrate the design, build and operation of the project?** Bidders will view the whole life costs of the facility as the design, build and maintain obligations rest with them. The integration of the design, build and operation of the Project is expected to be achievable based upon the Project team's experience.	Y

Issue	Question	Y / N
	Are there significant ongoing operating costs and maintenance requirement? Are these likely to be sensitive to the type of construction? There will be significant operating and maintenance costs. Where these are the responsibility of the private sector, they will view the whole life costs and considered in the approach to construction. Where the costs for service provision lie with the Trust, the specifications are clear about the Trust's requirements and bidders solutions will be evaluated using total operating costs, eg additional space will result in additional cleaning and energy costs incurred by the Trust and this will be reflected in the evaluation of the solutions..	Y
OVERALL DESIRABILITY	**Overall, is the Trust satisfied that PFI would bring sufficient benefits that would outweigh the expected higher cost of capital and other disadvantages?** Overall, the trust is satisfied that PFI would bring sufficient benefits in the transfer of service delivery, responsibilities and risks to outweigh the expected higher costs.	**Y**
ACHIEVABILITY While PFI may allow a more efficient and effective combination of public and private sector skills, determining the rules that will govern the relationship between the two sectors does involve significant transaction costs. In particular, the procurement process can be complex and involve significant resources, including senior management time which may be required for project development and the ongoing monitoring of service delivery. Client capacity and capability, together with private sector deliverability, will have direct consequences for procurement times and the level and quality of market interest. PFI needs a robust competitive process to deliver fully its benefits and so the choice of procurement route should be informed by an assessment of the likely market appetite.		
Market Interest	**Is there evidence that the private sector is capable of delivering the required outcome?** General market experience and the Trust's soft market soundings suggest the private sector is capable of delivering the required outcome. A significant number of large construction companies and FM providers have contacted the Trust and visited the site over the past few years during the OBC development.	**Y**
	Does a significant market with sufficient capacity for these services exist in the private sector? There is a sufficient market with sufficient capacity to deliver this project.	**Y**
	Is there likely to be sufficient market appetite for the project? The Trust's soft market soundings suggest there is sufficient market appetite for the project. This is evidenced by the number of parties that have contacted the Trust on numerous occasions.	**Y**
	Has this been tested robustly? Is there any evidence of lack of market competition for similar projects? The Trust has spoken to a number of bidders about the scheme on numerous occasions Other recent NHS schemes have had 2-4	**Y** **N**

Issue	Question	Y / N
	strong contenders.	
	Have similar projects been tendered to market? Has the procuring authority's commitment to a PFI solution for this type of project been demonstrated? There have been a number of similar projects- in fact all large hospital projects over the past 20 years have been procured through PFI in England and the Trust has demonstrated its commitment to PFI and has an existing PFI already which demonstrates the Trust understands the associated risks and issues.	**Y** **Y**
	Does the nature of the project suggest it will be seen by the market as a profitable venture? Bidders will view a construction and 30 year maintenance contract as being a profitable venture provided bid costs are controlled and timetable adhered to. The new guidance assists in this regard, giving clear guidance on timetable with agreed approval processes and timing.	**Y**
	Are the risks associated with design, development and implementation manageable bearing in mind the likely solutions to the project? Any risks associated with this are manageable and placed with those best party able to manage it.	
Other issues	**Is the procurement feasible within the required timescale? Is there sufficient time for: resolution of key Authority issues; production/approval of procurement documentation; staged down-selection and evaluation of bidders, negotiation, approvals and due diligence?** The timetable has been agreed within the Trust, with advisors and with DH. The process is well known by the public and private sector and a new timetable has been mandated by HM Treasury which includes approach and timing of approvals.	**Y**
	Is the overall value of the project significant and proportionate to justify the transaction costs? The project scale is significant enough to justify the transaction costs.	**Y**
	Does the nature of the deal and/or the strategic importance of the work and/or the prospect for further business suggest that it will be seen by the market as a potentially profitable venture? See above	**Y**
	Does the Authority have the skills and resources to define, deliver and support the service throughout the procurement and the subsequent delivery period? The Trust has the skills and resources to manage the procurement and monitor the service. The Trust has an existing PFI from which they are able to draw upon experience gained. The Trust has specialist advisors in place with significant PFI experience.	**Y**
OVERALL	**Overall, is the Trust satisfied that a PFI procurement**	**Y**

Issue	Question	Y / N
ACHIEVABILITY	**programme is achievable, given client side capability and the attractiveness of the proposals to the market?** The Trust is satisfied that a PFI procurement programme is achievable, that it has the capability to deliver and the bidder market is interested.	

Tabled paper

Sandwell and West Birmingham Hospitals NHS
NHS Trust

TRUST BOARD (PRIVATE)

DOCUMENT TITLE:	**MMH - Value for Money Assessment**
SPONSOR (EXECUTIVE DIRECTOR):	**Graham Seager, New Hospital Project Director/ Director of Estates**
AUTHOR:	**Graham Seager, New Hospital Project Director/ Director of Estates**
DATE OF MEETING:	**28 November 2013**

EXECUTIVE SUMMARY:

The purpose of this paper is to update the Board on the outcome of workshops to determine if PF2 represent a Value for Money solution to fund the new hospital build.

REPORT RECOMMENDATION:

The Qualitative and Quantitative assessments have both shown that procuring the new hospital using PF2 represent value for money. The Board are recommended to pursue delivery of the Midland metropolitan Hospital using PF2.

ACTION REQUIRED *(Indicate with 'x' the purpose that applies)*:

The receiving body is asked to receive, consider and:

Accept	Approve the recommendation	Discuss
	X	X

KEY AREAS OF IMPACT ***(Indicate with 'x' all those that apply):***

Financial	X	Environmental		Communications & Media	
Business and market share		Legal & Policy		Patient Experience	
Clinical		Equality and Diversity		Workforce	

Comments:

ALIGNMENT TO TRUST OBJECTIVES, RISK REGISTERS, BAF, STANDARDS AND PERFORMANCE METRICS:

21st Century Facilities- New Hospital Project

PREVIOUS CONSIDERATION:

Private Board meeting in October 2013

Tabled paper

Sandwell and West Birmingham Hospitals NHS
NHS Trust

MMH - VALUE FOR MONEY ASSESSMENT

Report to the Trust Board (Private Session) – 28 November 2013

Purpose

The Board will recall the previous papers on Value for Money assessment of the new hospital, the purpose of which were to describe the overall approach to assessing Value for Money (VfM) of PF2 for funding the MMH and present the update on the qualitative VfM analysis which had been completed (represented here as Appendix 1) as well as an update on the quantitative analysis.

The purpose of this paper is to update the Board on the findings of the quantitative analysis.

Quantitative Analysis

The VfM quantitative analysis activities have been undertaken in a number of project team workshops at which each identified risk was considered focusing on the potential consequence, impact and probability of each occurring. Once those parameters had been established, further analysis including Net Present Value (NPV) calculations were undertaken, the most significant, i.e. those with the greatest financial impact, were considered by the team in further detail to sense check the valuations.

The VfM quantitative assessment tool ("the Model" is a spread sheet based tool available for the Board to view) has been designed specifically to aid procuring Trusts in their choice between procurement routes. The Trust has prepared the Model in accordance with accepted practice and following discussions with a Department of Health representative in November 2013.

The workshops compared procuring the new hospital in a conventional way using a Design and Build form of contract with a new hospital delivered through PF2. A further analysis was then undertaken to determine the effect of the Trust receiving £100m Public Dividend Capital as part of the funding solution.

This exercise attempts to quantify the level of risk retained under each procurement option, thus allowing the Trust to make an informed decision on the appropriate procurement route and also to better understand the potential risks and future costs that may arise under each scenario.

Methodology

The aim of the exercise is to compare the risk adjusted NPV costs of each procurement route investigated and the lowest NPV is determined to be the preferred option in terms of the quantitative assessment.

The Trust's overarching aim, as a public sector body, is to deliver high quality, sustainable services and safeguard public money.

Representatives from the Trust, our financial advisors Deloitte, Technical Advisors/Cost Consultants attended the session to agree appropriate underlying costs, levels of risk borne in each scenario and

the impact and probability of various risk scenarios. These discussions enabled an overall picture of the risk adjusted costs of each procurement route to be created for comparison.

For each of the outlined risks a consistent approach to analysis was applied.

Considered examples

For each of the risks practical examples were drawn upon and discussed. These examples included the Trust's experience with the BTC, experiences of both the Trust's financial and technical advisers and published sources. This assisted in allowing comparison and gaining a feel for the probability and impact of each risk should it crystallise.

