Secondment of Staff for the New Tyne Tunnel

Based on HM Treasury VfM Methodolgy

CENTRE for PUBLIC SERVICES

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List of abbreviations

BVPP	Best Value Performance Programme
BVR	Best Value Review
FBC	Full Business Case
FM	Facilities Management
HMT	Her Majesty's Treasury
NPV	Net Present Value
OBC	Outline Business Case
OGC	Office of Government Commerce
ODPM	Office of the Deputy Prime Minister
OJEU	Official Journal of the European Union
PFI	Private Finance Initiative
PSC	Public Sector Comparator
PTA	Passenger Transport Authority
SPV	Special Purpose Vehicle
TUPE	Transfer of Undertakings (Protection of Employment) Regulations 1981
VfM	Value for Money
4ps	Public Private Partnerships Programme

Executive Summary

Secondment model

Staff employed by the PTA on the existing Tyne Tunnel should be seconded to the tunnel operator who will build the new tunnel and operate both tunnels plus the cycle and pedestrian tunnels. There are secondment agreements already operating successfully in local and health services.

80% of Tyne Tunnel staff are in the 40-65 year age group compared to just 62% of Newcastle City Council staff. Thus both the quality and security of pension arrangements are vitally important. The current crisis in pensions clearly demonstrates that the security of a 'broadly comparable' pension is equally important as the quality of the pension. Secondment eliminates this major concern.

Advantages of secondment

- Employee pensions safeguarded
- PTA retains flexibility and capacity
- More contented and secure workforce
- Improved staff recruitment and retention
- Less risk of industrial action
- PTA corporate policies implemented

Support services can be excluded from PFI/PPP projects

Government policy states that operational services such as repairs and maintenance, cleaning, grounds maintenance and security can be excluded from Private Finance Initiative (PFI) contracts **before** the procurement process commences (see Part 1).

A decision to exclude support services must be based on strategic priorities, the PTA's procurement policy and a HM Treasury value for money and quantitative assessment.

The case

1. Legally possible to exclude support services.
2. Not a traditional PFI project so even more flexibility.
3. The in-house team which successfully operated the existing tunnel for 25 years, achieving significant cost reductions and savings whilst maintaining availability and quality of service, should not be penalised by the funding arrangements for the new tunnel.
4. The operational risk is very small relative the design, technical and construction risks associated with its construction.
5. The operational risks must be discussed in the context of staff performance since 1967.
6. The case for secondment needs to be clearly set out so that all parties are confident that this option is beneficial for the success of the project.
7. The private sector will want 'security' in terms of cash flow and maintenance of the asset and assurances that replacement rates are maintained.
8. There are clear benefits to Tyne and Wear PTA, the four local authorities, staff, investors and the consortia to retain in-house provision for the entire project.

Value for money not at expense of workers

The Treasury has stated that value for money should not be achieved at the expense of workers' terms and conditions. There is also substantive evidence which shows the importance of job satisfaction and employee participation in achieving productivity gains and service improvements.

The methodology and evidence to justify the exclusion of support services

The report uses HM Treasury's Value for Money methodology to demonstrate why support services should be excluded from PFI/PPP projects. The methodology includes the strategic rationale, improved standards of service delivery, flexibility of public service provision, equity, efficiency and accountability criteria set by the Treasury.

The Treasury's quantitative assessment covers lifecycle costs, operating expenditure, third party income, transaction costs and a wide range of indirect value for money factors. The report explains how these costs and impacts should be built into the spreadsheet and identifies sources of evidence. In particular, it examines the externalities and non-market factors in a worked example of a multi-criteria analysis performance matrix. The report also discusses how optimism bias and risk assessment should be considered in the qualitative assessment.

Part 1
Introduction

In March 2004 the Tyne and Wear Passenger Transport Authority (PTA) commenced procurement of a new Tyne Tunnel with a OJEU notice seeking expressions of interest to design, build and operate the tunnel. The contract will include upgrading and maintaining the existing Tunnel and maintaining the cycle and pedestrian tunnels.

The new Tyne Tunnel is not classified as a PFI project but a PPP in which the principles applicable to PFI will operate. The PTA plans to transfer the operation of the existing tunnel and the workforce to the contractor and operator of the new tunnel. UNISON believes it would be perverse to transfer operational functions from the existing tunnel to the private sector, particularly since the existing tunnel is projected to have cleared its debt by 2006.

The government extended the Code of Practice on Workforce Matters in Local Government to the rest of the public sector in March 2005. It will apply to "new contracts in procurement up to the stage to the invitation to Negotiate stage, from the date of the government's announcement" (Letter from Cabinet Office to TUC, 2005).

This report sets out the case for the PTA to adopt a Retention of Employment Model or secondment of staff. Several PPP projects are based on the secondment of staff (see Part 2).

This is further supported by the fact that PFI and PPP projects can exclude support services which can continue to be supplied by in-house services. PFI guidance explicitly states that:

- Support services need not be included in PFI projects if it is not essential for achieving the overall benefits of improved standards of service delivery specified by the procuring organisation.
- Value for money should not be pursued at the expense of the terms and conditions of staff.

The process of excluding support services must be robust, transparent and open to scrutiny. This report provides the rationale and evidence to support this approach.

Invitation to submit outline proposals

The Invitation to Submit Outline Proposals (PTA and Arup, March 2004) included a section on 'staff issues' which asked potential bidders to identify the key issues which they considered needed to be addressed as part of the transfer of existing tunnel staff and how they would manage these issues. It also asked for their experience of taking on staff under TUPE, whether they had "any issues about" the Code of Practice on Workforce Matters, and their views on the impact of the Code of Practice on Workforce Matters on operating costs.

It did not seek potential bidders views about a secondment option. The question about costs is surely irrelevant if the application of the Code of Practice is a requirement. Any question of whether the Code did or did not apply has been removed with the government agreeing to apply the Code across the public sector earlier this year.

