



OFFICE OF THE
DEPUTY PRIME MINISTER

Private Finance Initiative (PFI) for Housing Revenue Account Housing – Early Lessons from the Pathfinder Programme

June 2003

**A report for the Office of the Deputy Prime Minister
by PA Consulting**

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**A report for the Office of the Deputy Prime Minister by Jim Knox,
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The views expressed in this report are those of the authors, not necessarily those of the Office of the Deputy Prime Minister (ODPM) (Nor do they reflect Government Policy).

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1 Introduction...

1 INTRODUCTION

This section provides the context for the baseline evaluation of process lessons from the Pathfinder HRA PFI schemes, and sets out the purpose and structure of this paper.

1.1 BACKGROUND TO THIS STUDY

In this section we set out the background to this study, before going on to set out our terms of reference.

1.1.1 The PFI initiative for HRA housing

Ensuring sufficient levels of investment in major refurbishment works has been an enduring challenge for social housing policy. Several years ago the Chartered Institute of Housing reported a £21-23 billion investment backlog - an amount that is unlikely to be affordable from traditional capital funding routes. PFI potentially provides an important new route for generating additional affordable investment and, by placing risk with the private sector where it is best equipped to manage it, securing value for money. Local government capital funding regulations were relaxed in 1998 to allow PFI to be undertaken on refurbishment projects involving HRA land. While local authorities (LAs) could use their own resources to fund PFI projects, in practice they rely on support from central Government in the form of PFI credits.

Stock transfer already provides a mechanism to raise additional private capital for social housing investment, by transferring ownership from the public to private sector. However, there are constraints on how far this approach can be pursued, not least because it requires the approval of tenants. More recently the provision of capital monies for Arms Length Management Organisations (ALMOs) provides yet another potential new route to accessing (limited) investment for stock requiring refurbishment. Therefore PFI for HRA needs to be seen in the context of a variety of investment routes for social housing.

1.1.2 The Pathfinder Local Authorities

At the end of 1998 the DETR (subsequently DTLR and now ODPM ~ for simplicity we refer to the department as ODPM throughout the remainder of this report) wrote to LAs asking if they would be interested in participating in a PFI for HRA. Those expressing an interest were asked to provide a submission detailing a scheme and, of these LAs, 8 were selected as Pathfinders and invited to produce an outline business case (OBC). The Pathfinder LAs are:

- London Borough of Camden (LBC)
- North East Derbyshire District Council (NEDDC)
- London Borough of Islington (LBI)
- Leeds City Council (LCC)
- Manchester City Council (MCC)
- London Borough of Newham (LBN)
- Reading Borough Council (RBC)
- Sandwell Metropolitan Borough Council (SMBC).

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These authorities were selected in order to maximise lessons about how PFI could be made to work in different contexts. The pathfinder PFI schemes cover a range of different types and numbers of dwellings. They also vary in the extent to which they are concentrated in particular geographical locations. The characteristics of the pathfinder PFI projects range from traditionally built estates (Leeds), to high rise tower blocks (Camden), to street properties interspersed with private properties (Islington) to clusters of PRC-constructed dwellings distributed over a large part of a county (North East Derbyshire). In keeping with this diversity and the reasons for selecting the Pathfinders the schemes have a range of objectives including wider area regeneration and tenure diversification, in addition to the core aims of securing long term improvement in social housing stock.

Tables summarising the characteristics of the Pathfinder LA stock subject to PFI (**Appendix A**), the range of objectives for the schemes (**Appendix B**), and the housing services packaged into contracts (**Appendix C**) are appended to this paper.

1.1.3 Overview of Progress of the Pathfinders

The Pathfinder HRA PFI schemes have now been progressing for up to 3 years although none have yet reached the stage of signing a contract. The state of play on current timetables, provided there are no further issues causing significant delays, is:

- Manchester have chosen a preferred bidder and are negotiating a final offer with a view to awarding a contract in the near future
- Islington have received Best and Final Offers (BAFOs) from their two bidders and these are currently being evaluated with the aim of selecting a preferred bidder and negotiating to a close early next year
- Derbyshire are seeking to select a preferred bidder and negotiate to a close in the near future
- Sandwell intend to select a preferred bidder soon
- Other Pathfinders' timetables are not so advanced, with award dates projected well into 2003
- There is most uncertainty in Camden where the original competition reduced to one bidder and there has been a hiatus while the option of re-opening the competition again has been considered and the ability to refresh the competition was explored.

A chart showing the timetables and how they have changed since the plans set out at, or around, OBC stage is provided at **Appendix D**.

Since the Outline Business Cases were approved the estimated costs of the schemes have on average nearly doubled (aggregate [88%] increase), and the aggregate level of PFI credit sought from the Department to support the schemes is now over [2½] times the amount approved for the schemes at OBC stage. At the same time the projected total costs of the procurements in many schemes (covering the in-house costs and bought in external support) are over [£1m] on average.

In the meantime a second round of 11 HRA PFI schemes have been launched, 5 of which are in existing Pathfinder LAs (LBC, LBI, LCC, MCC, LBN) and only 4 of which are in new LAs (Ashford BC, LB of Lewisham, Oldham MBC and Rochdale MBC). A third round of HRA PFI schemes may also follow later in 2002.

It is therefore an appropriate time for ODPM to provide a baseline evaluation of the Pathfinder schemes, including an assessment of the early experience of the Pathfinder schemes to see what lessons can be learnt for the subsequent development of first and second round schemes, or indeed any potential third wave of schemes.

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1.2 PURPOSE OF THIS PAPER

1.2.1 Our terms of reference

Our terms of reference were to identify process lessons both for authorities and the ODPM, based on the experience of the Pathfinder LAs so far. This research was structured around a list of key issues agreed with ODPM at the outset of the research (this is provided at **Appendix E**).

The ability to draw lessons from all stages of the process so far is, however, limited by the extent to which LAs have progressed their schemes. In particular, the most advanced LAs have just reached the Best & Final Offer (BAFO) or equivalent stage of getting final bids from potential suppliers. Many key issues may or not be fully resolved, depending on the outcome of these bids. We note these issues and, subject to the timetables in MCC and LBI, we hope to incorporate in the final version of our report a brief update of the position consequent on the evaluation of the bids.

1.2.2 Limits of Study

This initial study is mainly qualitative in scope. It is based primarily on interviews with some document analysis. The ODPM intends to commission a full impact study - inevitably a longer-term exercise - in the near future.

1.2.3 Programme of work

Our programme of work consisted of the following elements:

- Discussion with ODPM officials to clarify the policy and organisational processes within ODPM for the oversight of the programme of Pathfinder schemes and the aspirations for enhancing the approval and support processes (**Appendix F** provides details of all those interviewed for the study)
- Meetings with key staff from the Pathfinders and follow up discussions where necessary to understand further the distinctive characteristics of their schemes, the progress made in the procurements and the key issues emerging
- A review of the documentation for each scheme provided by the Pathfinder LAs (directly or via ODPM), to understand the evolving nature of individual PFI schemes, the development of the contractual documentation and the procurement processes (**Appendix G** provides details of the material seen for each of the Pathfinder projects)
- Discussions with other key players such as advisers to Pathfinder LAs (many of whom work for more than one Pathfinder), potential suppliers and 4Ps¹ to obtain their perspective on the experience and issues arising with HRA PFI schemes so far.

1.2.4 The distinctive features of PFI

There are distinctive features of PFI that need to be understood as forming the backdrop to the process lessons derived from the initial part of the baseline evaluation of the programme. These include:

¹ 4Ps were set up by local authority associations to help authorities to increase investment in services through PFI and PPP. They assist individual authorities, disseminate information and lobby on authorities behalf.

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- **The distinctive approach to allocating risk** ~ (between the authority and the contractor) to the party that can manage it best. From an evaluation perspective this begs the question whether those risks which are allocated to the private sector, such as those concerning the management of project cost and timetable, are indeed managed effectively
- **The emphasis of PFI on an output based specification** ~ leaving the private contractor free to find the most cost-effective means of delivering the desired outputs (for example, might the contractor move away from traditional programmed repairs towards an innovative 'just-in-time' investment approach,)
- **Major refurbishment work is packaged within a contract alongside housing management services** ~ potentially allowing synergies between the two to be realised
- **The length of PFI contracts** ~ these are expected to last for 30 years which present issues in terms of sustaining delivery over this period, effectively managing the contract to achieve continuing value for money and securing hand-back on acceptable terms
- **The involvement of tenants** ~ although an issue under contracting out, PFI interposes a commercial relationship with a contractor between its own relationship with tenants. This examines whether tenants secure the desired level of involvement in running their housing - another Government policy objective - and how this is achieved within the contractual framework is an interesting evaluation issue
- **A distinctive procurement process** ~ PFI involves a distinctive and relatively sophisticated procurement process which poses its own challenges for both the authorities and the DETR in terms of deploying the project management and commercial skills necessary to arrive at the best possible deal. The success of authorities in managing the procurement process will be an important determinant of value for money and needs consideration.

This paper aims to provide a summary of the early lessons that can be gleaned from the experience of the Pathfinder schemes so far, and suggestions for enhancing the processes for taking the programme of HRA PFI schemes forward where appropriate. In our view applying these lessons and suggestions would be valid for the subsequent development of the existing round one and two schemes, although they would assume greater importance for any potential third or subsequent rounds of HRA PFI schemes as they could be incorporated in guidance and plans from the outset.