The risks fell into the following key areas:

- Design;
- Construction;
- Performance;
- Operating;
- Revenue;
- Termination;
- Technology;
- Control;
- Residual Value; and
- Other

Best/Worst/Medium Case Scenarios and Probabilities

For each risk a Best/Med/Worst case scenario was outlined and a probability assigned to each case (totalling to 100%). This was then used to calculate an overall quantum of risk for each scenario.

Proxy Value

For each risk a value was assigned based upon practical experience and empirical data where available. This proxy value could then be adapted for each of the scenario probabilities.

A worked example of the quantification of one of the risks included within the Model is included within Appendix 3.

Outcome of the Workshops

The table below shows the NPVs of the project cost of each procurement route and the NPV of the risk retained in each instance. The results below demonstrate that:

- The PSC has a lower risk adjusted NPV than the PF2 option which excludes a PDC-based capital contribution and therefore offers better value for money.

- The PF2 option with a £100m capital contribution has a lower risk adjusted NPV than the PSC option and therefore represents better value for money.

Option[1] £m	NPV of project cost	NPV of risk retained by Trust	Total risk adjusted NPV
PF2 (no capital contribution)	407.3	18.3	425.6
PF2 (capital contribution, recognition of £100m, divided by 3)	379.5	18.3	397.9
PSC	323.2	95.3	418.5

The Procurement Routes

Public Sector Comparator ("PSC")

The PSC route is the conventional approach to delivering the scheme via a design and build contract procured by the Trust. The costs of the PSC cover the construction, 30 years of FM and lifecycle and associated costs of undertaking the project.

An assessment of the potential cost of undertaking the project as a traditional procurement was undertaken. These figures were also used as the base for the PSC option in the HMT Quantitative model.

- The NPV of the PSC cash flow is £323m

PF2

The PF2 route is based upon delivering the same facilities and services as the PSC however under a 33 year contractual obligation.

The input costs were provided by the Trust; having been adjusted based upon NHS benchmarks for PPP projects, and translated into an annual unitary charge by our financial advisers Deloitte. Two scenarios were modelled as follows:

- PF2 – No capital contribution – NPV of unitary charge is £407m
- PF2 – £100 capital contribution – NPV of unitary charge is £380m

A summary of the key differences in quantified risk for the two procurement routes is included in Appendix 2.

The modelled risk retained by the Trust for each option is as follows:

- PSC – NPV of risk retained is £95.3m
- PF2 – No capital contribution – NPV of risk retained is £18.3m

[1] The PF2 scenarios do not currently include a tax adjustment. This amount, if included would improve the vfm position of the PF2 options when compared with the PSC.

- PF2 – £100 capital contribution – NPV of unitary charge is £18.3m

Next Steps

The workshop assessments have shown that PF2 with a £100m PDC contribution represents better value for money than conventional procurement. This conclusion needs testing and challenge through:-

- Undertake a high level, top down approach to review examples where risks have materialised on similar projects within the sector.

- Discuss the key assumptions and outcomes with representatives from the Department of Health and re-visit the high value risks and associated assumptions if necessary

Conclusion and Recommendation

The Qualitative and Quantitative assessments have both shown that procuring the new hospital using PF2 represents value for money. The Board are therefore, recommended to pursue delivery of the Midland metropolitan Hospital using PF2.

Appendix 1 - Value for Money: Qualitative Assessment (October 2013)

Issue	Question	Y / N
VIABILITY For PFI to be viable the investment objectives and desired outcomes need to be translatable into outputs that can form the basis of a contract and a sound payment mechanism; for example the quality and quantity of the outputs need to be ones that can be measured. Many services areas can be described in contractual terms, but some areas will be inherently 'non-contractible' as outputs.		
Project level outputs	**Is the project delivery team satisfied that a long term contract can be constructed for this project? Can the contractual outputs be framed so that they can be objectively measured?** The contract will follow the requirements of DH Standard Form as amended by SOPC4 reflecting the new requirements set out by HM Treasury in PF2. Service outputs have been developed and can be objectively measured.	**Y**
	Is the requirement deliverable as a service and as a long term arrangement? Can the contract describe the requirements in clear, objective, output-based terms? The Trust's requirements can be delivered as a service and must be as a long term arrangement. Again, the contract describes the construction and service requirements in clear, objective, output-based terms.	**Y**
	Can the quality of the service be objectively and independently assessed? The Project Agreement sets out in clear terms the Trust's service requirements and incorporates measurable performance standards, objectively and independently. The requirements of the Contract can and will be appropriately assessed using both an independent tester and the contractual requirements of the payment mechanism. There is a clear description of the requirements of the construction and the Facilities will need to comply with those requirements in order for the independent tester to declare them complete. The service output specification, against which the provider will be assessed, contains clear and measurable KPIs. Failure to meet any of these KPIs results in a deduction to the monthly payment. The Trust has experience of successfully delivering another PFI project, understands the contract and the obligations of the various parties involved and has the skills to manage the contract and relationship with the provider.	**Y**
	I**s there a good fit between needs and contractible outcomes?** The Trust has established its requirements and the service specifications which will measure the outcomes required. These requirements and service specifications have been tested with stakeholders in user consultation sessions and based upon previous PFI procurement and delivery experience. The development of the design and construction specification has involved a significant representation of the Trust staff.	**Y**
	Can the contract be drafted to avoid perverse incentives and to deliver quality services? The contract is drafted and avoids perverse incentives whilst delivering quality	**Y**

Issue	Question	Y / N
	services. The contract will follow the requirements of DH Standard Form enhances by the HM Treasury's PF2 changes. Using this standard document as a base and with the combined experience of the wider project team and its advisers, the Trust is confident that the contract has been drafted to avoid perverse incentives and deliver quality.	
	Does the project require significant levels of investment in new capital assets? This project requires significant investment, approximately £300m.	**Y**
	Are there fundamental issues relating to staff transfer? Would any transfer be free from causing any loss of core skills that have strategic and/or long term importance to the procuring authority? The Trust is transferring hard FM staff (just over 40 people) but will retain some staff to ensure the position of a knowledgeable client remains. Given the contract is for 30 years, the movement of the staff will not cause strategic difficulties. The Trust will continue to utilise some of the existing estate and therefore will continue to employ some hard FM staff as well as management level staff for managing the contract.	**N**
	Is service certification likely to be straightforward in terms of agreeing measurable criteria and satisfying the interest of stakeholders? Again, the contract contains measurable objectives which reflect the Trust's requirements. There are national standards which will be adhered to in the design and development of the Project (for example HMTs and HBNs). As part of minimising the carbon footprint the specification will also operate to the latest environmental standards. The Trust also adheres to high design standards as part of its design approach which will be included in the tender documentation issued to bidders. In addition, the process of certifying the operation of hard fm services should also be straightforward based on the fact that: a) The Output Specification is similar to many others which are tried and tested; b) The standards for FM delivery are consistent with those expected of the previous PFI existing within the Trust; c) The Trust will consider changes required to reflect the experience of other Trusts as well as its own experience of its PFI.	**Y**
	Does the project have clear boundaries (especially with respect to areas of procuring authority control)? If there are interfaces with other projects are they clear and manageable? The obligations of the provider are clear, design, construct, fund, insure and provide FM services (including lifecycle). The Trust intends to elect that the following services are also provided through the PFI: ground & gardens, snow clearance, external window cleaning, pest control. There will be an interface with the Trust in the provision of soft FM but this is a typical issue within the NHS PFI market with an acceptable position.	**Y**