The four bidders expressing an interest in the contract stated their commitment to TUPE transfers. The Bouygues group stated that they did not consider that the Code itself would have a differential impact and that "it raises a threshold for the market as what is acceptable employment and HR practices (which the Consortium fully supports) as it requires all bidders to price on the same basis." The T4 group referred to having broadly comparable terms and conditions and pensions for transferred staff and new starters. They noted that employers pensions contributions could be reduced because pensions are not included in TUPE but "the loss of motivation, commitment and therefore the efficiency of the workforce that would be likely to arise from the imposition of reduced pension rights would more than offset the direct cost savings nominally made." The Laing and Balfour Beatty/Haden responses also stated commitment to the Code and broadly comparable pensions.

Tyne Tunnel services

Tyne Tunnel staff are deployed in three sections – management and administration, operations (revenue collection, safe passage of users, breakdowns, vehicle inspection, security, hazardous and abnormal loads) and maintenance (infrastructure repairs and improvements, mechanical and electrical repairs, tunnel repairs and defects).

Table 1: **Existing staffing structure**

Management and Administrative Activities	Operations Prime Tasks	Maintenance Activities
Management 3 staff	Traffic 49 staff	Maintenance 18 staff
Administration 6 staff	Tolls 14 staff	Environmental 5 staff
Catering 3 staff		
Total: 12	Total: 63	Total: 23

Source: Tyne Tunnels Organisation, NTC Project Open Day, Peter Hedley, 1 April 2004.

Under a secondment arrangement only managers and senior supervisors would be transferred to the private operator. The PTA would continue to employ the operational, maintenance, toll and administrative staff and would be responsible for employing additional staff required when the new tunnel becomes operational.

The decision on excluding support services will need to be taken in the context of the principles and processes in the PTA's procurement strategy and policy. Newcastle City Council's procurement strategy sets out the procedure to be followed if a service has not recently been subjected to a Best Value Review. In these circumstances the procedure requires future service needs to be assessed and informed by "…..a full understanding of the City Council's aims and external environment" including the needs and views of service users, the purpose of the service and its contribution to the council's strategic aims, the track record of other forms of provision, the added value to equalities, diversity, community well-being and environmental sustainability (Newcastle City Council, 2003).

Once future service needs have been identified, including delivery, "…..the existing service will be compared to the future needs and when a service does not appear to have the expertise, culture or capacity to:-

- meet future needs or
- be capable of developing a service improvement plan or,
- where either:-
    - a service improvement plan fails to be implemented or
    - falls short of user expected service delivery or
    - fails to achieve targeted performance indicators

a procurement exercise will be undertaken.

In other words, where a service is performing well, can meet future needs and has an improvement plan, the procurement process is not automatically triggered (ibid).

Part 2
The Retention of Employment or Secondment Model

There are two secondment models. The first is a model secondment agreement developed by Liverpool City Council for the joint venture with BT and a similar agreement drawn up Rotherham MBC, also with BT. All staff within the scope of the contract were seconded to BT with new starters also being employed by the local authority. The Secondment Agreement sets out the obligations, employment status of the secondees and their management by the contractor.

The second model is the Department of Health Retention of Employment model (RoE) developed for NHS staff in England for NHS Trusts involved in PFI projects. It covers catering, cleaning, laundry, security and portering services although supervisory and managerial staff are transferred to the private contractor.

Table 2: **Examples of Staff Secondment**

Public sector body	Contractor	No of jobs	Services supplied
Liverpool City Council	BT	850	ICT and related services
Rotherham MBC	BT	450	ICT and related services
Stoke on Trent	Balfour Beatty	N/a	PFI schools – support staff
Department of Health/NHS Trusts Blackburn Newcastle	N/a	N/a	NHS support services
Environment Agency	N/a	N/a	Broadlands flood protection project

Risks borne by staff

The advantage of the secondment model is that it substantially reduces the risks of employment change when staff are transferred when a service is outsourced. **The PTA's proposal effectively means that they are transferring a series of risks to their existing staff.** TUPE transfers and the Code of Practice do not provide any guarantees. Pensions are not covered by TUPE. There is considerable change occurring in the pensions sector with private sector employers replacing final salary with money purchase schemes and a growing number of under-funded pension schemes.

Other risks are transferred to staff such as changes to terms and conditions of service, changes to staff consultation and representation, and to workplace conditions.

Table 3 identifies and compares the levels of risk borne by employees in the secondment model and with a TUPE transfer in outsourcing.

Table 3: **Employment Risk Matrix**

Risk	Secondment	Transfer
Risk of changes to terms and conditions of service		
Risk of changes to staffing levels after transfer without staff agreement.	**No** risk because of Change Control Procedure in Secondment Agreement	**High** risk Code of Practice on Workforce Matters does not prevent changes over time
Risk of changes to terms and conditions of employment.	**No** risk as staff remain on local authority terms and conditions	**High** risk Code of Practice on Workforce Matters does not prevent changes over time
Risk of not meeting annual pay award in full and on time	**No** risk	**Low** risk - Code of Practice on Workforce Matters should prevent it happening.
Risk of changes to the composition of pay and benefits such as holidays	**No** risk as staff remain on local authority terms and conditions	**High** risk Code allows contractor to change mix of pay, holidays and pension.
Risk of two-tier workforce developing	**Low** risk - only if large differences between transferees and seconded staff develop	**High** risk Staff on different mixes of terms and conditions could create two-tier workforce
Risk of changes to pension arrangements	**Low** risk	**Medium** risk Code is ‘permissive’ with regard to defined benefit/final salary scheme
Risk of no or inadequate redeployment	**Low** risk	**High** risk Not applicable therefore staff bear the risk
Risk of inadequate implementation of family friendly policies	**Low** risk	**Medium** risk
Risk of changes to workplace conditions		
Risk of changes to trade union facility time	**Low** risk	**Medium** risk of demanding/imposing a reduction
Risk of changes to health and safety policies and practices	**Low** risk	**Low** risk
Risk of changes to grievance and disciplinary procedures	**Low** risk	**High** risk as private sector has own procedures.
Risk of changes to equal opportunities policies and practices	**Low** risk	**Medium** risk in terms of degree of implementation
Failure to implement corporate policies and priorities	**Low** risk	**Medium** risk of some corporate policies not fully implemented
Risk of loss of public service ethos	**Low** risk as staff remain council employees	**High** risk - staff will be private sector employees