1.3 STRUCTURE OF THIS PAPER

This paper presents the results of this initial part of the baseline evaluation in the following structure:

- **Section 2 presents the findings of our early process evaluation**, within the following structure:
 - Findings on the nature of the schemes (their objectives, and the stock and housing services included within them)
 - Findings on the management of the schemes as projects (covering internal LA processes, the commissioning of external support, and central support from ODPM)
 - Findings on the involvement of key stakeholders (local politicians, the wider corporate body of the LA, and tenants)
 - Findings on the HRA PFI procurement process as experienced by the schemes (the structure of and the process itself, the development of documentation, and the stock condition and tenant surveys)
 - Findings on the key issues that have emerged in the process of applying PFI to the HRA context (statutory, legal and financial issues)
- **Section 3 presents a consolidation of the lessons from the findings**, structured in a way that facilitates their application by highlighting the overarching importance of communication and:

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- Lessons for the role of the centre (the role of ODPM and the support they commission for the programme of projects as a whole)
- Lessons for LAs pursuing or thinking of pursuing HRA PFI schemes
- Lessons for all parties in relation to engaging and developing the market for HRA PFI.

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2 FINDINGS ON PROCESSES IN PATHFINDER HRA PFI SCHEMES

In this section, we set out the key issues and findings emerging from our review of the Pathfinders' experiences. Note that the focus of this section is reporting on the experience of schemes from the perspective of ODPM, LAs, advisers and bidders; the next section draws out the main lessons for the HRA PFI programme going forward.

2.1 INTRODUCTION TO KEY FINDINGS

We present the key findings in the tables in the following paragraphs, based on a sift of the mass of information gathered in the study. We have grouped the findings in relation to a number of key issues:

- the nature of the schemes themselves
- the management of the procurement projects
- the involvement of key stakeholders
- the PFI procurement processes and documents used
- specific housing, legal and financial issues that have arisen for HRA PFI schemes.

Note that the study did not set out to provide a detailed critique of any particular scheme or the processes, documents or contractual mechanisms developed for it. Instead the focus is on the lessons for the future that might be drawn from the early experience so far. These are flagged up in the findings and developed in a more coherent structure in section 3 of the report.

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2.2 THE NATURE OF PATHFINDER SCHEMES

In this section we consider the nature of the schemes themselves and lessons from the experience of the Pathfinders for the design of future schemes.

2.2.1 Scheme objectives

Why do LA's prefer PFI as their route to invest in social housing?	Key findings
When the alternative methods of getting investment are not acceptable politically.	<p>As part of the LA's housing strategy all schemes sought funding needed to address poor stock conditions that was not otherwise available from the traditional housing investment programme route to accessing capital funds.</p> <p>In almost every case the alternative of Large Scale Voluntary Transfer had been considered and was deemed to be politically unacceptable and tenants in the LA as a whole either rejected this in a ballot or would be expected to reject this in a ballot for the scheme.</p>
When the alternative methods of getting investment are not viable economically	<p>In at least 5 cases the LSVT alternative was calculated not to be viable given the condition of the stock.</p> <p>These schemes aimed to secure through PFI the funding needed to address poor stock conditions that other alternative sources of investment could not provide.</p>
To support regeneration by securing housing investment	<p>Regeneration is not thought necessary to make HRA PFI schemes work (given that there is no significant linkage to regeneration in 3 cases and varying degrees of linkage in the others).</p> <p>Nevertheless in 2 cases HRA PFI investment has been used explicitly to provide the foundation or catalyst for wider regeneration (LCC and LBN).</p>
To provide greater flexibility in remodelling stock to match demand	<p>At the time these schemes were launched it was perceived that alternative approaches to investing in social housing did not provide the same flexibility to adjust stock levels to match demand - particularly with the retention of stock.</p> <p>In at least 3 cases HRA PFI has been used to significantly adjust the stock profile to match local demand, and to a lesser degree in another one or two others.</p> <p>(However it may also be the case that there are wider options for achieving such aims now with the opportunity to pursue non-HRA PFI schemes that give greater scope for non-HRA social housing new build).</p>
To lock in investment and access funding over a long period	<p>A distinctive feature of HRA PFI is the 30-year contract defining output standards for the housing stock.</p> <p>This means that HRA PFI is the only investment mechanism that locks in investment to maintain housing over such a long period, and some Pathfinders see this as adding value (although some authorities were nervous about this new approach and expressed some concerns as well - see section 2.4.1 below on "Local political support for HRA PFI schemes").</p>

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2.2.2 Stock and services

How is PFI being used and are there circumstances where PFI is thought unlikely to work, or not work as well?	Key findings
HRA PFI appears to work for all types of stock, although it is more difficult in some circumstance	<p>The initial finding is that it appears HRA PFI can work for all the types of stock included in the Pathfinder schemes (i.e. the market is prepared to construct propositions for renewing the various dwelling types involved.)</p> <p>However, there have been particularly difficult issues to address in making it work for certain type of stock (in particular leaseholder properties in blocks - particularly because of the cost floor issue - and non-traditional construction dwellings).</p>
Larger schemes may be more attractive to the market but need not be estate based	<p>The Pathfinder experience suggests HRA PFI can work for between 700 and in excess of 2,500 units, irrespective of whether these are dispersed (LBI) or concentrated on estates (most other cases).</p> <p>However there is some evidence to suggest higher numbers of units might work better and it is the case that particular issues arise for different stock distribution patterns (e.g. Islington, which consists mainly of dispersed street properties, believe the market views the size of their scheme(s) as very attractive, and tenant involvement has a different focus there).</p>
The constraint that PFI applies only to stock renewal and not new build is potentially disadvantageous	<p>Given the long-term nature of the schemes it could be more economic to replace some stock with new build within certain HRA PFI schemes. Nearly all Pathfinder schemes have mentioned that the ability to include new build could enable the schemes to offer better VFM, as there is generally at least one stock type in each scheme which would prove cheaper to rebuild and run for 30 years than to refurbish and run for the same period.</p> <p>Our understanding is that this is not permitted by legislation within HRA PFI schemes (although there are related issues here that we discuss later in the report).</p>
PFI is being used to achieve improvements above Decent Homes Standard	<p>All schemes are intending to secure stock condition standards at least equal to and to varying degrees above that of the Decent Homes standard.</p> <p>This is perceived to be a potential issue by Pathfinders in affordability terms (they are concerned that they are committing to fund standards above a level that might be supported in the longer term by government subsidy if this is focused on meeting Decent Homes), and there are related questions about whether this will be providing VFM.</p>
Is it appropriate to include significant ongoing housing services into the contracts for stock renewal	<p>There appears to be consensus that it is appropriate to package a core of housing services in HRA PFI contracts.</p> <p>However there are reservations on some services where bidders or LAs perceive risk issues in passing responsibility to a contractor (rent collection, and elements of tenant management in 2 cases).</p>

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2.3 MANAGING PATHFINDER HRA PFI SCHEMES

In this section we consider how PFI schemes have been managed and the lessons learned by local authorities involved.

2.3.1 Internal LA processes

What do LA's need to do to manage the PFI process effectively?	Key findings
Effective project management is crucial throughout	<p>All LA's emphasised strong project management and continuity of key personnel appear as key factors in enabling progress, although this does not on its own guarantee success in holding to planned timetables.</p> <p>In all cases where personnel changes have occurred midway through the procurement, the handover appears to have been less than thorough, which creates difficulties.</p>
Multi-disciplinary teams are required	<p>An effective multi-disciplinary team containing housing, technical, finance and legal skills also appears to be helpful in enabling progress - in particular benefiting the development of the Output Based Specification (OBS), the payment mechanism, and the quality of the service offerings ultimately obtained from bidders. (We note it is not necessary to provide all skills in house.)</p> <p>LA technical staffs, with considerable knowledge of the stock, are useful to manage external support, educate bidders on key issues and challenge perceptions of risks. (However PFI requires a different approach to funding works, and it is necessary to guard against expectations of a traditional approach.)</p> <p>It is helpful to involve in-house financial expertise, as longer-term ownership of business case financial models and payment and performance mechanisms is an issue. If these are produced externally the in-house team should expect to take ownership of functioning models.</p>
The process needs adequate resources over time to match demands (particularly the in house technical, finance and legal staff)	<p>In general it is perceived that there were shortages of resources for the internal teams, at the times when required. The most common difficulty appears to have arisen due to staff being provided to work on the procurement part time while retaining their main job tasks. This can become a major issue when their involvement needs to 'ramp up' e.g. during evaluations.</p> <p>Even where inputs are not dedicated full time, continuity of personnel is helpful - particularly in ensuring adequate involvement from housing as well as technical experts in evaluations.</p>
Understanding of the PFI process is a great help	<p>Teams without prior PFI/PPP experience have found the learning curve steep, and although the ability to call off expertise from external advisers has helped, often this input has not been put in place early enough.</p> <p>It is not essential that prior experience has been gained in the application of PFI to housing; other service areas can also provide a useful understanding of the requirements (e.g. PFIS for schools, heating schemes, or street lighting).</p>

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What do LA's need to do to manage the PFI process effectively?	Key findings
Cost/resource burden of the process	<p>The process has cost a great deal (running into 7 figures in some cases) and constitutes a significant overhead (although in some cases this might be acceptable in relation to the overall scheme cost at between 2-5%).</p> <p>Procurement costs do not seem to have deterred interest from LA's in Round 2 in Pathfinders, as there is an expectation that procurement timetables and costs will reduce by up to 50% with the benefit of learning from Round 1 schemes.</p>

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2.3.2 External support for LA processes