Issue	Question	Y / N
	Can the service be provided without the essential involvement of authority personnel? To what extent does any involvement negate the risk transfer that is needed for VfM? The service can be provided without the essential involvement of Trust personnel and therefore does not negate risk transfer. However, in the case of issues which could affect clinical services or the Trust's reputation, the Trust can step in if required and recharge the provider.	**Y**
	Is the contractor able or likely to have control/ownership of the intellectual property rights associated with the performance/ design/development of the assets for the new service? It is unlikely that there will be intellectual property rights to the hard FM service provision.	**N**
	Will existing or planned elements within the scope of the project – or interfacing vitally with it – be complete before the start of the new service? The only planned development is the clearance of the land and it will be completed before the start of the new service. The Trust now owns all the land and whilst there are still a few tenants in situ, the site will be clear prior to the procurement commencement.	**Y**
Operational flexibility	**Is there a practical balance between the degree of operational flexibility that is desired and long term contracting based on up-front capital investment?** The Trust recognises that the delivery of healthcare will change significantly in the future and will procure facilities that provide for future flexibility (e.g. office accommodation is currently designed in potential future expansion space between critical departments eg Theatres and Critical Care). The preferred bidders design may create additional or alternative flexibility. The exclusion from the PFI of soft FM, I M & T and equipment in particular will secure the Trust's ability to respond to future service change. In addition, the Trust under PF2 is included the additional services mentioned earlier under a flexible arrangement. The cost of the services can be market tested and can be removed from the contract without any termination cost should the Trust wish to manage or provide those services direct.	**Y**
	What is the likelihood of large contract variations being necessary during the life of the contract? The Trust is not anticipating any large variations: however the contract contains variation clauses. Over a 30 year concession it is conceivable that changes to the delivery of the FM services may be required however it is anticipated that any such changes could be accommodated through the contract variation mechanisms and changes to the FM service would be relatively straightforward. Alterations to the facility are more complex and as such the Trust has incorporated a number of changes to the small works obligations to minimise the cost associated with small changes. Larger changes could be funded via a variation facility and can be costly to implement and therefore the flexibility of design becomes more important. Also, the Trust has existing retained estate and if the clinical services (fewer patients or improved efficiency etc) change resulting in a decrease in accommodation within the PFI then it can close existing accommodation.	**UnKn**
	Can the service be implemented without constraining the delivery of	**Y**

Issue	Question	Y / N
	future operational objectives? The hard FM service can be implemented without constraining the delivery of future operational objectives.	
	Is there confidence that operational flexibility is likely to be maintained over the lifetime of the contract, at an acceptable cost? The Trust has retained substantial operational flexibility by the exclusion of soft FM services. The cost of the main hard FM service is fixed for the contract period. In addition, the market for construction, maintenance and management of Hospital facilities is mature and the Trust has experience of delivering similar infrastructure/services.	**Y**
Equity, efficiency and accountability	**Are there public equity, efficiency or accountability reasons for providing the service directly, rather than through a PFI contract?** The Trust is not aware of any reasons of equity, efficiency or accountability that might indicate a preference for the direct delivery of services. The transfer of risk and responsibility is of value to the Trust. A number of potential options for the delivery of the Project have been considered as described within the OBC. The Trust is also mindful, but in no way reliant, of the assumption that in many programmes that new build accommodation projects are often considered to deliver the greatest VFM when they are procured through PFI. This is based on an assumption that on a whole life cost basis with risk transfer PFI provides the greatest level of VFM. On the basis of the available evidence, the Trust believes that there is no significant reason relating to public equity, efficiency or accountability reasons why the project cannot be delivered through PFI. The Project's scope relates only to the infrastructure of the new facility and hard fm services.	**N**
	Does the scope of the service lend itself to providing the contractor with "end-to-end" control of the relevant functional processes? Does the service have clear boundaries? The service is defined to cover the end-to-end requirements and has clear boundaries.	**Y**
	Are there regulatory or legal restrictions that require services to be provided directly? There are no regulatory or legal restrictions requiring the services to be delivered directly.	**N**
	Is the private sector able to exploit economies of scale through the provision, operation or maintenance of other similar services to other customers (not necessarily utilising the same assets)? Given the size of this scheme, it is unlikely that further economies could be made with other customers. Were this to be possible, the benefits would depend upon the private sector's other contracts in the area or through purchasing power.	**UKn**
	Does the private sector have greater experience/expertise than the procuring authority in the delivery of this service? Are the services non-core to the procuring authority? The private sector focuses solely on construction and on the delivery of hard FM services. The services are non-core to the procuring authority.	**Y**
	Is a PFI procurement for this project likely to deliver improved value for money to the health service as a whole, considering its impact on other	**Y**

Issue	Question	Y / N
	projects? PFI has been demonstrated quantifiably to be value for money to the health service as a whole as well as to the Trust.	
OVERALL VIABILITY	**Overall, in considering with PFI, is the Trust satisfied that a suitable long term contract can be constructed, and that strategic and regulatory issues can be overcome?** The Trust is satisfied that the standard form contract (as amended for SOPC and PF2) has been constructed to offer a suitable long term contract. There are no strategic or regulatory issues to be overcome.	**Y**
DESIRABILITY **PFI can provide better risk management and produce incentives to develop innovative approaches to output delivery. Consistent high quality services can be incentivised through performance and payment mechanisms. However, risk transfer is priced into the contract. The purpose of these questions is to consider whether the benefits of PFI are likely to outweigh any additional costs and disadvantages.**		
Risk management	**Bearing in mind the relevant risks that need to be managed for the project, what is the ability of the private sector to price and manage these risks?** The project is straightforward and likely bidders will have priced and managed risks in the past. We would expect there is a wide range of contractors who will be familiar with the design and development of such facilities – as such, they will also have substantial experience of managing the risks associated with these projects.	**Strong**
	Can the payment mechanism and contract terms incentivise good risk management? The standard form payment mechanism and contract terms have been designed to incentivise good service delivery and management of risk. HMT has issued a payment mechanism and output specification to be used with PF2. The Trust is reviewing these documents to consider the acceptability and to identify if there are alterations to the risk transfer and if this is acceptable or not (if not then the team will seek to agree changes with HMT who have already accepted the concept that the NHS may have specific requirements. The Trust is also reviewing and updating the payment mechanism and output specifications to reflect lessons learnt on the existing PFI.	**Y**
Innovation	**Is there scope for innovation in either the design of the solution or in the provision of the services?** The Trust has prepared an output based specification. The private sector has scope for innovation in either design of the solution or in the provision of the services	**Y**
	Does some degree of flexibility remain in the nature of the technical solution/service and/or the scope of the project?	**Y**

Issue	Question	Y / N
	Flexibility remains on the technical solution but the scope of services has been described.	
	Does a preliminary assessment indicate that there is likely to be scope for innovation? Soft market sounding suggest potential bidders may approach the project in ways that indicate there is scope for innovation while still meeting the Trust's vision and specification.	Y
	Could the private sector improve the level of utilisation of the assets underpinning the project (e.g. through selling, licensing, commercially developing for third party usage etc)? There is an opportunity for a commercial development with third party usage but not from core space. The Trust will decide on the management of the TPI opportunities (such as shops) as may conclude it is better value for money to manage the contract internally.	Y
Contract duration and residual value	**How far into the future can service demand be reasonably predicted? What is the expected life of the assets? What are the disadvantages of a long contract length?** The Trust has undertaken a detailed market analysis and has worked closely with PCTs considering future activity considering demographics, epidemiology and models of care. The asset is expected to last 60 years. The disadvantage of a long contract length is the cost of change. The design requirements will encourage flexibility so that use and volume of activity can change without significant cost.	
	Are there constraints on the status of the assets after the contract end? The assets at the end of the contract revert to the Trust in Condition B. It is intended that the assets will continue to be used as a hospital after the end of the concession.	
	Given the possibility of changes to the requirement, the assets and the operating environment, is it possible to sustain value for money over the life of the contract utilising as appropriate, mechanisms such as benchmarking and technology re-fresh? **See also para 2.5 below.**	Y
Incentives and monitoring	**Can the outcomes or outputs of the investment programme be described in contractual terms, which would be unambiguous and measurable?** The contract (in particular the output specification and payment mechanism) is clear about the outputs required and the standards to be met and these are unambiguous and measurable.	Y
	Can the service be assessed independently against an agreed standard? Each service specification contains performance standards which can be measured and independently assessed.	Y
	Would incentives on service levels be enhanced through a PFI payment	Y

Issue	Question	Y / N
	mechanism? The payment mechanism will provide an incentive to meet the service levels, through the potential to face significant reductions in payment due to under performance. The whole payment is at risk of poor performance.	
Lifecycle costs	**Is it possible to integrate the design, build and operation of the project?** Bidders will view the whole life costs of the facility as the design, build and maintain obligations rest with them. The integration of the design, build and operation of the Project is expected to be achievable based upon the Project team's experience.	Y
	Are there significant ongoing operating costs and maintenance requirement? Are these likely to be sensitive to the type of construction? There will be significant operating and maintenance costs. Where these are the responsibility of the private sector, they will view the whole life costs and considered in the approach to construction. Where the costs for service provision lie with the Trust, the specifications are clear about the Trust's requirements and bidders solutions will be evaluated using total operating costs, eg additional space will result in additional cleaning and energy costs incurred by the Trust and this will be reflected in the evaluation of the solutions..	Y
OVERALL DESIRABILITY	**Overall, is the Trust satisfied that PFI would bring sufficient benefits that would outweigh the expected higher cost of capital and other disadvantages?** Overall, the trust is satisfied that PFI would bring sufficient benefits in the transfer of service delivery, responsibilities and risks to outweigh the expected higher costs.	**Y**
ACHIEVABILITY While PFI may allow a more efficient and effective combination of public and private sector skills, determining the rules that will govern the relationship between the two sectors does involve significant transaction costs. In particular, the procurement process can be complex and involve significant resources, including senior management time which may be required for project development and the ongoing monitoring of service delivery. Client capacity and capability, together with private sector deliverability, will have direct consequences for procurement times and the level and quality of market interest. PFI needs a robust competitive process to deliver fully its benefits and so the choice of procurement route should be informed by an assessment of the likely market appetite.		
Market Interest	**Is there evidence that the private sector is capable of delivering the required outcome?** General market experience and the Trust's soft market soundings suggest the private sector is capable of delivering the required outcome. A significant number of large construction companies and FM providers have contacted the Trust and visited the site over the past few years during the OBC development.	**Y**