Risk	Secondment	Transfer
Risk of changes to staff consultation and representation		
Risk of lack of consultation with ICT staff over improvement plans and reengineering proposals	**Low** risk because of Change Control Procedure in Secondment Agreement	**Medium** risk based on experience of PPP and outsourcing contracts
Risk of lack of consultation with staff in other PTA Departments	**Low** risk because of Change Control Procedure in Secondment Agreement	**Medium** risk based on experience of PPP and outsourcing contracts
Risk of changes to working practices which have not been agreed with staff and trade unions	**Low** risk because of Change Control Procedure in Secondment Agreement	**High** risk based on PPP and outsourcing contracts.
Risk of inadequate training	**Low** risk because of Change Control Procedure in Secondment Agreement	**High** risk based on PPP and outsourcing contracts
Risk of changes to the industrial relations framework	**Low** risk because of Change Control Procedure in Secondment Agreement	**High** risk based on PPP and outsourcing contracts
Risk of problems with secondment agreement		
Risk of secondment agreement failing	**Low** risk based on experience in other parts of the public sector	**No** risk – not applicable
Risk of legal challenge to secondment agreement re TUPE	**Low** risk based on experience in other parts of the public sector	**No** risk – not applicable

Source: Centre for Public Services, 2005.

The scoring of the Risk Matrix is summarised in Table 4. It shows clearly that 100% of the risks for the secondment model are in the none/low risk category compared to only 19% in the transfer model. The transfer model has 48% of the risk for employees in the high category and 33% in the medium risk category.

The Risk Matrix shows clearly that PTA employees will be bearing a substantial element of risk if they are transferred to a tunnel operator compared to the much lower level of risk associated with the secondment option.

Table 4: **Summary of Employment risk**

Risk level	Secondment		Transfer	
	Number	%	Number	%
None	4	19	2	9.5
Low	17	81	2	9.5
Medium	-	-	7	33
High	-	-	10	48
Total	21	100	21	100

Pension arrangements

In Liverpool and Rotherham and the NHS examples staff remain in their respective public sector pension funds. In the event of seconded staff being paid by a contractor, Inland Revenue have provided guidance in Occupational Pensions Practice Notes which states:

> "3.12 An employee who is temporarily absent or is seconded to another employer and remains resident in the United Kingdom may remain in full membership of an approved scheme (even though during his or her absence no *remuneration* is paid by the original employer), if:
>
> (a) there is a definite expectation of return to service, and
>
> (b) during the period of absence he or she does not become a member of
>
> * another approved *retirement benefits scheme*,
>
> * a *retirement benefits scheme* seeking approval, or
>
> * a *personal pension scheme* other than
>
> - a "minimum contributions" only scheme, or
>
> - through eligibility to contribute to a *personal pension scheme* under section 632B ("concurrency").
>
> Absence during which no retirement benefits accrue (where the benefit of remaining a member flows from aggregation of two periods of service for benefit calculation purposes and/or the provision of death in service cover during the absence) is not subject to the conditions at (a) and (b) above.
>
> 3.13 A period of full membership while temporarily absent may, subject to paragraph 3.12 above, continue for up to 10 years without reference to *IR SPSS*."
>
> (Occupational Pension Schemes Practice Notes, Inland Revenue, 2001)

Commenting on the legal aspects of the Retention of Employment model in the NHS, Davies concludes that:

> "By remaining an employee of the Trust the Retained Employee also retains the ability to remain or become a member of the NHS Superannuation Scheme. This is a key feature of ROE: employees are able to continue to participate in a public sector final salary scheme. Given the turbulence of the equity markets in recent years and the myriad examples of private sector pension scheme funding gaps, this is likely to be a crucial issue for many employees." (Industrial Law Journal, 2004).

Pensions and the age structure of Tyne Tunnel staff

The age profile of the current Tyne Tunnel workforce is set out in Table 5. This shows that 79% of the workforce are in the 40-65 age group. This age group has 76% of the female staff compared to 63% of the male employees.

Table 5: **Age profile of the current Tyne Tunnel staff**

Age profile of Tyne Tunnel Staff, April 2005				
Age group	**Female**	**Male**	**Total**	**%**
50 – 65 years	5	27	32	32.3
40 – 49 years	11	36	47	47.5
30 – 39 years	3	14	17	17.2
20 – 29 years	2	1	3	3.0
Total	21	78	99	100.0

Source: Tyne Tunnel PTA.

Newcastle City Council Staff age profile

The age profile of City Council staff shows a more even and younger profile compared to the Tyne Tunnel workforce – see Table 6. There are significant differences such as the 64%/36% female/male gender divide in city council staff compared to the 21%/78% gender divide in the Tyne Tunnel workforce. Sixteen percent of the city council workforce are under 30 years old compared to only 3% in the Tyne Tunnel staff.