What might LA's have done to get better value from external advisors?	Key findings
<p>LAs can be smarter in managing support inputs from consultants</p>	<p>By definition, Pathfinders have been learning as to how best to manage PFI for HRA housing. However, in our view a greater understanding of how to use advisers in a process like this would be beneficial and greater use could be made of guidance about how to engage and manage consultants (e.g. Audit Commission). For example, LA's should:</p> <ul style="list-style-type: none"> ➤ Ensure advisers have clear briefs with defined deliverables, products or outcomes from support and for example that attendance at general scheme progress meetings is commensurate with the need for specialist advice or input ➤ Consider fixed prices relating to defined deliverables and outcomes ➤ Procure support when needed and ensure that the consultants hired have the specific skills required <p>One concern expressed to us is that external advisers effectively have been charging development costs to Pathfinders, and it should be expected that in future in a maturing market LAs would secure keener prices from advisers.</p>
<p>It is possible to better match the profile of support to gaps in internal skills and volumes of resources (technical, financial and legal inputs)</p>	<p>The PFI process has particular 'pinch' points when additional volumes of support or specialist expertise may be needed. There is plenty of guidance about what needs to be done at each stage of the process, and in some cases this could have been better used to inform plans and to engage consultants to augment internal resources when they were required.</p> <p>There may be an argument for a higher level of external input at initial stages (particularly where in house resources are scarce) to ensure that the procurement starts off correctly.</p>
<p>Advisers need sufficient and appropriate housing as well as PFI expertise.</p>	<p>Authorities have been satisfied with the level of knowledge of the PFI/PPP process demonstrated by legal or financial advisers. However there have been some concerns expressed about the level of advisers' understanding of specific housing-related issues raised by HRA PFI.</p> <p>In some cases it appears that external surveyors may not have fully appreciated the need in HRA PFI to cost works required in response to Stock Condition Surveys (SCS's) on the basis of maintaining output standards over time with an associated risk transfer to the provider. This may explain some of the difference between in-house estimates and provider bid costs, (although we are also aware that it has also been difficult for some in-house staff to adjust their approach to costing works).</p>

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What might LA's have done to get better value from external advisors?	Key findings
In future LAs will need to rely less on advisors to develop contract documents.	<p>Most Pathfinders have developed their ITN/draft contract documents in-house, but with significant inputs of specialist advice in particular areas such as payment and performance mechanisms, and in part drawing on various guidance documents. Nevertheless, this work has taken considerable time.</p> <p>The learning from the Pathfinders should enable future Rounds to develop these documents faster and cheaper (if it is captured through greater sharing of documents, development of more standardised documents - and re-use of base documents in those Pathfinders with Round 2 schemes).</p>

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2.3.3 Central support for LA processes

Has central support been adequate and effective?	Key findings
Pathfinders appear to have found central guidance satisfactory	<p>Generally the guidance from DTLR/ODPM to Pathfinders has been found to be helpful.</p> <p>Pathfinders do not think there are gaps in the supplementary guidance provided, but need to see the outcomes of the BAFOs or bids before concluding the guidance has effectively dealt with all the issues it has covered.</p>
On occasion, central advice could be provided faster	<p>Some LAs felt it would be helpful if ODPM had taken a more proactive role to sort out a “party line” on problem issues and/or in some cases faster. There is a perception that the leaseholder issues could have been addressed faster by the Department taking a line.</p> <p>There is also a perception that it would be helpful for ODPM to clarify roles and communication lines in relation to the approvals process. It is not always clear to Pathfinders what process the Department has to go through itself (although it needs to be acknowledged that everyone is in a learning situation).</p>
There is a view that perhaps funding support could be provided for external advice in the development of HRA PFI	<p>There is concern that the burden of paying development costs for the market and/or advisers has fallen unevenly, and that some authorities in the lead on particular issues may perhaps have paid a disproportionate share of the ‘development costs’ for HRA PFI.</p> <p>Some Pathfinders believe that the ODPM should have provided revenue support for Pathfinder schemes; not least since those Pathfinders with Round 2 schemes anticipated much lower costs. That said, all Pathfinders volunteered to take part in the programme without any initial promise of revenue funding.</p>

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2.4 STAKEHOLDER INVOLVEMENT IN HRA PFI SCHEMES

In this section we look at how stakeholders, inside and outside the local authority have been involved in schemes.

2.4.1 Local support for HRA PFI schemes

Has PFI for HRA Housing been well supported as Member, Corporate and Housing Department level?	Key findings
All Pathfinder schemes have political support	<p>The Pathfinder LA's all appear to have broad cross-party support for their schemes. In most cases this involves passive (on the basis that any investment in housing is good) rather than active championing of HRA PFI.</p> <p>However, there are some reservations about the long-term lock-in to spending required by PFI.</p>
HRA PFI schemes have not been seen as a major corporate issue	<p>Generally HRA PFI schemes are seen as strategic issues for the Housing department rather than as key corporate issues, which is not unexpected.</p> <p>However there are emerging reservations about the levels of cost involved in managing the PFI procurements and whether this is offering VFM (although the size and length of the procurements and the risks involved may well justify the costs on the levels observed).</p> <p>There does not appear to have been a particular problem about securing sufficient input from in house experts in other departments, beyond general resource prioritisation issues.</p>
PFI schemes remain housing priorities (for the moment)	<p>The original decisions to pursue PFI for the schemes all reflected need for investment in housing that would not otherwise be met, and in that sense the schemes are all consistent with the housing strategies of the LAs</p> <p>However there are concerns that the costs of managing the procurements are in the short term pre-empting use of resources, either in securing other sources of investment or in directly investing in housing works. The effect of the schemes may over time be to focus a disproportionate amount of investment and management attention on a small proportion of stock in the LAs.</p>

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2.4.2 Tenant and leaseholder involvement in HRA PFI schemes

Issue	Key findings
The level of tenant involvement varies	<p>All LAs have been keen to involve tenants to some degree. The involvement of tenants and/or residents in the schemes varies significantly. In some areas efforts to involve tenants have met with little response (with street properties) In a number of cases there has been much tenant interest and the problem has been one of channelling this into constructive input (eg some of the estate based schemes).</p> <p>Beyond this it appears hard to draw out generally applicable lessons on this issue.</p>
Establishing a local presence might be helpful (if appropriate)	<p>Some schemes established a local presence to provide an easily accessible focus for involvement of tenants and residents. Other schemes have not yet established such a presence but are considering doing so.</p> <p>However there are issues about when it might be appropriate to establish a local presence, as doing so before there is any certainty over PFI timetables or potential solutions may lead to difficulties either in getting engagement or managing expectations.</p>
There has been little innovation in involvement of tenants and residents in local management	<p>There appears to be little evidence of genuinely innovative approaches to tenant and/resident involvement in the schemes so far. However one Pathfinder is considering passing on the monitoring and day-to-day management of the project to an Arms Length Management Organisation (ALMO) once the contract is awarded.</p>

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2.5 THE HRA PFI PROCUREMENT PROCESS

In the following section we examine those aspects of the PFI process that have been identified as crucial to the success of schemes.

2.5.1 Issues in the HRA PFI procurement process

What might be done better in procuring HRA PFI projects?	Key findings
Initial scoping of scheme is critical	<p>Concerns have been raised by bidders about how well - or how clearly - the Pathfinder schemes have been scoped. Particular issues that have been mentioned are:</p> <ul style="list-style-type: none"> ➤ Requiring Decent Homes standards as against lettability, in relation to availability standards and payments ➤ Matching demand for housing in the area, and the inclusion of demolition and re-provision ➤ Clarity about regeneration linkage (i.e. underpinning or catalyst) and contractual formality of the relationship
Ensuring there is good joint understanding of the structure of the requirements is also critical	<p>The discrepancy between in-house estimates and contractors cost estimates has been an issue. Contractors tend to see the affordability envelopes that they are being asked to work within as unrealistic, and that these have been arrived at using previous, PFI incompatible, approaches to costing (i.e. 'quick fixes' rather than meeting 30-year output standards). While it might be expected bidders would take such a line, it does appear there may be a valid point here, and that not all Pathfinders were fully aware of these issues at the outset.</p> <p>This has risked inadvertently alienating the PFI-experienced players in the market. Some bidders may fear that this difference in understanding could be carried through into the evaluation, due to insufficient explanation of the requirements and failure to target key areas of compliance, and that winning bids will be those which have been (under-)priced on a misunderstanding of the risk transfer intended.</p>
There is a desire for clarification of the approvals process	<p>Pathfinders LA's have had to go back, or will be going back, to the PRG for increased levels of PFI Credit (in some cases up to 2 to 3 times the original estimate). There is a perception among Pathfinders that the approval for this has taken longer than necessary particularly since, in their view, the need has been obvious for some time.</p> <p>It is claimed that approval of documentation has taken up to 5-6months (in the case of some ITNs), and Pathfinders have not been clear why. Greater clarification on the process would be appreciated. The need to get full council approval in advance of PRG has been questioned, as it is generally recognised that further council agreement (and delay) may well be needed after a PRG decision that introduces any change.</p>
Questions about the attractiveness of PFI/PPP in relation to other housing investment programmes	<p>We noted in section 2.2 that for most Pathfinders, it is generally the case that Stock Transfer would not prove viable or attractive. However, the recent increased housing improvement funding for ALMOs has raised questions about the relative attractiveness of PFI against other routes.</p>