Issue	Question	Y / N
	Does a significant market with sufficient capacity for these services exist in the private sector? There is a sufficient market with sufficient capacity to deliver this project.	**Y**
	Is there likely to be sufficient market appetite for the project? The Trust's soft market soundings suggest there is sufficient market appetite for the project. This is evidenced by the number of parties that have contacted the Trust on numerous occasions.	**Y**
	Has this been tested robustly? Is there any evidence of lack of market competition for similar projects? The Trust has spoken to a number of bidders about the scheme on numerous occasions Other recent NHS schemes have had 2-4 strong contenders.	**Y** **N**
	Have similar projects been tendered to market? Has the procuring authority's commitment to a PFI solution for this type of project been demonstrated? There have been a number of similar projects- in fact all large hospital projects over the past 20 years have been procured through PFI in England and the Trust has demonstrated its commitment to PFI and has an existing PFI already which demonstrates the Trust understands the associated risks and issues.	**Y** **Y**
	Does the nature of the project suggest it will be seen by the market as a profitable venture? Bidders will view a construction and 30 year maintenance contract as being a profitable venture provided bid costs are controlled and timetable adhered to. The new guidance assists in this regard, giving clear guidance on timetable with agreed approval processes and timing.	**Y**
	Are the risks associated with design, development and implementation manageable bearing in mind the likely solutions to the project? Any risks associated with this are manageable and placed with those best party able to manage it.	
Other issues	**Is the procurement feasible within the required timescale? Is there sufficient time for: resolution of key Authority issues; production/approval of procurement documentation; staged down-selection and evaluation of bidders, negotiation, approvals and due diligence?** The timetable has been agreed within the Trust, with advisors and with DH. The process is well known by the public and private sector and a new timetable has been mandated by HM Treasury which includes approach and timing of approvals.	**Y**
	Is the overall value of the project significant and proportionate to justify the transaction costs? The project scale is significant enough to justify the transaction costs.	**Y**

Issue	Question	Y / N
	Does the nature of the deal and/or the strategic importance of the work and/or the prospect for further business suggest that it will be seen by the market as a potentially profitable venture? See above	**Y**
	Does the Authority have the skills and resources to define, deliver and support the service throughout the procurement and the subsequent delivery period? The Trust has the skills and resources to manage the procurement and monitor the service. The Trust has an existing PFI from which they are able to draw upon experience gained. The Trust has specialist advisors in place with significant PFI experience.	**Y**
OVERALL ACHIEVABILITY	**Overall, is the Trust satisfied that a PFI procurement programme is achievable, given client side capability and the attractiveness of the proposals to the market?** The Trust is satisfied that a PFI procurement programme is achievable, that it has the capability to deliver and the bidder market is interested.	**Y**

Appendix 2 High Level Risk - Table

	Risk Retained NPV - PSC	Risk retained NPV – PF2	Risk Transfer	Commentary
Design	5,100,876	2,222,222	2,878,654	This is the risk of material failure of the project to deliver the costed design on which the project was based. This includes the failure of both the Trust e.g. Trust led design change and the contractor e.g. design failure. Key Risks Retained by the Trust under the PSC are: • Continuing development of design • Failure to translate the design The Best/Med/Worst scenarios were created using design team monthly costs of £0.5m (based upon total monthly design cost within PF2 option of £1m – assumed to continue at 50% capacity for the overrun period) and potential overruns of 3 to 6 months.
Construction	52,682,342	4,955,665	47,726,677	This is the risk of material failure to deliver the construction phase in line with the project plan. This includes the risk of increased costs, failure to deliver to timetable, contractor default and poor project management. Key Risks Retained by the Trust under the PSC are: • Incorrect Construction cost estimates; • Incorrect Construction timetable estimates; • Contractor Default • Poor project Management The key assumptions used to quantify the above have been based upon the experiences of the Trust's financial and technical advisers on other similar projects; the Trust's own experiences and published information. There is an element of subjectivity to the exercise however the rationale adopted included the following: • Statistics report by the National Audit Office projects that experienced a significant overrun and incurred additional construction costs. This was referenced to support the assessment of the likelihood of delays/overruns

	Risk Retained NPV - PSC	Risk retained NPV – PF2	Risk Transfer	Commentary
				within the chance of the medium case set at 50% in line with this statistic. • An example of a known Trust having to replace a significant amount of cladding as a result of poor quality material being used (c£27m cost impact – 10% of construction cost). • Recent examples of Contractor default such experienced by the Trust were cited and used to arrive at the probability, timetable impact and monetary impact figures within the model (12 -18 month procurement length and 10% - 15% additional costs incurred as a result of replacing Contractor). • The 'worst case' contractor default scenario was set at 2% (i.e. 1 in 50 projects require the Construction contractor to be replaced. • The 'medium case' scenario was set at 10% probability – this 1 in 10 probability was more representative of a major subcontractor such as an FM provider defaulting and requiring replacement on the project.
Performance	18,601,390	1,233,147	17,368,243	This is the risk of material failure in the performance of the contract including the risk of latent defects, failure of the contractor to the performance standards and availability. Our estimates are based on the recent Health PFI examples. Key Risks Retained by the Trust under the PSC are: • Latent Defects in new build; • Failure to meet performance standards; • Availability of the facility The key assumptions used to quantify the above have been based upon the experiences of the Trust's financial and technical advisers on other similar projects; the Trust's own experiences with the BTC and published information. There is an element of subjectivity to the exercise however the rationale adopted included the following: • Latent Defects – Modelled as a smoothed provision in operational years 15-24 • Latent Defects – Worst/Med/Best cases based upon 15%/10%/5% of initial capital costs however the probability of the scenarios set at 0.1%/1%/98.9%. • Failure to meet performance standards – Based upon the Hard FM annual cost. Best case scenario assumes 5% of the annual hard fm cost will be deducted

	Risk Retained NPV - PSC	Risk retained NPV – PF2	Risk Transfer	Commentary
				(Probability of this case set at 80%) – this is standard for a moderately well run PFI scheme. Medium and Worst cases set at 10%/20%. • Availability of facilities – assumed a loss of income per patient of £2,700 per day (sourced from Trust) and remedial works for a ward of £1m to repair/refurbish and recommission. Med/Worst case scenarios based upon: 32 patients and 6 week impact/ 32 patient and 3 month impact.
Operating	18,470,496	9,707,271	8,763,226	This is the risk of material failure in the operation of the contract including estimations of the maintenance costs and the cost of energy. Key Risks Retained by the Trust under the PSC are: • Incorrect cost of maintenance; • Incorrect estimation of volume of energy used • Patient infection caused by poor FM delivery The key assumptions used to quantify the above have been based upon the experiences of the Trust's financial and technical advisers on other similar projects; the Trust's own experiences and published information. There is an element of subjectivity to the exercise however the rationale adopted included the following: • The incorrect cost of maintenance was based upon scenarios of an additional 5%/10%/15% of hard FM costs being incurred (respective probabilities at 5%/10%/80%). Per technical advice this was felt to be a realistic expectation of cost overrun. • Energy usage was based upon scenarios of an additional 5%/10%/15% of energy being consumed (respective probabilities at 10%/30%/60%). Per technical advice this was felt to be a realistic expectation of energy consumption overrun. Some of this risk was also retained by the PF2 as the payment mechanism contained a cap and collar around the annual utility consumption target. • Patient infection as a result of poor FM. Legal damages per incident of £750k were used and the cost of a significant rectification set at £1m. This was based on empirical and historical evidence from the Trust and occurrences in the

	Risk Retained NPV - PSC	Risk retained NPV – PF2	Risk Transfer	Commentary
				sector. Worst case scenario assumed 4 instances of legal action/remediation – however an incident of this scale was only expected to occur 1% (i.e. 1 in 100 hospitals). Under this risk under a PSC the Trust would be liable however under PF2, whilst the Trust would be liable in the first instance they would then seek to be reimbursed by the PFI contractor is the issue was caused by their poor delivery of services. Project team assessed that whilst 100% of the risk sat with the Trust under PSC, only 50% sat with the Trust under PF2 with the remainder passed to the PFI contractor.
Revenue	0	0	0	No significant risk transferred
Termination	158,940	68,037	90,903	No significant risk transferred
Technology	60,339	30,170	30,170	No significant risk transferred
Control	118,403	67,949	50,454	No significant risk transferred
Residual value	41,076	41,076	0	No significant risk transferred
Other	97,770	705	97,065	No significant risk transferred
Total	**95,331,632**	**18,326,241**	**77,005,391**	

Appendix 3 Risk Calculation Example:

Risk:
A failure of the Architects to interpret the Trust's requirements will result in additional briefings and design work. The cost implications of this are reflected as further expenditure on Design Team fees and the Trust's Project Team. The probability distribution indicates that this risk is minimal but not insignificant.