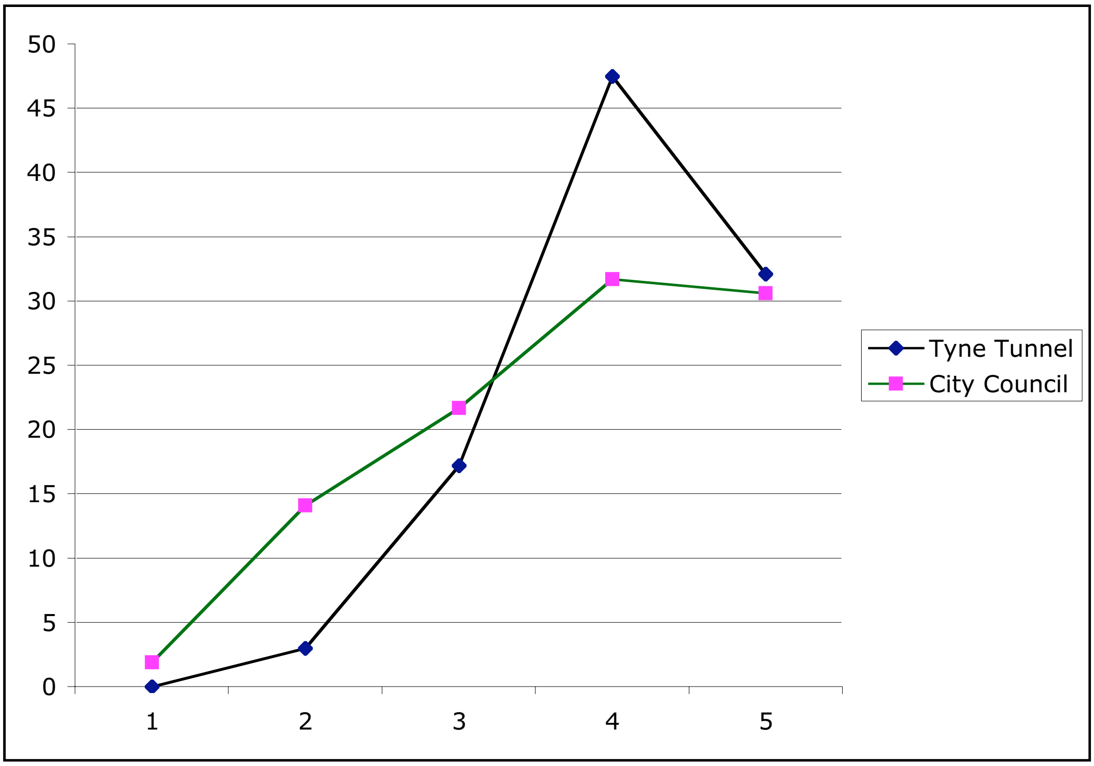
Table 6: **Age Profile of Newcastle City Council Staff, 2005**

Age profile of Newcastle City Council Staff, April 2005				
Age group	**Female**	**Male**	**Total**	**%**
50 – 65 years	3,336	1,897	5,233	30.6
40 – 49 years	3,437	1,986	5,423	31.7
30 – 39 years	2,437	1,281	3,718	21.7
20 – 29 years	1,529	895	2,424	14.1
16 – 19 years	145	176	321	1.9
Total	10,884	6,235	17,119	100.0

Source: Newcastle City Council.

The key difference in comparing the age profile of the Tyne Tunnel and city council workforce is the age profile in the 40-49 year and 50-65 year age groups. This is illustrated in Figure 1 which shows that the Tyne Tunnel workforce has a much higher percentage of staff in these two age bands. The quality and security of pension arrangements is therefore of vital importance for the Tyne Tunnel staff.

Figure 1: **Comparison of Tyne Tunnel and Newcastle City Council Staff Age Profiles**



16-19 yrs 20-29 yrs 30-39 yrs 40-49 yrs 50-65 yrs

Quality and security of pensions

There are two key questions for staff. The first is the quality of their pensions. The bidders indicated that they are committed to 'broadly comparable' pensions although how this works out in practice remains a key concern. The second question is the security of the pension scheme at a time when the private sector has been closing final salary schemes and others have reported significant under-funding of pension funds. A pension is only 'broadly comparable' if the security of the pension fund is also broadly comparable to the Local Government Pension Scheme (LGPS). This is highly unlikely to be the case with any of the bidders for the new Tyne Tunnel. Private companies are always vulnerable to takeover and mergers and changes to pension funds. The secondment of staff would eliminate this major concern.

Advantages of secondment

The advantages of secondment are substantial and are summarised below:

- Employee pensions are safeguarded
- PTA retains flexibility and capacity
- More contented and secure workforce
- Improved staff recruitment and retention
- Less risk of industrial action
- PTA corporate policies implemented

Part 3

The government's position on the exclusion of support services

PFI guidance on the exclusion of support services

> "A crucial choice for Procuring Authorities is the extent to which a range of services is included in the scheme. Are these restricted to hard FM or does the scheme also include support FM? **There is no *priori* reason why a PFI scheme has to include support services where the Authority believes that their transfer is not essential for achieving the overall benefits of improved standards of service delivery specified by the procurer, and where not transferring staff is consistent with delivering the Prime Minister's commitment to flexibility in public services.** This should form part of both the quantitative and qualitative analysis" (Value for Money Guidance, HM Treasury, August 2004, para 1.10, our emphasis).

The Treasury report, 'PFI: Meeting the Investment Challenge', which detailed the government's approach to PFI, also made virtually the same statement, adding

> "The Government believes that PFI procurement does not involve maximising the transfer of employees to the private sector and that the value for money benefits it can offer……are not obtained at the expense of workers' terms and conditions." (*PFI: Meeting the Investment Challenge*, HM Treasury, July 2003, para 7.18)
>
> The Green Book: Appraisal and Evaluation in Central Government (Annex 1 p.55) outlines "the importance of considering the impact on employment in appraisal." (para A.10, HM Treasury, 2004)

Other evidence

There is also other evidence to support the case for the exclusion of support services.

A study by Eversheds in 2002 concluded that it was generally accepted that there were no legal obstacles to local authority Direct Service Organisations (DSOs) participating in PFI schemes for support services. They also concluded that the provision of support services by in-house teams did not compromise transfer of risk to the private sector and, therefore, met the FRS5 test allowing the project to remain 'off balance sheet'. Significantly, the study also concluded that the provision of 'hard' services such as Design and Building Maintenance could also be delivered on an in-house basis, whilst still meeting the FRS5 test (*The Involvement of DLOs and DSOs in Local Authority PFI Schemes 2002*", APSE, 2002).

Prior to this, a 1998 DETR document *Local Government and the Private Finance Initiative* had clearly stated that the choice on which services to include was a decision for Local Authorities. The Treasury also wrote to the Association for Public Service Excellence stating that "…the government has made it clear that there is not a requirement for staff providing 'support facilities management' services – such as ancillary staff in hospitals – to transfer as part of a PFI contract" (UNISON: May 2000).