2 Findings on processes in Pathfinder HRA PFI schemes...

2.5.2 Scheme documentation

What do Pathfinders tell us about the role of key documentation in PFI for HRA housing?	Key findings
Getting the Output Based Specification (OBS) right at the outset	<p>Linked to our point about initial scoping, some LA's and bidders emphasised that sufficient development needs to be done at an earlier stage to ensure that the OBS is relevant, precise and deliverable given:</p> <ul style="list-style-type: none"> ➤ The specifics of each scheme ➤ The capabilities of the market ➤ The estimated affordability envelope.
It is vital to develop the Payment and Performance Measurement Mechanism in parallel with other key stages	<p>The payment and performance mechanism is a key element in determining the viability of a scheme, particularly from the point of view of third party funders. We have found that this has caused some issues in the Pathfinders. Given that funders normally only engage in detail late in the process, it is vital that during the development of these mechanisms the following reviews are carried out to ensure LAs enter later stages well prepared:</p> <ul style="list-style-type: none"> ➤ Performance mechanism alignment with the OBS standards ➤ Scenario modelling for likely levels of financial remedy under various conditions ➤ Analysis of the reasonableness and number of triggers for penalties and their possible severity ➤ Review of the monitoring and checking procedures to ensure feasibility ➤ A review of the possibilities for innovative payment profiles should be made early in the procurement.
There are some basic points that could be got right on Invitations to Negotiate	<p>The ITN must set out a methodical process for ensuring the response meets the requirements (the OBS and the information requirements for evaluation). There should be a clear onus upon the bidders to state clearly where they are departing from the OBS requirement and the price and risk transfer consequences they believe this will have. We found that not all Pathfinders felt they got this right first time.</p> <p>Also suggestions were made that the base case bids should be made more prescriptive, in terms of the timing and level of work required, in order to improve comparability of the bids. There is also a desire among all parties for the affordability envelope to be published to allow meaningful bids to be entered or issues about viability to be raised, although we appreciate there are risks of limited price competition (all bids submitted just within the envelope) by doing this.</p>

2 Findings on processes in Pathfinder HRA PFI schemes...

What do Pathfinders tell us about the role of key documentation in PFI for HRA housing?	Key findings
Establishing the evaluation methodology early on is important	The schemes that thought they received bids that were closest to their expectations expressed the view that it was vital to have in advance a detailed approach to evaluation (covering the structure and detailed criteria, teams and their responsibilities, and the weighting and the scoring method). By aligning the required format of the response required to the ITT to this plan, and sharing all but the scoring with the bidders, it is possible to improve their understanding of the requirement and therefore the quality of their bids (as well as facilitating smoother evaluation).

2 Findings on processes in Pathfinder HRA PFI schemes...

2.5.3 Stock Condition Surveys (SCSs)

What do SCSs need to deliver and how best are they managed?	Key findings
It is important to get the timing, scope, and management/delivery of Stock Condition Surveys (SCSs) right	<p>There does not yet appear to be agreement between all parties on the best time to do the SCS or the ideal sample size. We note that due to the discrepancies between current cost estimates and those at OBC stage, there is a desire by ODPM to see a large sample survey carried out prior to the OBC. LAs see a risk in that if the PRGG turns down the scheme this might leave them having spent an additional £150,000 or more for the survey for a failed bid.</p> <p>Experience appears to suggest that no matter how detailed an initial survey is carried out there will be a requirement to do further work later, particularly to satisfy the funders. The reasons for future work quoted by funders include the time lapse from initial survey to works, the original survey needs validation, lack of involvement in agreeing the original brief, and lack of trust in a survey not carried out under their control.</p>
Managing bidder involvement in agreeing the SCS brief and managing the delivery is essential	<p>We note that joint management of the delivery of the survey is not necessarily effective in getting buy-in from all bidders, and can lead to delay. The SCS needs to be clearly project managed, as with the procurement as a whole.</p> <p>The SCS project manager has to keep the bidders on board as well as meet the LA's needs, and it might be most appropriate to appoint an independent party as a project manager. In the cases where this route was followed there appears to be some evidence that it is successful (e.g. Islington).</p>
There are key principles for a SCS brief	<p>Our research suggests the SCS brief needs to reflect the following principles. It has to:</p> <ul style="list-style-type: none"> ➤ Meet the information needs of various parties (the LA needs enough information for a realistic OBC 'should cost' model, ODPM want to be reassured the OBC costs are soundly based, bidders will want progressively larger sample coverage at ITN and then BAFO stage to remove uncertainty and unnecessary risk) ➤ Align with the availability standard in the output specification (as opposed to any other 'standards' for surveys) and cost the level of works required to reflect this and the risk involved over the life of the contract (as opposed to traditional approaches to costing LA housing works) ➤ Include ground condition and other elements where relevant, and include separate questions specifically to address Decent Homes standards.
Access issues increase the cost and time taken for SCSs	<p>Access to occupied dwellings has been highlighted as a key issue in both the cost and the time taken to complete the survey process in high sample cases. This will need to be factored into LAs' plans for their projects.</p>

2 Findings on processes in Pathfinder HRA PFI schemes...

What do SCSs need to deliver and how best are they managed?	Key findings
There may be a way of developing a 'standard' SCS approach	<p>It does not appear that it will be appropriate to develop a single standard brief for any HRA PFI SCS given the different types of scheme, stock, and objectives that might be present in any one case.</p> <p>There appears to be a strong argument for the joint development by ODPM with the market of a 'standard' approach to conducting the SCS (in particular agreement as to the level of sample required at particular stages of the procurement to avoid requiring re-work or delays). This may create enough buy-in to enable successive PFI schemes to use a standard approach and tailor this to scheme particulars.</p> <p>This could involve successively greater sample sizes at OBC stage (to inform the OBC and PQQ/ISOP responses), ITN (to inform bids) and BAFO (to enable close with minimum unnecessary risk) - and a 'checklist' for other specialist surveys that might be required in some cases (e.g. ground conditions, contaminated land).</p>

2 Findings on processes in Pathfinder HRA PFI schemes...

2.6 HOUSING ISSUES IN HRA PFI

In this section we comment on a number of statutory, legal and financial issues which are specific to the effective use of PFI to achieve renewal in HRA housing.

2.6.1 Statutory issues to resolve

Does the current statutory framework governing social housing cause potential problems for PFI?	Key findings
Right To Buy (RTB)	<p>RTB has given rise to number of issues for HRA PFI. Loss of properties from the scheme due to RTB reduces the income stream for the supplier, and therefore bidders seek mechanisms to compensate for this over the life of the contract. It may also affect the ability of a LA to finance repayment of the debt element of the funding in the event that properties exit the scheme due to RTB after the work has been carried out. The two main questions raised in relation to HRA PFI are:</p> <ul style="list-style-type: none"> ➤ Whether or not 75% of the receipts from the sale need to be set aside to repay housing debt? ➤ Whether the cost of works done under the PFI scheme can be counted as money spent by the LA in improving the property (and thus be included in calculation of the cost floor where relevant)?
Section 20 Landlord and Tenant Act 1985 (requiring 2 quotes for work to leasehold dwellings)	<p>The key questions which have been raised by HRA PFI in relation to this issue and its proposed treatment are:</p> <ul style="list-style-type: none"> ➤ Will the amendment to S.20 be sufficient to deal with the issue, by removing the need for 2 quotes in PFI? ➤ Can schemes be signed in advance of the amendment with provision to take it in to account once it is in force? ➤ What level of consultation must be carried out on the amendment and when will it be completed?
Section 27 of the Housing Act 1985 (delegation of housing management)	<p>Pathfinders have raised the question of whether or not there is a definitive view as to the need for a Regulatory Reform Order (RRO) to clarify the position for HRA PFI?</p> <p>A second question raised is whether in the event that it is decided that a change is needed (to allow the functions of housing management to be carried out over a contract period by the consortia without possible hindrance), the market is satisfied that an RRI is sufficient?</p>

2 Findings on processes in Pathfinder HRA PFI schemes...

Does the current statutory framework governing social housing cause potential problems for PFI?	Key findings
Regulation 24 of the Public Works Contract Regulations 1991	<p>Potential suppliers have (perhaps unsurprisingly) expressed a preference to move towards a 'partnership' approach without competition allowed under Regulation 24, as they say it will allow cheaper and faster development of schemes that are viable, fundable and meet all the LAs' requirements.</p> <p>LAs have expressed more mixed views on the subject. The reduction in time to selection of partner is cited as a potential advantage, while the lack of competition is a potentially major disadvantage. A legal concern has been raised that as there have been (so far unsuccessful) challenges against the use of the negotiated procedure, the use of Regulation 24 is even more likely to be challenged. Nevertheless, there is interest among Pathfinders in seeing whether the market is mature enough to 'play fair' under such rules.</p>
Inclusion of new build	<p>There is an issue about whether or not Regulation 16 allows the inclusion of new build in HRA PFI schemes (see also section 2.2.2 above). The rationale for new build is that it can be more economic to build new stock of the right type than carry out expensive refurbishment of units that are not in demand.</p>

2 Findings on processes in Pathfinder HRA PFI schemes...

2.6.2 Legal issues to resolve

Have Pathfinder experienced any particularly 'thorny' legal issues.	Key findings
Generic risk issues	<p>There are some risks that are being negotiated in different ways across all the Pathfinders, and this ultimately may not prove to be the most effective outcome for HRA PFI programme as a whole. These include:</p> <ul style="list-style-type: none"> ➤ Latent defects ➤ Tenant damage ➤ Asbestos. <p>It may be possible for ODPM to establish standard guidance on the core positions to be adopted on each of the generic risks (at least for all of the Pathfinder schemes, and then subject this to review for subsequent Rounds/schemes). This approach would not be universally popular even with LAs but would reduce the time required to negotiate deals and has been used elsewhere. The three risks listed above are the ones with the highest need for satisfactory resolution one way or another.</p>
Contract Documentation	<p>Many of the schemes still have a considerable way to go before documentation is completed - and some of them may have to complete contracts in a single bidder situation.</p> <p>It is not yet clear how many difficulties will be encountered in finalising contracts (the bidders' comments so far may be comprehensive but are often ambiguous about the degree which they accept draft contracts). It is also to be expected that the traditionally contentious areas in PFI (including those listed below) will prove no less challenging in closing HRA PFI deals:</p> <ul style="list-style-type: none"> ➤ Rights of Termination ➤ Compensation on Termination ➤ Relief/Delay Events and Excusing Causes ➤ Set Off and Step in <p>The guidance commissioned by ODPM has so far proved helpful - along with the OGC Standard Form - but the production of specific standardised form for HRA PFI after the first wave would be beneficial to speed future procurements.</p>
Planning & Consultation Issues	<p>Issues of planning and related consultation are not generally threatening to the timetables of the Pathfinders. The issue with the most potential for delay is consultation over the replacement of highways.</p>