Risk retained under PF2: 0% - Risk of failing to design to Trust brief sits wholly with the Contractor

Risk retained under PSC: 100% - Risk of failing to design to Trust brief sits wholly with the Trust

Considered examples: Experience of previous PFI procurements and typical overruns, communication issues, failure to interpret designs.

Best/Worst/Medium Case Scenarios and Probabilities

Best Case: No additional design cost impact.
Medium Case: Impact would amount to 1 month of additional design costs.
Worst Case: Impact would amount to 3 months of additional design costs.

Best Case: 20%
Medium Case: 70%
Worst Case: 10%

Proxy Value
One month design costs estimated at £500k. This is based upon the cost consultants overall design costs and timeframe

Risk Totals: Proxy Value * number of month's impact * Probability

Best Case: £500k * 0 * 20% = 0
Medium Case: £500k * 1 * 70% = £350k
Worst Case: £500k * 3* 10% = £150k

TOTAL = **£500k**

Risk within PSC Option = £500k *100% = £500k
Risk within PF2 Option = £500k * 0% = £0k

This approach was discussed with the Department of Health and the Trust aims to arrange a meeting/workshop with an Economic Advisor from DH in order to provide any further insight into the process before final approval is sought.

Sandwell and West Birmingham Hospitals NHS
NHS Trust

TRUST BOARD (PRIVATE)

DOCUMENT TITLE:	**MMH - Value for Money Assessment - Update**
SPONSOR (EXECUTIVE DIRECTOR):	**Graham Seager, New Hospital Project Director/ Director of Estates**
AUTHOR:	**Graham Seager, New Hospital Project Director/ Director of Estates**
DATE OF MEETING:	**19 December 2013**

EXECUTIVE SUMMARY:

The purpose of this paper is to update the Board on the outcome of further progress on the exercise to determine if PF2 represents a Value for Money solution to fund the new hospital build. The Board agreed that it did when we met in November, but further work was requested as well as the outcome of discussions with DH and other stakeholders.

REPORT RECOMMENDATION:

The Qualitative and Quantitative assessments confirm that procuring the new hospital using PF2 represents value for money when viewed alongside the public sector comparator (PSC). Whilst this is the case both with and without a PDC contribution of £100m, the solution with £100m PDC delivers the optimum VfM and continues to feature as part of the base case modelling for affordability and sustainability purposes. The Trust Board is recommended to maintain its decision to pursue delivery of the Midland Metropolitan Hospital using PF2.

ACTION REQUIRED *(Indicate with 'x' the purpose that applies)*:
The receiving body is asked to receive, consider and:

Accept	Approve the recommendation	Discuss
	X	X

KEY AREAS OF IMPACT ***(Indicate with 'x' all those that apply):***

Financial	X	Environmental		Communications & Media	
Business and market share		Legal & Policy		Patient Experience	
Clinical		Equality and Diversity		Workforce	

Comments:

ALIGNMENT TO TRUST OBJECTIVES, RISK REGISTERS, BAF, STANDARDS AND PERFORMANCE METRICS:

21st Century Facilities- New Hospital Project

PREVIOUS CONSIDERATION:

Trust Board November 2013

Purpose

The Board will recall the previous papers issued on financing options and Value for Money assessment of the new hospital, the purpose of which were to describe the overall approach to assessing Value for Money (VfM) of PF2 for funding the MMH. Since the last report the project team has undertaken the following:

- Met with a representative from the Department of Health to discuss initial findings and approach;
- Engaged with another Trust undertaking a similar project to compare the VFM methodology adopted; and
- Held an additional workshop to further refine the Qualitative VFM model, to reflect the discussion outlined above and comments from the Board discussion on construction risk.

The purpose of this paper is to update the Board on the revised findings of the quantitative analysis. These do not alter the previous conclusion reached by the Board.

Quantitative VFM position outlined within November 2013 report

The table below shows the NPVs of the project cost of each procurement route and the NPV of the risk retained in each instance as reported within the November 2013 paper. The results below demonstrated that:

- The PSC had a lower risk adjusted NPV than the PF2 option with no capital contribution, therefore currently offered better value for money.
- The PF2 option with a £100m capital contribution had a lower risk adjusted NPV than the PSC option and therefore offered better value for money.

Option[1] **£m**	**NPV of project cost**	**NPV of risk retained by Trust**	**Total risk adjusted NPV**
PF2 (no capital contribution)	407.3	18.3	425.6
PF2 (capital contribution, recognition of £100, divided by 3)	379.5	18.3	397.9
PSC	323.2	95.3	418.5

Updated Quantitative VFM position as at December 2013

The table below shows the NPVs of the project cost of each procurement route and the NPV of the risk retained in each instance following the further workshop to refine the model. The updated results below demonstrate that:

- The PF2 option without a capital contribution has a lower risk adjusted NPV than the PSC option and therefore offers better value for money.

[1] The PF2 scenarios do not currently include a tax adjustment as guidance requires this to a be a neutral factor. This amount, if included would improve the vfm position of the PF2 options when compared with the PSC.

- The PF2 option with a £100m capital contribution has a lower risk adjusted NPV than the PSC option and therefore offers better value for money.

Option[2] **£m**	**NPV of project cost**	**NPV of risk retained by Trust**	**Total risk adjusted NPV**
PF2 (no capital contribution)	409.7	18.3	428.0
PF2 (capital contribution, recognition of £100, divided by 3)	392.1	18.3	410.4
PSC	323.2	105.4	428.6

The changes reflect further consideration of various risks, mainly those relating to Construction (following discussion at Board) and Performance risk (see appendix 1)

Methodology

The methodology adopted in the latest workshop was consistent with previous workshops held. All risks where a significant amount of risk was deemed to be transferred were revisited and, where necessary, reassessed taking into account any insight gained from discussions held with DH, the other Trust and the Trust's advisers. These discussions enabled a revised overall picture of the risk adjusted costs of each procurement route to be created for comparison.

The Trust's overarching aim, as a public sector body, is to deliver high quality, sustainable services and safeguard public money.

For each of the outlined risks a consistent approach to analysis was applied.

For the risks that sit with the PSC any costs arising will be borne by the Trust. The analysis shows that if a risk associated with design, construction or poor project management crystallises adding just 10% of the capital cost this would leave the trust trying to secure £28m to cover the exposure.

Should an error of this magnitude arise the Trust would be responsible for funding the rectification – an amount significantly above the delegated capital level.

The Procurement Routes

Public Sector Comparator ("PSC")

The PSC route is the conventional approach to delivering the scheme via a design and build contract procured by the Trust. The costs of the PSC cover the construction, 30 years of FM and lifecycle and associated costs of undertaking the project.

[2] The PF2 scenarios do not currently include a tax adjustment. This amount, if included would improve the vfm position of the PF2 options when compared with the PSC.

An assessment of the potential cost of undertaking the project as a traditional procurement was undertaken. These figures were also used as the base for the PSC option in the HMT Quantitative model.

- The NPV of the PSC cash flow is £323.3m

PF2

The PF2 route is based upon delivering the same facilities and services as the PSC however under a 33 year contractual obligation.