Part 4
Employment and workforce matters

Meeting the Investment Challenge set out a number of principles for employee protection in PFI projects:

- being open with staff and achieving greater transparency
- protecting terms and conditions for both transferees and new joiners
- protecting staff pensions
- retaining flexibility in public service delivery

Where staff are transferred, the Best Value Code of Practice on Workforce Matters will apply.

Value for money should not be achieved at workers' expense

The HM Treasury Value for Money Assessment Guidance makes clear the position on employment:

> "VfM should not be achieved at the expense of workers' terms and conditions; the position of the workforce within any PFI deal is a vital consideration for appraisers and project teams. Appraisers should consider carefully the impact on the risk allocation and the ensuing benefits and disadvantages of transferring staff when considering whether PFI is appropriate."

The guidance also states:

> "In undertaking a PFI procurement, Procuring Authorities should take full account of the suite of guidance pertaining to the treatment of staff. This should include the Cabinet Office Statement of Practice issued in 2001, HM Treasury Guidance relating to bulk transfer agreements and, where applicable, the Best Value Code of Practice, NHS guidance on Retention of Employment and the Scottish Protocol on Employment issues. Due care should also be given to the advice set out in PFI: Meeting the Investment Challenge, Workforce Issues. VfM should not be pursued at the expense of staff terms and conditions; this position is embedded in the quantitative spreadsheet used at stages 1 and 2**."** (Value for Money Assessment Guidance, HM Treasury, August 2004, paras 1.6 and 1.7).

The scope of the Best Value Code of Practice on Workforce Matters is limited in several important ways:

Firstly, it only applies when staff are transferred to a contractor. It does not apply when local authorities transfer work to the private sector by commissioning spot contracts or when a new service is initiated.

Secondly, private contractors can join the Local Government Pension Scheme to provide transferred staff with pensions but too few contractors do so. In addition the Code is "…permissive" with regard to the defined benefit/final salary option (Wing, 2004).

Thirdly, a private contractor could agree to implement the Code at the start of a contract but later use delaying tactics in awarding annual pay increases or reclassify the job titles/descriptions of new starters.

Finally, the requirement to offer new starters "…overall no less favourable" terms and conditions and a pensions package could lead to some contractors devising pay and conditions which undermine this principle. Although the Code will be part of the PFI contract, the risk of cuts and variations developing over a 30 year period is far greater than most other risks associated with PFI, particularly since it is the staff who bear the risk, not the PFI contractor or the PTA.

It is for these reasons that a TUPE Plus transfer should be standard practice.

The importance of having a skilled and committed workforce throughout the contract period is very important. An Office of the Deputy Prime Minister (ODPM) study into the role of staff in delivering high quality public services concluded that:

- A majority of local authority survey respondents believe that active staff engagement in best value and performance improvement brings positive benefits in improved service performance, higher productivity, improved staff morale, and staff recruitment and retention;
- Survey analysis identified a positive association between staff involvement in the implementation of action plans following best value reviews and local authority Comprehensive Performance Assessment (ODPM, 2004).

Earlier studies have also highlighted the importance of job satisfaction and employee participation in achieving productivity gains and service improvements (IDeA et al, 2000). However, experience in Strategic Service-Delivery Partnerships operated by private sector firms in Lincolnshire, Middlesbrough, Blackburn, Liverpool and Southwark reveals a lack of employee consultation in change management and poor training despite these practices featuring prominently in the company's promotional material and during the procurement process (Centre for Public Services, 2003).

Part 5

Value for Money assessment of support services

This section examines the Treasury's Value for Money (VfM) model and provides a detailed case for the exclusion of support services within the framework provided by this model. Value for Money (VfM) is defined as "…the optimum combination of whole-life cost and quality (fitness for purpose) to meet the user's requirements" which is "…rarely synonymous with lowest price" (Office of Government Commerce, 2004).

The criteria developed for the exclusion of support services can also be used as the justification for the exclusion of a wide range of educational support services.

The need for the estimation of operating and lifecycle costs in the VfM assessment to be realistic is emphasized by the 4ps in the following statement on OBC guidance:

> "Operating costs should cover the on-going provision of services included within the scope of the project, and the associated operating, facilities management, energy, maintenance and lifecycle costs. It is easy to overlook or underestimate the costs of implementing a project and the transitional and change management resources required. It is important, therefore, that realistic estimates are prepared and included in the appraisal" (4ps, 2004).

The case for the exclusion of support services

The Treasury's VfM Assessment Guidance (August 2004) has a qualitative assessment methodology based on three factors - viability, desirability and achievability. The key issues and questions are summarized in Table 1 with the sections applicable to support services included in full.

Table 7: **Treasury Value for Money Methodology for excluding support services**

Value for Money Methodology	
Issue	**Question**
VIABILITY Programme level objectives and outputs Operational flexibility	
Equity, efficiency and accountability	**"Are there public equity, efficiency or accountability reasons for providing the service directly, rather than through a PFI contract?** Are there regulatory or legal restrictions that require services to be provided directly? Have the expected staff terms and conditions at stage 2 been considered and what are the impacts on the contract, equity efficiency and accountability?"
OVERALL VIABILITY	
DESIRABILITY Risk management Innovation Incentive and monitoring Lifecycle costs and residual value	
Service Provision	**"Are there good strategic reasons to retain support service provision in house?** • What are the implications in the longer term for the organisation in losing these skills- are all the expertise transferring or is there some retention? E.g. skills to manage contracts or let future similar contracts. **Is support service transfer essential for achieving the overall benefits of improved standards of service delivery?** • What are the relative advantages and disadvantages? • Is there a commitment that the assumed benefits are deliverable without eroding the overall terms and conditions for staff? • Is transfer necessary to achieve the optimal risk allocation? **Where support services are not transferred, is this consistent with the Prime Minister's commitment to flexibility of public service provision?** • Are there changes in working practices that are only deliverable through transfer or are there other ways these could be achieved and do they deliver VfM?"
OVERALL DESIRABILITY	
ACHIEVABILITY Transaction costs and client capacity Competition	
OVERALL ACHIEVABILITY	

Source: Value for Money Guidance, HM Treasury, August, 2004.