2 Findings on processes in Pathfinder HRA PFI schemes...

2.6.3 Financial issues to resolve

Have the Pathfinders experienced particularly difficult financial issues?	Key findings
CRI (Consolidated Rate of Interest)	<p>Pathfinders are unhappy at being charged at variable rates of interest for credits that they need to meet the cost of PFI. Interest for credits being on a variable rate basis (it is understood that this is due to the fact that the HRA capital funding has always been provided on this basis). We heard arguments for CRI on a fixed rate basis as follows:</p> <ul style="list-style-type: none"> ➤ It makes sense for the HRA CRI to be on the same basis as General Fund CRI ➤ The actual funding for HRA PFI comes from Banks and is provided on a fixed rate basis ➤ If the interest is variable there is a risk of an affordability gap occurring.
Rental income stream	<p>Several of the Pathfinders have experienced problems with rent restructuring proposals, due to the requirement to increase rents to align with non-HRA rent levels, leading to schemes becoming unaffordable as the expected housing benefit costs increase - either from day one or over a 10-year period as parity is achieved between council and RSL rents.</p> <p>There is concern that the treatment of this issue may not be consistent across all schemes affected.</p>
Right To Buy cost issues	<p>The Pathfinders that have made more progress towards closing deals have already developed methodologies for dealing with the financial issues arising from RTB along the lines set out in the guidance.</p> <p>Bidders have yet to comply with the request to separate their costs into fixed and variable elements to facilitate the understanding of cost floor and recharging implications, and there may yet be further issues around this.</p> <p>Another aspect of the RTB issue is concern over the volume of exits. The two key areas are the minimum sustainable or economically viable level of stock for each scheme, and how likely it is that this level will be reached.</p>
Debt Restructuring	<p>At least one LA has asked what happens to the subsidy in the event that the HRA debt is repaid before the end of the 30-year period (which raises an issue about what effect its removal would have on affordability).</p>
HRA Financing Issues	<p>The issue of whether Pathfinders' financial models have been correctly structured has been raised by at least one scheme. It is believed that PFI Credits will not always come in at the beginning of a year, and there may also be a risk that the 2% subsidy will not provide the required amount of support in the first year.</p>

3 Lessons from this early review of PFI processes...

3 LESSONS FROM THIS EARLY REVIEW OF PFI PROCESSES

In this section, we consolidate the lessons that emerge from our research. We have set these in a structure that helps clarify the links between issues, and that is more helpful for the Department in thinking about whether and how to take action on any of these issues.

3.1 INTRODUCTION

This study focussed on the experience of the Pathfinders. It is inevitable that in a programme of this nature there will be considerable learning and we appreciate the difficulties faced by all concerned with this complex investment mechanism. We also recognise that some of the lessons we point out are already being taken on board, for example by Pathfinder authorities that have won approval for a phase 2 scheme. But in order to be comprehensive we have included as many learning points as possible to help the three key stakeholders in their roles:

- ODPM - to develop the framework of policy, guidance and support for HRA PFI, working with LAs and other agencies involved in supporting PFI projects in local government
- Local authorities - running or thinking of starting HRA PFI projects - to address local and scheme specific issues
- The Market - where a joined up approach between LAs and government would appear helpful in maintaining, building and fully engaging a healthy market of housing PFI providers.

However, we first comment on the overall context of the programme.

3.2 CONTEXT OF THE EVOLVING HRA PFI PROGRAMME

Over the last eight years there have been many advances in the concept of using the private sector's experience and funding to deliver services for the benefit of the public sector. This does not mean that the processes used in the procurement of one type of service will be readily or automatically applicable to another without amendment. The application of an established procurement process in a new area is seldom straightforward. Methods that have been refined in one context - while providing a useful starting point - will almost certainly need adaptation to fit the new environment. This is clearly the case with applying PFI to HRA schemes.

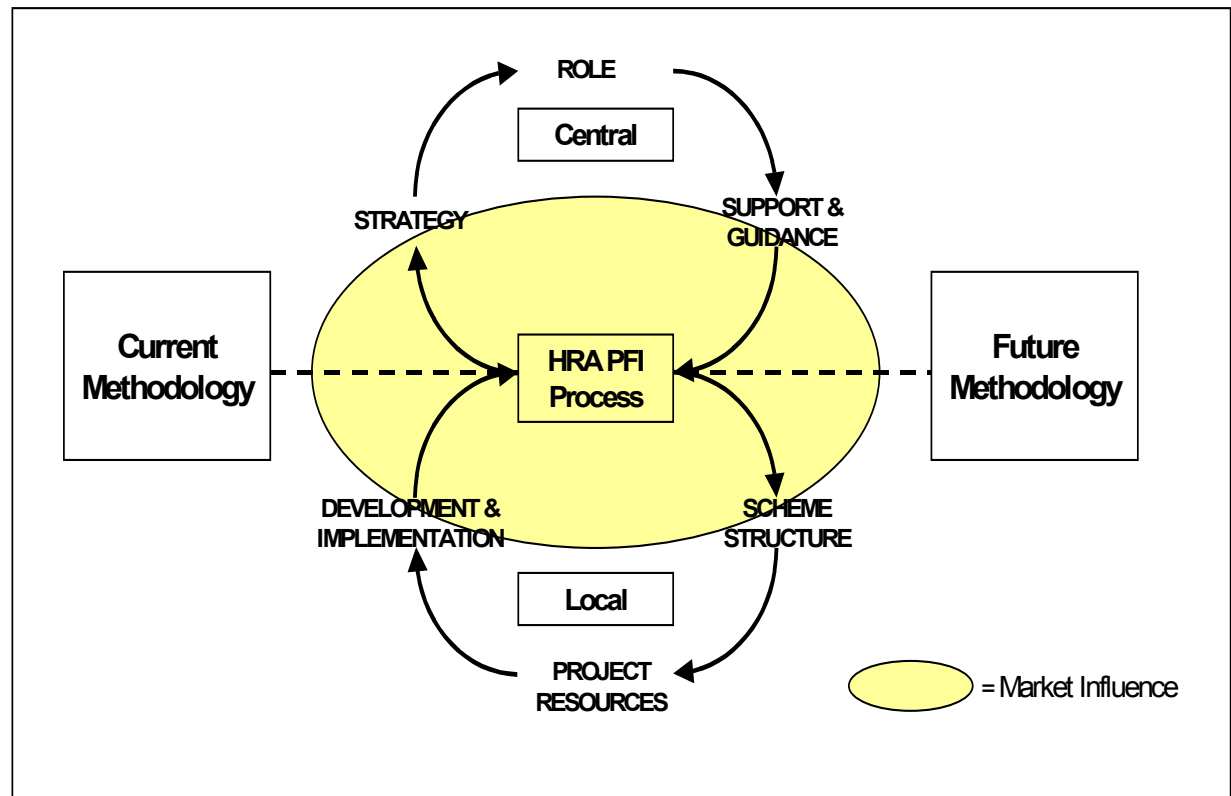
All parties involved in HRA PFI have had varying degrees of involvement in PFI/PPP schemes in other markets. While this has been helpful in many respects, the fact that everyone is bringing their understandings and expectations from different sectors can sometimes create as many problems as it solves.

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The creation of a successful market is an iterative process, as is shown in the diagram opposite. Bearing this in mind, and remembering the factors above, the biggest issues in determining how quickly and easily the process will become well established are:

- Clarity of understanding around the developing process and
- The quality of communication underpinning the development process.

In the course of our review we have found many learning points that have arisen from the various approaches taken by the Pathfinder authorities. In addition, the process has also highlighted a variety of actions that ODPM could undertake centrally to improve the process going forward. In the following sections we attempt to develop these key points within a structure that is helpful as a basis for taking action on the lessons, where it is considered appropriate. The lessons have been grouped on the basis of who is able to take or lead action, although we also recognise that for some issues to be resolved action will be needed jointly by more than one of the parties.



3.3 LESSONS FOR ODPM

As has been mentioned before our findings are based on views we have obtained from the interview we conducted amongst a wide range of participants interviewees as well as analysis of scheme documentation, and it is understood that the Department has addressed, or is in the process of addressing, many of the issues raised.

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3.3.1 Approving schemes to take the PFI route

PFI is only one way of securing investment in social housing in need of improvement. With a number of relatively new approaches being developed (e.g. ALMOs and non-HRA PFI) it may not always be clear to LAs which option is most applicable, particularly when there is a desire to secure any funding that might be available from whatever source:

- All LAs should be fully aware of the range of options available for the improvement of social housing when embarking on a project, including the conditions under which they are expected to be successful
- When approving schemes, the Department should require LAs to make explicit the reasons why a specific investment approach has been chosen and the scheme should be checked to ensure it has been structured appropriately (rather than “shoe-horned” to fit the available route - for instance a ‘failed’ LSVT scheme being turned into PFI - which may lead to inappropriate risk transfer or poor VFM).

We think there could be benefit in ODPM putting together a brief paper that sets out all of the available methods of improvement funding, their relevant advantages and disadvantages in different contexts, and the requirements and restrictions that are imposed by each of them.

3.3.2 Helping Authorities design schemes

- The development and dissemination of scheme design criteria reflecting what has been shown to be workable in existing HRA PFI schemes would improve the quality and structure of future bids
- Understanding the costs and risks involved in bringing certain types of property up to an acceptable standard at an early stage of scheme design increases the likelihood of designing an affordable scheme.

Provision by ODPM of an outline of the factors to take into consideration when putting together a scheme in different circumstances (e.g. involving flats, leaseholders, etc) would assist in the development of future projects that are more likely to succeed. This could include guidance on a range of acceptable costs for improvements and 30-year maintenance, for various types of property, that would be incurred under a PFI/PPP transaction.