The input costs were provided by the Trust; having been adjusted based upon NHS benchmarks for PPP projects, and translated into an annual unitary charge by our financial advisers Deloitte. Two scenarios were modelled as follows:

- PF2 – No capital contribution – NPV of unitary charge is £409.7m
- PF2 – £100 capital contribution – NPV of unitary charge is £392.1m

The modelled risk retained by the Trust for each option is as follows:

- PSC – NPV of risk retained is £105.4m
- PF2 – No capital contribution – NPV of risk retained is £18.3m
- PF2 – £100 capital contribution – NPV of unitary charge is £18.3m

Updated Qualitative VFM position as at December 2013

The qualitative VFM analysis undertaken is deemed to still be appropriate (and is included at Appendix 2 for reference).

Capital Contribution at Financial Close

The level of risk transferred does differ slightly between the PF2 option with a capital contribution and PF2 without a capital contribution. The key difference is the level of construction risk transferred. Under the PF2 (with PDC) a lower amount of the construction risk is passed to the private sector partner as a larger proportion of the construction cost is paid up front based on completion milestones. Conversely, in the PF2 option without a capital contribution, the construction cost is repaid over the whole project life via the UP, hence a greater level of construction risk sits with the private sector partner. Both PF2 scenarios are VFM when compared to the PSC (as outlined in the table above) and the PF2 capital contribution scenario has a significant amount of headroom over the PSC.

PFI/PF2 Changes

In undertaking the qualitative risk assessment the project team were mindful to ensure that the key changes between PF2 and PFI were reflected and the quantitative model adjusted accordingly. The

changes reflect the retention of risks by the Trust where they are more appropriately managed by the public sector than the private sector.

The following list highlights the key changes and adjustments made:

- Non NHS specific legislative/regulatory changes – under PFI this risk sat with the Contractor however under PF2 this risk now sits with the Trust. The quantitative model has been adjusted so that this risk sits with the Trust under both the PSC and PF2 option.
- The Trust is responsible for soft FM services; therefore all risks relating to soft FM delivery have been removed from the quantitative assessment.

Equity

One of the key differences between PF2 and PFI is the level of equity taken by the public sector. The benefits of this are twofold:

i) The greater level of equity gives the public sector greater input and control of the project throughout its life as a result of the increased level of ownership. The public sector will have a seat at the SPV board and have input into the direction of the project and key decisions.

ii) The public sector will receive an income stream from the dividend paid. This will effectively reduce the UP (and the resultant PF2 NPV). At this point this income stream has not been quantified as, until bidder solutions are further developed and funders engaged, levels of equity return are not known. However, comfort can be gained that this income stream will only improve the overall VFM position for both PF2 options.

Wider benefits of PF2

Appendix 3 includes a summary of the wider benefits of pursuing a PF2 procurement route for reference.

Conclusion and Recommendation

The Qualitative and Quantitative assessments confirm that procuring the new hospital using PF2 represents value for money when viewed alongside the public sector comparator (PSC). Whilst this is the case both with and without a PDC contribution of £100m, the solution with £100m PDC delivers the optimum VfM and continues to feature as part of the base case modelling for affordability and sustainability purposes. The Trust Board is recommended to pursue delivery of the Midland metropolitan Hospital using PF2.

APPENDIX 1

Comparison of Risks retained by Risk Category

Risk Category	**NPV Risk Retained PSC revised Dec13**	**NPV Risk Retained PSC Nov 13**		**NPV Risk Retained PF2 revised Dec13**	**NPV Risk Retained PF2 Nov 13**
Design	5,009,088	5,100,876		2,222,222	2,222,222
Construction	47,515,974	52,682,342		4,955,665	4,955,665
Performance	33,858,653	18,601,390		3,279,749	1,233,147
Operating	18,676,114	18,470,496		7,671,580	9,707,271
Revenue	0	0		0	0
Termination	64,985	158,940		68,037	68,037
Technology	60,339	60,339		30,170	30,170
Control	118,403	118,403		67,949	67,949
Residual value	41,076	41,076		41,076	41,076
Other	97,770	97,770		0	705
Total	**105,442,402**	**95,331,632**		**18,336,448**	**18,326,241**

APPENDIX 2

Value for Money: Qualitative Assessment (October 2013)

Issue	Question	Y / N
VIABILITY For PFI to be viable the investment objectives and desired outcomes need to be translatable into outputs that can form the basis of a contract and a sound payment mechanism; for example the quality and quantity of the outputs need to be ones that can be measured. Many services areas can be described in contractual terms, but some areas will be inherently 'non-contractible' as outputs.		
Project level outputs	**Is the project delivery team satisfied that a long term contract can be constructed for this project? Can the contractual outputs be framed so that they can be objectively measured?** The contract will follow the requirements of DH Standard Form as amended by SOPC4 reflecting the new requirements set out by HM Treasury in PF2. Service outputs have been developed and can be objectively measured.	**Y**
	Is the requirement deliverable as a service and as a long term arrangement? Can the contract describe the requirements in clear, objective, output-based terms? The Trust's requirements can be delivered as a service and must be as a long term arrangement. Again, the contract describes the construction and service requirements in clear, objective, output-based terms.	**Y**
	Can the quality of the service be objectively and independently assessed? The Project Agreement sets out in clear terms the Trust's service requirements and incorporates measurable performance standards, objectively and independently. The requirements of the Contract can and will be appropriately assessed using both an independent tester and the contractual requirements of the payment mechanism. There is a clear description of the requirements of the construction and the Facilities will need to comply with those requirements in order for the independent tester to declare them complete. The service output specification, against which the provider will be assessed, contains clear and measurable KPIs. Failure to meet any of these KPIs results in a deduction to the monthly payment. The Trust has experience of successfully delivering another PFI project, understands the contract and the obligations of the various parties involved and has the skills to manage the contract and relationship with the provider.	**Y**
	Is there a good fit between needs and contractible outcomes? The Trust has established its requirements and the service specifications which will measure the outcomes required. These requirements and service specifications have been tested with stakeholders in user consultation sessions and based upon previous PFI procurement and delivery experience.	**Y**

Issue	Question	Y / N
	The development of the design and construction specification has involved a significant representation of the Trust staff.	
	Can the contract be drafted to avoid perverse incentives and to deliver quality services? The contract is drafted and avoids perverse incentives whilst delivering quality services. The contract will follow the requirements of DH Standard Form enhances by the HM Treasury's PF2 changes. Using this standard document as a base and with the combined experience of the wider project team and its advisers, the Trust is confident that the contract has been drafted to avoid perverse incentives and deliver quality.	**Y**
	Does the project require significant levels of investment in new capital assets? This project requires significant investment, approximately £300m.	**Y**
	Are there fundamental issues relating to staff transfer? Would any transfer be free from causing any loss of core skills that have strategic and/or long term importance to the procuring authority? The Trust is transferring hard FM staff (just over 40 people) but will retain some staff to ensure the position of a knowledgeable client remains. Given the contract is for 30 years, the movement of the staff will not cause strategic difficulties. The Trust will continue to utilise some of the existing estate and therefore will continue to employ some hard FM staff as well as management level staff for managing the contract.	**N**
	Is service certification likely to be straightforward in terms of agreeing measurable criteria and satisfying the interest of stakeholders? Again, the contract contains measurable objectives which reflect the Trust's requirements. There are national standards which will be adhered to in the design and development of the Project (for example HMTs and HBNs). As part of minimising the carbon footprint the specification will also operate to the latest environmental standards. The Trust also adheres to high design standards as part of its design approach which will be included in the tender documentation issued to bidders. In addition, the process of certifying the operation of hard fm services should also be straightforward based on the fact that: a) The Output Specification is similar to many others which are tried and tested; b) The standards for FM delivery are consistent with those expected of the previous PFI existing within the Trust; c) The Trust will consider changes required to reflect the experience of other Trusts as well as its own experience of its PFI.	**Y**
	Does the project have clear boundaries (especially with respect to areas of procuring authority control)? If there are interfaces with other projects are they clear and manageable? The obligations of the provider are clear, design, construct, fund, insure and provide FM services (including lifecycle). The Trust intends to elect that the following services are also provided through the PFI: ground & gardens, snow	**Y**