The case for the exclusion of support services is made below using the three statements in the Service Provision section in Table 1.

"Are there public equity, efficiency or accountability reasons for providing the service directly, rather than through a PFI contract?" In the Tyne Tunnel scenario, this statement could include the rationale for secondment.

- Traffic volumes have increased steadily since 1967, however, the number of staff has declined from 167 to 97 in 2002 – a 42% decline. This is a strong and consistent Best Value track record.
- The safeguarding of public sector final salary pensions is justified on equity grounds alone given the potentially significant differences between pensions and the current moves to money purchase and underfunding of private sector pensions.

"Are there good strategic reasons to retain support service provision in-house?" The strategic reasons also apply to the secondment of staff.

- In-house services have direct responsibility for implementing the PTA's corporate policies and priorities on employment, equalities and the adoption of family-friendly policies with more flexible working arrangements. The implementation of corporate policies by third parties is frequently less comprehensive and significantly slower.
- Provides better-quality jobs, terms and conditions. Although the Best Value Code of Practice on Workforce Matters provides some protection against a two-tier workforce this is not guaranteed.
- Better health and safety practices and track record in in-house services.
- Equality issues are more fully addressed by in-house services.
- Better quality training with established opportunities for education, learning and career development. This will translate into better-trained staff, higher levels of job satisfaction, which in turn results in better quality services (IDeA et al, 2001 and ODPM, 2004).

"Is support service transfer essential for achieving the overall benefits of improved standards of service delivery?"

This is usually justified on grounds of flexibility, risk transfer, better-quality services and value for money. The answer to the question is 'no' for the following reasons:

Flexibility: see below

High quality service: In-house services have the ability and capacity to provide equivalent or better quality services (Audit Commission, 2003).

Value for money: see Part 6.

"Where support services are not transferred, is this consistent with the Prime Minister's commitment to flexibility of public service provision?"

The exclusion of support services can achieve greater flexibilities for the following reasons:

- The emphasis of in-house services will be on responsiveness to user needs and changing circumstances rather than simply on contract flexibility.
- The local authority/public sector industrial relations frameworks are more comprehensive and stable compared to most private contractors. This will facilitate negotiation of changes in working methods and implementation of continuous improvement plans over the contract period.

There are additional reasons which support the case for the exclusion of support services which are taken into account in the viability section of the Qualitative Assessment:

Equity

There are several important aspects of equity in service delivery – such as policies and practices which prevent a two-tier workforce from developing over the contract period. Reliance on the Best Value Code of Practice on Workforce Matters alone to achieve this objective is highly questionable. In addition, there is the need for equitable employment policies within and between sections of the workforce.

Efficiency

Local authorities have demonstrated that they can drive and achieve efficiencies in service delivery working in different forms of partnerships.

Following the Gershon Review the government has set a target of 2.5% per annum year on year efficiencies for local government. This does not require a blanket application across all services. Facilities Management services have been subjected to ongoing review and efficiency drives over many years and the extent to which annual efficiency targets of 2.5% can be achieved is questionable.

Accountability

Establishing customer satisfaction assessment methodologies is another important part of value for money and continuous improvement.

Part 6

Quantitative assessment for the exclusion of support services

The Treasury's Quantitative Assessment guidance consists of a user guide and a spreadsheet to support the VfM decision as whether to use PFI or conventional procurement and whether to exclude or include support services within the scope of a PFI contract.

The quantitative assessment includes modelling the whole life costs with a spreadsheet divided into five components:

- Capital expenditure (including equipment)
- Investment in lifecycle costs
- Operating expenditure (the cost of buildings and grounds maintenance and support services, overheads and insurance)
- Residual costs
- Transaction costs

This report focuses on the provision of services and hence covers only the lifecycle, operating and transaction costs.

The approach to quantitative assessment in this report is based on three key issues:

- Identifying and valuing the advantages of the exclusion of support services.
- Identifying those parts of the model which assume that PFI provision or outsourcing have benefits over in-house provision but where evidence suggests that the in-house option is equally capable of achieving similar change and improvements. Where this is the case, the model should be adjusted to neutralise PFI bias.
- Identifying parts of the model which exaggerate the PFI advantage. The model is hard-wired so that adjustments cannot be made. However, this bias towards PFI is unjustified and compensatory adjustments must be made elsewhere in the model to eliminate bias.

Lifecycle costs

The adoption of maintenance policies by the PTA to "…maintain the asset so that it remains fit for its intended purpose" and the adoption of operational practices at least equal to those of PFI facilities management good practice (outlined in Part 6) means that there should be no difference in lifecycle costs between the exclusion or inclusion of support services.

The lifecycle interval for the PFI option is hard-wired as an annual cost and the option of excluding support services should be based on the same premise.

Operating expenditure

The modelling of whole-life costs includes the operating expenditure which is the cost of operating the asset/running services to be included within the scope of the contract. The level of service will be the same for the Public Sector Comparator (PSC) and the PFI option. (Where support services are excluded it is assumed that they are treated like other services, for example, educational support and teaching services, which fall outside the scope of PFI services and are excluded from the spreadsheet.)

A public body could include the provision of support services within the PSC/PFI option appraisal but the spreadsheet has been designed to nullify differences in terms and conditions, although not potential differences in the number of jobs. This is explained below:

> “In the Spreadsheet, the employment Operating Expenditure is the product of the average annual employment cost per employee and the number of employees. A PFI should not be undertaken at the expense of workers’ terms and conditions, the average annual cost per employee is the same under the PFI Option as the PSC Option as this is not expected to vary simply on account of the procurement route. The Spreadsheet does not allow differential inputs for the average annual cost per employee to ensure that PFI is never selected as a consequence of lower terms and conditions for employees. However, it is possible that the number of employees may differ under the PFI Option from the PSC Option as services may be provided in a different manner and differential efficiencies achieved. Any differential input must be supported by evidence, and accordingly the Spreadsheet allows the user to enter a different figure for each option.” (Quantitative Assessment User Guide, HM Treasury, August 2004, para A.99)

Transaction costs

Three types of transaction costs are usually incurred in capital and service projects:

Transitional costs – the cost of carrying out the procurement process including preparing specifications and contract documentation, advertising and evaluation costs together with consultants fees.