3.3.3 Making the HRA PFI process clear at the outset

Our findings indicate that it might be helpful to provide greater clarity to LAs about elements of the ODPM’s role in the HRA PFI programme. The particular aspects that could be clarified to minimise the scope for confusion and misunderstandings include:

- Overall role of ODPM:
 - The Department’s strategy for the HRA PFI process
 - Clarity over the relationship between advisory and approvals roles to avoid confusion or any potential conflict between them
 - Formal and informal communication lines - between the Department and Pathfinders/PFI schemes on the one hand, and the market on the other
- The role of different sections within ODPM:

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- The respective roles and responsibilities of each section involved within the Department could be made clear to all parties
- Where they exist or are established, service agreements, process timescales, and operational arrangements could be explained fully
- Approvals and reporting requirements
 - Approval requirements, both in terms of format/content and timing for all stages in the process could be set out (and changes/updates notified)
 - Processes and timescales for feedback on approvals decisions and/or delays in timescales could be set out
 - Further clarification could be given on the use of, and issues surrounding, financial and economic models and the PSC at OBC and FBC to demonstrate VFM.
- Role of other linked parties (4Ps & PUK)
 - The role of other bodies and their status in the various processes should be clearly understood by all parties
 - Where other bodies fulfil any part of the approvals role, the operational timescales and contact arrangements should be communicated to LAs.

Greater understanding in relation to the points above could be achieved by ODPM setting out what it sees as its role - and how the other parties such as 4Ps and PUK fit in - and communicating this to other key stakeholders.

In addition it would be useful to (re-) state the approvals process, setting out what is required when, who does what, how the various bodies interact, and what the timescales are for various actions in the approval process.

3.3.4 Guidance and issue resolution

- Guidance on PFI is provided by many Other Government Departments (OGDs), and although it is not all relevant to every PFI market, something of value for HRA PFI can be gleaned from it. At minimum, information on the guidance that exists in OGDs should be circulated to LAs running or considering HRA PFI schemes, including notes on its purpose and relevance. Better still, ODPM could consolidate and tailor existing guidance from across government specifically for HRA PFI, and to encapsulate the initial learning from Pathfinders
- The Department has sought to take the lead in resolving certain issues by commissioning Supplementary Guidance, which has been well received although the success of this guidance will only become clear following the outcome of BAFOs (or equivalent). There may need to be further work on some of the issues, for example on Right to Buy and the cost floor. As the programme grows, we wonder if more could be done to rapidly address and communicate the issues, what action is being taken and the timescale for their resolution (together with regular updates). This would reduce uncertainty by enabling schemes to plan accordingly and reduce the levels of concern in the market.
- For specific HRA PFI issues where no guidance currently exists, ODPM's intentions around future production of guidance should be set out to reduce unnecessary work by individual LAs.

On the resolution of Supplementary Guidance issues, regular (but brief) activity reports could be published setting out what is happening, who is involved and what the timetable is for resolving issues on the critical path for signature in the leading schemes (including, for instance, Sections 20/27 and cost floor issues). One way of doing this would be to set up a secure website accessible to LAs, or to adapt the service provided through the 4Ps website.

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3.3.5 Disseminating model documentation

- PFI is highly dependent on key documentation (business case, output specification, invitation to tender, etc.) and there may be opportunities to prevent authorities from 'reinventing the wheel.' However, simply issuing example documentation (used by the Pathfinders) on its own may not be the most effective approach. This runs the risk that what is seen to have worked in the past is adopted without either careful tailoring to the current context or alignment with other elements in the particular scheme in question. It would be more valuable to annotate model documentation to explain why it is representative and under what circumstances and how it should be used.

Documentation from front running schemes should be analysed for areas of good practice and circulated to new HRA PFI schemes with explanatory notes to increase understanding of its applicability.

3.3.6 Identifying the best approach to common risks

- The development of a standard risk allocation matrix for generic risks for an HRA PFI scheme (setting out issues, probability of occurrence and likely impact, costs, potential mitigations - that could be tailored to the detailed make up of schemes) could reduce the amount of time spent across the individual pathfinders. This would ensure consistency and would provide LAs with strengthened negotiating positions
- Authorities should be advised that key issues on the risk allocation matrix should be agreed with bidders before the appointment of a preferred bidder for any particular scheme, to reduce the risk involved in single bidder negotiations.
- There may be a case for setting a standard position where it will outweigh the cost and likely price outcomes of multiple negotiations across individual Local Authorities. A common approach to pricing vandalism might be an example of this but it is recognised that some issues such as latent defects need a more scheme specific view to be taken
- The current view that all cases for variation of current practice will be looked at is welcome, but in the case of something like New Build it may be hard to price without significant input from the Private sector. This may in turn prove hard to get as there is no clue as to the likelihood of a change to policy being made.

The establishment of positions on risks common across the programme would assist in achieving the best way forward in a timely manner. This could be accessed through the website referred to above.

The website could also be used to log new issues as they arise, and prompt the initiation of any 'resolution process' established.

In relation to issues of critical importance affecting Affordability and VFM (such as the inclusion of new build, expiry of debt, timing of subsidy receipt and, critically, variable interest on Credits), we think that a proactive review by the Department - in consultation with Pathfinders closest to signature - might be a more productive approach than asking, individually or collectively, the Pathfinders to submit a case and then responding.

3.3.7 Promoting a common approach to Stock condition surveys (SCS)

- The development of the SCS brief has improved both in terms of understanding of the issues and collaboration with the bidders; however a standard basis for all briefs is required to meet the need to carry out part of the survey prior to OBC without duplication later in the process

3 Lessons from this early review of PFI processes...

- The SCS must reflect what is set out in the Output Based Specification
- Benefit would be gained from standardisation across the programme of the timing and level of the surveys; this would need to be agreed by both the market from a bidding point of view and the Department in light of its scheme selection approval role
- Acceptance by the market that surveyor's Professional Indemnity insurance is the method of providing reassurance as to the quality of the information provided in SCSs is vital to ensure bidders are able to bid without forcing the LA to take back risk on the accuracy of the information
- Acceptance of the process must be gained from all parts of the consortia, as any repeated costs will rest ultimately with the Authority.

The possibility of developing and agreeing with the market a standard approach to SCSs should be explored. This might be on the basis of letting SCS contracts in stages with a certain level of sampling carried out prior to OBC, more before ITN, and close to 100% before signature.

To ensure that all parties understand what is expected, a standard outline SCS brief - that would be populated in full and tailored for each scheme - could also be developed to cover the requirements of PFI and the basis on which SCS results should be costed so that more consistent and realistic costing estimates are produced at the relevant stages.

3.4 LESSONS FOR LOCAL AUTHORITIES

While much rests on the Department providing the appropriate framework of guidance, support and assistance to help resolve issues, ultimately the responsibility for delivering HRA PFI schemes rests with LAs. Our findings suggest a number of areas where LAs new to HRA PFI can capitalise on the experience of the Pathfinders' Round 1 schemes - in the same way that these LAs are themselves applying the lessons of their first projects in taking forward their Round 2 schemes, where they have them.

3.4.1 Scheme design

- Desired outcomes ~ LAs must be clear about the desired outcome of their scheme at the outset and ensure that bidders understand this vision at an early stage and throughout. This is particularly true of the desired timescale to reach Decent Homes standards. This will increase the likelihood that ultimately they will deliver what is required. Conversely, local authorities should also understand bidders broader business objectives - a better and cheaper deal will be reached if there is alignment of each party's objectives and both sides understand the key pressures on each side
- Funding ~ knowledge of the different types of financial structure that might be employed is important, and this leads to the ability to structure schemes that are attractive to as many funders as possible, which in turn reduces the risk of curtailing innovation
- Stock selection ~ knowledge and understanding of the cost implications of including various archetypes and levels of dilapidation is necessary at a local level in order to structure a scheme that delivers the most affordable and best VFM solution for the LA.

A clear statement of the LA's intent at the Outline Business Case stage will minimise the risks that the bidder will misunderstand the requirements. It needs to be broken down into the key elements of the scheme, covering physical improvements, housing services, tenant involvement, regeneration, etc.

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3.4.2 Project planning and resourcing

- Project planning ~ it is crucial that PFI procurements - as complex and relatively costly exercises - are carefully planned and managed using the principles and disciplines of established project management methodologies. Authorities should provide this capability to limit the risk and pre-empt any 'show stopping' issues that may arise
- Resourcing the internal team
 - It is important that Project Management is provided by a dedicated, full-time resource, and this person should have good organisational skills and experience of project management, including running a procurement (preferably with some PFI experience and knowledge of negotiation)
 - There should be sufficient full-time support to keep the information flows smooth and manage the internal and external communications
 - Professional support is needed to cover Legal, Financial and Building Surveying/Technical Services but it must be blended effectively with understanding of the Housing Management dimension; ideally there would be full-time support in all these areas but we recognise that there are long periods when this would prove to be uneconomic
 - The importance of a multi-disciplinary team is crucial in the development of a balanced scheme and in terms of having the ability to evaluate bids properly; there needs to be a level of committed resource available not only in key periods but throughout the procurement
 - Where part time support is provided it is helpful to have continuity of personnel involved across time where possible; the onus must be on the LA to ensure that where support is provided on this basis the individuals concerned accord sufficient priority to the procurement at appropriate points - and planning ahead is critical in ensuring this support is committed and available when required
 - Where staff on project teams change or leave there is a need to ensure there is a full handover to prevent the loss of project knowledge that frequently occurs on such occasions subsequently slowing down the scheme
 - Consideration should be given to the members of the team who will manage the contract after signature and, if they differ from the project team, they must be kept informed of the process at key stages particularly prior to contract award.