Issue	Question	Y / N
	clearance, external window cleaning, pest control. There will be an interface with the Trust in the provision of soft FM but this is a typical issue within the NHS PFI market with an acceptable position.	
	Can the service be provided without the essential involvement of authority personnel? To what extent does any involvement negate the risk transfer that is needed for VfM? The service can be provided without the essential involvement of Trust personnel and therefore does not negate risk transfer. However, in the case of issues which could affect clinical services or the Trust's reputation, the Trust can step in if required and recharge the provider.	**Y**
	Is the contractor able or likely to have control/ownership of the intellectual property rights associated with the performance/ design/development of the assets for the new service? It is unlikely that there will be intellectual property rights to the hard FM service provision.	**N**
	Will existing or planned elements within the scope of the project – or interfacing vitally with it – be complete before the start of the new service? The only planned development is the clearance of the land and it will be completed before the start of the new service. The Trust now owns all the land and whilst there are still a few tenants in situ, the site will be clear prior to the procurement commencement.	**Y**
Operational flexibility	**Is there a practical balance between the degree of operational flexibility that is desired and long term contracting based on up-front capital investment?** The Trust recognises that the delivery of healthcare will change significantly in the future and will procure facilities that provide for future flexibility (e.g. office accommodation is currently designed in potential future expansion space between critical departments eg Theatres and Critical Care). The preferred bidders design may create additional or alternative flexibility. The exclusion from the PFI of soft FM, I M & T and equipment in particular will secure the Trust's ability to respond to future service change. In addition, the Trust under PF2 is included the additional services mentioned earlier under a flexible arrangement. The cost of the services can be market tested and can be removed from the contract without any termination cost should the Trust wish to manage or provide those services direct.	**Y**
	What is the likelihood of large contract variations being necessary during the life of the contract? The Trust is not anticipating any large variations: however the contract contains variation clauses. Over a 30 year concession it is conceivable that changes to the delivery of the FM services may be required however it is anticipated that any such changes could be accommodated through the contract variation mechanisms and changes to the FM service would be relatively straightforward. Alterations to the facility are more complex and as such the Trust has incorporated a number of changes to the small works obligations to minimise the cost associated with small changes. Larger changes could be funded via a variation facility and can be costly to implement and therefore the flexibility of design becomes more important. Also, the Trust has existing retained estate and	**UnKn**

Issue	Question	Y / N
	if the clinical services (fewer patients or improved efficiency etc) change resulting in a decrease in accommodation within the PFI then it can close existing accommodation.	
	Can the service be implemented without constraining the delivery of future operational objectives? The hard FM service can be implemented without constraining the delivery of future operational objectives.	**Y**
	Is there confidence that operational flexibility is likely to be maintained over the lifetime of the contract, at an acceptable cost? The Trust has retained substantial operational flexibility by the exclusion of soft FM services. The cost of the main hard FM service is fixed for the contract period. In addition, the market for construction, maintenance and management of Hospital facilities is mature and the Trust has experience of delivering similar infrastructure/services.	**Y**
Equity, efficiency and accountability	**Are there public equity, efficiency or accountability reasons for providing the service directly, rather than through a PFI contract?** The Trust is not aware of any reasons of equity, efficiency or accountability that might indicate a preference for the direct delivery of services. The transfer of risk and responsibility is of value to the Trust. A number of potential options for the delivery of the Project have been considered as described within the OBC. The Trust is also mindful, but in no way reliant, of the assumption that in many programmes that new build accommodation projects are often considered to deliver the greatest VFM when they are procured through PFI. This is based on an assumption that on a whole life cost basis with risk transfer PFI provides the greatest level of VFM. On the basis of the available evidence, the Trust believes that there is no significant reason relating to public equity, efficiency or accountability reasons why the project cannot be delivered through PFI. The Project's scope relates only to the infrastructure of the new facility and hard fm services.	**N**
	Does the scope of the service lend itself to providing the contractor with "end-to-end" control of the relevant functional processes? Does the service have clear boundaries? The service is defined to cover the end-to-end requirements and has clear boundaries.	**Y**
	Are there regulatory or legal restrictions that require services to be provided directly? There are no regulatory or legal restrictions requiring the services to be delivered directly.	**N**
	Is the private sector able to exploit economies of scale through the provision, operation or maintenance of other similar services to other customers (not necessarily utilising the same assets)? Given the size of this scheme, it is unlikely that further economies could be made with other customers. Were this to be possible, the benefits would depend upon the private sector's other contracts in the area or through purchasing power.	**UKn**
	Does the private sector have greater experience/expertise than the procuring authority in the delivery of this service? Are the services non-	**Y**

Issue	Question	Y / N
	core to the procuring authority? The private sector focuses solely on construction and on the delivery of hard FM services. The services are non-core to the procuring authority.	
	Is a PFI procurement for this project likely to deliver improved value for money to the health service as a whole, considering its impact on other projects? PFI has been demonstrated quantifiably to be value for money to the health service as a whole as well as to the Trust.	**Y**
OVERALL VIABILITY	**Overall, in considering with PFI, is the Trust satisfied that a suitable long term contract can be constructed, and that strategic and regulatory issues can be overcome?** The Trust is satisfied that the standard form contract (as amended for SOPC and PF2) has been constructed to offer a suitable long term contract. There are no strategic or regulatory issues to be overcome.	**Y**
DESIRABILITY **PFI can provide better risk management and produce incentives to develop innovative approaches to output delivery. Consistent high quality services can be incentivised through performance and payment mechanisms. However, risk transfer is priced into the contract. The purpose of these questions is to consider whether the benefits of PFI are likely to outweigh any additional costs and disadvantages.**		
Risk management	**Bearing in mind the relevant risks that need to be managed for the project, what is the ability of the private sector to price and manage these risks?** The project is straightforward and likely bidders will have priced and managed risks in the past. We would expect there is a wide range of contractors who will be familiar with the design and development of such facilities – as such, they will also have substantial experience of managing the risks associated with these projects.	**Strong**
	Can the payment mechanism and contract terms incentivise good risk management? The standard form payment mechanism and contract terms have been designed to incentivise good service delivery and management of risk. HMT has issued a payment mechanism and output specification to be used with PF2. The Trust is reviewing these documents to consider the acceptability and to identify if there are alterations to the risk transfer and if this is acceptable or not (if not then the team will seek to agree changes with HMT who have already accepted the concept that the NHS may have specific requirements. The Trust is also reviewing and updating the payment mechanism and output specifications to reflect lessons learnt on the existing PFI.	**Y**
Innovation	**Is there scope for innovation in either the design of the solution or in the provision of the services?** The Trust has prepared an output based specification. The private sector has scope for innovation in either design of the solution or in the provision	**Y**

Issue	Question	Y / N
	of the services	
	Does some degree of flexibility remain in the nature of the technical solution/service and/or the scope of the project? Flexibility remains on the technical solution but the scope of services has been described.	**Y**
	Does a preliminary assessment indicate that there is likely to be scope for innovation? Soft market sounding suggest potential bidders may approach the project in ways that indicate there is scope for innovation while still meeting the Trust's vision and specification.	Y
	Could the private sector improve the level of utilisation of the assets underpinning the project (e.g. through selling, licensing, commercially developing for third party usage etc)? There is an opportunity for a commercial development with third party usage but not from core space. The Trust will decide on the management of the TPI opportunities (such as shops) as may conclude it is better value for money to manage the contract internally.	Y
Contract duration and residual value	**How far into the future can service demand be reasonably predicted? What is the expected life of the assets? What are the disadvantages of a long contract length?** The Trust has undertaken a detailed market analysis and has worked closely with PCTs considering future activity considering demographics, epidemiology and models of care. The asset is expected to last 60 years. The disadvantage of a long contract length is the cost of change. The design requirements will encourage flexibility so that use and volume of activity can change without significant cost.	
	Are there constraints on the status of the assets after the contract end? The assets at the end of the contract revert to the Trust in Condition B. It is intended that the assets will continue to be used as a hospital after the end of the concession.	
	Given the possibility of changes to the requirement, the assets and the operating environment, is it possible to sustain value for money over the life of the contract utilising as appropriate, mechanisms such as benchmarking and technology re-fresh? **See also para 2.5 below.**	Y
Incentives and monitoring	**Can the outcomes or outputs of the investment programme be described in contractual terms, which would be unambiguous and measurable?** The contract (in particular the output specification and payment mechanism) is clear about the outputs required and the standards to be met and these are unambiguous and measurable.	Y