Permanent costs – the cost of client/commissioning functions including monitoring and managing markets by assessing provision, market forces and designing regulatory frameworks.

Periodic costs – the cost of reviewing and implementing organisational change as contracts are won or lost or adapting to new regulations to control markets.

The Treasury guidance refers to private sector costs being hard-wired into the spreadsheet and also refers to public sector costs incurred in reaching contractual agreement. However, this is a very narrow definition of transaction costs and bears little relation to reality and the widely agreed technical and academic definition of transaction costs (Williamson, 1985).

The exclusion of support services should reduce the total transaction costs because support services will not have to go through the procurement process. This will mainly be a saving to the bidders rather than to the procuring authority since the FM partner would not have to tender or subcontract the core support services. Because of the relatively small sums involved, there is likely to only a marginal impact on bid prices.

In addition, the PTA will avoid the costs of a TUPE transfer – this would be a one-off cost reduction.

It is widely recognised that there is an additional cost of monitoring private contractors compared to in-house services.

The cost of assessing implementation of corporate policies and priorities by third parties, ie private contractors providing facilities management services, must also be taken into account. This will involve the authority in an additional annual cost of monitoring and verifying compared to collecting the same information through in-house management and accountability structures.

Indirect VfM factors

Local authorities can take indirect impacts into account in the spreadsheet. Indirect impacts are divided into Externalities and Non-Market impacts:

Externalities: These are benefits that accrue to the PTA which are not directly included in the price of the project.

Non-market impacts: These are benefits associated with the particular form of procurement used. This will include hard-to-value, intangible benefits but only those which can be monetarised and are directly associated with a particular method of procurement can be included in the spreadsheet. The spreadsheet ignores those economic benefits which are similar under both procurement methods.

Where benefits cannot be given a financial value there are other methods to value non-market impacts such as willingness to pay, willingness to accept, valuing time, weighting and scoring and various methods commonly used to assess health and environmental impacts as discussed in the Treasury's Green Book (HM Treasury, 2003). Unfortunately, most of these methods are not appropriate or could only be carried out at unreasonable cost. It is therefore proposed that the supply chain, environmental, commitment to family friendly policies, social inclusion, improved social relations, and more holistic neighbourhood management criteria are scored separately from the costings. Alternatively, a PTA could attribute a financial value related to the failure to achieve these objectives.

The Quantitative Assessment Spreadsheet

Costs must be assessed or valued over a 30-year contract period and expressed as the Net Present Value (NPV).

Table 8: **Quantitative Assessment of support services**

Quantitative Assessment of Support Services	
Input cells	**Evidence source**
OpEx Escalators	
Lifecycle costs	In-house service design, planned maintenance and continuous improvement should mean no difference in lifecycle costs or lifecycle intervals.
OpEx Non-employment costs Employment costs Employee numbers	Spreadsheet hardwired to ensure that the employment cost per person is equal for both PFI and PSC option. Number of employees the same in PFI and PSC option as per HM Treasury worked example.
Transaction costs Avoidance of procurement costs for support services Avoidance of TUPE transfer costs incurred by the PTA. Reduction in monitoring costs with in-house provision. Additional cost of assessing and verifying implementation of corporate policies in provision by private sector.	SPV will avoid tendering/subcontracting costs – estimate based on client tendering costs from government market testing, plus Public body avoids cost of preparing tenders if support services excluded on VfM grounds. (Cabinet Office 1995). PTA should be able to calculate HR, legal and administration costs based on equivalent previous transfers. 20%-30% saving in annual client monitoring costs. For example, cost could be expressed as the salary, pension, National Insurance and allowances costs associated with a monitoring officer. Could also be expressed as all or part of the salary, pension, National Insurance and allowances costs associated with a senior monitoring officer.
Third Party income	Not relevant.
Flexibility	The scope change, probability factor, level of scope change and premium flexibility factor inputs for the PSC should be the same as those in the PFI hard wired model. The performance and risk of private FM sector and approach of the in-house service make usual bias to PFI unjustified.
Indirect VfM Factors **Externalities** **Innovation:** The adoption of continuous improvement plans, planned maintenance, service assessments and other best practice operational systems will eliminate differentials between PFI and in-house provision **Health:** Better health and safety track record for in-house service will mean better	Ensure that any unjustified bias is eliminated and treat innovation as a product of the project partnership. Fewer accidents, lower sickness absence rates and fewer financial reductions caused

occupational health and also benefit to public health.	by non-availability. A 10% - 20% reduction in cost of sickness absence could be used to represent this saving.
Employment Better trained in-house workforce with education and learning programme and workforce development.	Reduction in retention and recruitment costs. Use % reduction in cost of HR services.
Non-Market impacts	
Better quality pension provision - a final salary scheme has economic value for staff and the local economy. It also means that public expenditure will be lower than it would otherwise be because fewer elderly people require income support.	Comparison of differentials between public and private pension schemes, calculate potential loss of income for retirees over 30 years and convert into % spending in local economy and employment ratio. Use average cost of job creation/support by local authority economic development to calculate equivalent number of jobs lost by lower pensions.
Equalities: Mainstreaming of equalities in management and operational practice providing access to employment for all equality groups.	Evidence of public/private differentials in implementation of equalities policies, local authorities own track record (BVPI) and equalities profile data.
Production and supply chain: Develop a local and regional production and supply chain including Small and Medium Enterprises (SMEs) as part of local purchasing strategy and achieve sustainable development targets. Also strengthens employment in local and regional economy.	Assess as non-market impact and weighting.
Commitment to family friendly working practices.	Assess as non-market impact and weighting.