The development of a detailed project plan, including a fully costed resource plan for the all stages of the procurement, will increase the chances of sufficient resource being made available by the authority. In practice there may be variation from the plan, but the presence of such a plan at the Outline Business Case stage will at least make sure that the LA understands the level of input required and is fully committed to the process.

Where staff leave or transfer a full handover process, including knowledge and skills transfer, must be followed to ensure continuity.

- Senior officer involvement
 - A strong project board is essential including senior members of the Departmental (and/or corporate) management team; this ensures that issues are addressed at the correct level
 - Informal but regular access to senior members of the board improves both issue resolution and increases credibility with the bidders.

Authorities should consider the appointment of a senior corporate officer to act as sponsor and allow an informal route for project issues to be raised as necessary.

- Selection and management of advisers

3 Lessons from this early review of PFI processes...

- Sound guidance exists for LAs on appointing and managing consultants effectively (e.g. by the Audit Commission); LAs should be aware of the general lessons set out here and act on them as appropriate in commissioning support on HRA PFI and then managing the ongoing support from advisors
- The type of advisers required and how they will be used individually and in concert should be agreed prior to tendering for any of them; the level of involvement expected will depend to some extent on the level of expertise available in the internal team
- It is important to communicate the LA's underlying vision to the external advisory team(s) at the outset and during the procurement process, in the same way that this is important with bidders. Without this they may become too compartmentalised
- The advisory team must have a good understanding of PFI. In addition a knowledge of housing specific issues will assist greatly in the prevention of errors. This is particularly relevant if they are providing general, rather than specific, expertise.
- Effective communication is essential as long periods can occur where advisers are only involved intermittently
- The LA team should retain the ownership of the process, as it is the LA and not the advisers who will sign the contract.

It is helpful to set out clearly the objectives and role of each set of advisers, and their responsibilities for deliverables at each stage, prior to their appointment. This should be consistent with, and an integral part of, the overall project plan and matching resourcing plan for the procurement. Consideration should also be given to the issue of continuity due to the fact that there may be parts of the process where the involvement of external advisers is sporadic.

3.4.3 Procurement issues

- Project management
 - Project management should follow the disciplines of established methods, e.g. Prince 2, including the key elements of a PID, risk register, critical path analysis and communication strategy (e.g. with bidders, tenants, Members)
 - Regular communication with project managers from other, more advanced schemes will improve add insight and allow new schemes to avoid the pitfalls that others have already experienced.

We think the existing forum for schemes to exchange information provides a sound basis for extension to new HRA PFI schemes. Exchanging regularly updated risk and issue plans throughout the individual procurements, through this forum and/or the website discussed in section 3.3.4, would enable the discussion of blockages and hurdles to the benefit of individual schemes and the programme as a whole.

- Support and approvals
 - Any shortfalls in resource to manage the PFI should be dealt with as soon as possible by the LA; generally it is our experience that failure to be prepared fully for each stage will ultimately have much more severe financial implications than the additional staffing or support costs required to fix the problem up front in a timely manner
 - Internal Council approvals should only need to be sought when a stage product is finalised or an issue fully resolved; constantly referring every twist and turn of the procurement to LA Members risks creating 'deal fatigue'
 - Maintaining a steady flow of informal discussions with ODPM can pre-empt lengthy and/or repetitive loops of activity on approvals.

3 Lessons from this early review of PFI processes...

We stress again the importance of maintaining good formal and informal communication between LA project teams and ODPM at all stages in the schemes; in particular this will pay dividends prior to formal sign off in smoothing the way for approvals.

3 Lessons from this early review of PFI processes...

- Selection of bidders
 - The range of bidders should be as wide as possible to encourage innovation, but with the proviso that they must be capable of delivering the base requirements over a 30 year period
 - An understanding of the risks inherent in a PFI bid is vital in ensuring that costings are accurate and sufficient, including the fact that compensation for termination will be expected to cover the re-procurement cost of the Authority
 - The Authority should understand how the supplier's consortium is put together and the risk carried by each different consortium member.

Initial investment in providing clear statements of scheme specific requirements - set within increasingly standardised documentation for HRA PFI procurements - will be helpful in obtaining a greater degree of understanding and acceptance of issues from bidders at an early stage.

The levels of agreement achieved early on will provide an indication of the suitability of the various consortia.

- Procurement stages and requirements
 - Running PFI procurements requires a good degree of understanding of the steps before the procurement starts; the stages cannot be learnt one at a time as they are all connected and the learning curve is too steep once the process is underway
 - Resourcing for key stages such as bid evaluation must be sufficient to meet the stated targets. This is an area where the authorities have been underprepared in nearly all cases
 - Greater clarity and detail of requirements upon bidders would improve comparability; greater prescription of the methodology for the base bid would be helpful when comparing bids.

There is plenty of guidance on running PFI procurement in other sectors, and we discussed how ODPM might make this more visible to LAs – and possibly tailor this for HRA PFI - in section 3.2.4 above. This will provide a sound basis of guidance for LAs to plan their procurements.

In addition LAs might want to consider some training for their project teams on specific elements of the process, and at the very least team-building and/or briefing workshops would enable clarification and the development of a fuller understanding of what lies ahead.

- Use of guidance prepared by OPDM and development of documentation
 - Guidance must be used intelligently and the appropriateness of standardised documents carefully considered. The lessons contained should be tailored to the specific context of the scheme in question
 - Documents such as the OBS and Payment Mechanism must be properly aligned to each other to ensure that they incentivise the providers to deliver the desired outcome
 - All of the documentation must be tailored to the individual project and agreement throughout; the OBS should be realistic given the state of the stock and the environment, as should the triggers for performance deduction, and the remedies should reflect the consequence of the failure
 - Clarification of intentions is always helpful for the avoidance of doubt; we think it is helpful to preface all contractual mechanisms with a statement of intent.

3 Lessons from this early review of PFI processes...

We commented that the production or adaptation of existing “how to” guidance could prove useful to authorities who have limited experience of this type of procurement, as discussed in section 3.2.4 above.

Another possibility is for LAs considering HRA PFI schemes is to shadow current PFI schemes (HRA or not), or looked at the other way for Project Managers (who have been through the learning curve) to provide a ‘mentoring’ role for LAs new to HRA PFI.

3.5 LESSONS FOR THE HRA PFI MARKET

Our findings have revealed areas where both the centre (ODPM and other bodies involved in supporting the HRA PFI programme) and LAs pursuing HRA PFI schemes can capitalise on the learning experience of the Pathfinders. However, the market is also going through this learning curve, and our work reveals a number of concerns in the market about the levels of uncertainty pertaining to HRA PFI. In commercial terms uncertainty means risks, and the market’s willingness to take, manage and price risks is central to the success of HRA PFI at a scheme and programme level. Therefore there are areas where all the public sector stakeholders (ODPM and LAs) need to join in an integrated approach to addressing issues related to the emerging market for HRA PFI.

3.5.1 Market development responsibilities

- Many assumed that it would be easy to translate the PFI concept to housing and that schemes would be easier to complete than has been the case. The difficulties in managing the bids on all sides have been thrown into sharp relief by the belated discovery of the scale of many of the risks
- Some interviewed believe that the number of potential bidders in the market is shrinking. If this is so, it is a major concern for all parties. Some rapid solutions acceptable to all parties need to be found for the key issues in order to maintain supplier interest and enable the development of a healthy ongoing market
- The marketplace has a right to expect that the key tenets of risk allocation are followed - that risks are placed with those best able to manage them. But bidders also need to understand the untried nature of these projects and therefore the limited amount of trust that LAs can afford to place in bidders at an early stage
- The inclusion of RSLs in consortia may mean that deals need to be structured differently to other service areas; the fact that RSLs are not commercially oriented does not mean that the risks should automatically be passed back to the public sector partners
- The market needs to play its part in exploring the key issues and possible solutions with both LAs and with the Department and other central bodies.

We think that it might be helpful to have a regular, but not necessarily very frequent, round-table ‘market development forum’ involving bidders, ODPM, other bodies and (representatives of) LA HRA PFI schemes. This could provide a mechanism at the very least to get issues ‘on the table’ and to broker agreed courses of action to address them. By focusing not just on current issues but also the future development of the process, it might allay market concerns and allow the development of a greater understanding of emerging potential in the marketplace.

3.5.2 Involvement of parties

- The *early* involvement of all commercially interested parties – especially funders and insurers - in a consortium is essential to ensure that all issues are fully understood from the outset; economic viability is as crucial to the consortium as affordability is to the LA

3 Lessons from this early review of PFI processes...

- The late discovery of key concerns (e.g. on funding) is not conducive to the success of the HRA PFI deals; it is the responsibility of the lead parties in the consortia to manage these issues in the same way that LAs need to manage input from their end to prevent late disclosure.

ODPM should reinforce the importance of the points above in forthcoming guidance, and broker with the market general acceptance of the requirements for lead partners in consortia to take on board their responsibilities.

Authorities should request from bidders the expected levels of input from all members of the consortia at each stage, and incorporate the responsibilities on lead members of consortia in their scheme requirements and bid selection criteria.

This will help to ensure that agreement is sought from all those in the market who have an interest in an issue at the appropriate. Bidding responses and methods

- Schemes have had to commit substantial resources to the evaluation of market offerings at various stages of the procurements. The clarification process required by bids that do not specifically and systematically address the requirements in the OBS, ITN or ITT has proven long and difficult and in some cases has not led to resolution of issues. Our findings suggest the clarity of bids needs to improve significantly
- We found concerns among bidders that documentation provided by LAs will not lead to a fair and reasonable evaluation of their bid; this issue should be addressed as soon as possible
- The Authority must have enough information to provide a reasonable level of certainty and both parties must have an understanding of the point at which there is enough information to take a decision
- Where bids do not specifically fit to the requirements, the departures should be highlighted more clearly to assist identification; the principle is not to penalise those who raise genuine concerns but to ensure that what may be major areas of under-specification are picked up at the same time
- We refer to this issue in terms of basic 'get rights' for ITNs and ITTs; clarity around intentions, alignment between all elements of the procurement documentation (OBS, ITN/ITT, draft contract and contract mechanisms, requirements for the format, content and structure of responses from bidders and evaluation processes and criteria) are essential.