Issue	Question	Y / N
	Can the service be assessed independently against an agreed standard? Each service specification contains performance standards which can be measured and independently assessed.	Y
	Would incentives on service levels be enhanced through a PFI payment mechanism? The payment mechanism will provide an incentive to meet the service levels, through the potential to face significant reductions in payment due to under performance. The whole payment is at risk of poor performance.	Y
Lifecycle costs	**Is it possible to integrate the design, build and operation of the project?** Bidders will view the whole life costs of the facility as the design, build and maintain obligations rest with them. The integration of the design, build and operation of the Project is expected to be achievable based upon the Project team's experience.	Y
	Are there significant ongoing operating costs and maintenance requirement? Are these likely to be sensitive to the type of construction? There will be significant operating and maintenance costs. Where these are the responsibility of the private sector, they will view the whole life costs and considered in the approach to construction. Where the costs for service provision lie with the Trust, the specifications are clear about the Trust's requirements and bidders solutions will be evaluated using total operating costs, eg additional space will result in additional cleaning and energy costs incurred by the Trust and this will be reflected in the evaluation of the solutions..	Y
OVERALL DESIRABILITY	**Overall, is the Trust satisfied that PFI would bring sufficient benefits that would outweigh the expected higher cost of capital and other disadvantages?** Overall, the trust is satisfied that PFI would bring sufficient benefits in the transfer of service delivery, responsibilities and risks to outweigh the expected higher costs.	**Y**
ACHIEVABILITY While PFI may allow a more efficient and effective combination of public and private sector skills, determining the rules that will govern the relationship between the two sectors does involve significant transaction costs. In particular, the procurement process can be complex and involve significant resources, including senior management time which may be required for project development and the ongoing monitoring of service delivery. Client capacity and capability, together with private sector deliverability, will have direct consequences for procurement times and the level and quality of market interest. PFI needs a robust competitive process to deliver fully its benefits and so the choice of procurement route should be informed by an assessment of the likely market appetite.		
Market Interest	**Is there evidence that the private sector is capable of delivering the required outcome?**	**Y**

Issue	Question	Y / N
	General market experience and the Trust's soft market soundings suggest the private sector is capable of delivering the required outcome. A significant number of large construction companies and FM providers have contacted the Trust and visited the site over the past few years during the OBC development.	
	Does a significant market with sufficient capacity for these services exist in the private sector? There is a sufficient market with sufficient capacity to deliver this project.	**Y**
	Is there likely to be sufficient market appetite for the project? The Trust's soft market soundings suggest there is sufficient market appetite for the project. This is evidenced by the number of parties that have contacted the Trust on numerous occasions.	**Y**
	Has this been tested robustly? Is there any evidence of lack of market competition for similar projects? The Trust has spoken to a number of bidders about the scheme on numerous occasions Other recent NHS schemes have had 2-4 strong contenders.	**Y** **N**
	Have similar projects been tendered to market? Has the procuring authority's commitment to a PFI solution for this type of project been demonstrated? There have been a number of similar projects- in fact all large hospital projects over the past 20 years have been procured through PFI in England and the Trust has demonstrated its commitment to PFI and has an existing PFI already which demonstrates the Trust understands the associated risks and issues.	**Y** **Y**
	Does the nature of the project suggest it will be seen by the market as a profitable venture? Bidders will view a construction and 30 year maintenance contract as being a profitable venture provided bid costs are controlled and timetable adhered to. The new guidance assists in this regard, giving clear guidance on timetable with agreed approval processes and timing.	**Y**
	Are the risks associated with design, development and implementation manageable bearing in mind the likely solutions to the project? Any risks associated with this are manageable and placed with those best party able to manage it.	
Other issues	**Is the procurement feasible within the required timescale? Is there sufficient time for: resolution of key Authority issues; production/approval of procurement documentation; staged down-selection and evaluation of bidders, negotiation, approvals and due diligence?** The timetable has been agreed within the Trust, with advisors and with DH. The process is well known by the public and private sector and a new	**Y**

Issue	Question	Y / N
	timetable has been mandated by HM Treasury which includes approach and timing of approvals.	
	Is the overall value of the project significant and proportionate to justify the transaction costs? The project scale is significant enough to justify the transaction costs.	**Y**
	Does the nature of the deal and/or the strategic importance of the work and/or the prospect for further business suggest that it will be seen by the market as a potentially profitable venture? See above	**Y**
	Does the Authority have the skills and resources to define, deliver and support the service throughout the procurement and the subsequent delivery period? The Trust has the skills and resources to manage the procurement and monitor the service. The Trust has an existing PFI from which they are able to draw upon experience gained. The Trust has specialist advisors in place with significant PFI experience.	**Y**
OVERALL ACHIEVABILITY	**Overall, is the Trust satisfied that a PFI procurement programme is achievable, given client side capability and the attractiveness of the proposals to the market?** The Trust is satisfied that a PFI procurement programme is achievable, that it has the capability to deliver and the bidder market is interested.	**Y**

APPENDIX 3

Wider Benefits of PF2

Where PF2 is effectively utilised, it offers a number of advantages in the delivery of public sector infrastructure. These advantages arise from the sharing of risk in public projects within a structure in which the private sector puts its own capital at risk to ensure delivery and performance.

In the right circumstances and if executed correctly, PF2 can help ensure:

- Desired service standards are maintained. Since under PF2 the private sector's capital, not just its profit, is at risk depending on private sector performance, there is a very strong incentive for the private sector to maintain high and reliable service standards throughout the life of the contract;

- The private sector contractor does not get paid until it delivers. The record of conventional procurement is poor in this respect, with frequent delays before public assets become operational; and

- More efficient use of public money. In the past, some conventional public procurement has gone heavily over budget, consuming funds which could otherwise have been invested in other public services. Under PF2, the public sector only pays for the service it has contracted for, at the price it has contracted for, and only when that service is available. Under conventional procurement the public sector is forced to fund cost overruns, and pays out whether or not the service it needs is actually available.

Listed below are a number of the key advantages of pursuing a PF2 Competitive Dialogue procurement route in comparison with a traditional procurement:

Competitive Dialogue/Competitive Tension

The PF2 procurement route allows the Trust to harness the efficiency that can come from contestability in competitive dialogue procurement. This enhanced competitive tension ideally leads to superior design solutions and 'keener' price estimates as bidders are evaluated against each other on both price and quality of their solutions at various stages of the process.

All in one solution

Under the PF2 route a preferred Contractor is appointed to design, build, finance and operate the hospital over the 30 year concession period. Therefore, through the design process many of the interface issues between construction, operation and long term maintenance solutions are considered and 'built in' to the overall whole life solution.

Contractors are incentivised to deliver the required service over the whole life of the asset. The private sector partner only gets paid (via the unitary payment) if it maintains standards throughout the length of the contract (for example 30 years in on this project). This means that in designing, building and maintaining a the hospital the private sector has a strong incentive to ensure high standards are built in and maintained across the building's whole life, as it would be forced to remedy defects and make repairs in the future.

Mature Market and Market Ready Solution

A significant number of hospitals have been successfully delivered via PFI across the UK. As such, there is an established market and experienced amount of contractors capable of delivering projects of this nature and scale. Each contractor will have access to a preferred supply chain (either an umbrella company or standalone provider) and a template solution and approach which is capable of being adapted for each individual project.

The process of standardising PFI and subsequently PF2 contracts has helped to spread best practice, improving PF2 procurements across the public sector and reducing the length and cost of PF2 procurement.
At the same time, the standard contracts maintain flexibility for an individual project to set its needs and requirements, while providing standard terms for those elements that are common to all procurement processes.

Private sector expertise and risk transferred to party best placed to manage said risk

Private sector expertise and experience has always been utilised in public sector procurement, but, where in traditional procurement private companies built and then walked away, PF2 seeks to ensure that the private sector takes responsibility for the quality of design and construction it undertakes, and for long-term maintenance on an asset, so that value for money is achieved. PF2 projects can capture the benefits of having the private sector incentivised to perform by having its own capital at risk, while safeguarding and advancing the public interest in the best public services for all.

In effective PFI procurement:

- The public sector specifies the outputs it requires and a private sector consortium then contracts to meet those requirements;

- The risk involved in the project is shared between the parties, with each party managing the risks they are best able to. This approach to risk sharing provides powerful incentives for the private sector to perform, and ensures value for money for the public sector; and

- The public sector ensures the quality and continued effective delivery of public services is maintained, with the ability to make deductions for poor performance, the flexibility to make necessary changes in future, provisions for the consortium or funders to replace poor service providers, and ultimately the right to terminate the contract.

Private Finance

The involvement of private finance in taking on performance risk is crucial to the benefits offered by PF2, incentivising projects to be completed on time and on budget, and to take into account the whole of life costs of an asset in design and construction. Private finance in PF2, particularly third-party finance, takes the risks in a project and allocates them to the party best able to manage them. The lenders to a PF2 project, as they have significant capital at risk, have a powerful incentive to identify, allocate and ensure the effective management of all the risks the private sector assumes in a project. Private finance therefore plays an important part in PF2's ability to deliver value for money benefits, and will continue to be integral to its success.