Source: Quantitative Assessment, HM Treasury, 2004, and Centre for Public Services, 2004.

Valuing non-market impacts

There are a number of methods for assessing the value of non-market impacts, for example, using ‘willingness to pay’ and ‘willingness to accept’ techniques. The quantification of potential social, health and environmental impacts can also be identified through revealed preference techniques or a stated preference approach. These techniques require information on the valuation of impacts or preferences on individuals but the non-market criteria in the exclusion/inclusion of services are experienced collectively or community-wide. In addition, other techniques such as valuing time, quantifying health benefits, a prevented fatality or injury, design quality and environmental impacts discussed in the Treasury’s Green Book are not appropriate for the purpose of this report.

Weighting

Weighting of the criteria, using numerical weights between 1 and 10, could take account of the relative importance of the objectives. For example, the economic and employment benefits of a production and supply chain may be more highly valued than improved social relations in schools between teaching, non-teaching and community organisations. These are difficult decisions and must take into account the prevailing circumstances.

Optimism Bias

The new spreadsheet must also be adjusted for optimism bias. Uncertainty leads to overstating benefits and understating the timings and level of both capital and operating costs. The Green Book requires that appraisals be adjusted to take account of optimism bias. The Quantitative Assessment guidance states that "…there is little, if any, evidence to suggest that either conventional or PFI-type procurement methods deal any more or less efficiently" with optimism bias (HM Treasury, 2004).

The guidance goes on to state: "There is however, better evidence that the allocation of risks achieved under a PFI contract, once awarded, reduces the impact on the Procuring Authority of those uncertainties that remain inherent in a project, when compared with the contractual arrangements that typically result from the PSC Option" (ibid). Whilst the exclusion of support services will change the risk matrix, the performance of PFI FM contractors indicates that risk transfer to the private sector is frequently exaggerated. The political and often financial consequences of poor performance ultimately rest with the PTA and are even more costly to resolve when the flexibility is impaired by a legally binding long-term contract.

The Treasury quantitative assessment guidance states that a public body "…might be able to argue that that the Post-FBC Optimism Bias Factor for the PSC Option is similar to that for the PFI Option if it can demonstrate that it routinely achieves the same, very high level of confidence in its cost/benefits estimates for conventionally funded projects as is seen under PFI and contractual arrangements it normally enters into following conventional procurement provide a similar level of protection to the impact of unexpected costs and/or shortfall in benefits to that achieved (and paid for) under PFI" (ibid, page 21). Given that some key risks remain with the PTA or are shared with the PFI contractor, any costs differences must be carefully scrutinized.

Part 7

Risk assessment

The bulk of the project risk will be eliminated once the construction work on a new tunnel is completed and it is operational. The operational costs of the new tunnel represent a small proportion of the overall costs.

The Risk Matrix below does not seek to identify every risk associated with the project but is intended to demonstrate that the operating risk is very insignificant compared to the main elements of risk in the construction stage. Of course, there are operational risks associated with the ventilation plant, power supply, tunnel cladding, lighting system, pumping plant, road surfacing and miscellaneous electrical and mechanical risks. Replacement costs and rates of these capital costs are built into the overall project cost.

The main operational risks will be:

- Lane availability (with deductions based on periods of lane closure and will vary by time of day)
- Quality of toll booth collection (tolls will be set by the PTA, thereafter can be increased by changes in RPI or to cover the costs and expenses of the PTA).
- Traffic volumes
- Lifecycle and service costs
- Quality and environmental standards
- Industrial action affecting availability and/or toll revenue collection
- Staff recruitment and retention

Impact of secondment on operational risks

The Secondment Agreement will specify that the operational contractor will have management and supervisory responsibility for the seconded staff. Any changes in these arrangements could only be achieved by negotiation through the Change Control Procedure set out in the Service Provision Agreement.

Hence the contractor would bear the bulk of the operational risk as they would have day-to-day managerial and supervisory responsibility for staff. The fact that the contract was based on secondment should only marginally affect the transfer of risk from the PTA to the operator. Whilst operators may initially claim that this option forces them to reduce the level of risk they are willing to accept, this is likely to be more of a negotiating position than a fixed long term position. The Liverpool and Rotherham secondment contracts have been operational for several years, employ a much larger number of staff than the tunnel operator will employ, and are engaged in complex service delivery and change management processes, yet the principle of secondment has not been an issue.

Secondment should reduce the risk associated with staff recruitment and retention because terms and conditions and pensions would be much more secure under this option than a full TUPE transfer. This option would also significantly reduce the risk of industrial action.

Table 9: **Risk Matrix for New Tyne Tunnel**

RISK MATRIX	
Risks	**Transfer or responsibility of risk**
Design Standards	Risk transferred to designers and engineers/shared with client
Geological difficulties	Risk transferred to designers and engineers/shared with client.
Technical difficulties	Risk transferred to designers and engineers/shared with client.
Construction costs	Main contractor via consortia
Construction timetable	Main contractor via consortia
Making good physical damage from tunnel and/or approach roads	Main contractor via consortia
Pricing risk	Main contractor via consortia
Volume of traffic flows fails to meet expectations	
Volume of traffic flows exceeds expectations causing congestion and delays.	
Changes in safety standards, utility cost increases and off-site failure, emergency planning and changes in quality standards.	Shared between PTA and consortia
Operational Risks - examples	
Availability	Operator responsibility
- maintenance schedules overrun causing limited lane access.	
- failure to deal with accidents within agreed targets which causes delays	
- mechanical breakdown of ventilation equipment	
- staff recruitment and employment difficulties	
- industrial action affecting service availability	
- vandalism	
Quality of service	Operator responsibility
- failure to achieve quality and environmental standards	
- health and safety issues	
Lifecycle and service costs	Operator responsibility
- economy of scale savings operating two tunnels not achieved.	
- lifecycle costs higher than expected	

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