This is where the framework of central guidance and advice, project management of individual schemes, effective development of the procurement documents and joint understanding of requirements and drivers for all parties (ODPM, LAs, and the market) come together and are encapsulated in an ITN or ITT. We have referred to all of these elements separately in preceding sections.

Given the current state of development of the HRA PFI market, we think that a greater degree of prescription of the nature and content of bid responses, whilst tedious, will provide greater likelihood that the responses from potential suppliers will be fit for purpose and enhance the degree of comfort with the process all round.

3 Lessons from this early review of PFI processes...

APPENDIX A: STOCK CHARACTERISTICS

Nature of stock	Pathfinder schemes															
	LB Camden		NE Derbyshire		LB Islington		Leeds CC		Manchester CC		LB Newham		Reading BC		Sandwell MBC	
	OBC	Now	OBC	Now	OBC	Now	OBC	Now	OBC	Now	OBC	Now	OBC	Now	OBC	Now
Number of dwellings																
Total	708	708	961	534	2,310	2,310	2,730	>2,235	1,091	1,091	1,236	1,126	1,556	1440	1,680	1,680
Council owned		620			1,900	1,900	2,730	2,235	1,029		1,158	1,126				
Leasehold		88			410	410	0	Some	62		78	0				
Type																
Traditional					✓	✓	✓	✓					✓	✓	✓	✓
Houses					2,310	2,310	208						1,400		634	634
Block of flats							146						156		508	508
Non-traditional	✓	✓					✓	✓			✓	✓			✓	✓
Houses			961	534			1,301				372	359			467	487
Block of flats							1,054									
High rise	708	708					21				786	767			71	71
Location																
Estate based		✓		✓				✓		✓		✓		✓		✓
Street properties						✓										
Works to be carried out																
Refurbishment	✓	✓	732	534	✓	✓	1,781		500	500 ²	✓	✓	✓	✓	1,416	1,416
Demolition			229	229			949		453	430					264	264
Re-provision (building)									✓	✓					✓	✓

² After disposal of a further 161 properties

3 Lessons from this early review of PFI processes...

APPENDIX C: CONTRACT PACKAGING/HOUSING SERVICES

Housing Services	Pathfinder schemes																
	LB Camden		NE Derbyshire		LB Islington		Leeds CC		Manchester CC		LB Newham		Reading BC		Sandwell MBC		
	OBC	Now	OBC	Now	OBC	Now	OBC	Now	OBC	Now	OBC	Now	OBC	Now	OBC	Now	
Core services																	
Repair and Maintenance	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Voids		✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Rent collection & arrears management			✓	✓	✓	✓		✓	✓	?	✓	✓	✓	✓	✓	✓	✓
Estate management																	
Estate management/cleaning and caretaking	✓	✓ ³	✓	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓
Public space/ communal areas	✓	✓			✓	✓	✓	✓	✓	✓	✓	✓	✓	✓			✓
Security services	✓	✓					✓	4	✓	✓	✓	✓	✓	?	✓	✓	✓
Tenant management																	
Nuisance complaints			✓	✓ ⁵	✓	✓			✓	✓	✓	✓	✓	✓	✓	✓/X	✓
Tenant consultation/housing advice			✓/X	✓/X	✓	✓			✓	✓	?	?	✓	X/✓	✓	✓	✓
New tenant management			✓	✓		✓			✓	✓	✓	✓	✓	✓	✓	✓	✓

³ Possibly included; bidders can submit variant bids including these services

⁴ Not considered to be a requirement any longer

⁵ All tenancy management services for NEDDC scheme covered by variant bid

3 Lessons from this early review of PFI processes...

APPENDIX E: ISSUES TO BE INVESTIGATED IN BASELINE EVALUATION OF PROCESS

Stage	Issues
Expression of Interest	<ul style="list-style-type: none"> ➤ Why were these areas chosen for PFI schemes? ➤ What were the expectations of authorities?
Outline Business Case	<ul style="list-style-type: none"> ➤ What level of Stock condition survey was carried out, and will it meet the needs of the evaluation? ➤ How were tenants consulted? ➤ How were did the Council handle tenants expectations?
Invitation to Negotiate	<ul style="list-style-type: none"> ➤ Was too much/too little detail given in the output specification? ➤ Were the expected outcomes realistic? ➤ Was the payment mechanism structured realistically?
Evaluation	<ul style="list-style-type: none"> ➤ What methodology was used and how successful was it? ➤ How has it been affected by EU procurement rules (which route was chosen)? ➤ What guidance was given to bidders on how to structure bids and did they comply with guidance?
Negotiation	<ul style="list-style-type: none"> ➤ What factors caused bid prices to come in higher than anticipated? ➤ Did the bid price drop substantially, and if so at what stage did bid price drop - BAFO/preferred bidder? ➤ How was the contract developed
All Stages	<ul style="list-style-type: none"> ➤ What were the reasons for cost rises? ➤ What were the reasons for delays? ➤ How effective was the tenant consultation? ➤ What role did advisers play in this process? ➤ How does the type of scheme affect the processes? ➤ What effect does the size, constitution and experience of project teams have? ➤ To what extent was DTLR guidance used? ➤ What have been the demands on Council resources? ➤ What buy-in and support has there been from the Council?

3 Lessons from this early review of PFI processes...

APPENDIX F: INTERVIEWS

Interviewees	Pathfinder schemes							
	LB Camden	NE Derbyshire	LB Islington	Leeds CC	Manchester CC	LB Newham	Reading BC	Sandwell MBC
LA staff	Judi Wilson, Project Manager Pat O'Neil, Housing Technical Services Andrea Melvin, Finance Department	Marcus Bishop PFI Project Co- Ordinator	John Garrity, Project Manager Andy Jennings, Housing Director	Linda Raine PFI Project Manager	Bridget Guilfoyle Project Manager Derek Martin Head of Strategy Hillary Vaughan Head of Finance	Kamal Faizi Divisional Director Philip Dallard PFI Project Manager CT Billy Lopez PFI Project Manager FG Mark Bowen Assistant Director Legal Dave Baldock Group Finance Manager	John Newton PFI Project Manager Debbie Ward Deputy Director Housing Alan Cross Finance Director Chris Brooks Head of Legal	Dave Tatman PFI Project Manager Darren Carter Corp Finance Manager Sean Reynolds PFI Technical Manager
Scheme Adviser(s)	(Richard Parker, PwC)	(Simon Claridge, Abros)	Richard Stebbing, Hunter & Partners (Richard Parker, PwC) Alan Aisbett, Pinsent Curtis Biddle	James Stone, Addleshaw Booth	Tim Skipwith, Hammond Suddards Edge Simon Claridge, Abros	Paul McDermott, Nabarro Nathanson (Simon Claridge, Abros)	(James Stone, Addleshaw Booth) (Simon Claridge, Abros) (Richard Stebbing, Hunter & Partners)	(Richard Parker, PwC) (James Stone, Addleshaw Booth)
Other Advisers	David Goldstone - PUK			Peter Impey - PUK			Steve Truman - 4Ps	

3 Lessons from this early review of PFI processes...

APPENDIX G : DOCUMENTS ANALYSED

Documents	Pathfinder schemes							
	LB Camden	NE Derbyshire	LB Islington	Leeds CC	Manchester CC	LB Newham	Reading BC	Sandwell MBC
Pre-ITN	OBC ⁶ (Feb 2000) OJEC Notice v6 (Oct 2000) PQQ ⁷ (Nov 2001) ISOP ⁸ (Feb 2001) ISOP responses (Mar 2001) Brief for SCS ⁹ (Final Jul 2001)	OBC (Oct 1999) Prospectus & PQQ (Feb 2000) OS v5.1 (Aug 2000) MS ¹⁰ v3 (Aug 2000) PPM ¹¹ Draft 2 (Sep 2000)	OBC (Oct 1999) OJEC Notice (May 2000) Prospectus (May 2000) PQQ (May 2000)	OBC (Sep 1999) PQQ (Jun 2000)	OBC (Jun 1999) Prospectus & PQQ (Nov 1999) PPM (Consultation draft Sep 2000) OS (Consultation draft Sep 2000)	Prospectus & PQQ (Jun 1999) SCS Final Report (Nov 1999) OBC (Feb 2000) ISOP (Jul 2000)	OBC (Feb 2000) OS (Draft chapter Mar 2000) OJEC Notice (Oct 2000) PQQ (Oct 2000)	OBC (Sep 1999) PQQ (Apr 2000) OS (Aug 2000) PPM (Aug 2000) Evaluation Methodology (Jul 2001)
ITN	ITN (Final draft Jun 2000; not issued yet)	ITN (July 2001)	ITN (Jun 2001) OS ¹² (Jun 2001) PPM (Jun 2001) PA ¹³ (Jun 2001) SCS Report (June 2001)	ITN (Dec 2001)	ITN (Apr 2001)	ITN (May 2002)	ITN (Apr 2002)	ITN (Apr 2002)
Post ITN	N/a		DTLR model PFI1 (Feb 2002) BAFO documents (May 2002)					

⁶ Outline Business Case

⁷ Pre-Qualification Questionnaire

⁸ Initial Submission of Outline Proposals

⁹ Stock Condition Survey

¹⁰ Method Statements

¹¹ Payment and Performance Mechanism

¹² Output Specification

¹³ Project Agreement